NEW YORK STATE BAR ASSOCIATION
One Elk Street, Albany, New York 12207 • PH 518.463.3200 • www.nysba.org

New York State Bar Association
Committee on Professional Ethics

Opinion 1196 (06/12/2020)

Topic: Litigation Financing, Conflicts of Interest.

Digest: In a medical malpractice action commenced on behalf of an infant, a lawyer may refer the parent or legal guardian in whose name the action is brought to a litigation funding company owned by the lawyer's sibling for a non-recourse loan to finance litigation expenses only if the parent or legal guardian gives informed consent, confirmed in writing, to waive personal-interest conflicts in compliance with Rule 1.7(b) and satisfies the conditions of Rule 1.8(f) for accepting a thing of value from a non-client related to the client's representation.

Rules: 1.0(j), 1.6(a), 1.7(a)(2); 1.7(b); 1.8(e); 1.8(f); 1.8(i)

FACTS

1. The inquirer is a personal injury attorney whose primary focus is pursuing medical malpractice actions that are brought on behalf of infants by a legal guardian, almost always a parent. Upon conclusion of such actions, whether by way of settlement or judgment, the inquirer's contingent fee is subject to court approval, on notice to the guardian, pursuant to Judiciary Law § 474.

2. According to the inquirer, so-called alternative litigation funding – known as "ALF" and referring to litigation financing provided by entities other than the parties, their lawyers, or insurers – is widely available to finance some medical malpractice actions but not the type of actions in which the inquirer concentrates. We are told that this circumstance results from the reluctance of some courts, exercising their authority under Judiciary Law § 474, to approve disbursement of settlement or judgment proceeds to the ALF funder in accordance with the terms of the ALF agreement.

3. The inquirer has found one ALF company willing to finance the actions brought by inquirer's firm, a company that is owned by the inquirer's sibling. The inquirer has no financial interest in the sibling's company, and the sibling has no financial interest in inquirer's law firm. Their family financial interests intersect only with respect to their separate minority interests in a family-owned property in which neither has any management role.

4. ALF may be used to pay litigation expenses, the legal fees of the attorneys who are prosecuting the action, the living expenses of the client, or any combination of these costs. The funding may take the form of a recourse or non-recourse loan, or the purchase of an interest in the litigation. If a loan, the borrower may be the attorneys or the client. Here, the inquirer proposes to refer clients to the sibling's ALF company to secure non-recourse loans to finance only litigation expenses, not the payment of the firm's attorneys' fees, nor the clients' living expenses.

QUESTION

5. In a medical malpractice action commenced on behalf of an infant, may a lawyer refer the legal guardian, in whose name the action is brought, to a litigation funding company owned by the lawyer's sibling, for a non-recourse loan to finance litigation expenses?

OPINION

Rules 1.8(e) and 1.8(i)

6. Rule 1.8(e) of the New York Rules of Professional Responsibility ("Rules") prohibits an attorney from providing financial assistance to a client; Rule 1.8(i) prohibits an attorney from acquiring a proprietary interest in a litigation the lawyer is conducting for a client. Rules 1.8(e) and 1.8(i) have exceptions that allow an attorney representing a client on a contingent fee basis to advance on behalf of the client, or to pay on the lawyer's account, only litigation expenses, which are to be recovered only out of the proceeds of the action. *See* Rules 1.8(e)(1) and (3), and 1.8(i)(2).

7. In N.Y. State 855 (2011), we concluded that a lawyer may not permissibly refer a client to a company owned by the lawyer's spouse to secure ALF for client living expenses. We noted our prior opinions that had "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"; we said that, because the referring lawyer could not ethically provide the financial assistance under Rules 1.8(e) or 1.8(i), the lawyer could not cause a spouse to provide that same assistance, "essentially using the spouse as a front for advancing improper financial assistance to a client for whom the lawyer is conducting litigation." *Id.* ¶¶ 11, 13.

8. Again relying on Rules 8.1(e) and 8.1(i), we concluded in N.Y. State 1145 (2018) that neither the inquiring lawyer nor the lawyer's law firm could represent a client in a commercial litigation funded by an ALF company in exchange for a percentage of the prospective recovery in which one of the firm's lawyers was an investor. We noted that the exceptions that allow an attorney to advance or pay litigation expenses in contingency cases were inapplicable on the facts presented and stated: "Lawyers are never permitted to give litigation clients the more sweeping kinds of assistance – such as lawyer's fees billed on a non-contingency basis – that, under the inquiry, would apparently be provided by the Company." *Id.* ¶ 16.

