Legal Backgrounder

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TEPID GUIDANCE ON A HOT TOPIC:

NEW YORK CITY BAR ETHIC OPINION ON LITIGATION FINANCING

by
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The biggest recent stir in the emerging subject area of third-party legal funding is a June 2011 ethics opinion issued by the New York City Bar Association. Before turning to the substance of the opinion itself, it is important to note the limitations inherent in its source. Since it is an ethics opinion, it by definition cannot affect the legality of litigation funding. Furthermore, as an advisory opinion it is neither binding in courts nor dispositive if ethics charges are brought against a lawyer – the New York Appellate Division of State Supreme Court and grievance committees appointed by that court are responsible for regulating the conduct of attorneys in the state. And as discussed below, the *City* Bar Opinion covers no significant ground that the New York *State* Bar Association has not already covered.

Nevertheless, the opinion – New York City Bar Association Ethics Opinion 2011-2 – deserves some attention as an alarming example of how passively the litigation industry is being accepted by the profession. The opinion is remarkable for its lack of rigorous ethical analysis. Most importantly, it seems to scarcely notice the substantial difference between the type of funding that amounts to a cash advance paid to an individual plaintiff and that which directly underwrites a litigation by providing, for example, a line of credit to a plaintiff's law firm. The latter is the major growth area in the field and presents the gravest ethical issues, but the opinion shows no recognition of this and contains no analysis directly addressing it. One critical issue is whether a firm has a potential conflict of interest when its own bills are being paid by a third-party funder with whom it has an ongoing relationship. May it ethically pass on to its clients the interest charges levied by the funder – as is routinely done in the industry today – and can a lawyer possibly provide a client with dispassionate advice about agreeing to such an arrangement, which directly benefits the lawyer? Ethics Opinion 2011-2 is silent on these matters.

Even within its limited scope, the opinion is strikingly tepid. For example, it provides that lawyers must not accept a referral fee from a company in exchange for referring one of their clients *if doing so would impair their ability to advise their client about the arrangement*, a subject about which the City Bar Association expresses no opinion. But the State Bar Association said plainly 17

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years ago that a lawyer is barred from accepting a fee to refer a client to a third-party funder, because of the inherent conflict of interest. N.Y. State 666 (1994). The City Bar Association Opinion adds that lawyers *may* be barred from offering financing to clients themselves, not discussing the longstanding and universal prohibition on lawyers funding their own clients' cases. *See, e.g.*, N.Y. Rules of Prof'l Conduct R. 1.8(e) ("[A] lawyer shall not advance or guarantee financial assistance to the client . . ."); *see also* 1.8(f)(2) ("A lawyer shall not accept compensation . . . from one other than the client unless . . . there is no interference with the lawyer's independent professional judgment or with the client-lawyer relationship[.]"); 1.8(i) ("A lawyer shall not acquire a proprietary interest in the cause of action . . ."). To round things off, State Bar Assoc. Opinion 666 explicitly forbids lawyers from advancing money to their clients to be recovered from a settlement or verdict.

The opinion goes on to caution lawyers that arrangements with third-party lenders may waive attorney-client privilege with regard to anything communicated to the funding company, and suggests that they exercise care. This significantly understates the risk. Under the current state of the case law, a lawyer speaking to a litigation funder should do only under the assumption that everything said to the funder will be discoverable. *See Leader Tech. v. Facebook*, 719 F. Supp. 2d 373 (D. Del. 2010); *Bray & Gillespie Mgmt. v. Lexington Ins.*, No. 6:07-cv-222-Orl-35KRS, 2008 WL 5054695 (M.D. Fla. Nov. 17, 2008). Practice tip: add to your routine discovery requests in civil litigation a demand for all communications with any third-party funder, whether ultimately retained or not, relating to the case.

Finally, the opinion informs lawyers that *absent client consent*, they should not permit the litigation funding company to direct litigation strategy. Any lawyer who feels complacent about third-party decisionmaking in their lawsuit should close Ethics Opinion 2011-2 and open the Rules of Professional Conduct again. Rule 2.1 gives one of the foundational principles of the attorney-client relationship: "In representing a client, a lawyer shall exercise independent professional judgment and render candid advice." Rule 5.8 provides:

> The practice of law has an essential tradition of complete independence and uncompromised loyalty to those it serves. Recognizing this tradition, clients of lawyers practicing in New York State are guaranteed 'independent professional judgment and undivided loyalty uncompromised by conflicts of interest.' Indeed, these guarantees represent the very foundation of the profession and allow and foster its continued role as a protector of the system of law. Therefore, a lawyer must remain completely responsible for his or her own independent professional judgment . . .."

Indeed.

