Formal Opinion 2011-2:
THIRD PARTY LITIGATION FINANCING

TOPIC: Third-party litigation financing

DIGEST: It is not unethical *per se* for a lawyer to represent a client who enters into a non-recourse litigation financing arrangement with a third party lender. Nevertheless, when clients contemplate or enter into such arrangements, lawyers must be cognizant of the various ethical issues that may arise and should advise clients accordingly. The issues may include the compromise of confidentiality and waiver of attorney-client privilege, and the potential impact on a lawyer's exercise of independent judgment.

RULES: 1.2(d); 1.6(a); 1.7(a); 1.8(e), (f); 2.1; 2.2; 5.4(c)

QUESTION: What ethical issues may arise when a lawyer represents a client who is contemplating or has entered into a non-recourse litigation financing agreement?

OPINION

I. Background

Third party litigation financing first emerged as an industry in the United States in the early 1990s, when a handful of small lenders began providing cash advances to plaintiffs involved in contingency fee litigation. Within a decade, as many as one hundred companies were offering financing to lawyers, their clients, or both.[1] As of 2011, this industry has continued to grow, both as to the number and types of lawsuits financed and financing provided. The aggregate amount of litigation financing outstanding is estimated to exceed $1 billion.[2]

This opinion addresses non-recourse litigation loans, *i.e.*, financing repaid by a litigant only in the event he or she settles the case or is awarded a judgment upon completion of the litigation. Under these arrangements, financing companies advance funds that will be reimbursed, if at all, solely from any proceeds of the lawsuit. As compensation, the financing companies are entitled to receive specified fees, often calculated as a percentage of any settlement or judgment.

Non-recourse loans are extended most often to plaintiffs in personal injury cases. These loans may be used to pay the costs of litigation, but also may be used to cover the plaintiff's living expenses during the pendency of the lawsuit.

Non-recourse financing of commercial claims is a more recent development, although it has become increasingly common.[3] The providers of this financing typically undertake an analysis of the merits of the contemplated claim that is more rigorous than the analysis employed in personal injury cases. If the claim appears meritorious, the financing company will advance amounts to cover attorneys fees and the other costs of the litigation.[4] These advances typically are made to the claimant or its outside litigation counsel, in return for a percentage of any eventual recovery.

The growing use of non-recourse litigation financing recently has attracted increasing attention, both within and outside the legal profession,[5] in part because the arrangements are largely unregulated, and, in the view of some critics, may require the payment of relatively exorbitant financing fees that appear usurious, create the potential for expanding the volume of litigation, and raise the specter of reviving the historically reviled practice of champerty, defined broadly as the support of litigation by a stranger in return for a share of the proceeds.

From the legal ethics perspective, perhaps the greatest concern stems from a financing company's involvement in the details of a claimant's case. Because a financing company's decision to fund will hinge on the company's analysis of the merits of the lawsuit, i.e., the likelihood and size of the expected return, the availability of financing necessarily depends on the company's ability to obtain access to information relevant to its assessment of risks of its investment, both before and after a decision to fund has been made. As part of this process, a financing company may contact the claimant's

lawyer to obtain confidential and privileged information regarding the case before making any loan commitment. And even after funding has been provided, the financing agreements may require litigation counsel to periodically update the financing company with developments in the case and/or provide the company with direct access to the claimant's file.

Providing financing companies access to client information not only raises concerns regarding a lawyer's ethical obligation to preserve client confidences, it also may interfere with the unfettered discharge of the duty to avoid third party interference with the exercise of independent professional judgment. While litigation financing companies typically represent that they will not attempt to interfere with a lawyer's conduct of the litigation, their financial interest in the outcome of the case may, as a practical matter, make it difficult for them to refrain from seeking to influence how the case will be handled by litigation counsel.

II. Analysis

Against this backdrop, we discuss below the ethical issues potentially implicated by non-recourse financing arrangements and examine how lawyers may properly address these issues as they arise.

A. Legality of the Agreement

Whether a particular financing arrangement comports with the law will depend on its terms and governing law, matters outside the scope of this opinion. Nevertheless, under Rule 1.2(d) of the New York Rules of Professional Conduct, if the arrangement is unenforceable under applicable laws, such as those governing champerty and usury, or is otherwise unlawful, an attorney should so advise the client and refrain from facilitating a transaction that is unlawful.

1. Usury

A financing company generally makes its funding determination based on the "merits" of the lawsuit, *i.e.,* on the likelihood of success and the amount of any anticipated recovery. In the same vein, it will seek to set the fee it collects for providing funds based on its assessment of the likelihood of recovery. Fee arrangements vary widely as a result.

Critics have focused on fee arrangements that ultimately require litigants to pay financing companies a substantial portion of any recovery, noting that if the advances made in exchange for these fees were characterized as "loans," the fees could be deemed usurious.[6] While financing companies generally characterize non-recourse financing arrangements as a "purchase" or "assignment" of the anticipated proceeds of the lawsuit (and therefore not subject to usury laws),[7]lawyers should be aware that in certain circumstances, courts have found that non-recourse litigation financing agreements violate usury laws.[8]

2. Champerty

Champerty is a form of maintenance in which a nonparty furthers another's interest in a lawsuit in exchange for a portion of the recovery. The law of champerty varies by jurisdiction.[9] While we are aware of no decision finding non-recourse funding arrangements champertous under New York law, lawyers should be mindful that courts in other jurisdictions have invalidated certain financing arrangements under applicable champerty laws.[10]

