

# NEW HAMPSHIRE BAR ASSOCIATION

## Crowdfunding Legal Fees

### Ethics Committee Opinion #2021-22/02

#### **ABSTRACT:**

Representing a client in a matter funded in whole or in part through donation-based crowdfunding is not unethical per se. Lawyers are encouraged to exercise substantial caution when undertaking a crowdfunded matter, however, as ethical concerns abound and increase as an attorney's involvement with the fundraising increases.

#### **ANNOTATIONS:**

Lawyers contemplating undertaking a crowdfunded matter are encouraged to exercise caution.

Lawyers are encouraged to employ a written engagement letter and must satisfy the client consent and other duties arising where a third-party funds litigation. Lawyers should understand a contemplated crowdfunding platform's functionality, and alternatives, sufficiently to enable them to reasonably counsel the client about the potential impact on the client's matter, with particular attention to privilege.

Lawyers should consider their duties to potential donors, including truthful disclosure.

Lawyers should consider how funds will make their way from the platform to the lawyer's operating account and how funds raised in excess of the cost of the representation will be disposed of. Bear in mind that at the end of the day, fees and expenses must be "reasonable" and "earned."

### **OPINION**

#### Background:

This Opinion discusses the ethical concerns presented by donation-based crowdfunding, which appears to be growing in popularity as a means of financing legal representation for those who might not otherwise be able to afford it.

Through Internet-based crowdfunding, typically small amounts of money are raised from a large number of people. Funds may be raised for virtually any legal purpose, using one of the many platforms designed for that purpose. Crowdfunding platforms offer five basic types of incentives that projects seeking funding may offer funders: debt, equity, royalty, and donation (with or without "rewards").

In the emerging scenario we consider here, legal services are funded through donation-based crowdfunding ("DBC"). Contributions are solicited to fund a specific individual's specific legal matter. Donors acquire neither any control over the matter nor any direct financial interest in its

outcome. Solicitation of donations may take various forms and typically involves processing donations through one of the many Internet platforms designed for that purpose. If contributors are offered “rewards,” the rewards are limited in type and value as discussed below.

The DBC model is distinct from equity-based crowdfunding and other forms of alternative litigation finance. Those funding sources raise some of the same ethical concerns as DBC; note the Committee’s prior guidance concerning non-recourse litigation funding. New Hampshire Ethics Committee Advisory Opinion #2004-05/01 *Non-Recourse Lawsuit Financing*.

DBC presents a variety of ethical concerns, concerns that increase as the attorney’s involvement in the fundraising increases.

#### I. Commencing the Engagement

*Engagement Letters.* The Committee strongly encourages the use of written engagement letters in matters involving DBC. *Cf.* NHRPC Rule 1.5(b) (written agreement preferable but not required). The engagement letter should be clear regarding the terms under which the funds will be drawn down. NHRPC Rule 1.5(b). It should also be clear how lawyer and client will proceed not just if donations exceed costs (whether due to natural conclusion, settlement, or the client’s decision not to pursue the matter) but also if costs exceed donations, or because for whatever reason the attorney-client relationship terminates. Subject to NHRPC Rule 1.6, plans for these contingencies ought to be disclosed to donors if necessary to make the pitch truthful. NHRPC Rules 1.1, 1.3, 2.1., 4.1 and 7.1.

*Duties Where Receiving Funds From Other Than the Client.* Compensation may be accepted from a source other than the client only when the following conditions set forth in NHRPC 1.8(f) are satisfied: “(1) the client gives informed consent; (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and (3) information relating to representation of a client is protected as required by Rule 1.6.” NHRPC 1.8(f).

*Potential Business Transaction.* A lawyer should always be alert to the possibility that their contemplated conduct might constitute a “business transaction” with a client, triggering the disclosure and documentation requirements set forth in NHRPC Rule 1.8(a). Where a lawyer entangles themselves deeply with a client’s DBC fundraising, at some point it becomes reasonable to assume that those disclosure and documentation requirements must be satisfied.