The New York State Bar Association has addressed third-party litigation funding four times, in Opinions 666 (1994), 754 (2002), 769 (2003), and 855 (2011). In Opinion 666, the Bar ruled that a lawyer could refer a client to a third party that would lend the client money contingent on a personal-injury recovery, but could not receive a fee to do so, own an interest in the lending institution, or provide money to the client himself. Opinion 754 briefly addressed the other type of third-party legal funding – funding paid by a lender to the *law firm* to underwrite the litigation in

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exchange for an interest in the recovery. The Bar opined that a firm that has received such funding can pass along interest charges to its client so long as the client is aware of his liability for the charges and consents to them, and the interest rate is reasonable. (Whether it is conceivable that a lawyer could do so without having a conflict of interest, or could secure meaningful assent from a personal-injury client, particularly in a class action context, is another question – one not raised therein.) Opinion 769 provided that a lawyer could represent a client in negotiating terms with a third-party lender, and charge a fee for doing so, subject to all of the cautions mentioned above about the risks of lawyers being involved with lenders at all. Finally, in Opinion 855, the Bar opined that a lawyer may not refer a client to a litigation financing company owned by the lawyer's spouse if the lawyer himself would be barred from providing the financial assistance sought.

Perhaps the most remarkable aspect of this legal ethics discussion is that third-party litigation funding is *illegal* in New York – as several of the bar opinions discussed above mentioned (though they said that they would not opine on the legality of it themselves, except to note that if it was indeed illegal, it would also be unethical to participate in it). N.Y. Judicial Law § 489(1) forbids champerty – providing money to support a lawsuit in exchange for an interest in it: "No . . . corporation . . . shall . . . be in any manner interested in…any claim or demand, with the intent and for the purpose of bringing an action or proceeding thereon[.]" In *Trust v. Love Funding*, 591 F.3d 116 (2d Cir. 2010), investors in mortgages purchased rights to sue from the original mortgagors, and this action was challenged under § 489(1). The Court of Appeals analyzed the transaction under § 489(1), and approved the transaction *only* because the investors had a preexisting proprietary interest in the matter – *i.e.*, they had a prior investment in the mortgages, and only acquired a right to sue in order to defend what they considered to be a tortious impairment of their interest in that investment. The strong implication is that a party who purchased a right to sue with no prior interest, and only to cash in on the value of the right to sue, would violate § 489(1).

Champerty, and its close cousin maintenance – the underwriting of a lawsuit *without* taking a financial interest in it – are illegal in many states. Lobbying by coalitions of litigation funders, recently by their trade association the American Legal Finance Association, has overturned court decisions and statutes in several states. For example, a 2003 Ohio Supreme Court decision upholding the doctrines of champerty and maintenance and voiding a litigation funding contract – *Rancman v. Interim Settlement Funding Corp.*, 789 N.E.2d 217 (Ohio 2003) – was later voided by statute after aggressive lobbying by ALFA. See OHIO REV. CODE ANN. § 1349.55 (West 2011).

The litigation funding industry continues to make loans across the country, at increasing volume, and more and more those loans directly underwrite plaintiffs' firms to bring major litigations. Two recent examples in the New York courts are the Ground Zero litigation on behalf of workers and the huge class action brought against Chevron in Ecuador. A vigorous and well-organized lobbying response by industry is long overdue, though organizations like the U.S. Chamber of Commerce, the American Tort Reform Association, and the Product Liability Advisory Council have already joined the struggle.

Selections from THE LEGAL PULSE
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Food Advertising Class Action Feeding Frenzy?

July 7, 2011

Class action lawsuits against food companies alleging false or misleading advertising are on the rise. The cause of this trend is subject to debate. . . . (Continue reading)

Hot Coffee, The Movie: Cup-Half-Full Propaganda on Legal Reform

June 29, 2011

The *Merriam Webster Dictionary's* definition of the word "propaganda" is "ideas, facts, or allegations spread deliberately to further one's cause or damaging an opposing cause." That definition fits a spare-no-expense 90-minute documentary movie titled *Hot Coffee*. . . . (Continue reading)

Supreme Court Observations: *Goodyear Dunlop Tire Operations v. Brown*

June 27, 2011

Is a foreign company subject to suit in the United States solely because another entity sells that foreign company's products in the United States? No, a unanimous Supreme Court held today, reversing a contrary ruling by the North Carolina Court of Appeals in *Goodyear Dunlop Tires Operations, S.A. v. Brown*. . . . (Continue reading)

Online Privacy Organizations Get "Buzzed" on Millions from Google Lawsuit Settlement

June 1, 2011

In a *Legal Pulse* post last November, *What's that Buzz? It's the Sound of Class Action Lawyers Celebrating their Impending Fees*, we discussed the settlement of a lawyer-driven lawsuit alleging Google violated various federal and state laws by not sufficiently protecting customers' privacy in its "Buzz" networking service. Judge James Ware of the Northern District of California has since been weighing objections to the settlement . . . . (Continue reading)

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