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How to Prevent Attorneys from Forcing their Clients out on the Street: Permitting Corporate Investment in Law Firms as a Replacement for Reverse Contingency Fees to Fund Litigation Against Lenders in the Context of the Mortgage Foreclosure Crisis

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## INTRODUCTION

For many the “American Dream” includes a beautiful house, spacious backyard, a white picket fence, 2.5 children, and a dog. This dream has been achievable for some, but for others it has remained a distant fantasy. The harsh reality is that many people do not have sufficient income and assets to purchase a home, and those that do have sufficient funds to purchase a home may not have the ability to purchase their *desired* home. The hope to start a new marriage, raise a family, or retire in a picturesque abode is shared by many.

Individuals have to rely on their own judgment and decision-making skills to determine what type of home they are capable of purchasing. In conjunction with individual self-regulation it is of the utmost importance that lenders are not only mindful of the financial abilities of individuals but that they take these abilities into account when approving financing and executing mortgages. Unfortunately, there was recently a breakdown in this hypothetical tandem relationship between individuals and lenders, which resulted in a nightmare for both parties.<sup>1</sup> The aftermath produced from the breakdown of this relationship painfully illustrated the fact that many Americans do not have access to the legal system even when they have legitimate claims and legal services may be incredibly helpful.<sup>2</sup>

The breakdown of responsible and realistic homeownership was fueled by adjustable-rate mortgages, which allowed sub-prime borrowers to purchase their “dream homes” and unfortunately for many only temporarily live out their dreams.<sup>3</sup> Sub-prime borrowers tend to be individuals who have low credit scores resulting from significant debt.<sup>4</sup> Lending to sub-prime

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<sup>1</sup> Individuals were unable to make their mortgage payments, defaulted on their mortgages, and lost their “dream homes.” Lenders were left with unpaid loans and homes that were ultimately worth less than the mortgages.

<sup>2</sup> See *infra* note 101 and accompanying text.

<sup>3</sup> See *infra* text accompanying notes 12-14.

<sup>4</sup> Mara Lee, *Subprime Mortgages: A Primer*, NPR.ORG, <http://www.npr.org/templates/story/story.php?storyId=9085408> (Mar. 23, 2007).

borrowers is considered a high risk so these borrowers typically do not qualify for traditional loans.<sup>5</sup> To balance the high risk involved in lending to a sub-prime borrower, lenders customarily offer them adjustable-rate mortgages.<sup>6</sup> In fact, roughly 80% of sub-prime borrowers have adjustable-rate mortgages.<sup>7</sup>

Adjustable-rate mortgages became incredibly popular in the last decade. Between 2004 and 2006 more than \$2 trillion of adjustable-rate mortgages came into existence.<sup>8</sup> Adjustable-rate mortgages are popular for sub-prime borrowers because the initial mortgage payments and interest rates are relatively low making them seem more affordable.<sup>9</sup> The payments required during the initial period of an adjustable-rate mortgage actually tend to be less than the payments required by a traditional fixed rate mortgage.<sup>10</sup> However, after the initial period, the interest rates periodically increase over adjustment periods, making the mortgage payments more expensive and less affordable.<sup>11</sup>

Many sub-prime lenders who entered into adjustable-rate mortgages believed they would be able to refinance their loans before the initial period expired.<sup>12</sup> Refinancing proved to be a more difficult task to complete than expected, when housing prices began to rapidly decline in 2006.<sup>13</sup> Once the interest rates began to increase, many sub-prime borrowers were unable to fulfill their mortgage payment obligations and defaulted on their loans.<sup>14</sup> To make matters

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<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> Kenneth C. Johnston et al., *The Subprime Morass: Past, Present, and Future*, 12 N.C. BANKING INST. 125, 127 (2008).

<sup>9</sup> See Freddie Mac, *Adjustable-Rate Mortgages*, FREDDIEMAC.COM, [http://www.freddiemac.com/corporate/buyown/english/mortgages/what\\_is/adjustable\\_rate.html](http://www.freddiemac.com/corporate/buyown/english/mortgages/what_is/adjustable_rate.html) (last visited Mar. 24, 2011).

<sup>10</sup> See Lee, *supra* note 4.

<sup>11</sup> See FREDDIEMAC.COM, [http://www.freddiemac.com/corporate/buyown/english/mortgages/what\\_is/adjustable\\_rate.html](http://www.freddiemac.com/corporate/buyown/english/mortgages/what_is/adjustable_rate.html) (last visited Mar. 24, 2011).

<sup>12</sup> *Subprime Mortgage Crisis*, <http://www.stat.unc.edu/faculty/cji/fys/2010/subprime-mortgage.pdf> (last visited Mar. 24, 2011).

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

worse, the value of many of these homes was ultimately worth less than what was owed on the mortgage, creating an incentive for homeowners to desert their homes.<sup>15</sup> It is estimated that by 2009 more than 4.5 million homeowners were in a position where their homes' values was worth less than 75% of what was owed on the mortgage.<sup>16</sup>

Economic and social problems that have resulted from the mortgage foreclosure crisis include individuals and families losing their homes, properties remaining vacant, banks left with homes they are unable to sell or are forced to sell at incredibly low prices, an overall economic recession, and an increase in criminal activity.<sup>17</sup> The mortgage foreclosure crisis is a national problem, but some states have suffered more than others. There are a few states that seem to be particularly impacted by the crisis. Michigan, Florida, and California have been the backdrop for many mortgage foreclosures and are illustrative of this crisis.<sup>18</sup>

For example, the crisis has made a brutally negative impact on Detroit, Michigan. More than twenty percent of homes in Detroit are vacant.<sup>19</sup> The vacancy rate has more than doubled within the city of Detroit and in some of the surrounding suburban areas since 2000.<sup>20</sup> The high vacancy rate can be to some extent attributed to the foreclosure crisis, since there were 57,800 foreclosures in Detroit between 2005 and 2010.<sup>21</sup>

Florida has also felt the unfortunate impact of the mortgage foreclosure crisis. Since 2007 more than 1.2 million homes have gone into foreclosures in Florida.<sup>22</sup> The Florida

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<sup>15</sup> David Streitfeld, *No Help in Sight, More Homeowners Walk Away*, N.Y. TIMES, Feb. 2, 2010, at A1.

<sup>16</sup> *Id.*

<sup>17</sup> See Neighbor Works America, *Foreclosure Statistics*, FDIC.GOV, [http://www.fdic.gov/about/comein/files/foreclosure\\_statistics.pdf](http://www.fdic.gov/about/comein/files/foreclosure_statistics.pdf) (last visited Apr. 10, 2011).

<sup>18</sup> Kevin Chiu, *5 More States Get \$600-Million in Housing Relief*, HOUSINGPREDICTOR, <http://www.housingpredictor.com/housing-relief.html> (Mar. 30, 2010).

<sup>19</sup> John Gallagher, *More than 1 in 5 Detroit Homes Vacant, Census Shows*, DET. FREE PRESS, Mar. 23, 2011.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> Christine Stapleton & Kimberly Miller, *Florida Bar says Foreclosure Lawyers Must Report Fraud to Court*, PALM BEACH POST, Feb. 1, 2011.

Attorney General's Office is investigating "foreclosure mills" that forged signatures and backdated documents in order to execute more mortgages.<sup>23</sup>

Similarly, California has struggled with the influence that numerous foreclosures have made on its economy. A report compiled by Senator Barbara Boxer of California illustrates the impact of the mortgage foreclosure crisis in California.<sup>24</sup> There were 148,147 foreclosure filings in California during the third quarter of 2007.<sup>25</sup> This number translates into one foreclosure filing for every 88 households.<sup>26</sup> These events have triggered a loss in city and state taxes and a \$67 billion loss in property values.<sup>27</sup>

Many consumers who entered these adjustable-rate mortgages have valid reasons to believe that lenders were fraudulent in securing mortgages and filing foreclosures.<sup>28</sup> There is a plethora of evidence in support of the claim that lenders commonly utilized fraudulent, dishonest and unlawful tactics.<sup>29</sup> These sub-prime borrowers do not have the ability to pay their mortgages, making the idea of paying an attorney to assist them in bringing their claims against lenders seem impossible.<sup>30</sup> Without professional legal assistance many of these homeowners may end up on the street, even though they might have strong arguments for reducing the mortgage obligations remaining on their homes. It is a heartbreaking truth that due to cost barriers many people in America who are in desperate need of legal services are unable to obtain

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<sup>23</sup> *Id.*

<sup>24</sup> Staff of U.S. Senator Barbara Boxer, *The Foreclosure Crisis and California*, SENATE.BAXTER.GOV, <http://boxer.senate.gov/en/issues-legislation/issues/upload/Senator-Boxer-s-Foreclosure-Crisis-Report.pdf> (last visited Mar. 24, 2011).

