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Case Comments

Legal Ethics: Unauthorized Practice of Law by Collection Agencies

Defendant collection agency solicited accounts from the public and attempted to collect. If the usual collection procedures failed, the collection agency informed the creditor that the agency was willing to bring a lawsuit on the account as agent or assignee of the creditor. When the creditor agreed to such action, the collection agency retained an attorney and started legal proceedings, either in the creditor's name or in its own name as assignee. All legal work was done by licensed attorneys hired and controlled by the collection agency. In an action for an injunction brought by the State Bar Association of Wisconsin, the Wisconsin Supreme Court held that such activities constituted the unauthorized practice of law. *State ex rel. State Bar v. Bonded Collections, Inc.,* 154 N.W.2d 250 (Wis. 1967).

The practice of law is the performance of legal services for others. Such activities constitute the unauthorized practice of law if performed by persons who are not permitted by law to do so. A lay person practices law either by acting as an attorney and performing legal services directly, or by interposing himself as an intermediary between a licensed attorney and a client. In deciding whether acts are the unauthorized practice...
of law, the courts rely on different factors depending upon whether the direct practice of law by an individual or the indirect practice of law by a lay intermediary is involved.

The exercise of control over the attorney by a person other than the one whose interests are at stake in the legal proceeding is the indirect practice of law. The courts impute to the intermediary the acts of his attorney on an agency theory. Thus, if the attorney is practicing law, the person who hires and controls the attorney is also practicing law. The unauthorized practice of law by a lay intermediary is deemed undesirable because of the danger of solicitation which may result in the encouragement of lawsuits and, more importantly, the absence of an attorney-client relationship. The primary evil in the lack of an attorney-client relationship is said to be the diverting of the duty and allegiance of the attorney from the person whose interests are at stake in the legal proceedings, thereby giving rise to a possible conflict of interest. Diverted allegiance

5. This responsibility, inherent in the judicial power, is primarily the concern of the courts. E.g., Clark v. Austin, 340 Mo. 467, 101 S.W.2d 377 (1937).

6. The rationale underlying the regulation of the direct practice of law by nonlawyers is based primarily on a desire to protect the public. The layman lacks the legal education and training of an attorney and is not subject to the same high standards of conduct or close judicial scrutiny. Moreover, the layman has not met the standards of competence set by each state which authorize the practice of law in that state. For these reasons, the courts and legislators of this country have decided that the nonlawyer, when practicing law, performs a disservice to the public. AMERICAN BAR FOUNDATION, UNAUTHORIZED PRACTICE STATUTES, Book iii (1961). However, as to a lay intermediary, these objections are not valid because the legal services are actually performed by a qualified attorney who is subject to the same standards as any other attorney.


10. Note, Unauthorized Practice of Law by Collection Agencies, 8 W. RES. L. REV. 492, 500 (1957); see Comment, 24 U. CHI. L. REV. 572, 576 (1957); authorities cited notes 3 & 9 supra.
must be found before the activities constitute the unauthorized practice of law by a lay intermediary.\textsuperscript{11}

Courts have considered the legality of many different methods used by collection agencies to collect accounts for others. It is generally accepted that the usual collection agency practice of dunning is legal.\textsuperscript{12} The outright assignment of the whole account for purposes of collection is also considered legal, since the creditor retains no interest in the account or in the outcome of any possible litigation.\textsuperscript{13} Since the creditor has no interest, the collection agency is not representing his interests and, therefore, is not an intermediary. Forwarding, the transfer of an account to an attorney chosen either by the creditor or the collection agency,\textsuperscript{14} is permissible\textsuperscript{15} if the collection agency is to perform only ministerial duties.\textsuperscript{16} The collection agency

11. See authorities cited note 9 supra.


13. If the assignment were taken at the initial contact between the creditor and the collection agency, this result is correct. It would be merely an assignment of an account. The collection agency becomes the sole owner of the account and has a right to collect as it deems necessary, including hiring an attorney to bring suit. If, however, the assignment is taken at the time when it is obvious that legal proceedings are necessary, it may be deemed invalid as contrary to public policy and may constitute the unauthorized practice of law. See Professional Recovery Servs., Inc. v. John & Mary Doe, 29 UNFAIR PRACTICE NEWS 80 (La. 1962).

14. For an excellent analysis of what constitutes forwarding and the requisites of valid forwarding see Commercial Law League, Re Forwarding of Collection Claims by Agencies to Lawyers, 65 COM. L.J. 207, 213 (1960); Maxwell & Zug, Brief Sur Draft Opinion and Proceedings Before the Committee on Behalf of the Commercial Law League of America, 66 COM. L.J. 155, 161 (1961) [hereinafter cited as Brief Sur Draft]. There is presently little doubt that a person may engage an agent to select an attorney and arrange compensation, which is often done in forwarding. See, e.g., State ex rel. District Attorney v. Lytton, 172 Tenn. 91, 96, 110 S.W.2d 313, 315 (1937).