B. Attorney as Advisor

A lawyer may be asked by a client to recommend a source of third party funding or to review or negotiate a non-recourse financing agreement for a client. If the lawyer does so, Rule 2.1 requires the lawyer to provide candid advice regarding whether the arrangement is in the client's best interest.[11]

In providing candid advice, a lawyer should advise the client to consider the costs and the benefits of non-recourse financing, as well as possible alternatives.[12]With respect to costs, a common criticism of non-recourse financing is that the fees charged to clients may be excessive relative to other financing options, such as bank loans, thereby significantly reducing the client's recovery.[13] A lawyer thus should bear in mind the extent to which non-recourse financing will

limit a client's recovery. And before recommending financing companies, a lawyer should conduct a reasonable investigation to determine whether particular providers are able and willing to offer financing on reasonable terms.[14] In addition, if a lawyer assists a client with non-recourse financing, the lawyer may wish to make clear that such assistance itself is not an endorsement of the financing company.[15]

With respect to benefits, a lawyer should advise the client to consider whether, absent funding, the client would be unable to cover litigation or living expenses, or prematurely could be forced into a relatively disadvantageous settlement, effectively limiting his or her access to seek redress through the legal system. Commercial claimants also may lack the resources to pursue a claim absent funding, or may be able to deploy resources more effectively for their business needs by financing some or all of their litigation costs.

C. Conflicts of Interest

Within the parameters discussed above, a lawyer may refer a client to a litigating financing company. When making a referral, the lawyer is barred from accepting a referral fee from the company if the fee would impair the lawyer's exercise of professional judgment in determining whether a financing transaction is in the client's best interest and would compromise the lawyer's ethical obligation to provide candid advice regarding the arrangement; even where the fee is permitted, the lawyer may be required to remit the fee to the client.[16] A conflict also may arise in the event the lawyer is asked to advise the client about financing when the client cannot afford to commence or continue litigation absent a third party advance of the lawyer's fees. And the conflict rules may prohibit a lawyer, or possibly a company in which the lawyer has a substantial ownership interest, from extending financing to a client that the lawyer represents in litigation.[17] Lawyers should carefully evaluate these and other potential conflicts when initiating or continuing the representation of a client who contemplates the use of financing for the conduct of litigation.

D. Privilege and Confidentiality

Non-recourse financing arrangements also may result in waiver of the attorney-client privilege or other protection from disclosure. This risk arises from provisions requiring a claimant or his or her lawyer to disclose documents and information to financing companies to enable them to evaluate the strength of the claims in the litigation to be financed.[18] In addition, financing arrangements may require a lawyer to inform the financing company of developments in the case and/or allow periodic reviews of the case file.[19] And for very large claims, some financing companies reserve the right to share information regarding a matter with other companies that may participate in the financing.

This opinion does not address whether such communications between the client or lawyer and a financing company result in a waiver of the attorney-client privilege or other applicable protection. We note, however, that the argument has been made that the common interest privilege does not apply to such communications because the financing company's interest in the outcome of a litigation is commercial, rather than legal.[20]

With the foregoing in mind, a lawyer may not disclose privileged information to a financing company unless the lawyer first obtains the client's informed consent, including by explaining to the client the potential for waiver of privilege and the consequences that could have in discovery or other aspects of the case.[21] In making disclosures to the financing company, a lawyer should take care not to disclose any more information than is necessary in his or her judgment.[22]

E. Control Over the Legal Proceeding

Non-recourse financing agreements often require the claimant's lawyer to keep the financing company apprised of any developments in the litigation or to seek the company's consent when taking steps to pursue or resolve the lawsuit, such as making or responding to settlement offers. These notice provisions raise the specter that a financing company, armed with information regarding the progress of the case, may seek to direct or otherwise influence the course of the litigation.[23] For example, to protect its own interest in maximizing the fee it may earn, a financing company may object to steps calculated to advance the client's interests, such as pursuing a promising line of additional discovery at a cost the company would prefer to avoid, or accepting a settlement offer that does not meet the company's expectations regarding

the return on its investment. While a client may agree to permit a financing company to direct the strategy or other aspects of a lawsuit, absent client consent, a lawyer may not permit the company to influence his or her professional judgment in determining the course or strategy of the litigation, including the decisions of whether to settle or the amount to accept in any settlement.[24]

III. Conclusion

Non-recourse litigation financing is on the rise, and provides to some claimants a valuable means for paying the costs of pursuing a legal claim, or even sustaining basic living expenses until a settlement or judgment is obtained. It is not unethical*per se* for a lawyer to advise on or be involved with such arrangements. However, they may raise various ethical issues for a lawyer, such as the potential waiver of privilege and interference in the lawsuit by a third party. A lawyer representing a client who is party, or considering becoming party, to a non-recourse funding arrangement should be aware of the potential ethical issues and should be prepared to address them as they arise.

June, 2011

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[1]*See* Terry Carter, *Cash Up Front: New Funding Sources Ease Strains on Plaintiffs Lawyers*, ABA Journal 34-36 (Oct. 8, 2004), *available at*http://abajournal.com/magazine/article/cash_up_front/.

[2]*See* Binyamin Appelbaum, *Investors Put Money on Lawsuits to Get Payouts*, New York Times (Nov. 14, 2010), *available at*http://www.nytimes.com/2010/11/15/business/15lawsuit.html.