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> See Stephanie Armour, *All 50 States Launch Joint Investigation Into Foreclosures*, USA TODAY (Oct. 14, 2010) ("USA's state attorneys general are vowing to halt improper mortgage foreclosures as they open a coordinated 50-state investigation into the industry's alleged use of faulty or fraudulent documents to complete tens of thousands of foreclosures.").

<sup>29</sup> See Stapleton & Miller, *supra* note 22; see also Armour, *supra* note 28.

<sup>30</sup> See David Streitfeld, *Taking On a Second Mortgage to Pay the Foreclosure Lawyer*, N.Y. TIMES, Nov. 6, 2010.

such services even to assist them with fundamental necessities like maintaining one's home.<sup>31</sup>  
This crisis is illustrative of the overarching problem of the unmet need of legal services.<sup>32</sup>

In order to assist this large class of unrepresented homeowners in bringing their legal actions against mortgagors, many Florida attorneys are utilizing a unique payment method.<sup>33</sup> This model is known as a reverse contingency fee arrangement. The fee is determined by a percentage of the amount the attorney reduces the mortgage obligation owed by the client to the lender.<sup>34</sup> This essentially allows the attorney to take another mortgage on the client's home in order to collect fees.<sup>35</sup> The client pays a certain sum to the attorney every month and the house is used as collateral.<sup>36</sup> If the client fails to make the mortgage payments, then the attorney ultimately could end up forcing the client into foreclosure.<sup>37</sup> The result is that the client ends up having two creditors that may institute foreclosure proceedings, if the client fails to meet the required mortgage obligations. This type of relationship creates an inherent conflict between the attorney and the client.

Contingency fee arrangements are common in personal injury cases and other tort-like lawsuits where there is potentially a large sum of money for the plaintiff to recover.<sup>38</sup> The attorney's payment is usually a fixed percentage of the amount awarded to the plaintiff, usually about a third of the total amount.<sup>39</sup> However, if the plaintiff is not awarded money, then the

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<sup>31</sup> See sources cited *infra* notes 69, 101.

<sup>32</sup> See sources cited *infra* notes 69, 101.

<sup>33</sup> See Streitfeld, *supra* note 30.

<sup>34</sup> For example, if the attorney reduces the mortgage by \$100,000 then his fee might be 40% of that amount or \$40,000.

<sup>35</sup> See Streitfeld, *supra* note 30.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> See American Bar Association, *Legal Fees and Expenses: What are Contingent Fees?*, AMERICANBAR.ORG, [http://www.americanbar.org/groups/public\\_education/resources/law\\_issues\\_for\\_consumers/lawyerfees\\_contingent.html](http://www.americanbar.org/groups/public_education/resources/law_issues_for_consumers/lawyerfees_contingent.html) (last visited Mar. 27, 2011).

<sup>39</sup> *Id.*

attorney typically does not get paid.<sup>40</sup> The reverse contingency fee deviates from this typical contingency fee model in that the client is not in a position to earn an award of money. The attorney is reducing the debt owed by the client to another party and takes a percentage of the amount of debt reduced as a fee.

A reverse contingency fee model is not serving clients' best interests in the context of the mortgage foreclosure crisis even though the attorney might reduce the overall debt the client owes on a mortgage. The fact that the attorney has reduced the overall debt is overshadowed by the reality that the client ends up with an additional mortgage and an added party with the right to force the client into foreclosure. Furthermore, an attorney who utilizes the reverse contingency fee model in the mortgage foreclosure context knows from the beginning of the relationship that the attorney and client will ultimately have conflicting interests. Reducing the client's overall debt is only marginally helping clients and a superior payment model should be instituted to better serve these clients.

Part I of this article explains that the Model Rules of Professional Conduct do not prohibit the use of reverse contingency fees in the mortgage foreclosure context. This is problematic because the arrangement creates an inherent conflict between the attorney and the client. Although existing rules address attorney fees and the client-lawyer relationship,<sup>41</sup> these rules do not adequately protect mortgage foreclosure clients who are paying attorneys under a reverse contingency model. This note asks the ABA 20/20 Commission to amend the Model Rules to explicitly address the use of reverse contingency fees.

Part II opines that allowing reverse contingency fees in the mortgage foreclosure context will only further damage the already impaired relationship between attorneys and the general

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<sup>40</sup> *Id.*

<sup>41</sup> MODEL RULES OF PROF'L CONDUCT R. 1.5, 1.8 (2010).

public. Part III proposes several solutions that would provide legal representation to homeowners allowing them to bring their claims without having to agree to the imposition of a second mortgage on their homes. The article concludes that corporate investment in law firms, although somewhat controversial, offers a potentially better and more efficient way to provide legal services to homeowners who are in danger of losing their homes to unlawful lenders.

### **I. FLORIDA MORTGAGE FORECLOSURE ATTORNEYS ARE NOT NECESSARILY VIOLATING THE MODEL RULES OF PROFESSIONAL CONDUCT.**

There are several Model Rules that may be implicated by the utilization of a reverse contingency fee, but none of them directly address the topic. This fee arrangement calls into question Model Rules 1.5, 1.8(f), 1.8(i), and 1.8(a).<sup>42</sup> However, although this fee arrangement may involve some of the Model Rules, it does not necessarily appear to violate any of these rules.

#### **A. The Use of Reverse Contingency Fee Arrangements in the Mortgage Foreclosure Context is a Situation of First Impression.**

The use of reverse contingency fee arrangements is implicitly permitted by the Model Rules.<sup>43</sup> There are professionals who even encourage using reverse contingency fees based on a percentage of the difference between the amount the plaintiff demands and the amount the defendant actually pays, instead of using the billable hour model.<sup>44</sup> Furthermore, reverse contingency fee agreements have actually been explicitly approved by the ABA Committee on

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<sup>42</sup> MODEL RULES OF PROF'L CONDUCT R. 1.5, 1.8(a), (f), (i).

<sup>43</sup> See discussion *infra* Part I.B-F.

<sup>44</sup> See, e.g., Jim O. Stuckey, *Reverse Contingency Fees: A Potentially Profitable and Professional Solution to the Billable Hour Trap*, 16 NO. 3 PROF. LAW. 25 (2005).

Ethics and Professional Responsibility in civil cases, provided that the fee amount is reasonable and the client has given informed consent.<sup>45</sup>

However, the facts set forth in the ABA formal opinion pertain to a situation where a client is sued for damages and the attorney's fee is based on a percentage of the difference between the amount initially requested and the amount the client ultimately pays.<sup>46</sup> These facts differ drastically from the facts in the mortgage foreclosure context because the attorney is not securing a mortgage on the subject matter of the litigation. There have been several specific instances where reverse contingency fee arrangements have been approved in limited circumstances<sup>47</sup> and disapproved in others<sup>48</sup> but the use of this arrangement has never been addressed in the context of the mortgage foreclosure crisis. The ABA 20/20 Commission should amend the Model Rules to address the use of reverse contingency fee agreements in the context of the mortgage foreclosure crisis in order to protect potential clients from incurring additional financial burdens as a result of mortgage obligations to their attorneys.

