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New York State Bar Association
Committee on Professional Ethics

Opinion 1051 (3/25/15)

Topic: Attorney's fees, amending fee agreement, litigation funding

Digest: Where a contingent fee agreement provides for the fee to be calculated on the amount of the recovery "by settlement or judgment," whether the lawyer may take a percentage of the amount loaned to the client by a third party is a question of law beyond the jurisdiction of the Committee. A retainer agreement may ethically provide for such a payment *ab initio*. If it does not, the lawyer may ask the client to amend the retainer agreement to provide specifically for such payment. However any such amendment would be subject to scrutiny under Rule 1.8(a) as a business transaction with a client, because (1) there has been no apparent change of circumstances, other than the fact that the client has determined to pay a litigation funding firm for earlier access to funds, (2) the lawyer apparently would be taking funds from property other than that recovered through the lawyer's efforts in the litigation, (3) the amendment would benefit solely the lawyer, (4) the advance would likely come at a significant cost to the client, and (5) it is likely that the client would be looking to the lawyer to exercise professional judgment on behalf of the client in connection with the amendment.

Rules: 1.5, 1.8(a).

FACTS

1. The inquirer represents numerous plaintiffs in a mass tort action that has been settled. The settlement establishes a fund to which the various plaintiffs may apply in the future if they should meet specific criteria regarding damages.

2. The settlement fund might not pay out to a particular member of the plaintiff class for years because the settlement covers many currently asymptomatic individuals, and will pay out only if they develop the defined symptoms under the settlement. Some class members may not want to wait to see if they develop the defined symptoms. They are interested in taking an "advance" settlement, rather than risking that they will never qualify for a payout under the settlement.

3. One company is offering an immediate payment to individuals covered by the settlement. That company would lend money to a client (an "advance"), in exchange for any of the proceeds the individual recovers under the settlement, up to the amount of the advance, plus interest. Amounts due under the advance would be secured with a lien on the individual plaintiff's monetary recovery, if any. If the individual never recovered under the settlement, he or she would not owe anything to the lender and could keep the advance.

4. The inquirer's engagement agreement states, "If a monetary recovery is obtained for CLIENT by settlement or judgment, ATTORNEYS will be entitled to compensation for their services in the amount of 25% of the recovery and attorneys shall also be entitled to recovery of costs."

QUESTION

5. Where an attorney has a retainer agreement with a plaintiff in a lawsuit giving the lawyer a contingent fee based on any recovery "by settlement or judgment," may the attorney take the contingent fee from an advance the client has received in exchange for a lien on the plaintiff's monetary recovery?

OPINION

6. At the outset, we note that this inquiry does not raise, and we do not opine on, the ethical issues that arise in connection with litigation funding. This Committee has addressed such issues in the past. *See* N.Y. State 666 (1994) (addressing whether a lawyer could properly refer a client to a litigation funding firm); N.Y. State 769 (2003) (addressing whether the attorney could represent a client in negotiating and carrying out a litigation funding agreement and charge the client an additional fee for this service). *See also* N.Y. City 2011-2 (2011) (concluding that 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, but discussing a number of ethical issues that may arise, including the possible compromise of confidentiality and waiver of attorney-client privilege, and the potential impact on a lawyer's exercise of independent judgment).[1]

7. Rule 1.5 of the New York Rules of Professional Conduct (the "Rules") provides as follows: "A lawyer shall not make an agreement for, charge, or collect an excessive or illegal fee or expense." Rule 1.8(e) prohibits a lawyer from acquiring a proprietary interest in a cause of action the lawyer is conducting, except that the lawyer may "contract with a client for a reasonable contingent fee in a civil matter."

8. Rule 1.5(c) contains detailed requirements with respect to contingent fee agreements. It provides:

> (c) A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law. Promptly after a lawyer has been employed in a contingent fee matter, the lawyer shall provide the client with a writing stating the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial or appeal; litigation and other expenses to be deducted from the recovery; and whether such expenses are to be deducted before or, if not prohibited by statute or court rule, after the contingent fee is calculated. The writing must clearly notify

[1] See generally ABA, Commission on Ethics 20/20, Informational Report to the House of Delegates on Alternative Litigation Finance, available at http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf

the client of any expenses for which the client will be liable regardless of whether the client is the prevailing party. Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a writing stating the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination.

9. Contingent fees in claims and actions for personal injury are also governed by court rules. *See, e.g.,* 22 NYCRR § 603.7 (First Dep't), 22 NYCRR § 806.13 (Third Dep't) (where an attorney's fee depends in whole or in part upon the amount of the recovery, and is equal to or less than the amount contained in the rule's schedule of fees, the fee is deemed to be fair and reasonable).