[3] *See* Holly E. Loiseau, Eric C. Lyttle, and Brianna N. Benfield, *Third-Party Financing of Commercial Litigation*, ABA In-House Litigator (2010), http://www.weil.com/files/Publication/17c770d9-514d-426d-aalf-bbc4c7547c0c/Presentation/PublicationAttachment/cacabd85-lea5-46ac-8657-40ffd9eac8be/IHL_2010_ThirdPartyFinance.pdf.

[4]*See* Louis M. Solomon, *Third-Party Litigation Financing: It's Time to Let Clients Choose*, N.Y.L.J. (Sept. 13, 2010).

[5] For articles (in addition to those cited elsewhere herein), *see, e.g.,* Steven Garber, Alternative Litigation Funding in the United States: Issues, Knowns and Unknowns (Rand Corp. 2010); Susan Lorde Martin, The Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed, 10 Fordham J. Corp. & Fin. L. 55 (2004); Douglas R. Richmond, Other People's Money: The Ethics of Litigation Funding, 56 Mercer L. Rev. 649 (Winter 2005); Julie H. Mclaughlin, Litigation Funding: Charting a Legal and Ethical Course, Vermont Law Review, Vol. 31, No. 3 615-662 (Spring 2007). For ethics opinions, *see, e.g.,*N.Y. State 666 (1994); Utah State Bar Op. 97-11(1997); State Bar of Mich. Op. RI-321 (2000); FL. Bar Op. 00-3 (2002); Virginia Legal Ethics Op. 1764 (2002); N.Y. State 769 (2003); State Bar of Nevada Standing Comm. On Prof'l. Responsibility, Formal Op. 29 (2003).

[6]*See generally* Appelbaum, *supra* note 2; Garber, *supra,* note 3 at 10; *see also*Binyamin Appelbaum, *Lawsuit Loans Add New Risk for the Injured*, New York Times, (Jan. 16, 2011), *available at*http://www.nytimes.com/2011/01/17/business/17lawsuit.html?pagewanted=1&emc=eta1. Usury laws in New York set a maximum allowable rate of interest per annum. *See* N.Y. Banking Law § 14-a (McKinney 2008); *see also* N.Y. Gen. Oblig. Law § 5-501 (McKinney 2001 & Supp. 2011).

[7]*See, e.g.*, in the personal injury context, Frequently Asked Questions: What percentage of the proceeds do we purchase?, FastFunds, http://www.fastfunds4u.com/pages/faqs.html (last visited Apr. 19, 2011) ("We provide funds by purchasing a small portion of the anticipated proceeds. It is not a loan, so there is no interest, no matter how long it takes for the case to be resolved. Like the claimant and the attorney, we take the risk of a successful resolution. If the case is lost, we lose our money.").

[8]*See, e.g.*, *Echeverria v. Estate of Lindner*, 2005 N.Y. Slip Op. 50675(u), at 4-5 (Sup. Ct. Nassau County 2005) (finding non-recourse agreement was "loan" because recovery was certain under strict liability statute and interest rate

was usurious); *Lawsuit Fin. v. Curry*, 683 N.W.2d 233, 236 (Mich. Ct. App. 2004) (finding same because judgment had already been entered in favor of plaintiff when she entered into financing agreement).

[9] Twenty-eight states reportedly no longer prohibit champerty. *See* Ashby Jones,*The Next National Investment Craze: Lawsuits*!, The Wall Street Journal Law Blog (June 4, 2010), *available at* http://blogs.wsj.com/law/2010/06/04/the-next-national-investment-craze-lawsuits/. The Court of Appeals of New York has recently clarified the law of champerty in New York. *SeeTrust for Certificate Holders of Merrill Lynch Mortgage Investors, Inc. v. Love Funding Corp.*, 13 N.Y.3d 190, 192 (2009).

[10]*See, e.g., Johnson v. Wright*, 682 N.W.2d 671 (Minn. Ct. App. 2004).

[11]*See* N.Y. State 666 (1994) (attorney may refer client to financing company for living expenses); *see also* Fla. Bar, Op. 00-3 (Mar. 15, 2002) (same). In addition to Rule 2.1's duty of candor, a lawyer may have other obligations. For example, several financing companies doing business in New York State have entered into a Stipulation with the Attorney General that requires the companies to follow certain guidelines, such as procuring an attorney certification that the lawyer has reviewed the financing agreement with the client. *See* American Legal Finance Association, ALFA Agreement (Feb. 17, 2005), *available at*http://www.americanlegalfin.com/alfasite2/documents/ALFAAgreementWithAttorneyGeneral.pdf. Signatories to the Agreement include Plaintiff Support Services, Pre-Settlement Finance, QuickCash, Magnolia Funding, BridgeFunds Limited, Plaintiff Funding Corp. d/b/a LawCash, Oasis Legal Finance, The Whitehaven Group, and New Amsterdam Capital Partners. *Id* at 9-18. The Stipulation is posted on the website of the American Legal Finance Association (AFLA). Currently, 21 companies belong to the Association nationwide. *See* American Legal Finance Association,*availableat* http://www.americanlegalfin.com/index.asp (last visited Apr. 19, 2011).

[12]*See* N.Y. State 769 (2003) (attorney should advise the client of costs and benefits of the transaction as well as alternative courses of action); *see also* Fla. Bar, Op. 00-3 (Mar. 15, 2002).

[13]*See* Garber, *supra* note 3*,* at 10; Appelbaum, *supra* note 2.

[14]*See* Nev. State Bar Standing Comm. On Ethics and Prof'l Responsibility, Formal Op. 29 (Aug. 7, 2003).