### **B. Implication of the Model Rules.**

The reality that reverse contingency fees in the mortgage foreclosure context do not inherently violate any of the Model Rules is problematic, because this demonstrates that the Model Rules are failing to protect vulnerable clients from attorneys who may be taking advantage of them. It seems intrinsically unethical that an attorney may assist a client, who is

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<sup>45</sup> ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 93-373 (1993).

<sup>46</sup> *Id.*

<sup>47</sup> *See, e.g.*, Ky. Ethics Op. E-359 (1993) (Adopting ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 93-373 (1993) and finding that lawyers using a reverse contingency fee must prove that the amount and method of computation are reasonable); Pa. Ethics Op. 92-76 (1992) (Approving the use of a reverse contingent fee based upon the amount a client saves in a tax appeal); DC Bar Legal Ethics Comm., Op. 347 (2009) (Attorneys may utilize a reverse contingent fee given the fee amount is reasonable and the client consents to it after an explanation of the disadvantages and benefits.).

<sup>48</sup> *See, e.g.*, *Brown & Sturm v. Frederick Rd. Ltd. P'ship*, 768 A.2d 62 (Md. Ct. Spec. App. 2001) (Reverse contingency fee where lawyer charged almost \$4.8 million for reducing an IRS tax liability based on a \$60 million property valuation to a liability based on a \$20 million property valuation was unreasonable based on the time, labor, and risk involved).

involved in foreclosure proceedings in reducing the mortgage on the client's home, and then turnaround and secure a second mortgage on the same home. The attorney's services were initially required because the client was unable to pay the first mortgage. After the attorney's services have been provided, the result is that the client has two mortgages on the home.

The Preamble to the Model Rules describes the lawyer's role as an advisor, advocate, negotiator, and evaluator.<sup>49</sup> Attorneys deviate from this guidance, when they knowingly enter a transaction with a client that may result in more harm than help to the client. The ABA 20/20 Commission should amend the Model Rules to directly address the use of reverse contingency fees in order to protect potential clients and give guidance to attorneys.

### **C. The Model Rules Fail to Explicitly Address Reverse Contingency Fees.**

Model Rule 1.5 generally allows for contingency fee arrangements as long as it is reasonable and other requirements are met.<sup>50</sup> A standard reasonable contingency fee usually is about one third of the value of the judgment although that number may vary.<sup>51</sup> The rule does not specifically address the use of reverse contingency fee arrangements, presumably implicitly allowing the use of such an arrangement. Although not explicitly addressed by the rules, the ABA Committee on Ethics and Professional Responsibility has approved the use of reverse contingency fees in civil cases provided that the fee is reasonable and that the client gave informed consent.<sup>52</sup>

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<sup>49</sup> MODEL RULES OF PROF'L CONDUCT PMBL.

<sup>50</sup> See MODEL RULES OF PROF'L CONDUCT R. 1.5. (A contingency fee agreement must be in writing and signed by the client. The agreement must state how the fee will be determined. A contingency agreement is prohibited in domestic relation cases and in representing a criminal defendant.) See also MODEL RULES OF PROF'L CONDUCT R. 1.5. cmt. 3 (Contingent fees must be reasonable and their reasonableness depends on the facts and circumstances of the case.).

<sup>51</sup> See Eric Cooperstein, *Using Reverse Contingent fees for Clients Caught in the Mortgage Mess*, LAWYERIST.COM, <http://lawyerist.com/using-reverse-contingent-fees-for-clients-caught-in-the-mortgage-mess/> (Oct. 14, 2008).

<sup>52</sup> ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 93-373 (1993).

#### **D. Rule 1.8(f) Likely Permits Reverse Contingency Fee Arrangements.**

Some Florida mortgage foreclosure attorneys are providing the second mortgage themselves in their reverse contingency fee models.<sup>53</sup> However, a situation could arise in which a third party lender arranges the mortgage. Rule 1.8(f) imposes certain conditions on situations where someone other than the client is paying the attorney's fee.<sup>54</sup> In a reverse contingency fee arrangement it seems that a lender, who arranges the mortgage that the lawyer secures on the client's home, is intimately involved in paying the attorney's fee. This could potentially lead to a violation of 1.8(f), if certain conditions are not met.<sup>55</sup> However, the Rule would probably allow the attorney to accept compensation in the form of a second mortgage, even though it is secured by a third party as long as the client gives informed consent, the lender does not interfere with the lawyer's professional judgment, and communication between the client and attorney remains confidential.<sup>56</sup>

#### **E. Rule 1.8(i) Probably Allows Reverse Contingency Fee Arrangements.**

Rule 1.8(i) generally prohibits an attorney from obtaining a proprietary interest in the subject matter of the litigation in which he is representing a client.<sup>57</sup> However, the rule makes an exception allowing a lawyer to "acquire a lien authorized by law to secure the lawyer's fee or expenses."<sup>58</sup> Thus, Rule 1.8(i) probably is not violated since in the case of a reverse contingency fee the mortgage the lawyer secures on the client's home is essentially a lien securing the lawyer's fee. Rule 1.8(i) also makes an exception that allows a lawyer to "contract with a client

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<sup>53</sup> See Streitfeld, *supra* note 30.

<sup>54</sup> See MODEL RULES OF PROF'L CONDUCT R. 1.8(f) (An attorney may receive compensation from someone other than the client if the client gives informed consent, the third party does not interfere with the attorney's professional judgment or the relationship between the client and attorney, and the relationship between the attorney and client remains confidential.).

<sup>55</sup> *Id.*

<sup>56</sup> See *id.*

<sup>57</sup> See MODEL RULES OF PROF'L CONDUCT R. 1.8(i).

<sup>58</sup> MODEL RULES OF PROF'L CONDUCT R. 1.8(i).

for a reasonable contingent fee in a civil case.”<sup>59</sup> If it is the lender that secures the mortgage on client’s home as opposed to the attorney then this arrangement would implicate Rule 1.8(f), which would not be violated as long there is informed consent, there is no interference with the lawyer’s professional judgment, and confidentiality persists.<sup>60</sup>

#### **F. Reverse Contingency Fees Probably do Not Violate Rule 1.8(a).**

Rule 1.8(a) describes how an attorney can lawfully “acquire an ownership, possessory, security or other pecuniary interest adverse to a client.”<sup>61</sup> Violation of this rule can be avoided if the attorney’s interest is disclosed to the client, the transaction is fair to the client, the client is advised in writing to seek independent legal advice, and the client gives informed consent in writing.<sup>62</sup> The truth is that it is unlikely that a client would actually seek independent legal advice since it is already financially burdensome for the client to afford one attorney.

Nonetheless, it appears that Rule 1.8(a) will not prevent an attorney from securing a mortgage on a client’s home by way of a reverse contingency fee, as long as the attorney complies with the requirements set forth in the Rule.

## **II. REVERSE CONTINGENCY FEES MAY HAVE A HARMFUL IMPACT ON THE REPUTATION OF ATTORNEYS.**

One problem with the legal profession is that the general public tends to have had either a negative experience or no experience whatsoever with attorneys.<sup>63</sup> This leads many to doubt the honesty, loyalty, motives and role that attorneys play in society. Allowing attorneys to secure mortgages on their clients’ homes will only work to damage the already impaired relationship between the general public and attorneys.

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<sup>59</sup> *Id.*

<sup>60</sup> See discussion *supra* Part I.D.

<sup>61</sup> MODEL RULES OF PROF’L CONDUCT R. 1.8(a).

<sup>62</sup> See *id.*

<sup>63</sup> See *infra* notes 69, 101 and accompanying text.