15. Brief Sur Draft 161; Commercial Law League, supra note 14, at 207. See also Comment, 41 MINN. L. REV. 475 (1957).

16. Commercial Law League, supra note 14, at 219, app. 2. The requisites of proper forwarding are: 1) the attorney must be paid by the creditor; 2) the forwarding must be expressly authorized by the creditor and must comply with Canons 34, 35, and 47 of the Canons of Professional Ethics. Canon 34 prohibits division of fees for legal services except with another lawyer, based upon a division of service or responsibility. Canon 35 prohibits control or exploitation of a lawyer's services by a lay agency which intervenes between the client and the lawyer. Canon 47 prohibits attorneys from aiding or making possible the unauthorized practice of law by any lay agency. See ABA CANONS OF PROFESSIONAL ETHICS No. 35 [hereinafter cited by CANON number only].
must not receive a share of the attorney fees and must have no control over the attorney. If the collection agency exercises control beyond ministerial duties, it will be engaged in the practice of law as an agent of the creditor in conducting the lawsuit. When control and the duty and allegiance of the attorney are diverted from the creditor, it is usually held that the collection agency is engaged in the unauthorized practice of law. The difference between forwarding and acting as an agent is merely a matter of degree.

The taking of a partial assignment by a collection agency for the purpose of commencing legal proceedings is generally considered to be the unauthorized practice of law. The creditor retains no control over his interest in the account and the collection agency, therefore, is acting as an intermediary. Solicitation is present, and the allegiance of the attorney is diverted to the collection agency, apparently because it is an independent

17. See CANON 34.
18. See CANON 35.
20. The diverted allegiance is apparently found because the collection agency operates as an independent entity. See Comment, 21 RUTGERS L. REV. 577, 584 (1967).
23. See, e.g., Bump v. District Court, 232 Iowa 623, 5 N.W.2d 914 (1942); Bay County Bar Ass'n v. Finance Sys., Inc., 345 Mich. 434, 76 N.W.2d 23 (1956); State v. James Sanford Agency, 167 Tenn. 339, 69 S.W.2d 895 (1934); Nelson v. Smith, 107 Utah 382, 154 P.2d 634 (1944). Contra, Cohn v. Thompson, 128 Cal. App. 783, 16 P.2d 364 (1932); Mutual Bankers Corp. v. Covington Bros. & Co., 277 Ky. 73, 125 S.W.2d 202 (1939). See also Resh, Collection Agencies—The Case Against Assignment for the Purpose of Suit, 32 UNFAIR PRACTICE NEWS 1 (1966). Most courts say that the partial assignment is valid and gives the collection agency standing to sue. The mere fact of validity of the assignment, however, does not necessarily authorize the collection agency to sue. The courts say that the statutes giving standing to sue are merely procedural and are intended to protect the debtors in these cases. The effect of one having standing to sue is merely a guarantee to the debtor that if he is sued by such a person, another who also has an interest may not also collect from the debtor. See Bump v. District Court, supra; Bay County Bar Ass'n v. Finance Sys., Inc., supra. The standing to sue statutes, therefore, have no effect on whether a person is engaged in the unauthorized practice of law.
24. See note 23 supra.
In the instant case, the collection agency took an assignment of a part interest in the account. The court found that the assignee had only a “naked legal title” and the creditor, whose cause of action was at stake in the lawsuits, remained the true client. The court also found that control of the lawsuit was in the hands of the collection agency, and, since its interest in the account was merely a fee for services rendered, it was an intermediary. Such arrangement diverted the duty and allegiance of the attorney from the creditor to the collection agency. The court concluded that habitual activity of this type for a fee constituted the unauthorized practice of law.

The court similarly objected to the diversion of allegiance and control by the collection agency in connection with the agency agreements, and consequently held that these also constituted the unauthorized practice of law. The court recognized, however, that where a true attorney-client relationship is created, there is no unauthorized practice of law problem even though the attorney deals with an agent of the creditor.

Although Bonded follows the majority of decisions in this area, the rationale of the courts should be reconsidered in light of the needs of society today. Collection agencies have been operating in this country for over one hundred years and most authorities agree they serve a useful and needed business function. They are not, in and of themselves, contrary to any

25. See note 20 supra.
26. 154 N.W.2d at 255.
27. Finding that the collection agency’s interest in the account was for a fee only was not necessary to finding control and diverted allegiance because, when only a partial interest is assigned, the collection agency still represents the creditor as to his remaining interest.
28. 154 N.W.2d at 256.
29. Id. The requirement of a fee, however, has been generally abandoned by courts in recent years. The argument is that the activity itself is objectionable, not just when it is for profit. Therefore, it should be the unauthorized practice of law regardless of whether or not a fee is paid. Cf. State Bar v. Arizona Land Title & Trust Co., 90 Ariz. 76, 366 P.2d 1 (1961); Winkenhofer v. Chaney, 369 S.W.2d 113 (Ky. 1963); Report of the Standing Committee on Unauthorized Practice of the Law, Pernicious Doctrines, 60 A.B.A. Rep. 521, 533 (1935). Although these cases deal with the direct practice of law, the lay intermediary problem should be treated similarly with respect to the question of a fee.
30. 154 N.W.2d at 257.
31. See note 23 supra.
32. Brief Sur Draft 156.
33. Id.; Commercial Law League, supra note 14, at 207; Note, Unauthorized Practice of Law by Collection Agencies, 8 W. Res. L. Rev. 492, 494 (1957).
public policy and are generally recognized as valid and legal business enterprises. They provide a service which cannot, in many cases, be provided as economically by the creditors themselves, especially in the case of smaller operations.