[15]*See* N.Y. State 769.

[16]*See* N.Y. Rules of Prof'l Conduct R. 1.7(a), 1.8(f), 5.4(c) (2010); N.Y. State 682 (1996) (lawyer must offer client any referral fee the lawyer receives for standard products and services); N.Y. State 671 (1994) (lawyer "absolutely forbidden" from receiving referral fee where amount of product or service purchased depends on attorney advice); ABA Formal Op. 331 (1972).

[17]*See* N.Y. Prof'l Conduct R. 1.8(e); N.Y. State 753 (2002) (reiterating that lawyer may not ethically represent a client in a real estate transaction if the lawyer acts as a principal in the title insurance agency that has been engaged for the transaction and that is performing non-ministerial tasks); *see also* N.Y. State 769; 666; Fla. Bar, Op. 00-3 (Mar. 15, 2002); Ohio Sup. Ct. Op. 2000-01 (2000)available athttp://www.supremecourt.ohio.gov/Boards/BOC/Advisory_Opinions/2000/Op%2000-001.doc (last visited Apr. 20, 2011); Phila. Bar Ass'n Prof'l Guidance Comm., Ethics Op. 91-9 (May 1991); cf. S.C. Bar Ethics Advisory Op. 92-06 (1992) (an attorney may own interest in a non-recourse financing company that provides funding to non-clients).

[18]*See, e.g.,* Frequently Asked Questions: Will my case qualify for an advance?, LawMax Legal Finance, http://www.fundmycase.com/en/FAQ.php4 .") (last visited Apr. 19, 2011) ("LawMax considers each request for an advance on a case-by-case basis. We will thoroughly review your case, and our underwriters will make a decision within 48 hours of receiving the required documentation from your attorney."); Frequently Asked Questions: Do we get involved in the case?, FastFunds, http://www.fastfunds4u.com/pages/faqs.html (last visited Apr. 19, 2011) ("Our only involvement is to initially review the attorney's file so we can evaluate the claim."); Case Documents for Plaintiff

Funding, LawLeaf, www.lawleaf.com/lawsuit-funding/case-documents-for-plaintiff-funding.html (requiring certain documents for evaluation of the claim).

[19]*See, e.g.*, The Funding Process, LawMax Legal Finance, http://www.litigationfinancing.com/FundingProcess.htm (last visited Apr. 19, 2011) ("We . . . ask . . . that we be kept aware of any developments in the case.");*see also* Del. State Bar Ass'n Comm. On Prof'l Ethics, Op. 2006-2 (Oct. 6, 2006) ("Th[e] information [requested] includes police/accident reports, medical records, witness statements, expert reports, and information relating to the defendant's insurance carrier and its policy limits."); Complaint, *S&T Oil Equip. & Mach. Ltd. v. Juridica Invests. Ltd.,* (S.D. Tex. Filed Feb. 14, 2011) (alleging that claimant's counsel "was required to place all information regarding the strategy, public profile, factual or legal developments regarding the [arbitration] on [the] internal website [of the law firm associated with the funding company]. This included key substantive pleadings, key documents, settlement documents and any scheduling orders.").

[20]*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 alsoAbrams 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).

[21]*See* N.Y. Prof'l Conduct R. 1.6(a) (2009).

[22]*See* N.Y. State 769.

[23]*See* Garber, *supra* note 3, at 18.

[24]*See* N.Y. Rules of Prof'l Conduct 1.7(a), 1.8(f), 5.4(c) (2010). After a settlement or judgment has been obtained, a lawyer may turn over to a funding company a portion of a client's recovery pursuant to the terms of that client's non-recourse financing agreement. *See* N.Y. State 666; Fla. Bar, Op. 00-3 (Mar. 15, 2002); S.C. Bar Ethics Advisory Op. 92-06 (1992); Phila. Bar Ass'n Prof'l Guidance Comm., Ethics Op. 91-9 (May 1991). We do not reach the issue, but note the potential conflict, where a lawyer is a signatory to a financing agreement and is instructed by the client not to pay over to the financing company the contractually-specified portion of the settlement or judgment.

3 of 100 DOCUMENTS

Topic: Conflict of interest; referral of clients to spouse's litigation financing company

Opinion No. 855

NEW YORK STATE BAR ASSOCIATION COMMITTEE ON PROFESSIONAL ETHICS

March 14, 2011

OPINION:

Digest: A lawyer conducting litigation for a client may not refer the client to a litigation financing company owned by the inquiring lawyer's spouse to provide financial assistance that the lawyer personally would be barred from providing.

Rules: 1.8(e), 1.8(i), 8.4(a).

QUESTION

1. When clients of a personal injury law firm have financing needs in connection with contemplated or pending litigation, may a lawyer at the firm refer such clients to a legal financing company formed by the lawyer's spouse for the purpose of advancing funds to clients?

OPINION

2. The inquirer practices law at a firm that handles personal injury cases. Clients of the firm are sometimes unable to pay living expenses or litigation expenses, and they may turn to a litigation financing company for help. The inquirer's spouse would therefore like to establish a litigation financing company to aid such clients, and the inquirer would like to refer clients to the spouse's litigation financing company.

3. This plan implicates provisions in the New York Rules of Professional Conduct (the "Rules") concerning financial assistance to clients, taking a proprietary interest in a client's matter, and violating a Rule of Professional Conduct through the actions of another.