### **A. Reverse Contingency Fee Agreements Will Only Deteriorate the Already Damaged Public Perception of Attorneys.**

There is a plethora of surveys and studies demonstrating the general public's cynical and negative attitude towards attorneys.<sup>64</sup> The legal community should collaborate towards improving the reputation of attorneys as opposed to allowing attorneys to use tactics such as reverse contingency fees in the mortgage foreclosure context, which will only harm the profession's reputation.<sup>65</sup>

In *Florida Bar v. Went For It, Inc.*,<sup>66</sup> the Supreme Court cited several surveys revealing that Floridians felt especially negative towards attorneys who used direct mailings to solicit business.<sup>67</sup> The predecessor case to *Florida Bar* also relied on surveys in discovering general cynicism toward the legal profession.<sup>68</sup> A more recent survey conducted by the ABA demonstrates that the public typically does not hire attorneys even when they may be in need of legal services and continues to view attorneys in a negative light.<sup>69</sup> One of the main reasons given by the general public for not hiring an attorney even when they needed one was because their services were too costly.<sup>70</sup>

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<sup>64</sup> See *infra* notes 66-70 and accompanying text.

<sup>65</sup> See Streitfeld, *supra* note 30 (Even some defense attorneys think the use of reverse contingency fees in the wake of the mortgage foreclosure crisis is “‘creepy’ and ‘crass.’”).

<sup>66</sup> 515 U.S. 618 (2002).

<sup>67</sup> *Id.* at 626-27.

<sup>68</sup> *Bates v. State Bar of Arizona*, 433 U.S. 350, 370-71 (1977).

<sup>69</sup> Krista Baker, *Public Perception of Lawyers*, LAWYERBIZCOACH, <http://www.lawyerbizcoach.com/2004/02/21/public-perception-of-lawyers/> (Feb. 21, 2004) (summarizing the findings of an ABA study conducted in 2002). Negative perceptions included belief that lawyers are manipulative, do not police themselves well, are “driven by profit and self interest rather than client interest,” are on the boundary of being unethical, and only 19% of those surveyed felt confident in the legal profession. *Id.* Additional negative connotations included the beliefs that lawyers charge too much for their services, prolong cases in order to charge more fees, and take on cases they are unable to properly handle. *Id.*

<sup>70</sup> *Id.*

## **B. Consumers Have Reason to Doubt the Legal Profession's Moral Compass.**

There have been instances in history where attorneys have acted in an unethical manner and this history has created skepticism among potential clients.<sup>71</sup> In *Brown & Sturm*, lawyers used a reverse contingency fee model in representing their clients in a proceeding to reduce their clients' tax liability to the IRS.<sup>72</sup> The IRS valued the clients' farm property at \$60 million and the lawyers, who were experts in this area of the law, knew this valuation was inflated.<sup>73</sup> But the attorneys did not provide the clients with a more realistic assessment and entered into a reverse contingent fee contract based upon the incredibly inflated \$60 million value.<sup>74</sup> The case was settled, with the IRS accepting a \$20 million assessment for the land.<sup>75</sup>

The attorneys billed their clients for \$4.8 million in attorneys' fees claiming they saved their clients \$40 million.<sup>76</sup> The Court of Special Appeals found the reverse contingency fee agreement was unenforceable, because the attorneys failed to disclose to their clients what they knew about the property's value.<sup>77</sup> Furthermore, the fee "was unreasonable because it bore little relation to time, labor, novelty and risk of the legal problem."<sup>78</sup>

This is a clear example of attorneys attempting to take advantage of clients and a microcosm for the reasons why the general public does not view attorneys in a positive light. Allowing attorneys to use reverse contingency fees in the mortgage foreclosure context will give unethical attorneys more opportunities to take advantage of clients, as the attorneys did in *Brown & Sturm*, and this is exactly what the legal community should try to prevent.

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<sup>71</sup> See, e.g., *Brown & Sturm v. Frederick Rd. Ltd. P'ship*, 768 A.2d 62 (Md. Ct. Spec. App. 2001).

<sup>72</sup> *Id.* at 75.

<sup>73</sup> *Id.* at 76-77.

<sup>74</sup> *Id.* at 76.

<sup>75</sup> *Id.* at 72.

<sup>76</sup> *Id.*

<sup>77</sup> *Id.* at 76-79.

<sup>78</sup> *Id.* at 81.

**C. Practical Issues: Clients do Not Have Sufficient Funds to Pay their First Mortgage so How Will They be able to Pay their Second Mortgage?**

Lenders have the right to institute foreclosure proceedings when the borrower-homeowner fails to make mortgage payments.<sup>79</sup> If a mortgage foreclosure attorney secures a second mortgage on clients' homes and if clients are unable to pay their attorneys, then the attorneys may force their clients into foreclosure.<sup>80</sup> Although some attorneys claim that they would never "enforce the mortgage and foreclose,"<sup>81</sup> it is hard to believe that this claim is true. Why would attorneys bother to secure a mortgage on their clients' homes, if they had no intention of foreclosing on the homes if the clients failed to make payments? Why wouldn't they simply send their clients a bill at the end of the representation? The mortgage provides security to the attorneys so that, if their clients do not pay them, then they can take matters into their own hands and get paid through the sale of their clients' homes. This creates a situation where there is a strong likelihood that the clients' and attorneys' interests will be truly adverse and these circumstances will only further damage the relationships between clients and attorneys.

**III. PROPOSED SOLUTIONS.**

The initial predicament is that homeowners who are involved in mortgage foreclosure proceedings might have viable claims against their lenders but do not have the financial ability to pay attorneys to represent them.<sup>82</sup> Many Florida attorneys are using a reverse contingency fee model in order to fund this type of legal representation.<sup>83</sup> This method is problematic for many reasons, but mainly the result is that the attorney ends up securing a second mortgage on the

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<sup>79</sup> See *Why Banks Foreclose on Real Estate*, MONEYMATTERS101.COM, <http://www.moneymatters101.com/Foreclosure/whyforclose.asp>, last visited (Apr. 3, 2011).

<sup>80</sup> Streitfeld, *supra* note 30.

<sup>81</sup> *Id.*

<sup>82</sup> See *supra* notes 28-31 and accompanying text.

<sup>83</sup> See *supra* notes 33-37 and accompanying text.

client's home in order to guarantee payments for legal services.<sup>84</sup> On the periphery of this situation is another problem of unemployment in the legal profession.<sup>85</sup> There must be a better and more efficient payment method than the use of reverse contingency fees to close the gap between the unmet need of legal services among people involved in the mortgage foreclosure crisis and unemployed attorneys who are looking for work.

**A. Amend the Model Rules to Permit Regulated Reverse Contingency Fees.**

Although the Model Rules<sup>86</sup> permit contingency fees with some limitations they fail to address the use of reverse contingency fees. Amending the Model Rules to address reverse contingency fees would help give guidance to attorneys and protect potential clients. Although permitting the use of reverse contingency fees may open the doors to the possibility of abuse there are certainly some benefits to this model.

First, this fee mechanism allows individuals, who are struggling financially, to have their day in court. Many individuals do not seek legal advice because they believe they cannot afford it.<sup>87</sup> The prospect of paying limitless hourly rate bills deters people from hiring attorneys even if they have solid legal claims.<sup>88</sup> The reverse contingency fee model lets the client postpone paying attorney fees, until after there is a reduction in their mortgage, and the attorney fee may be paid off in installments over a long period of time.<sup>89</sup> This payment method may seem practical and affordable to many people.

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<sup>84</sup> See *supra* text accompanying notes 35-37.

<sup>85</sup> Press Release, The Association for Legal Career Professionals, Class of 2009 Faced New Challenges with Recession: Overall Employment Rate Masks Job Market Weakness, <http://www.nalp.org/uploads/09SelectedFindingsPressRelease.pdf> (May 20, 2010) (stating that 88.3% of law school graduates in 2009 were employed but up to 41% of these positions were temporary, up to 50% were part-time positions, only 70% of the positions required a J.D., and 22% of employed graduates were actively looking for new jobs.).

<sup>86</sup> See MODEL RULES OF PROF'L CONDUCT R. 1.5(c).

<sup>87</sup> See *supra* notes 69, 101 and accompanying text.

<sup>88</sup> See *id.*

<sup>89</sup> See *supra* text accompanying notes 33-36.

Second, reducing a mortgage by a significant amount could very well make an enormous positive impact on clients' lives, even if they end up with a second mortgage.<sup>90</sup> Although the client still owes money to the lender and to the attorney, the total amount owed is less and this may enable clients to remain in their homes and maintain continuity in their lives. This overall reduction could make a substantial helpful impact on an individual's life.