10. The inquirer's retainer agreement entitles the inquirer to payment when "a monetary recovery is obtained for client by settlement or judgment." The interpretation of a fee agreement and the interpretation of the applicable court rules -- including whether a monetary recovery through an advance qualifies as "a monetary recovery by settlement or judgment" -- are matters of law. This Committee does not answer questions of law. *But cf*., *Knight v. Aqui*, 966 F. Supp.2d 989 (N.D. Cal. 2013) (attorney whose fee agreement is silent as to how attorneys' fees shall be paid in the event of a structured settlement is permitted to receive fees only on the same pro rata basis that the client receives compensation); American Law Institute, Restatement of the Law Governing Lawyers, § 35, cmt. *e* (when a client will receive a structured settlement providing for regular payments over the client's lifetime, a lawyer with a contingent fee agreement is entitled to receive the stated share of each such payment if and when it is made to the client, unless the client-lawyer contract provides otherwise).

11. Any attempt to collect a legal fee that is not authorized is an ethical issue. Any fee that is not authorized by a retainer agreement would be "excessive." *See* Rule 1.5(a)(prohibiting an "excessive or illegal fee"). Moreover, agreements regarding legal fees are strictly construed against the lawyer. *See, e.g.*, *Matter of Kuneicki*, 35 A.D. 3d 742, (2d Dep't 2006) ("In cases of doubt and ambiguity, an agreement between a client and the attorney must be construed most favorably to the client".)

12. If the retainer agreement as currently drafted would not be interpreted as including, in the phrase "monetary recovery by settlement or judgment," a loan or advance offered by a third party, then the question is whether the retainer agreement could ethically be amended to authorize such payment.

13. If the inquirer's retainer agreement had provided *ab initio* for payment of the lawyer's fees and expenses out of a loan or advance secured by an interest in the client's legal claim, such agreement would not have violated Rule 1.5, as long as the fee was not excessive within the meaning of Rule 1.5(a). Whether such a fee would be considered a contingency fee and entitled to the presumption of reasonableness contained in the court rules is a matter of law about which we do not opine.

14. In many instances, it is possible to amend a fee agreement with the concurrence of the lawyer and client. “However, such an amendment raises ethical concerns, because [a] lawyer is

often in a position to take unfair advantage of the client." N.Y. State 910 (2012).

15. As we noted in N.Y. State 910, while some amendments to fee agreements may be subject only to Rule 1.5's prohibition against excessive or illegal fees, other amendments are considered a "business transaction with a client" and are also subject to Rule 1.8. In N.Y. State 910, we set out a number of factors that will determine whether the higher scrutiny of Rule 1.8 is warranted.

16. First, we noted that, since the lawyer is the drafter of the fee contract and should be expected to anticipate most changes in circumstances that may occur during the representation, one consideration is whether there has been a material change in circumstances. A second and related factor is the length of time since the contract was entered into, which will affect the reasonableness of the lawyer's failure to anticipate the changed circumstances in the original contract. For example, in N.Y. State 910 we noted that if the representation was expected to be completed within a year, and the contract therefore did not make provision for the law firm's customary annual increases in billable rates, an amendment a year later would be tested under Rule 1.5, and not Rule 1.8. A third factor is the sophistication of the client, and whether the client is a frequent user of legal services and thus is in a position to determine the reasonableness of the proposed amendment. A fourth factor is whether the amendment benefits the client. For example, we noted in N.Y. State 910 that, if the client is no longer able to pay an agreed-upon hourly rate and the contract is amended to provide for a contingent fee, the amendment has been held to be subject to Rule 1.5 rather than Rule 1.8. ABA 11-458 (2011). New York case law often applies higher scrutiny to modifications of retainer agreements that are beneficial to the attorney. *See, e.g.*, *Baye v. Grindlinger*, 78 A.D.2d 60, 432 N.Y.S.2d 624 (2d Dep't 1989) (as to contracts made between the attorney and the client subsequent to employment which are beneficial to the attorney, it is incumbent on the attorney to show that the terms are fair and reasonable and fully known and understood by the client), *Naiman v. N.Y. Univ. Hosps Ctr.*, 351 F. Supp.2d 257, 264 (S.D.N.Y. 2005) (midstream modifications of retainer agreements must be carefully scrutinized and attorney must show that the terms are fair and reasonable to the client).