Prohibitions in Rule 1.8

4. Rule 1.8 is entitled "Current Clients: Specific Conflict of Interest Rules." Rule 1.8(e), which is identical to DR 5-103(B) of the former Code of Professional Responsibility as amended in 2007, provides:

> While representing a client in connection with contemplated or pending litigation, a lawyer shall not advance or guarantee financial assistance to the client, except that:
>
> (1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter;
>
> (2) a lawyer representing an indigent or pro bono client may pay court costs and expenses of litigation on behalf of the client; and
>
> (3) a lawyer, in an action in which an attorney's fee is payable in whole or in part as a percentage of the recovery in the action, may pay on the lawyer's own account court costs

> and expenses of litigation. In such case, the fee paid to the lawyer from the proceeds of the action may include an amount equal to such costs and expenses incurred.

5. If the inquiring attorney had asked this Committee whether a lawyer could *personally* form a litigation financing company to advance funds to clients, the Committee would have concluded that such an act violates Rule 1.8(e). Under Rule 1.8(e), the inquirer personally could not advance funds to clients in the form of loans. As Comment [10] to Rule 1.8 provides:

> Lawyers may not subsidize lawsuits or administrative proceedings brought on behalf of their clients, including making or guaranteeing loans to their clients for living expenses, because to do so would encourage clients to pursue lawsuits that might not otherwise be brought and because such assistance gives lawyers too great a financial stake in the litigation.

6. Nor could the inquirer overcome the prohibition against giving financial assistance to a client by obtaining the client's informed consent. As observed in SIMON'S NEW YORK RULES OF PROFESSIONAL CONDUCT ANNOTATED 116 (West 2009 ed.), "Rule 1.8 . . . makes some personal interest conflicts non-consentable no matter how fully a lawyer discloses the potential for conflicts of interest that will harm the client." Rule 1.8(e) addresses a type of personal conflict of interest that is not waivable by the client and cannot be cured by the client's consent.

7. Likewise, a lawyer may not evade the prohibition on financial assistance to clients by purchasing an interest in a client's litigation instead of providing a loan. Purchasing a proprietary interest would violate a different provision, Rule 1.8(i), which is substantially identical to former DR 5-103(A). Rule 1.8(i) states:

> A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:
>
> (1) acquire a lien authorized by law to secure the lawyer's fee or expenses; and
>
> (2) contract with a client for a reasonable contingent fee in a civil matter subject to Rule 1.5(d) or other law or court rule.

8. However, there is at least one legitimate route to avoiding the restrictions imposed by Rule 1.8(e) and (i): a lawyer may refer a client to a financial institution in which the lawyer has no interest. In N.Y. State 666 (1994), a lawyer wished to refer a client to a financial institution that would lend the client money for living expenses. Repayment of the loan would be contingent on the successful resolution of the client's claim for personal injuries. The Committee concluded that "a mere referral to the lending institution would not be unethical per se," considering that the lawyer did not propose to "pay" or "advance" any part of the loan. "The lawyer's sole function would be to refer the client to a lending institution that then would assess the value of the claim and take a lien on its proceeds to secure the loan."

9. In N.Y. State 769 (2003), which specifically concerned the litigation financing industry, we acknowledged that a lawyer could ethically refer clients to a litigation financing company, but we added: "As we pointed out in N.Y. State 666 (1994), the lawyer cannot own any interest in the financing institution; any such interest would be prohibited by the Code."

Referring Clients to the Lawyer's Spouse

10. That background brings us to the question posed here. If a lawyer may ethically refer a client to a lending institution in which the lawyer has no interest for the purpose of obtaining a loan contingent on the outcome of the client's case, may a lawyer refer a client to a lending institution owned by the lawyer's spouse?

11. The Committee has frequently concluded that various rules relating to conflicts involving financial interests apply both to the lawyer and to the lawyer's business relationships with the lawyer's spouse. See, e.g., N.Y. State 738 (2001) (referral to title abstract company in which spouse had an interest); N.Y. State 493 (1978), (lawyer or spouse as broker); N.Y. State 340 (1974) (lawyer and spouse as salesperson in a brokerage agency); N.Y. State 291 (1973) (lawyer or spouse with interest in a brokerage agency); N.Y. State 244 (1972) (lawyer and spouse real estate broker). For example, in N.Y. State 738 we asked: "May an attorney who represents clients engaged in real estate matters refer those clients to a title abstract company in which the attorney's spouse has an ownership interest?" We had stated in two previous opinions that a lawyer could not refer a real estate client to a title abstract company in which the lawyer personally owned an interest unless the abstract work was "purely ministerial" and the lawyer obtained consent from the client after full disclosure. Noting the unified financial interests of husband and wife, and based on N.Y. State 244, N.Y. State

291, N.Y. State 340, and N.Y. State 493, we concluded in N.Y. State 738 that an attorney "may not refer a real estate client to a title abstract company for other than ministerial title work where the lawyer's spouse has an ownership interest in the abstract company."

12. We believe the same conclusion applies when a lawyer refers clients to a litigation financing company owned by the lawyer's spouse, at least to the extent the lawyer personally would be barred from providing financial assistance to a client. Moreover, referring clients to a litigation financing company owned by the lawyer's spouse would usually also implicate Rule 8.4(a), which provides: "A lawyer or law firm shall not: (a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another." Referring clients to the spouse's financing company would violate Rule 1.8(e) "through the acts of another," essentially using the spouse as a front for advancing improper financial assistance to a client for whom the lawyer is conducting litigation.