Although there are some benefits to amending the Model Rules to allow a restricted form of reverse contingency fees the negative attributes outweigh the positives. One potential problem is that the overall acceptance of this payment method could increase litigation and flood the already overwhelmed court system.<sup>91</sup> There is a strong counterargument that increased litigation is not necessarily a detriment and that it is not "better for a person to suffer a wrong silently than to redress it by legal action."<sup>92</sup> However, the fact is that court systems that are deeply intertwined with the mortgage foreclosure crisis are completely overwhelmed and understaffed.<sup>93</sup>

There are also practical issues with amending the Model Rules to permit reverse contingency fees in a regulated format. The biggest concern is how the Model Rules could successfully be amended to prevent attorneys from taking advantage of clients. One idea is to put a limit on the reasonableness of the fee that can be charged. For example, a comment to the Model Rules could explain that, if the fee is more than 25% of the amount of the debt reduced,

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<sup>90</sup> For example, if an attorney reduces a mortgage obligation from \$200,000 to \$100,000 then the client is saved \$100,000. If the attorney's reverse contingency fee is one third of the amount reduced then the client would owe the attorney \$33,000 in attorney's fees. The result is that the overall amount owed is \$133,000 instead of \$200,000.

<sup>91</sup> Since 2007 more than 1.2 million homes have gone into foreclosures in Florida. See Stapleton & Miller, *supra* note 22. Even if a minority of these homeowners wanted to bring claims in the court systems to reduce their mortgages it would be burdensome to the court system. Rene Stutzman, *Florida Supreme Court: State Needs 80 New Judges*, ORLANDO SENTINEL, Feb. 17, 2011 (The Florida Supreme Court asked the State Legislature to create 80 new judgeships because tens of thousands of civil lawsuits stemming from the mortgage foreclosure crisis have flooded courtrooms.).

<sup>92</sup> *Bates v Arizona*, 433 U.S. 350, 376 (1977).

<sup>93</sup> See *supra* note 91 and accompanying text.

then it is unreasonable. However, it would be difficult to apply a rule like this to all cases. Reducing a mortgage by \$10,000 resulting in a \$2,500 attorney fee may seem reasonable whereas reducing a mortgage by \$100,000 resulting in a \$25,000 attorney fee may seem unreasonable. Furthermore, both cases might require similar time, work, and skills but the outcomes in terms of money owed to the attorneys are completely different. Setting the standard for charging reverse contingency fees as “reasonable” is insufficient to protect clients from abuse, and there may not be a better way to regulate this type of fee.

In addition, even a regulated version of reverse contingency fees may continue to harm the reputation of attorneys.<sup>94</sup> A regulated version of this type of fee may still yield the same result in that the attorney will have a mortgage on the client’s home.<sup>95</sup> The use of reverse contingency fees in the mortgage foreclosure context is contrary to one of the stated goals of the Model Rules, which is to protect and pursue a client's legitimate interests.<sup>96</sup>

Overall, amending the Model Rules to address reverse contingency fees would be a step in the right direction, because they currently do not address reverse contingency fees at all. Ideally, the amendments should explicitly prohibit an attorney from executing an agreement that secures a legal fee through a second mortgage on the client’s home. However, the Rules should still allow attorneys to use a regulated version of reverse contingency fees in non-mortgage situations. Making amendments to the Model Rules is not the best solution because it still leaves a lot of unanswered questions. It would be challenging to regulate the use of reverse contingency fees in the mortgage foreclosure context so that it protects clients across the board, and it leaves open too wide of a window for attorneys to abuse clients.

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<sup>94</sup> See *supra* Part II.A-B.

<sup>95</sup> See Streitfeld, *supra* note 30.

<sup>96</sup> MODEL RULES OF PROF’L CONDUCT PMBL.

## **B. Potential Federal Responses.**

In a situation where there is a consistent pattern of big powerful corporations who have the upper hand and are taking advantage of individual consumers,<sup>97</sup> there might be a call for the federal government to get involved and protect the weaker party. There are several ways that the federal government could respond to these types of circumstances.<sup>98</sup> One option is to prevent future mortgage foreclosure crises in the first place.<sup>99</sup> The federal government could enact some type of legislation that would prevent this type of problem from occurring.<sup>100</sup> Another option is to resolve the lack of legal representation<sup>101</sup> in the mortgage foreclosure context.<sup>102</sup> The federal government could provide legal services to individuals, and this would help bridge the gap between unemployed attorneys and unrepresented individuals.<sup>103</sup>

### ***1. Proactive Response: The Federal Government Should Enact***

#### ***Legislation to Prevent Future Mortgage Foreclose Crises.***

The stated purposes of the United States constitution are to “establish justice,” provide for the “common defence,” and to “promote the general welfare.”<sup>104</sup> The constitution gives the legislature the power to regulate federal spending and guarantees.<sup>105</sup> The federal government should live up to these goals by enacting legislation that will protect homeowners from lenders

<sup>97</sup> See Stapleton & Miller, *supra* note 22.

<sup>98</sup> See discussion *infra* Part III.B.1-2.

<sup>99</sup> See *infra* Part III.B.1.

<sup>100</sup> See *infra* Part III.B.1.

<sup>101</sup> See Mark D. Killian, *Study: Legal Needs Going Unmet*, FL BAR NEWS, Mar. 15, 1995, available at <http://www.afn.org/~afn54735/legalneeds1.html> (last visited Apr. 9, 2011) (explaining that “70 percent of low and moderate income households that have legal problems have no access to the legal system” in Florida). The mortgage foreclosure crisis can somewhat be attributed to a lack of legal representation for homeowners. “A lawyer can protect homeowners from lenders who break the law, ensure that lenders follow the law and help people renegotiate their loans. Further, lawyers help protect homeowners in bankruptcy proceedings, and they assist tenants of foreclosed landlords.” See David A. Love, *A Lack of Legal Assistance Fuels the Foreclosure Crisis*, THE PROGRESSIVE, Oct. 14, 2009, available at <http://www.progressive.org/love101409.html> (last visited Apr. 9, 2011).

<sup>102</sup> See *infra* Part III.B.2.

<sup>103</sup> See Love, *supra* note 101.

<sup>104</sup> U.S. CONST. pmbl.

<sup>105</sup> U.S. CONST. art. I, § 8.

who break the law and take advantage of uneducated, uninformed, or trusting borrowers.

Unfortunately, there has not been a uniform national response addressing the mortgage foreclosure crisis even though that response might resolve the problem most effectively.<sup>106</sup>

In addition to enacting legislation that regulates lenders and protects borrowers, the federal government could enact a fee-shifting statute. This statute would require predatory lenders to pay the attorney fees on behalf of homeowners who fell victim to the banks' unlawful practices. Although Congress tends to support fee-shifting statutes, courts are reluctant to extend the protection of fee shifting statutes so that they can reach their fullest benefit.<sup>107</sup> The federal government could also help protect consumers by offering educational programs that provide the public with information making them informed consumers before entering mortgages.

Unfortunately, enacting legislation at this point in the crisis might not be the best solution for current borrowers who are involved in or about to be involved in foreclosure proceedings. These individuals need help now and it takes time to enact and pass legislation into law. By the time legislation is passed, these borrowers might have already lost their homes. Although a federal response is tremendously important long-term because it might help prevent another mortgage foreclosure crisis from happening in the future, it is probably not very helpful to the current issue in terms of remedying homeowners' existing problems.

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<sup>106</sup> See Christine Harper, *Foreclosure Crisis Needs Federal Response, Harvard's Porter Says*, BLOOMBERG PRESS, Oct. 13, 2010) (explaining that these are systematic problems that could be better addressed by regulation as opposed to individually in the court system); See also Robin S. Golden & Sameera Fazili, *Raising the Roof: Addressing the Mortgage Foreclosure Crisis Through a Collaboration Between City Government and a Law School Clinic*, 2 ALB. GOV'T. L. R. 29, 31 (2009) (stating that the SEC has failed to intervene in the mortgage foreclosure crisis even though its supposed to regulate most of the entities involved in the crisis).