9. In contrast to N.Y. State 855 and 1145, the ALF funding proposed here – solely to pay litigation expenses – would constitute permitted financial assistance for the inquiring lawyer to offer under the litigation expense/contingency fee exceptions of Rule 1.8(e), and would not constitute the prohibited acquisition of interest in litigation under Rule 1.8(i). In any event, because the inquirer has represented that the inquirer has no financial interest in the ALF company owned by the inquirer's sibling, even if the financial assistance to be provided exceeded the safe harbors of Rule 1.8(e) and Rule 1.8(i), no issue would arise on whether ALF funding from the sibling's ALF company was a prohibited subterfuge for avoiding the application of these rules. This is because we have never imputed, between siblings, the same "unified financial interest" of spouses. *See* N.Y. State 855, ¶ 11.

10. Otherwise put, when, as here, a lawyer has no financial interest in the ALF company, a referral to an ALF company to secure financing, even for living expenses that would constitute prohibited financial assistance if made by a lawyer, is not unethical, provided that no referral fee is paid and client confidentiality is suitably protected. N.Y. State 666 (1994); *see also* N.Y. State

855, ¶ 8 ("there is at least one legitimate route to avoiding 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").

11. Accordingly, we conclude that neither Rule 1.8(e) nor Rule 1.8(i) presents an ethical bar to the inquirer's contemplated conduct. Nevertheless, though Rules 1.8(e) and 1.8(i) present no bar to the proposed referral of clients to an ALF company owned by lawyer's sibling, substantial questions remain about whether such a referral runs afoul of Rule 1.7(a)(2), which prohibits representations when a reasonable lawyer would conclude "there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests," or Rule 1.8(f), which imposes conditions upon a lawyer accepting compensation "or anything of value" related to the lawyer's representation of the client. We deem the sibling's willingness to provide a loan to the client to finance litigation expenses to be a "thing of value" indirectly provided to the inquirer because the inquirer's firm would otherwise need to secure financing of its own or forgo the opportunity to represent the client in the matter.

Rule 1.7(a)(2)

12. Under Rule 1.7(a)(2), strong filial bonds may cause the inquirer to favor a sibling's financial interests, consciously or not, over the client's interests with regard to advising the client (or, here, the guardian) on a number of issues that may arise in the course of the representation.

13. For example, although the inquirer is not necessarily a party to the negotiations between clients and the sibling-owned ALF on the specific terms and conditions of the ALF loan, it is unrealistic to assume that the inquirer's clients would not turn to the inquirer for advice about how the loan would likely affect the net recovery, how the loan compares to terms and conditions of litigation expense funding typically offered by other ALF funding sources, and what alternatives exist, if any, to fund litigation expense other than a loan from a company owned by the inquirer's sibling. The clients would reasonably assume that inquirer would exercise independent professional judgment in addressing these issues when, in fact, the inquirer might encourage clients to enter into ALF funding agreements with a sibling's company, and not with an unrelated third-party ALF funder on similar or even more favorable terms, simply to benefit the financial interests of the sibling.

14. Similarly, although the interests of the inquirer's law firm and the sibling's ALF company are logically aligned with regard to the risks of trial and the benefits of a compromise settlement --- because the inquirer earns a contingent fee and the loan by the sibling's company gets repaid only if there is a successful outcome --- it is quite plausible that inquirer and the sibling are in dissimilar economic circumstances. One of them is, or could in the future be, in greater need of cash and more willing to press the client to accept an early settlement that does not reflect the fair value of the case obtainable at a later stage of the litigation.

15. Finally, as the inquirer notes, the kind of actions at issue here often require the expenditure of large sums to acquire thousands of pages of medical records; the retention of more than one medical expert who are each compensated at substantial hourly rates for their time consulting, preparing expert reports and being deposed; stenographers who charge a premium for medical malpractice depositions; and the *per diem* fees of the medical experts who ultimately testify at trial. It is not hard to imagine a situation in which developments in a case indicate that the prospect of success at trial is less than assured, and the sibling–owned ALF company perceives its investment in jeopardy. At the same time, the best chance for a successful outcome might be the retention of additional experts requiring substantial additional expense. The issue – inherent in

any ALF financing – is whether these considerations would unduly influence the lawyer's management of the case. The prospect of outsized influence is heightened here by the family relationship between the client's counsel and lender – a potential tension exists between the lawyer's duty zealously to pursue a client's interests that may require the expenditure of substantial additional funds for litigation expenses and the sibling's resistance to advancing more funds owing to a diminishing likelihood of securing a recovery.