CONCLUSION

13. A lawyer may not refer a client for whom the lawyer is conducting litigation to a litigation financing company owned by the lawyer's spouse in order to advance financial assistance to the client based on the prospective recovery in that litigation if the lawyer personally would be barred from providing that financial assistance.

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAttorney FeesContingency FeesLegal EthicsClient RelationsConflicts of InterestLegal EthicsPublic Service

3 of 100 DOCUMENTS

Topic: Representing client in transaction with entity proposing to lend against litigation proceeds

Opinion 769

COMMITTEE ON PROFESSIONAL ETHICS

November 4, 2003

OPINION:

Digest: If proposed transaction with litigation financing company is legal, attorney may represent client in negotiating and carrying it out and may charge client an additional fee for this service.

Code: EC 1-5; EC 5-1; EC 7-8.

DR 1-102(A)(3); DR 1-106; DR 1-106(A)(3); DR 2-106(A), (B); DR 4-101(B), (C)(1); DR 5-101; DR 5-101(A); DR 5-103(B); DR 5-104(A); DR 5-107(A)(2); DR 7-102(A)(7), (8); DR 9-102(C).

QUESTION

May an attorney who represents a client in a personal injury matter on a contingency basis also represent the client in a transaction with a litigation financing company that advances the client cash in return for a portion of any eventual settlement or judgment received by the client? If so, may the attorney charge the client a fee for this separate representation in addition to the contingent fee already agreed for the underlying representation?

OPINION

Representation in the Financing Transaction

According to a recent column in the *ABA Journal:*

> The past several years have seen a dramatic increase in companies . . . that extend funding to plaintiffs . . . during the course of litigation. . . . What they offer is 'nonrecourse' funding, meaning that if the case loses at trial or is overturned on appeal, the client is not obligated to reimburse the funder: The loan usually is at a very high rate of interest. Some companies collect a flat sum; others receive a percentage of any final award or settlement.

Eileen Libby, *Whose Lawsuit Is It?: Ethics Opinions Express Mixed Attitudes About Litigation Funding Arrangements,* 89 A.B.A. J. 36 (May 2003). In N.Y. State 666 (1994), we considered the question whether a lawyer could properly refer a client to such a company. Analyzing the question under DR 5-103(B), we concluded that since the lawyer would not be paying or advancing the funds, the mere referral would not violate that section of the Code. We warned of the dangers of compromising confidentiality in disclosing information to the lender and pointed out that the lawyer could not own an interest in the lending institution nor receive any fee or other compensation for the referral. Although we did not opine on the legality of the proposed transaction, we stated that if it was illegal it would be unethical for the lawyer to make the referral.

In response to the continued increase in such lawsuit financings and the *de novo* nature of the question at hand, this Committee hereby revisits the subject of litigation financing transactions. We start by pointing out that whether such a transaction is legal requires an analysis of various court rules, statutes and cases. In this connection we call the bar's attention to New York's longstanding rules prohibiting "maintenance," *see, e.g.,* N.Y. Comp. Codes R. & Regs. tit. 22, ß

603.18 (2003); N.Y. Judiciary Law ßß 488, 489 (Consol. 2003) (prohibiting the buying of claims by attorneys and corporations for the purpose of bringing an action thereon) n1; N.Y. Gen. Oblig. Law ß 13-101(1) (Consol. 2003) (prohibiting the transfer of a claim for damages for personal injury); N.Y. Gen. Oblig. Law ß 13-103 (Consol. 2003) (permitting transfer of a judgment for a sum of money); and to New York cases distinguishing between a prohibited transfer of a claim and an assignment of its proceeds, *see Grossman v. Schlosser,* 19 A.D.2d 893 (1963); *Neilson Realty Corp. v. Motor Vehicle Accident Indemnification Corp.,* 47 Misc. 2d 260 (N.Y. Sup. Ct. Spec. Term. 1965). We also note the recent decision of the Ohio Supreme Court holding that such arrangements constitute champerty and maintenance and thus are void and unenforceable against the borrower under Ohio law. *Rancman v. Interim Settlement Funding Corp.,* 789 N.E.2d 217 (Ohio 2003).

n1 The Second Circuit, in interpreting Judciary Law ß 489, recognized that "on its face, this statutory command might appear to be remarkably broad in scope, forbidding essentially all 'secondary' transactions in debt instruments where the purchaser had an intent to enforce the debt obligation through litigation." *Elliott Assoc. v. Banco de la Nacion,* 194 F.3d 363, 372 (2d Cir. 1999). The Court held that "Section 489 is not violated when, as here, the accused party's 'primary goal' is found to be satisfaction of a valid debt and its intent is only to sue absent full performance." *Id.* at 381.

As we stated in N.Y. State 666 (1994), we do not opine on the legality of the proposed financing transaction. If what is proposed is illegal, then it would be unethical for an attorney to recommend the action or assist the client in carrying it out. DR 1-102(A)(3) (lawyer shall not engage in illegal conduct that "adversely reflects on the lawyer's honesty, trustworthiness or fitness as a lawyer"); DR 7-102(A)(7) and (8) (lawyer representing client shall not "counsel or assist the client in conduct that the lawyer knows to be illegal or fraudulent" or "knowingly engage in . . . illegal conduct"); EC 1-5 ("Even minor violations of law by a lawyer tend to lessen public confidence in the legal profession."); N.Y. State 479 (1978) (illegal conduct is "of course" unethical "with rare exceptions of inadvertent violations involving no moral turpitude"). On the other hand, if the transaction is legal, an attorney may properly assist the client in carrying it out, subject to several caveats.