<sup>107</sup> See, e.g., *Evans v. Jeff D.*, 475 U.S. 717 (1986) (A federal fee-shifting statute was not violated by a settlement offer that required the plaintiff's attorney to waive his right to have defendant pay his attorney's fees.); see also, *Buckhannon Bd. & Care Home v. W. Va. Dept. of Health & Hum. Res.*, 532 U.S. 598 (2001) (denying request to award attorney fees because plaintiff was not a prevailing party since it did not obtain relief from a court but rather through a voluntary action by the state to change its policy without a court order).

***2. Reactive Response: Use of Federal Funding to Provide Legal Services to Mortgagees in the Midst of Foreclosure Proceedings.***

Consumers desperately need the federal government to somehow get involved in the mortgage foreclosure crisis and protect consumers.<sup>108</sup> The federal government should strive to provide some type of stability to the unbalanced relationship between corporate lenders and individual borrowers. Many individuals have viable claims that could be successful in the court system but do not have the financial ability to hire an attorney.<sup>109</sup> The federal government should increase funding to provide legal representation to individuals who are going through foreclosure proceedings, and it should also eliminate funding restrictions to allow for more legal representation.<sup>110</sup>

There will be many practical problems in providing increased federal funding for individuals so that they can be represented adequately in court. This solution may not be possible because currently there is a bill pending in congress to eliminate federal funding for litigation services.<sup>111</sup> House Republicans were advocating a \$75 million decrease in funding to Legal Services Corporation (LSC).<sup>112</sup> This proposed budget cut would force LSC, which provides legal services to low-income individuals, to make extreme cuts in services.<sup>113</sup> However, both parties recently negotiated a bipartisan agreement to cut \$15.8 million from the

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<sup>108</sup> See Love, *supra* note 101.

<sup>109</sup> See *supra* notes 69, 101 and accompanying text.

<sup>110</sup> Melanca Clark & Maggie Barron, Brennan Ctr. for Justice at N.Y. Univ. Sch. of Law, *Foreclosures: A Crises in Legal Representation*, BrennanCenter.org, <http://www.brennancenter.org/content/resource/foreclosures/> (Oct. 6, 2009).

<sup>111</sup> H.R. 1473, 112th Cong. (2011).

<sup>112</sup> Tony Mauro, *Obama Proposes Legal Services Corp. Budget Increase*, BLT: THE BLOG OF LEGALTIMES (Feb. 14, 2011, 3:54 PM), <http://legaltimes.typepad.com/blt/2011/02/obama-proposes-legal-services-corp-budget-increase.html>.

<sup>113</sup> *Id.*

LSC budget and are expected to vote on the deal soon.<sup>114</sup> Although this budget cut is not as extreme as the \$75 million proposition it is still expected to impact over one hundred local legal aid organizations.<sup>115</sup>

There will probably be a general backlash from the public who will disagree with using federal funds in this manner. The general public may become angered if the government uses funds to help individuals who defaulted on their mortgages, when many homeowners have stayed current on their mortgage payments. In addition, the national debt is already over \$14 trillion<sup>116</sup> reflecting how careful the federal government must be in allocating its budget. There are many other causes that might require federal funding before funding should be used for hiring attorneys. Homelessness, poverty, failing schools, and terrorism are a few of the causes that will likely require funding before issues like lack of legal representation will be addressed.

### **C. Alternative Litigation Financing (ALF) as a Mechanism to Provide Legal Services to Mortgagees.**

ALF is a model that has been increasingly used in recent years as a way to fund litigation.<sup>117</sup> The general model involves investors, other than the parties, the parties' lawyers, or insurers, who provide funding in lump sums or periodic payments to the borrower in order to fund litigation.<sup>118</sup> In return the investor gets a portion of the proceeds of the judgment or

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<sup>114</sup> David Ingram, *Budget Deal Cuts \$15.8M From Legal Services*, BLT: THE BLOG OF LEGALTIMES (Apr. 12, 2011, 9:23 AM), <http://legaltimes.typepad.com/blt/2011/04/budget-deal-cuts-15m-from-legal-services.html>.

<sup>115</sup> *Id.*

<sup>116</sup> *U.S. National Debt Clock: Real Time*, <http://www.usdebtclock.org/> (last visited Apr. 9, 2011).

<sup>117</sup> Steven Garber, *Alternative Litigation Financing in the United States: Issues, Knowns, and Unknowns*, RAND INST. FOR CIVIL JUSTICE: LAW, FIN., & CAPITAL MKTS. 1 (2010), available at [http://www.rand.org/content/dam/rand/pubs/occasional\\_papers/2010/RAND\\_OP306.pdf](http://www.rand.org/content/dam/rand/pubs/occasional_papers/2010/RAND_OP306.pdf).

<sup>118</sup> *Id.*; See also, ABA Comm'n on Ethics 20/0 Working Group on Alternative Litigation Financing, *For Comment: Issues Paper Concerning Lawyer's Involvement in Alternative Litigation Financing 2*, available at [http://www.americanbar.org/content/dam/aba/migrated/ethics2020/alfposting\\_authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/migrated/ethics2020/alfposting_authcheckdam.pdf) (Nov. 23, 2010) [hereinafter *Issues Paper*]. In *Fauson v. U.S. Claims, Inc.*, 915 So. 2d. 626, 627 (Fla. Dist. Ct. App. 2005) the plaintiff received \$30,000 from U.S. Claims between August of 2001 and November of 2002 while her personal injury lawsuit was pending. The parties entered an agreement requiring plaintiff to repay an amount of money that was greater than \$30,000 by certain dates and the amount increased as the life of the lawsuit was prolonged. 915 So.

settlement.<sup>119</sup> If the borrower's claim is unsuccessful then the investor typically will not recover anything.<sup>120</sup>

### ***1. Benefits of ALF.***

There are many practical reasons for using ALF. Many defendants have litigation financing in the form of insurance.<sup>121</sup> Many plaintiffs, on the other hand, can only pursue their claims through ALF.<sup>122</sup> The average civil lawsuit costs \$15,000 and cases that require detailed evidence frequently cost more than \$100,000.<sup>123</sup> These costs make it extremely difficult for plaintiffs to pursue their claims against corporations with deep pockets.<sup>124</sup> This is an enormous financial burden to the average homeowner, especially one who already is unable to pay his or her mortgage. ALF has already been used successfully in medical malpractice, divorce, and class action cases against corporations.<sup>125</sup> It could also be utilized to help borrowers pursue their claims in mortgage foreclosure cases.

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2d. at 628. For example, if plaintiff won money from the lawsuit she would owe U.S. Claims \$42,890 by November 14, 2002, \$46,808 between November 14, 2002 and February 14, 2003, and \$50,937 between February 14, 2003 and May 14, 2003. 915 So. 2d. at 628. The plaintiff settled the case for more than \$200,000 and the court upheld the agreement requiring her to pay U.S. Claims \$50,937, in accordance with the repayment schedule. 915 So. 2d. at 629. But the court opined that there is a need for regulation in this area. 915 So.2d. at 629-30. Litigation loans serve a true need because people like the plaintiff in this case need money to take care of themselves and their families while litigations is pending. 915 So.2d. at 630. However, high interest rates and one-sided agreements may only further victimize individuals like the plaintiff. 915 So.2d. at 630. The court asked that the Florida legislature think about whether it should regulate this industry. 915 So.2d. at 630. The circumstances were similar in *Odell v. Legal Bucks*, 665 S.E.2d 767, 770-71 (N.C. Ct. App. 2008), where the plaintiff borrowed \$3,000 to fund her personal injury claim from Legal Bucks and per the repayment schedule she ultimately owed \$9,750 after she settled her case for \$18,000. Although the court expressed some concern about the negative impact of litigation funding it upheld the agreement. 665 S.E.2d. at 774, 782.

<sup>119</sup> See sources cited *infra* notes 117, 118.

