New York State Bar Association

Committee on Professional Ethics

Opinion 769 – 11/4/03

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

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, §603.18 (2003); N.Y. Judiciary Law §§488, 489 (Consol. 2003) (prohibiting the buying of claims by attorneys and corporations for the purpose of bringing an action thereon)[1]; N.Y. Gen. Oblig. Law § 13-101(1) (Consol. 2003) (prohibiting the transfer of a claim for damages for personal injury); N.Y. Gen. Oblig. Law § 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).

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");

[1] The Second Circuit, in interpreting Judciary Law §489, recognized that "[o]n 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.

EC 1-5 ("[E]ven 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); s*ee 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*, § 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,[2] 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, §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.

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 ("[T]he 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

[2] 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.

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, §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)