We do not believe, however, that the mere fact that a lawyer expects to receive fees and costs from an arrangement a client enters into with a third party, alone, even if the resulting financing were a condition of, and built into, the lawyer’s fee agreement with the client as a means to pay for the representation, would give rise to a “business transaction” between lawyer and client. To the extent our prior guidance suggested as much, we now believe that language to have been overbroad. We previously reasoned, in the context of non-recourse financing:

to the extent that a lawyer knows or has reason to know he/she will obtain some form of benefit, such as payment of fees and costs, through the client’s

participation in non-recourse lawsuit financing, such an arrangement could well constitute a “business transaction” between the lawyer and client.

NH Opinion 2004-05/1. In a footnote we added:

This would be especially true if participation in non-recourse lawsuit financing was a condition of and built into the lawyer’s fee agreement as a means to pay for the litigation.

*Id.*, FN 5. We believe that opinion’s determination that the disclosure and documentation requirements of Rule 1.8(a) might be implicated was based on the attorney’s intensive involvement in a commercial transaction, rather than by the attorney’s mere receipt of funds arising from an arrangement between client and a third party. Thus, we overstated the likelihood that non-recourse lawsuit financing, and by implication, DBC, would *per se* give rise to a “business transaction” as contemplated by NHRPC Rule 1.8(a). To that extent, we modify the language of the prior opinion.

*Understand How the Platform Works.* Even if the lawyer does not intend to be involved with the client’s use of a crowdfunding platform, the lawyer cannot adequately meet their obligations to counsel the client, discussed below, unless the lawyer understands the basic functionality of the platform, including how it treats funds raised on behalf of the client. A lawyer who intends to be directly involved with use of a platform must bear in mind their obligation to understand the risks and advantages associated with technology they use in their practice. NHRPC Rule 1.1.

*Legal Duties.* Lawyers must take reasonable steps to identify their legal obligations and to avoid entangling themselves in illegal conduct.<sup>1</sup> NHRPC Rules 8.4(b) and (c). For example, in addition to potential fraud and money-laundering, a lawyer may also have an obligation to identify the source of overseas funding. Bear in mind the scope of an attorney’s duties and the limits of the safe harbor set forth in NHRPC Rule 1.2 (d) and (e).

## II. Counseling the Client

*Duty to Consult with Client Generally.* Nothing in the manner funds are raised excuses any of an attorney’s obligations to their client. This includes, for example, the duty to consult with the client and abide by their decisions. NHRPC 1.2 and 1.4.

*Duty to Counsel Client re: Privilege.* In particular, an attorney must consider and counsel the client about the risks of disclosing information. As a practical matter, the success of a crowdfunding appeal often turns on how compelling the client’s story is. A crowdfunding website post seeking donations, like any other public social media, can provide an adversary with

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<sup>1</sup> For further discussion of potential attorney exposure under ethics rules and substantive law where clients engage in money laundering or use criminal proceeds to fund legal services, *see* DC Bar - Ethics Opinion 375 (2018); ABA Formal Op. 463 (2013); “Houston, We Have a Problem: Clients Who Engage in Unlawful Conduct During Your Representation,” Winter / Spring 2015 Edition of the ABA White Collar Crime Committee Newsletter, pages 1 and 9-11.

valuable information. Communications with funders may later be deemed to be unprivileged, an issue which has arisen in third-party funded matters in other jurisdictions.<sup>2</sup> Bear in mind the treacherous doctrine of subject matter waiver under which an entire topic can be rendered non-privileged. If confidentiality may already have been compromised, consider what damage control can be implemented.