<sup>120</sup> See *Issues Paper*, *supra* note 118, at 2.

<sup>121</sup> Susan Lorde Martin, Op-Ed., *Leveling the Playing Field*, N.Y. TIMES, Nov. 15 2010.

<sup>122</sup> *Id.*

<sup>123</sup> Emery G. Lee III & Thomas E. Willging, *Preliminary Report to the Judicial Conference Advisory Committee on Civil Rules*, FED. JUDICIAL CTR., available at [http://www.fjc.gov/public/pdf.nsf/lookup/dissurv1.pdf/\\$file/dissurv1.pdf](http://www.fjc.gov/public/pdf.nsf/lookup/dissurv1.pdf/$file/dissurv1.pdf) (Oct. 2009).

<sup>124</sup> Binyamin Appelbaum, *Investors Put Money on Lawsuits to Get Payouts*, N.Y. TIMES, Nov. 14 2010.

<sup>125</sup> *Id.*

## 2. *Negative Impact of ALF.*

Although the concept of ALF appears to have many benefits in bringing justice to plaintiffs who otherwise could not afford access to the judicial system, there are valid concerns that the use of ALF has negative impacts. One major dilemma is that ALF could become predatory. There have been instances where lawsuit lenders have taken advantage of borrowers by imposing high interest rates on the loans.<sup>126</sup> There have also been situations where a successful plaintiff ultimately owes more to the lawsuit lender than is awarded in the lawsuit.<sup>127</sup> The ABA Commission on Ethics 20/20 is currently examining the severity of predatory practices in the context of ALF.<sup>128</sup>

Another potential downside that may accompany ALF is that it might promote frivolous and abusive lawsuits.<sup>129</sup> ALF might increase the volume of weak claims that plaintiffs and attorneys normally would not pursue.<sup>130</sup> Investors will probably balance the amount of potential recovery against the likelihood of success and will invest in lawsuits where there is a low likelihood of success as long as the prospect for a large amount of damages is high.<sup>131</sup> However, some experts support more expansive use of ALF in lawsuits and disagree with the argument that lawsuits are less “authentic” when a third party is involved.<sup>132</sup> Furthermore, some commentators

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<sup>126</sup> Appelbaum, *supra* note 124 (stating that interest rates on lawsuits often are more than 15% a year).

<sup>127</sup> *Id.* (Referring to a situation where a plaintiff was awarded \$169,125 in a personal injury lawsuit but by the time she was awarded damages she owed the lenders \$221,000).

<sup>128</sup> *Issues Paper, supra* note 118, at 11 (Asking “[w]hat if any protections should legislation that authorizes ALF suppliers require to avoid excessive fees to the ALF supplier and predatory practices?”).

<sup>129</sup> John Beisner et al., *Selling Lawsuits, Buying Trouble: Third-Party Litigation Funding in the United States*, U.S. CHAMBER INST. FOR LEGAL REFORM 5 (Oct. 2009).

<sup>130</sup> *Id.*

<sup>131</sup> *Id.* at 6.

<sup>132</sup> See Anthony J. Sebok, *The Inauthentic Claim*, available at <http://www.law.georgetown.edu/LegalProfession/documents/SebokTheInauthenticClaim.pdf> (last visited Apr. 10, 2011).

not only disagree that ALF will increase frivolous and abusive lawsuits but argue that it may deter behavior that leads to lawsuits and in fact reduce the quantity of litigation.<sup>133</sup>

A third problem that might be associated with ALF is the grave possibility of violating the Model Rules of Professional Conduct. Rule 5.4<sup>134</sup> could be implicated because an arrangement involving ALF might be viewed as one in which the attorney is sharing legal fees with the litigation lender.<sup>135</sup> The Rules prohibit a situation where a nonlawyer influences an attorney's independent and professional judgment.<sup>136</sup> There could also be a potential violation of Rule 1.6<sup>137</sup> because the attorney might have to disclose privileged information to a litigation financing company so that the lender can decide if it wants to invest in the lawsuit.<sup>138</sup> Furthermore, ALF could also implicate Rules 1.8(a), 1.8(e) and 1.8(i), which respectively are the rule governing business transactions with clients, the rule disallowing financial assistance to clients, and the rule prohibiting an attorney from acquiring an interest in the client's case.<sup>139</sup>

### ***3. Impracticality of ALF in the Mortgage Foreclosure Context.***

The negative impacts that have been discussed regarding ALF<sup>140</sup> are definitely contributing factors as to why ALF is not the best way to provide legal representation to homeowners in the mortgage foreclosure context. However, the main reason why ALF is not the best solution to this problem is purely a practical one. There is no incentive for lawsuit lenders to invest in mortgage foreclosure lawsuits. In personal injury, divorce, and medical malpractice cases the plaintiff almost always is in a position to receive a judgment worth a large sum of

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<sup>133</sup> Garber, *supra* note 117, at 29.

<sup>134</sup> MODEL RULES OF PROF'L CONDUCT R. 5.4.

<sup>135</sup> Garber, *supra* note 117, at 19.

<sup>136</sup> *Id.*

<sup>137</sup> MODEL RULES OF PROF'L CONDUCT R. 1.6.

<sup>138</sup> Beisner, *supra* note 129, at 8.

<sup>139</sup> Brad Wendel, *What's Wrong with ALF*, LEGAL ETHICS FORUM, <http://www.legalethicsforum.com/blog/2010/11/whats-wrong-with-alf.html> (Nov. 15 2010).

<sup>140</sup> See discussion *supra* Part III.C.2.

money.<sup>141</sup> In these cases the borrower should be able to pay the lender's fee relatively easily since the borrower receives a sum of money if the lawsuit is successful.

However, in the mortgage foreclosure context the homeowner is not in a position to win any money but rather to reduce the amount of debt owed to the mortgagor.<sup>142</sup> There is not a portion of a judgment or settlement that the lawsuit lender can expect to receive. Using ALF as a mechanism to fund litigation in the mortgage foreclosure crisis simply is impractical for investors, because they will ultimately end up in a situation where homeowners owe them a fee that will be paid back over a long period of time instead of receiving instant cash at the end of a successful lawsuit.

#### **D. The Solution: Lift the Ban on Corporate Investment in Law Firms.**

The current form of the Model Rules prohibits corporate ownership in law firms.<sup>143</sup> Rule 5.4(b) provides that “[a] lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law.”<sup>144</sup> Furthermore, Rule 5.4(d)(1) explains that a lawyer may not practice in an organization for profit if a nonlawyer owns any interest in the organization.<sup>145</sup> The Comments to this Rule states that the purpose of Rule 5.4 is to “protect the lawyer’s professional independence of judgment.”<sup>146</sup> This ban on corporate investment in law firms means that a law firm must rely on itself to raise capital in the firm.<sup>147</sup> A law firm may not obtain capital through nonlawyer investors.<sup>148</sup>

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<sup>141</sup> See, e.g., cases cited *supra* note 118.

<sup>142</sup> See *supra* discussion p. 6.

<sup>143</sup> See MODEL RULES OF PROF'L CONDUCT R. 5.4.

<sup>144</sup> MODEL RULES OF PROF'L CONDUCT R. 5.4(b).

<sup>145</sup> MODEL RULES OF PROF'L CONDUCT R. 5.4(d)(1).

<sup>146</sup> MODEL RULES OF PROF'L CONDUCT R. 5.4 CMT. 1.