16. Based on these considerations alone, we believe that a reasonable lawyer would conclude that the inquirer's personal and financial interests pose a significant risk that the lawyer's professional judgment on behalf of a client may be adversely affected by the ALF funding proposed to be provided by a sibling's ALF company, and that a Rule 1.7(a)(2) conflict of interest therefore exists. We believe, however, that this conflict is subject to waiver under Rule 1.7(b) provided the inquirer satisfies the conditions that Rule imposes. Two of those conditions are relevant here – first, that the inquirer "reasonably believes that the lawyer will be able to provide competent and diligent representation" to the client; and second, that the client "gives informed consent, confirmed in writing."

17. In these circumstances, the inquirer alone is in a position to assess whether the lawyer reasonably believes that the lawyer is able to provide the requisite and diligent representation to the client despite the conflict of interest. The standard of reasonable belief in Rule 1.7(b) embeds both subjective and objective elements, meaning that the inquirer must make not only a personal judgment about the inquirer's capacity to satisfy the requirement but also an appraisal of how a disinterested lawyer would regard the situation. N.Y. State 1048 ¶ 20 (2015). On the circumstances presented, we see no objective consideration that would disable the lawyer from proceeding, but only the lawyer may make this decision based on all the facts known to the inquirer.

18. The second condition requires informed consent. Rule 1.0(j) defines "informed consent" to mean "information adequate for the person to make an informed decision, and after the lawyer has adequately explained to the person the material risks of the proposed course of conduct and reasonably available alternatives." This means, at a minimum, disclosure of the above considerations that led us to conclude that a Rule 1.7(a)(2) conflict of interest exists. The client should certainly be made aware of the family relationship between the inquirer and the inquirer's sibling, that ALF funding has an enormous profit potential, and that the inquirer and the ALF company may differ substantially on the level of risk that each is willing to tolerate. In addition, to assure that the consent is fully informed, the inquirer should discuss with the client the desirability of retaining independent counsel to provide disinterested advice regarding the client's best interest. As the New York City Bar Association Committee on Professional Ethics said in its Opinion 2011-2:

> In providing candid advice, a lawyer should advise the client to consider the costs and benefits of non-recourse financings, as well as possible alternatives. 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. 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.

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19. In the context of the current inquiry, an independent counsel, if any, might wish to discuss with the client (a) why the inquirer has elected not to secure the ALF funding by the inquirer's firm itself rather than have the client be the borrower, and (b) whether there are other competent lawyers or law firms who would be willing to represent the client and incur litigation expenses without the need for ALF funding to be secured by the client's recovery.

Rule 1.8(f)

20. Rule 1.8(f) allows a lawyer to accept "a "thing of value" from a non-party where three conditions are met: "(1) the client gives informed consent; (2) there is no interference with the lawyer's independent and professional judgment or with the client-lawyer relationship; and (3) the client's confidential information is protected as required by Rule 1.6."

21. The first and second conditions of Rule 1.8(f) for the inquirer's indirect acceptance of litigation financing from a sibling-owned company will be satisfied if the standard for waiving a personal conflict interest under Rule 1.7(a)(2) has been met. To comply with the third condition, however, that is, the protection of client confidentiality, the inquirer may disclose to the ALF funder for underwriting purposes only such information that is "confidential information" under Rule 1.6(a)(1) to the extent that the client has consented to the disclosure after receiving from the inquirer, as Rule 1.0(j) requires, "information adequate … to make an informed decision, and after adequately explain[ing]" to the client "the material risks" of disclosure and the "reasonably available alternatives."

CONCLUSION

22. In a medical malpractice action commenced on behalf of an infant, a lawyer may refer the parent or legal guardian in whose name the action is brought to a litigation funding company owned by the lawyer's sibling for a non-recourse loan to finance litigation expenses only if the parent or legal guardian gives informed consent, confirmed in writing, to waive personal-interest conflicts in compliance with Rule 1.7(b) and satisfies the conditions of Rule 1.8(f) for accepting a thing of value from a non-client related to the client's representation.

(11-20)