As we pointed out in N.Y. State 666 (1994), the lawyer cannot own any interest in the financing institution; any such interest would be prohibited by the Code. *See* DR 1-106(A)(3) (lawyer-owner of entity providing non-legal services is subject to the Code if client could reasonably believe such services are part of the attorney-client relationship); DR 5-101(A) (lawyer's financial interests must not interfere with representation); DR 5-104(A) (requirements for lawyer entering into business transaction with client); see *also* N.Y. State 752 (2002) (upholding past opinions barring a lawyer's provision of certain legal and nonlegal services in same transaction, even with consent of client). The lawyer cannot receive any compensation from the financial institution because DR 5-107(A)(2) states that without informed client consent, a lawyer cannot be paid "anything of value related to his or her representation of . . . the client" from "one other than the client". Furthermore, the lawyer may not permit the financing institution to in any way affect the exercise of the lawyer's independent professional judgment on behalf of the client. EC 5-1. *See also* Florida Opinion 00-3 (2002).

Depending on the circumstances the lawyer could have a personal interest in respect of the financing transaction that reasonably could affect the exercise of the lawyer's independent professional judgment on behalf of the client and give rise to a conflict of interest under DR 5-101. For example, the lawyer may be disposed to propose the financing transaction to assure that advances of litigation expenses made on behalf of an impecunious client will be repaid. Or the lawyer may wish to tout the ability to refer clients to the financing institution as a means of attracting clients. On the flip side, the lawyer may view such a transaction as potentially disadvantageous to the lawyer's own interests, resulting in the opposite influence on the exercise of the lawyer's professional judgment on behalf of the client. For example, the transaction may impose duties on the lawyer under DR 9-102(C), *see* N.Y. State 717 (1999) (plaintiff's attorney should pay holder of lien from settlement proceeds unless client disputes amount or validity of lien), with the possibility of liability if the lawyer pays out money in disregard of the financing institution's right to a portion of the funds received, *see Leon v. Martinez,* 84 N.Y.2d 83 (1994). Or the transaction might be viewed by the lawyer as likely to reduce the client's incentive to cooperate or settle the case, *see* Florida Opinion 00-3 (2002). If any of these or similar circumstances exist, the lawyer should not undertake the representation in the financing transaction without satisfying the requirements of disclosure and consent set out in DR 5-101(A).

Because the financing institution will likely insist on receiving considerable information about the underlying claim in order to evaluate whether and on what terms to enter into the transaction, the lawyer must be careful not to compromise confidentiality in disclosing information to the financing institution without the informed consent of the client. *See*

DR 4-101(B), (C)(1). The lawyer should advise the client that disclosures of confidential information to the financing institution might compromise the attorney-client privilege, *see generally* Paul R. Rice, *Attorney-Client Privilege in the United States,* ß 9 (2d ed. 1999), and might therefore cause the information to be available to an adverse party in discovery.

In representing the client in connection with the proposed transaction, n2 the attorney should determine whether he or she may have additional professional obligations stemming from the expansion in the scope of the representation. As a preliminary matter, the attorney should determine whether a new or updated letter of engagement may be required under N.Y. Comp. Codes R. & Regs. tit. 22, ß 1215.1-.2 (2003) when the lawyer undertakes a new matter for which the fee is expected to be $ 3000 or more. In addition, EC 7-8 provides in pertinent part that:

> A lawyer should exert best efforts to ensure that decisions of the client are made only after the client has been informed of relevant considerations. A lawyer ought to initiate this decision-making process if the client does not do so. Advice of a lawyer to the client need not be confined to purely legal considerations. A lawyer should advise the client of the possible effect of each legal alternative. A lawyer should bring to bear upon this decision-making process the fullness of his or her experience as well as the lawyer's objective viewpoint.

n2 Throughout this Opinion, we are assuming that an existing client in a personal injury matter is seeking representation in connection with a potential financing of litigation claims. Many of the concerns we express herein would be inapplicable if the client had already entered into a final agreement with the financing institution and the attorney was merely being asked to assist in carrying out its terms.

The lawyer should consider that an unsophisticated client may reasonably assume that by facilitating the transaction, the lawyer is also endorsing the entering into of the proposed transaction and/or the terms thereof. To address this possibility, the lawyer must either disclaim such responsibility, *see* N.Y. City 2001-03 ("The scope of a lawyer's representation of a client may be limited in order to avoid a conflict"), or advise the client of the costs and benefits of the proposed transaction, as well as possible alternative courses of action. We note that such arrangements may carry extremely high rates of interest. *See Rancman v. Interim Settlement Funding Corp.,* 789 N.E.2d 217 (Ohio 2003) (financing transaction had return exceeding 180 percent per year). Plainly, such lenders might be in a position to take unfair advantage of a client in dire need of cash. We also note that The Florida Bar has gone so far as to discourage the use of such advance funding companies, pointing out that they may create a disincentive for the client to cooperate in the prosecution or settlement of the case and that the harsh terms of the arrangements would rarely be in the client's best interests. *See* Florida Opinion 00-3 (2002).