<sup>147</sup> Bernard Sharfman, *Modifying Model Rule 5.4 to Allow for Minority Ownership of Law Firms by Nonlawyers*, 13 GEO. J. LEGAL ETHICS 477 (2000). See Jerome Kowalski, *Are we Willing to Have Law Firms Publicly Owned and Shares in Law Firms Publicly Traded?*, LEGAL JOBS – WASHINGTON, DC, (Feb. 18, 2011) <http://legaljobswashingtondc.com/2011/02/are-we-ready-to-have-law-firms-publicly-owned-and-shares-in-law-firms-publicly-traded/> (explaining that law firms typically raise capital through traditional bank lending and partner

Lifting the ban on corporate investment in law firms could be an effective way to provide legal services to the middle class where there is an unmet need of legal services.<sup>149</sup> Corporations like Wal-Mart, Costco, and Meijer are experts in delivering diverse types of goods and services to the public.<sup>150</sup> In addition to buying groceries and other home goods at Wal-Mart, consumers can get their pictures developed, fill up their gas tanks, complete banking transactions, get their taxes prepared by Jackson Hewitt for as little as \$38, visit a doctor at the walk-in clinic for less than \$65, and pick up a prescription at the pharmacy.<sup>151</sup> Many of Wal-Mart's customers are just barely surviving the recent recession, yet Wal-Mart has found a way to cater to their needs.<sup>152</sup>

Innovative and large companies with plenty of capital could find a way to effectively provide lower and middle income households with access to lawyers if the ban on corporate ownership in law firms was eliminated. Similarly to the millions of people who lack legal representation,<sup>153</sup> “nearly 30 million households either do not have a bank account or use one sparingly.”<sup>154</sup> Wal-Mart, K-Mart and Best Buy are setting up banking services in an effort to serve these 30 million households who currently do not use a bank.<sup>155</sup> Seventy percent of these households have an annual income of less than \$30,000.<sup>156</sup> Although it may seem unprofitable to provide banking and accounting services for a household that has a modest income, this business model shows that it must be profitable to serve a large group of these families as a

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capital contributions, both of which are recently becoming increasingly more difficult to obtain due to the economic climate).

<sup>148</sup> MODEL RULES OF PROF'L CONDUCT R. 5.4 CMT. 1.

<sup>149</sup> See *supra* notes 69, 101 and accompanying text.

<sup>150</sup> See Renee Knake, *Democratizing the Delivery of Legal Services: On the First Amendment Rights of Corporations and Individuals*, OH. ST. L.J. (forthcoming Spring 2012) (manuscript at 4) (on file with author), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1800258](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1800258).

<sup>151</sup> WAL-MART, <http://www.walmart.com/cp/Walmart-Services/538372> (last visited Apr. 10, 2011).

<sup>152</sup> Ben Steverman, *Wal-Mart and the Paycheck-to-Paycheck Consumer*, BLOOMBERG BUSINESSWEEK (Feb. 18, 2010).

<sup>153</sup> See *supra* notes 69, 101 and accompanying text.

<sup>154</sup> Ylan Q. Mui, *Retailers Offer Financial Services to 'Unbanked,'* WASH. POST, Jan. 31, 2011.

<sup>155</sup> *Id.*

<sup>156</sup> *Id.*

whole. Along the same lines, providing legal services to an individual homeowner who is involved in a mortgage foreclosure proceeding may not seem like a lucrative opportunity. However, a large corporation could probably find a ground-breaking way to profitably and successfully serve this largely unrepresented community as a whole.

Corporations could effectively assist consumers with standard legal services that do not necessarily require a lot of individual attention. For example, there could be a legal services department in large stores that help individuals draft wills, draft and review leases, start a small business, pursue non-contentious divorces, and assist in mortgage foreclosure proceedings.<sup>157</sup> This model of providing legal services is already established and continues to grow in the United Kingdom.<sup>158</sup> The middle class is generally unable to afford an attorney even when one is necessary but typically does not qualify for legal aid services.<sup>159</sup> Lifting the ban on corporate investment in law firms could help close this gap by providing necessary and everyday legal services to the lower and middle classes at affordable flat rates.

Given the difficult obstacles to overcome, lifting the ban on corporate investment in law firms might be the most workable model for addressing mortgage foreclosure cases because many of the problems stemming from the crisis are systematic.<sup>160</sup> These cases probably have similar facts since “foreclosure mills” often were issuing these mortgages.<sup>161</sup> This model would allow a homeowner to obtain legal representation and access to the court system under a

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<sup>157</sup> See Knake, *supra* note 150, at 34 (explaining that a large supermarket chain in the United Kingdom is already offering these types of legal services in its stores). See also Catherine Baksi, *Quality Solicitors in WHSmithTie-up*, LAW SOCIETY GAZETTE (Apr. 7, 2011), <http://www.lawgazette.co.uk/news/qualitysolicitors-whsmith-tie>. (WHSmith, a large drugstore chain in the United Kingdom, recently partnered with Quality Solicitors, a law firm. Quality Solicitors will begin providing legal services in 150 branches but plans to expand into 500 branches. The attorneys will provide services at fixed-fees and hopes to provide legal advice that is accessible and consumer-friendly.).

<sup>158</sup> See Knake, *supra* note 150, at 34; See also Baksi, *supra* note 157.

<sup>159</sup> Debra Cassens Weiss, *Middle-Class Dilemma: Can't Afford Lawyers, Can't Qualify for Legal Aid*, ABA J., [http://www.abajournal.com/news/article/middle-class\\_dilemma\\_cant\\_afford\\_lawyers\\_cant\\_qualify\\_for\\_legal\\_aid](http://www.abajournal.com/news/article/middle-class_dilemma_cant_afford_lawyers_cant_qualify_for_legal_aid) (Jul. 22, 2010).

<sup>160</sup> See Harper, *supra* note 106.

<sup>161</sup> See Stapleton & Miller, *supra* note 22.

consistent and predictable fixed fee.<sup>162</sup> The fees charged under this model are likely more reflective of the work involved than a reverse contingency fee model and does not put the homeowner in the unfortunate situation of incurring an additional mortgage on their home.

Some opponents might argue that permitting corporate investments in law firms and setting up law offices in stores like Wal-Mart might harm the reputation of attorneys. However, it does not appear that having pharmacists and doctors in these types of setting has hurt their professional reputations. In fact the reverse might occur, and lifting the ban on corporate investment in law firms might make lawyers appear more accessible and less elite to average consumers. Furthermore, Australia and the United Kingdom have already enacted laws permitting corporate ownership in law firms.<sup>163</sup> It does not appear that corporate investment in law firms in those countries has harmed the reputation of attorneys. An additional benefit is that this model would provide jobs for many unemployed attorneys who are looking for work.<sup>164</sup>

### CONCLUSION

The recent recession has been difficult for many families, businesses, and the country as a whole. Knowing that you have a home to return to everyday is one of the greatest securities a family can hope to expect. There are many consumers who are in situations where they have lost their homes or are about to lose their homes because they are unable to pay their mortgages.<sup>165</sup> Unfortunately, many lenders violated the law and consumers may have viable claims against lenders but do not have the financial support to fund lawsuits themselves.<sup>166</sup> Using a reverse contingency fee model to fund this type of litigation is not the best solution because it places

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<sup>162</sup> It is important to note that the possibility of restricting the way in which attorneys advertise a fixed price may exist. *See* Va. State Pharm. Bd. v. Va. Citizens Consumer Council, 425 U.S. 748 (1976).

<sup>163</sup> *See* Knake, *supra* note 150, at 34.

<sup>164</sup> *See supra* note 85 and accompanying text.

<sup>165</sup> *See supra* notes 12-16 and accompanying text.

<sup>166</sup> *See supra* notes 28-30 and accompanying text.

attorneys and clients in opposing positions from the beginning of the relationship.<sup>167</sup> If the attorney secures a mortgage on the client's home to ensure payment, then the attorney is in a position to put the client out on the street. There are several other ways to provide legal assistance to clients without taking this risk.

The ABA 20/20 commission should amend Model Rule 5.4 to lift the ban on corporate ownership in law firms in order to facilitate relationships between attorneys and clients who are in desperate need of affordable legal services.<sup>168</sup> Many corporations have shown that they are experts in successfully providing services to the general public in an efficient manner.<sup>169</sup> This model will provide predictable legal services at fixed rates to homeowners that they otherwise could not afford and will simultaneously provide employment opportunities for many attorneys who are looking for work.

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<sup>167</sup> See discussion *supra* p. 6.

<sup>168</sup> See discussion *supra* Part III.D.

<sup>169</sup> See discussion *supra* Part III.D.