

Loan modification: The not-so-golden business opportunity for lawyers

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In a tough economy, many lawyers would be grateful to have a golden business opportunity drop in their laps. Easy, convenient money and tapping into a burgeoning clientele may be the lures.

Some such opportunities aren't so golden for lawyers, however.

Non-lawyers are soliciting lawyers with business opportunities to provide help to distressed homeowners. This "help" can be in the form of renegotiating loans, documenting short sales or filing actions to stave off foreclosure.

While these business opportunities may be a good deal from the non-lawyer's perspective, lawyers need to remember that the ethical rules generally dictate otherwise for lawyers. In short, going into business with a non-lawyer or going to work for a non-lawyer to provide these kinds of services is ethically dangerous.

If you're thinking about the loan-modification business, keep these ethics tips in mind:

- Lawyers may not form a business with a non-lawyer if any part of the business will include the practice of law (ER 5.4)
- Lawyers may not split or share fees with non-lawyers (ER 5.4)
- Lawyers cannot pay ANYTHING OF VALUE for referrals (ER 7.2)
- Lawyers who employ non-lawyers or otherwise affiliate with non-lawyers must supervise the non-lawyers and all of their advertising (ER 5.3)
- Lawyers cannot provide legal services to a business that then conveys the advice to the business' customers (ER 5.5)

While every situation may be different, four scenarios are popular:

1. Non-lawyer wants lawyer to partner with non-lawyer in a business to provide loan-modification services to customers. The loan-modification

services may include renegotiating loans, documenting short sales or possibly filing actions to stave off foreclosure.

2. Non-lawyer has an existing loan-modification business and wants to hire lawyer as general counsel to the business. Lawyer would provide legal services to the non-lawyer's customers.
3. Non-lawyer has an existing business helping distressed homeowners and wants the lawyer, as part of the lawyer's independent law practice, to handle any legal matters those distressed homeowners may need. In turn, the lawyer also would refer any of the lawyer's clients who need loan-modification services to the non-lawyer's business. Lawyer and non-lawyer would pay each other referral fees or have a quid-pro-quo relationship.
4. Lawyer hires non-lawyer as either an employee or consultant to provide law firm clients with financial analysis services.

What's wrong and worrisome about each scenario?

- 1. Non-lawyer wants lawyer to partner with non-lawyer in a business to provide loan-modification services to customers. The loan-modification services may include renegotiating loans, documenting short sales or possibly filing actions to stave off foreclosure.**

Quick Answer: LAWYERS CAN'T DO THIS

- Performing "short sales" of property or filing court actions probably constitute the practice of law. *See* Rule 31(a)(2), Ariz.R.Sup.Ct. (defining what constitutes practice of law). However, real estate agents and brokers are authorized to enter into, draft, and negotiate certain contracts and other property-related documents. Renegotiating a loan amount may or may not be the practice of law in Arizona. No cases interpret this consumer-debt issue. A lawyer going into business with a non-lawyer loan-modification consultant, however, is practicing law with a non-lawyer and aiding and abetting the unauthorized practice of law. (ER 5.5)
 - In addition, the lawyer would be providing legal services as part of the partnership and thus would be sharing legal fees with the non-lawyer. (ER 5.4)
 - Depending on the circumstances, filing an action to stave off foreclosure could be frivolous. (ER 3.1)
 - A non-lawyer cannot have any ownership or equity interest in any firm that practices law – even if practicing law is only part of the business. (ER 5.4). Non-lawyers also cannot hold officer or director positions in any company that practices law.
- 2. Non-lawyer has an existing loan-modification business and wants to hire lawyer as general counsel for that business. The lawyer's primary duty**

would not be to provide legal services to the business but to provide legal services to the non-lawyer's customers.

Quick Answer: LAWYERS CAN'T DO THIS

- Presumably the business is for-profit. If so, then this would violate ER 5.4(d), which prohibits a lawyer from practicing law in an entity owned wholly or partly by a non-lawyer.
 - If the lawyer is general counsel to the business, then the lawyer's client is the business, not the business's customers, the distressed homeowners. To do legal work for the business's customers would constitute a conflict of interest for the lawyer. Ariz. Ethics Op. 96-11 (company cannot hire lawyer as in-house counsel and then have counsel provide legal advice to company's customers); Ariz. Ethics Op. 99-12 (lawyer employed by architectural company cannot provide legal advice to company customers and be paid a salary for services).
- 3. Non-lawyer has an existing business helping distressed homeowners and wants the lawyer, as part of the lawyer's independent law practice, to handle any legal matters those distressed homeowners may need. In turn, the lawyer would refer any of the lawyer's clients who need loan-modification services to the non-lawyer's business. Lawyer and non-lawyer would pay each other referral fees or otherwise have a quid-pro-quo relationship.**
- The lawyer could not pay the non-lawyer for funneling the lawyer clients, nor could the lawyer receive referral fees for referring clients to the non-lawyer. In fact, the two could not have a quid-pro-quo relationship in which the lawyer referred all distressed-homeowner clients to the non-lawyer and the lawyer accepted as clients all of the non-lawyer's customers. ER 7.2(b) prohibits a lawyer from paying anyone anything of value for recommending the lawyer's services. A quid-pro-quo relationship would be a conflict of interest under ER 1.7.
 - If the non-lawyer advertises his or her loan-modification business as being staffed by lawyers or implies that it is lawyer-based, then the lawyer to whom the non-lawyer refers business is responsible for both the advertising and supervision. Ariz. Ethics Op. 92-09; *In re Galbasini*, 163 Ariz. 120, 786 P.2d 971 (1990).
 - If the lawyer and non-lawyer avoid paying each other for referrals, the lawyer ethically *could* perform legal services for the clients who elect to retain him/her under a separate fee agreement. Caution: If the non-lawyer business wants to receive any information from the legal representation, the law firm client must authorize the disclosure of confidential information to the non-lawyer business. This could be a clause in the fee agreement.
- 4. Lawyer hires non-lawyer as either an employee or consultant to provide law firm clients with financial-analysis services.**
- Lawyers may provide loan-modification work as part of their law practices.

- The “customers” would then be legal clients and entitled to all of the rights resulting from the lawyer-client relationship.
- In this circumstance, lawyers could hire a loan-modification consultant as an employee or contract consultant, just as a lawyer could hire an engineer, CPA or other expert and pay that person for consulting work.
- The payments for the consulting work could not be a front for sharing legal fees, however. Ideally, the consultant should bill the client directly. (ER 5.4)

Worrying about the bottom line and wanting to take advantage of golden business opportunities may be universal. Lawyers, unlike loan-modification consultants, however, also have to worry about the ethical rules.