Charging the Client an Additional Fee for Assisting in the Financing Transaction

In addressing this question, we assume that the original contingent fee agreement with the client only contemplated representation in the underlying personal injury matter and did not anticipate or include the proposed transaction with the financing company. In that circumstance, the attorney's work in connection with this transaction would be a new and different matter for which the attorney may appropriately charge a separate fee. Under DR 2-106(A) that fee must not be "excessive"; DR 2-106(B) lists a number of factors to be considered in determining whether a fee is excessive. Furthermore, in calculating the legal fees for this representation, the attorney must avoid any violation of the Appellate Division Rules regarding maximum fees in personal injury cases. *See, e.g.,* N.Y. Comp. Codes R. & Regs. tit. 22, ß 603.7(e) (2003). Whether the money received from the financing institution would constitute a "sum recovered" under those rules is a question of law on which we do not opine. In any event, the attorney must ensure that the total fee does not violate any of the Rules of the Appellate Division by exceeding the maximum amounts specified therein.

CONCLUSION

Subject to the caveats expressed herein, an attorney who represents a client in a personal injury matter may undertake to represent the client in a transaction with a litigation financing company that advances the client cash in return for a portion of any eventual settlement or judgment received by the client. The attorney may charge the client a fee for such representation in addition to the contingent fee agreed to for the underlying representation.

(5-02)

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAttorney FeesContingency FeesLegal EthicsClient RelationsClient FundsLegal EthicsClient RelationsConfidentiality of Information

8 of 100 DOCUMENTS

Topic: Conflict of interest; maintenance; referring client to institution that will lend money for living expenses contingent on resolution of personal injury claim

No. 666 (73-93)

NEW YORK STATE BAR ASSOCIATION COMMITTEE ON PROFESSIONAL ETHICS

6/3/94

ACTION: Opinion

OPINION:

Digest: Lawyer may refer client to institution that will lend money for client's living expenses contingent on the resolution of personal injury claim.

Code: DR 4-101(B), (C)(1); 5-103(B)

QUESTION

May a lawyer refer a client to a financial institution that will lend the client money for living expenses, where the repayment of the loan is contingent on the successful resolution of the client's claim for personal injuries?

OPINION

New York has long proscribed "maintenance." The First Department, for example, has a separate rule of court that expressly forbids, "any attorney, directly or indirectly, as a consideration for [the placing of a] retainer, [to] pay any expenses attending the prosecution or defense of any . . . claim or action." Rules of the Appellate Division, First Department, 22 N.Y.C.R.R. ß 603.18. The perceived evils addressed by the traditional prohibition are the stirring up of unmeritorious litigation and the improper solicitation of retainers to pursue it. Thus, prior to Bates v. State Bar of Arizona, 433 U.S. 350 (1977), when lawyer advertising was proscribed, condemnation of maintenance often was combined with references to "barratry" and "champerty." Whether, or to what extent, those concerns continue to be viable in an age of widespread lawyer advertising, and whether the proposed conduct should be deemed "indirectly" paying a client for the placement of a retainer in construing the rule against maintenance, are matters of law on which this committee does not opine. Thus, in answering the question, we express no opinion as to whether the proposed conduct would violate the substantive law of New York. If what is proposed is illegal, then it would perforce be unethical. See, e.g., N.Y. State 495 (1978).

Ethically, the principles underlying the traditional ban on maintenance found their expression in DR 5-103(B). That rule prohibits a lawyer from advancing litigation expenses, the repayment of which is contingent on the outcome of the claim, because the client must remain "ultimately liable" for the expenses. See, e.g., N.Y. State 553 (1983); N.Y. State 464 (1977). The client must bear those expenses regardless of the outcome of the claim. The rule was only recently eased in this State for "indigent" clients "represented on a pro bono basis;" as of September 1990, lawyers are permitted to pay the expenses of litigation without holding such clients ultimately liable. DR 5-103(B)(2).

In the instant matter, the lawyer does not propose to "pay" or "advance" any part of the loan. The lawyer's sole function would be to refer the client to a lending institution that then would assess the value of the claim and take a lien on its proceeds to secure the loan. Thus, a mere referral to the lending institution would not be unethical per se. See Philadelphia Op. 91-9 (1991), indexed in ABA/BNA Lawyers' Manual on Professional Conduct at 1001:7502 (not im-

proper for lawyer to refer clients to finance company which would make loans based on its assessment of the clients' cases). Cf. Fla. Op. 75-24 (1975), indexed in Maru's Digest of Bar Association Ethics Opinions at 10832 (1980 Supp.) (unethical for lawyer to recommend a client to a lending institution that would loan client funds to cover living expenses pending outcome of case where lawyer, in effect, guarantees payment of loan).

The lawyer must be careful not to compromise confidentiality in disclosing information to the lending institution. The client must be made aware of such a possibility and any disclosures to the lending institution by the lawyer should be made with the fully informed consent of the client. See DR 4-101(B), (C)(1); see also Philadelphia Op. 91-9. Furthermore, the lawyer cannot own an interest in the lending institution, as that would indirectly constitute a loan by the lawyer to the client. Finally, the lawyer cannot be paid a fee or receive any other compensation from the lending institution. Cf. S.C. Op. 92-06 (1992), indexed in ABA/BNA Lawyers' Manual on Professional Conduct at 1001:7909 (lawyer may form corporation to make consumer loans to plaintiffs, secured by proceeds of a case, provided the loans are not to clients of the lawyer); Md. Op. 84-11 (1983), indexed in ABA/BNA Lawyers' Manual on Professional Conduct at 801:4334 (lawyer may not arrange for bank loan to pay for legal fees from litigation).

CONCLUSION

For the reasons stated and subject to the qualifications discussed above, the question posed is answered in the affirmative.

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsBilling & CollectionLegal EthicsClient RelationsClient FundsLegal EthicsLegal Services MarketingAdvertising