*Duty to Counsel Client re: Relevant Considerations:* Even if the lawyer plans to have no involvement in a client's fundraising, the lawyer has a duty to discuss with their client the potential impacts of the fundraising on the contemplated litigation, including available alternatives, the pros and cons of such financing, the ramifications on a potential recovery and any other material considerations. NHRPC Rule 1.3. See New Hampshire Ethics Committee Advisory Opinion #2004-05/01. The lawyer's duty to counsel the client extends to potential legal consequences of soliciting donations which the client might not otherwise anticipate. NHRPC Rules 1.1, 1.4(b) and 2.1. Where a lawyer is more deeply involved with the client's engagement with the DBC platform, the lawyer may have a duty to familiarize themselves with the platform's terms of service and to advise the client about potentially significant terms, e.g., waiving jury trial rights or agreeing to binding arbitration.

*Tax Issues:* The IRS may deem funds raised through DBC to be income taxable to the client. The lawyer should advise their client to seek appropriate guidance. The risk of a client neglecting this issue may be heightened due to some crowdfunding platforms reportedly structuring disbursements to avoid triggering the platforms' IRS reporting obligations.

### III. Communications with Potential Donors

*Disclosure Duties.* Communications between the attorney and potential donors must be truthful and must not raise "an unjustified expectation about results the lawyer can achieve." See NHRPC Rules 4.1 (truthfulness in statements to others) and 7.1 (communications concerning a lawyer's services). Donors should be informed where their funds will be nonrefundable, how any unearned donated funds will be distributed at the conclusion to the matter, that donors will not receive confidential information about the client's matter, and that donors will not have any opportunity to exert control over the lawyer's work. Depending on the circumstances, the attorney may be obligated to make such disclosures, see NHRPC Rules 4.1 and 7.1, or may be obligated to advise the client to make the disclosures. See NHRPC Rules 1.1, 1.3 and 2.1.

*The Ethics of Attorney Advertising May Apply:* Some online DBC platforms collect payment processing fees and receive a percentage of the funds raised if a campaign is successful. A lawyer compensating a third party to raise funds for a specific case would be wise to assume that

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<sup>2</sup> See, e.g., *Leader Techns., Inc. v. Facebook, Inc.*, 719 F. Supp. 2d 373 (D. Del. 2010) (compelling disclosure of documents shared with financing companies during discussions about potential financing); see also *Abrams v. First Tenn. Bank Nat'l Ass'n*, No. 3:03-cv-428, 2007 WL 320966, at \*1 (E.D. Tenn. Jan. 30, 2007); see also *Nate Raymond, Litigation Funders Face Discovery Woes*, NAT'L L.J., Feb. 21, 2011 (reporting that in at least one case, the initial conversations between a funding company and the client were not protected from disclosure by the attorney-client privilege).

the lawyer is engaged in advertising. In addition to the usual ethical concerns raised by attorney advertising, *see* in particular NHRPC Rules 7.1 and 7.2 and the comments thereto, and usual practices (such as disclosing the name, office address and jurisdictions of admission of at least one involved attorney) consider that any compensation the platform receives (or retains) must not exceed the “reasonable costs” permitted under Rule 7.2(b)(1). Consider any relevant disclaimers, *e.g.*, that a donation neither establishes an attorney-client relationship, nor entitles a donor to an equity interest or to any control over the matter.

*Beware of “Perks” and “Rewards.”* With respect to “perks” and “rewards” for donors, the coin of the crowdfunding realm, lawyers must tread cautiously. For example, there is no clear ethical bar to a lawyer committing to providing periodic updates to donors concerning the matter, provided communications are client-approved, and contain no confidential information. The thoughtful lawyer may be cautious however, about the risk of suggesting that donors will have any influence over the lawyer’s prosecution of the matter.

#### IV. Treatment of Raised Funds

*Disbursement of Funds.* The functionality of the platform utilized will determine how raised funds may be disbursed and how unutilized funds may be returned to donors or otherwise disposed of. For example, funds may be received by the client and disbursed to the attorney as billed, held by the crowdfunding platform and disbursed to the lawyer upon invoice, or deposited in the attorney’s client trust account as raised, to be drawn down as earned by the attorney.