17. Applying these factors, we believe a retainer agreement amendment to require that the client pay the lawyer out of the proceeds of any loan taken out by the client should be scrutinized under Rule 1.8(a) as a business transaction between the lawyer and client. First, it is not clear there has been any change of circumstances, other than the fact that the client has determined to pay a litigation funding firm for earlier access to funds. Second, Rule 1.8, Cmt. [16] provides that when a lawyer negotiates a contractual security interest in property other than that recovered through the lawyer's efforts in the litigation, the acquisition of the security interest is a business or financial transaction with a client that is governed by Rule 1.8(a). Similarly, the amendment here would give the lawyer access to the proceeds of the client's advance, which appear to be different from the moneys recovered through the lawyers efforts. Third, the amendment here would benefit solely the lawyer. Moreover, it might come at a significant cost to the client, both because a client who never develops symptoms meriting an award from the settlement fund might otherwise never have to pay the lawyer, and because, if the client does later develop symptoms and obtains an award from the settlement fund, the client will have to pay interest on the amount taken by the attorney as his fee under the amended agreement.

18. The inquiry here does not specify the terms on which the funding firm would make advances to individuals covered by the settlement. Literature on litigation funding firms indicates that such firms often charge 3-5 percent *monthly* for such advances (and sometimes more).[2] Because many litigation funding firms style their funding as a purchase of an interest in the eventual judgment rather than as a loan, most litigation funding loans are not considered to be "loans" under state law, and the effective interest rate generally is not considered to be "interest" for purposes of state usury laws. Thus, where the retainer agreement provides that the lawyer is entitled to take the contingency fee proportion of any advance arranged from a litigation funding firm, the agreement is essentially requiring the client to pay a high rate of interest in order to provide the lawyer with a portion of the legal fee at an earlier time than might otherwise be the case. For this reason, at least one state that regulates the provision of litigation funding services prohibits the proceeds of the litigation funding from being used for attorneys' fees or costs of litigation. *See* Okla. S. Supp. 2013, 14A-3-814(A)(8).

19. A key question under Rule 1.8(a) is whether the client "expects the lawyer to exercise professional judgment [in the transaction] for the benefit of the client." That question can turn on a number of factors, including the sophistication of the client and the complexity of the transaction. Here, a critical question for the client in assessing the proposed amendment to the fee agreement is whether the existing fee agreement already permits such a deduction of the fee from the proceeds of the advance, and, if not, whether agreeing to the amendment is in the client's best interest. When the lawyer explains to the client how a court would interpret the existing contract and whether the amendment benefits the client, the client will likely expect the lawyer to be exercising professional judgment for the benefit of the client. In addition, if the fee agreement does not already provide for taking the fee out of the loan proceeds -- and the lawyer presumably would be seeking an amendment only if the lawyer concludes that the fee agreement does not already so provide or is not sufficiently clear -- the client clearly needs the protections provided by Rule 1.8(a).

20. When Section 1.8(a) is applicable, the amendment must be fair and reasonable to the client and the terms of the transaction must be fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client; the client must be advised in a writing of the desirability of seeking (and be given a reasonable opportunity to seek) the advice of independent legal counsel, and the client must give informed consent, in a writing signed by the client, to the essential terms of the transaction, including whether the lawyer is representing the client in the transaction and whether the lawyer is receiving a referral fee or other compensation from the litigation funding firm. In addition, the lawyer has the burden of demonstrating that the terms of the amendment are fair and reasonable.

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[2] *See* Jonathan T. Molot, "A Market Approach to Litigation Accuracy," 2009, paper presented at "Third Party Litigation Funding and Claim Transfer—Trends and Implications for the Civil Justice System," RAND Institute for Civil Justice and UCLA Law policy symposium, RAND Corporation, June 2, 2009; see also *Rancman v. Interim Settlement Funding Corp*., 789 N.E.2d 217 (Ohio 2003)(financing transaction had return exceeding 180 percent per year). *See generally* Steven Garber, Alternative Litigation Funding in the United States: Issues, Knowns and Unknowns (Rand Corp. 2010).

CONCLUSION

21. Where a contingent fee agreement provides for the fee to be calculated on the amount of the recovery "by settlement or judgment," whether the lawyer may take a percentage of the amount loaned to the client by a third party is a question of law beyond the jurisdiction of the Committee. A retainer agreement may ethically provide for such a payment *ab initio*. If it does not, the lawyer may ask the client to amend the retainer agreement to provide specifically for such payment. However any such amendment would be subject to scrutiny under Rule 1.8(a) as a business transaction with a client, because (1) there has been no apparent change of circumstances, other than the fact that the client has determined to pay a litigation funding firm for earlier access to funds, (2) the lawyer apparently would be taking funds from property other than that recovered through the lawyer's efforts in the litigation, (3) the amendment would benefit solely the lawyer, (4) the advance would likely come at a significant cost to the client, and (5) it is likely that the client would be looking to the lawyer to exercise professional judgment on behalf of the client in connection with the amendment.

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