New York State Bar Association

Committee on Professional Ethics

Opinion 808 – 2/12/07

Topic: Obtaining a security interest in litigation (or its proceeds) to recover fees in prior proceeding.

Digest: In the absence of an available charging lien, a lawyer may not obtain a security interest in either (a) a client's cause of action to recover fees from a prior proceeding or (b) the proceeds of such cause of action, if the lawyer represents the client in the litigation pursuing the cause of action.

Code: DR 5-103A; EC 5-1, 5-7.

QUESTIONS

1. Third parties are often responsible for the legal fees of individuals and business entities. These arrangements may take the form of insurance or indemnity obligations. The latter is frequently the case for senior executives of companies who, for example, face litigation based upon conduct within the scope of their employment ("Primary Actions"). While the beneficiary of these obligations is the executive (the "Client"), their counsel in the Primary Action obviously has a keen interest in seeing to it that those obligations are honored. When they are not honored, the Client may pursue remedies at law, such as an action for a declaration that the third party has an obligation to fund legal fees and/or a claim for breach of contract for past due sums (a "Fee Litigation").

2. Defense counsel in the Primary Action, however, generally has no direct recourse against the third party for unpaid legal fees. Assuming a charging lien is not available to cover the unpaid fees in the Primary Action (and whether a charging lien does apply is a question of law on which the Committee does not opine), this circumstance raises the following questions:

(a) May a lawyer obtain a security interest in the proceeds of a Fee Litigation, to secure the Client's outstanding legal fees and

expenses owed to that lawyer in the Primary Action, when the lawyer is representing the client in the Fee Litigation?

(b) Would the answer to the foregoing question be different if the lawyer took a security interest in (or assignment of) the Fee Litigation itself?

(c) Would the answer to the foregoing questions be different if defense counsel in the Primary Action did not represent the Client in the Fee Litigation?

OPINION

3. DR 5-103(A) provides that a "lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation he or she is conducting for a client. . . ." As we explained in N. Y. State 786 (2005), the rule is premised upon two basic concerns: that (1) acquiring a financial stake in litigation may adversely effect a lawyer's exercise of independent judgment, and (2) the subsidizing of litigation by interested counsel might encourage clients to pursue lawsuits that should not otherwise be brought.

4. These considerations are further reflected in EC 5-7, which provides in part that the

> possibility of an adverse effect upon the exercise of free judgment by the lawyer on behalf of the client during litigation generally makes it undesirable for the lawyer to acquire a proprietary interest in the cause of the client or otherwise to become financially interested in the outcome of the litigation.

Even where the interests of a client and lawyer might appear to be aligned, there is a possibility that the lawyer's judgment might be compromised by the self-interest created by a proprietary interest in the litigation.

5. Defense counsel in the Primary Action obviously has a powerful interest in the successful prosecution of the Fee Litigation, since any recovery therein will primarily be to his or her benefit. Indeed, this distinguishes a Fee Litigation from circumstances in which by statute or otherwise a prevailing party is entitled to an award of legal fees; there, other -- primary -- relief is also awarded (such as a declaratory judgment that some conduct is wrongful). In a Fee Litigation, the only relief sought is the recovery of legal fees. While the Client may bear responsibility for the fees in the Fee Litigation if it is unsuccessful, the lawyer's particular interest in the result of the Fee Litigation is evident. Thus, obtaining a proprietary interest in the Fee Litigation for the work done in that litigation is likely to create incentives that may affect a lawyer's exercise of independent judgment, and falls within the proscription of DR 5-103(A).

6. While the Rule explicitly proscribes the taking of a "proprietary interest," the Code does not define that term. The common understanding of "proprietary interest" is broad: essentially, an interest in property. Indeed, BLACK'S LAW DICTIONARY (8th ed. 2004) defines "proprietary interest" as any "interest held by a property owner." Further, the concerns animating DR 5-103(A) -- which we noted in paragraph 3 above -- equally suggest that the term "proprietary interest" should not be unduly circumscribed in defining the scope of DR 5-103(A).

7. In this spirit, we believe that a "security interest" is a "proprietary interest" within the meaning of DR 5-103(A).[1] Were a lawyer to obtain a "security interest" in Fee Litigation, the policies DR 5-103(A) seeks to further would be transgressed: obtaining a security interest, like obtaining any other proprietary interest in the litigation, might (a) affect the lawyer's ability to exercise independent judgment and (b) encourage the pursuit of litigation that should not otherwise be brought.

8. We also understand that there is a distinction between taking a proprietary interest "in the cause of action or subject matter of the litigation" and taking such an interest "in the proceeds" of the Fee Litigation, in the event the lawsuit succeeds.[2] But making such a distinction in applying DR 5-103(A) would subvert its purpose, and invite the very mischief the Rule is designed to avoid.

9. On the other hand, DR 5-103(A) would not prevent an attorney from taking a proprietary interest in Fee Litigation where the lawyer is not representing the Client in the Fee Litigation. In this circumstance, the two underlying reasons for the prohibition under DR 5-103(A) (the potential impingement on a lawyer's independent judgment and the encouragement of lawsuits that should not otherwise be brought) are not implicated. Thus, a lawyer may acquire a proprietary interest in a client's cause of action or subject of litigation where the lawyer is not representing the client in that particular matter.

10. Moreover, a lawyer is not without recourse in collecting unpaid legal fees. DR 5-103(A)(1) permits a lawyer to acquire a lien "granted by law to secure the lawyer's fee or expenses." As E 5-7 notes, "it is not improper for a lawyer to protect the right to collect a fee for his or her services by the assertion of legally permissible liens, even though by doing so the lawyer may acquire an interest in the outcome of litigation." The Model Rules are different; they permit a lawyer to have not just liens "granted" by law, but also liens "authorized" by law.[3] This difference was purposeful: "authorized" replaced "granted" in order to "permit any legally recognized lien to secure fees to be acquired in property that is the

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[1] *See, e.g.,* BLACK'S LAW DICTIONARY 1387 (8th ed. 2004) (defining "security interest" to be a form of "property interest"). *See also* 11 U.S.C. § 101(51) ("security interest" is a "lien created by an agreement").

[2] *See, e.g.*, N.Y. State 769 (2003) (distinguishing between a transfer of a claim and an assignment of the proceeds of a claim); *Grossman v. Schlosser*, 19 A.D.2d 893, 244 N.Y.S.2d 749 (2nd Dept. 1963) (same).

[3] Model Rule 1.8(i)(1).

subject of the litigation." ABA 02-427. But, as with DR 5-103(A), the lien must still secure the lawyer's "fee or expenses." One such lien is the "charging lien" granted by Section 475 of the Judiciary Law, which attached to funds created by the attorney's efforts. [4] This opinion assumes, however, that a charging lien is not available in the Fee Litigation, or for some reason not sufficient, to cover the lawyer's work in the Primary Action (a question we do not decide).

CONCLUSION

11. An attorney may not obtain a security interest in the proceeds of a client's cause of action against a third party for the payment of legal fees. The answer is no different if the attorney were to take a security interest in (or assignment of) the action itself. However, DR 5-103(A) does not prohibit a lawyer taking a proprietary interest in Fee Litigation so long as the lawyer is not representing the Client in the Fee Litigation.

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[4] DR 5-103(A)(2) also permits contingency fee arrangements.