*Fees and Expenses Must be “Reasonable” and “Earned.”* Whether paid upon invoice or drawn down from the attorney’s trust account, fees must be both “reasonable” and “earned,” even if the retainer sets forth a flat-fee agreement. NHRPC Rules 1.5(a) and 1.15.<sup>3</sup> Any such funds not reasonably earned by the conclusion of the matter remain the property of the client, unless otherwise set forth in the client engagement letter, if not also the solicitation to donors. While we see no obstacle to excess funds being donated to a non-profit or allocated to fund similar litigation involving another client, it would be unethical for an attorney to personally retain a windfall that is not both “reasonable” and “earned” in a non-contingent matter. NHRPC Rule 1.5(a).

*Funds Raised by a Lawyer for Legal Costs Cannot be used for the Client’s Assistance:* A lawyer who becomes so materially involved in the fund-raising process as to be raising funds on behalf of the client must bear in mind the prohibition on providing financial assistance set forth in Rule 1.8(e). Note that New Hampshire chose not to adopt the ABA’s Model Rule 1.8(e)(3) permitting lawyers to offer such assistance to indigent clients.

*Donations Exceeding Reasonable Costs:* The solicitation of donations in excess of reasonably anticipated costs could raise various ethical concerns. *See, e.g.*, NHRPC Rules 4.1 (Truthfulness

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<sup>3</sup> *See Practical Suggestions for Flat Fees or Minimum Fees in Criminal Cases*, Ethics Committee Practical Ethics Article, presented to the Board of Governors January 17, 2008 (*available at: <http://www.nhbar.org/resources/ethics/ethics-corner-practical-ethics-articles/2008-01>*)

in Statement to Others), 8.4(c) (which prohibits a lawyer from engaging in dishonest or deceitful conduct) and 1.5(a) (which prohibits a lawyer from seeking an unreasonable fee). Ethics authorities in other jurisdictions<sup>4</sup> have identified the risk that a lawyer might be perceived as seeking an unreasonable fee due to the potential to raise funds in excess of the costs of the representation and a perception that the client might exercise less rigorous oversight over the lawyer's billings than if the funds were the client's own. The lawyer should ensure that a plan is in place to terminate fundraising when sufficient funds have been raised.

#### **NH RULES OF PROFESSIONAL CONDUCT:**

Rule 1.1 (Competence)

Rule 1.2(a), (d) and (e) (Scope of Representation)

Rule 1.3 (Diligence and Zeal)

Rule 1.4 (a) and (b) (Communication)

Rule 1.5(a) (Fees)

Rule 1.6 (a) (Confidentiality of Information)

Rule 1.8 (a), (e) and (f) (Conflicts of Interest: Specific Rules)

Rule 1.15 (Safekeeping of Property)

Rule 2.1 (Advisor)

Rule 4.1 (Truthfulness in Statements to Others)

Rule 5.4 (c) (Professional Independence of a Lawyer)

Rule 7.1 (Communications Concerning a Lawyer's Services)

Rule 7.2(b) (Advertising)

Rule 8.4(b) and (c) (Misconduct)

#### **NH ETHICS COMMITTEE OPINIONS AND ARTICLES:**

“Non-Recourse Lawsuit Financing,” Ethics Committee Advisory Opinion #2004-05/01 (2005)

#### **SUBJECTS:**

Crowdsourcing

Crowdfunding

Donation-based funding of legal services

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<sup>4</sup> See, e.g., “Ethical Considerations of Crowdfunding,” DC Bar - Ethics Opinion 375 (November 2018); Philadelphia Bar Association Professional Guidance Committee Opinion 2015-6 (2015); and Palmer, Mark, “Is Crowdfunding Legal Services Ethically Permissible?” Web blog post, *2Civility*, Illinois Supreme Court Commission on Professionalism; January 21, 2019 (updated August 16, 2020).

- **By the NHBA Ethics Committee**

*This opinion was submitted for publication to the NHBA Board of Governors at its June 17, 2022 meeting.*