Although the procedure of forwarding does relieve the creditors from some of the burdens of collection, the number of accounts handled by Bonded as agent or assignee for commencing and controlling legal proceedings seems to indicate a strong desire for these services. Apparently, the creditors want to let someone with expertise handle the collections and, when necessary, the direction of attorneys. Assignment of the whole account similarly eliminates the burden and nuisance on the creditor, but it is not often used, probably because of the difficulty in ascertaining reasonable prices for the uncollectable accounts and the desire of the creditor to take some of the risk himself on the chance that his accounts are more valuable than the average.

On examining the danger of increased litigation through active solicitation, it seems doubtful that the procedures utilized by Bonded will substantially increase it. Solicitation is present in both the forwarding process and assignment procedures and it is likely that most accounts handled by collection agencies will involve legal proceedings if they are otherwise uncollectable, and if the creditor wants to sue. Even assuming, however, that litigation will increase, this is not necessarily evil since creditors have a right to collect valid debts owed to them, and providing an easier and more economical method of collecting what is legally owing is, generally, of positive value.


35. Collection agencies solicit accounts from creditors for collection. Compensation is usually determined as a percentage of the amount recovered. If the agency cannot collect through their dunning procedure, they usually either return the account to the creditor or forward it to an attorney. If it is forwarded to an attorney, the agreement with the creditor usually provides that the creditor will receive a percentage of the amount recovered. The percentage is generally much lower than that agreed upon if the dunning had produced collection. Brief Sur Draft 155-57.

36. See Brief Sur Draft 159.

37. If the account is forwarded, the creditor is relieved from the burdens of finding a lawyer and performing ministerial duties, but he still must communicate with the attorney and make decisions.

38. It was alleged that Bonded instituted over 1000 legal actions from May, 1962, to July, 1965, as assignee or agent of creditors. From July, 1964 to July, 1965, it is alleged that Bonded instituted over 65% of all the claims filed in the small claims court of Eau Claire. 194 N.W.2d at 252.
The mere existence of control of an attorney by one other than the client is not objectionable. A person should be able to select whomever he pleases to deal with his attorney so long as that person does not have interests which substantially conflict with those of the principal. If a creditor feels someone other than himself can better handle the collection of accounts, including legal proceedings, there should be no objection to his hiring that person. Large institutions can provide themselves with such expert services internally, and small creditors should have the same opportunities to acquire expert assistance.

The danger of diverting the attorney's allegiance and creating a conflict of interest does not necessarily exist. The relationship between the collection agency and the creditor should be examined as to their respective interests. If their interests are the same, it should not matter that the attorney owes his allegiance to one rather than the other as his work will be equally beneficial to both. Also, even if there is a conflict of interest, it should not be fatal if there is full disclosure and the parties agree on representation.

Furthermore, the interests of the collection agency and the creditor will not substantially conflict if they arrange to split the amount recovered. The agency will be anxious to collect without an attorney in order to minimize expenses which are split by both. It will not unreasonably compromise the claim because the fee it receives is dependent on the amount of recovery. It will not bring unjust lawsuits because, if there is

39. See note 30 supra.
40. Brief Sur Draft 159.
41. See United Mine Workers v. Illinois State Bar Ass'n, 88 Sup. Ct. 353 (1967), in which the Court recognized that in certain lay intermediary situations there is no substantial conflict of interest, great need for the services, and no lowering of the legal ethics standards. The Court, therefore, balanced such interests against those of freedom of association under the first amendment and held in favor of the intermediary.
42. See CANON 6. The conflict of interests regulation is directed at attorneys, therefore, it may be used to prohibit attorneys taking cases where there are substantial conflicts of interests. See In re Blatt, 42 N.J. 522, 201 A.2d 715 (1964). If the attorney takes such a case, he is at fault, not the collection agency. If attorneys do not take cases if there is a substantial conflict of interests between the collection agency and the creditor, the collection agencies will not be able to prosecute the lawsuits with attorneys. If they seek to prosecute without an attorney, they will be practicing law directly and therefore be engaged in the unauthorized practice of law.
43. About 60-75% of accounts sent to collection agencies are collected without attorneys—of those remaining which are sent to attorneys (not all are) about 50-75% are collected without a law suit.