

NEW HAMPSHIRE BAR ASSOCIATION

Non-Recourse Lawsuit Financing

Ethics Committee Advisory Opinion #2004-05/01

ABSTRACT:

Participating in non-recourse lawsuit financing is not *per se* unethical, but many potential issues exist. An attorney contemplating involvement in such programs must be very cautious in determining that such involvement is in the client's best interests and in advising his or her client whether to engage in such financing.

ANNOTATIONS:

Although participation by an attorney with the client in lawsuit financing programs is not unethical *per se*, attorneys are encouraged to exercise substantial caution in involving clients in such programs and participating with them to obtain such funding.

Before participating in any non-recourse lawsuit financing program, the lawyer must be absolutely convinced that it is in the client's best interests and that the client can clearly articulate how and why such interests are so well-served.

Lawyers must discuss all aspects of such financing with the client, including available alternatives, the costs and impacts of such financing, the ramifications on a potential recovery and other important considerations.

Information provided to the non-recourse lawsuit funding source or broker could be voluntarily or involuntarily disclosed to the disadvantage of the client. Likewise, there is a possible waiver of the attorney-client privilege through the disclosure of information about the case to the third party broker or financing source seeking to extend such financing.

If non-recourse lawsuit financing is used for the payment of a lawyer's fees and costs, it may well be cast as a business transaction between an attorney and client. NHRPC 1.8(a) not only requires full disclosure and informed consent by the client and substantial certainty that participation in such financing is in the best interests of the client, but also requires counsel to afford the client a reasonable opportunity to seek review by independent counsel, a written consent and overall fairness – when viewed from the client's eyes at the time that such financing is sought.

OPINION

QUESTION:

May an attorney participate in a program in which a third party provides financing to assist clients with legal fees and expenses, and living costs?

FACTS:

A number of companies have sprung up across the nation which provide non-recourse funding to clients – usually plaintiffs — involved in lawsuits. That funding assists those plaintiffs in paying for legal fees and expenses, as well as living costs. Most of these programs seek to provide funding to clients involved in personal injury and medical malpractice cases, although it appears from advertising accompanying the programs that funding is available in a variety of different types of tort cases. Under the majority of programs, the client is usually alerted to such funding sources by his or her attorney. The companies generally prefer to fund cases that have been open for six months or longer – the logic being that some discovery has been developed to permit a sound evaluation of the case. The interested client then provides information to either a broker who works to link potential clients with a funding company source or the company itself. That information usually consists of a description of the incident giving rise to a claim and the client’s injuries and damages. The client also asks his or her attorney to submit information that is more extensive – including medical records and expenses, treatment regimens and status, insurance limits, employer information, the fee structure between the attorney and the client, the prospects and timing of settlement, the existence of other liens against any potential recovery, the attorney’s evaluation about the client and the case¹, and the impediments to settlement. This often involves a detailed production of materials, pleadings, depositions, accident reconstruction records, medical records and specials, and other similar materials from the client’s file.

If funding is approved, then funds are advanced against the client’s potential recovery. If there is no recovery, then no repayment is sought. The programs state that the advance is not a “loan” and that any recovery is paid to the funding source *after* the payment of attorney’s fees and litigation costs. Between the date of funding and the resolution of the case, the client can be charged a monthly fee based on the amount advanced. Alternatively, the client might agree to a higher percentage of the potential recovery or build the repayment of the monthly fee into the recovery. The cost to the client is usually dependent upon the risk that a recovery will ultimately result, with the cases in the highest risk category bearing the highest fees and costs. As one broker involved in such programs put it, “this is not cheap money, but it is usually the only way for the plaintiff to get cash to keep their case viable”².

Clients are not permitted to make any further assignments of the potential proceeds from their claim. They also grant a security interest to the funding source and represent that there are no prior assignments or commitments relating to such funding, except attorney’s fees, costs and properly perfected liens which have already been disclosed. The client is also required to waive any defenses to payment. In one instance, the client agrees to an out-of-state venue in the event of enforcement proceedings, and to liquidated damages in the amount of two times the advance if there is a breach. The client is also required to issue an irrevocable letter to his/her attorney instructing that payment be released to the funding source after payment of legal fees, costs and expenses, and properly perfected prior liens. Finally, the client executes a release which permits the funding company to obtain records and other materials, reports and documents relevant to the case in the future, although the companies state that they exercise no control, input or influence over the conduct of the client’s case.

RESPONSE:

At the outset, we offer two observations. First, it is not within this Committee's purview to express opinions about the legality of a lawyer's conduct under state or federal laws, statutes, regulations and codes. Nonetheless, lawyers should be cautious about the legality of such programs under the state's banking and consumer protection laws, as well as common law notions of champerty and maintenance. Second, we note for guidance that a number of other states have examined such non-recourse lawsuit financing, and have cautiously determined that attorneys may participate in such programs³.

For our part, this ethics inquiry encompasses many familiar principles that this Committee visited in 1994 in an opinion dealing with LAWCARD. *See Confidentiality and Conflict of Interest: Use of LAWCARD to Finance Legal Fees*, #1993-94/18 (November 17, 1994) (hereinafter the "LAWCARD Opinion"). In that program, a national company known as LAWCARD invited New Hampshire lawyers to participate in a program that assisted clients in paying a lawyer's legal fees. If LAWCARD accepted the client, it would then pay the lawyer's legal fees and expenses upon receipt of an invoice, and in return, obtain an assignment of the lawyer's right to collect such fees and expenses. Interest on the outstanding balance was charged based on the risk of recovery. In the instance of LAWCARD, advances by the company were truly loans in the sense that amounts advanced had to be repaid by the client irrespective of recovery⁴.

In that opinion, the Committee evaluated the LAWCARD program against the professional conduct rules related to confidentiality and conflicts of interest. *See gen.* New Hampshire Rules of Professional Conduct (NHRPC) 1.6, 1.7 and 1.8(a). Although the Committee found that a portion of the program was unethical – dealing with information and opinions that the attorney had to provide regarding the collectability of the financing, it stated that while an attorney may not encourage a client/borrower to apply for a specific, identifiable credit program, an attorney may ethically participate with the client/borrower in seeking such financing. *Id.*

We reach a similar conclusion in non-recourse, lawsuit financing. That is, the Committee finds that although participation by an attorney with the client in such financing programs is not unethical *per se*, attorneys are encouraged to exercise substantial caution in involving clients in such programs and participating with them to obtain such funding. Attorneys should examine each case and client individually to determine whether, in each instance, participation and involvement is warranted, given the ethical considerations outlined below.

Rule 1.7

As recognized in the LAWCARD opinion, the first area of examination is the conflict of interest rule – NHRPC 1.7. This is because "(i)t seems beyond question that the [non-recourse lawsuit financing programs] present, at least, the question of a conflict between the client's and the lawyer's interests and, therefore, requires scrutiny under the rule". LAWCARD Opinion at p. 2.

Rule 1.7(b) provides:

2. A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:
 1. the lawyer reasonably believes the representation will not be adversely affected; and
 2. the client consents after consultation and with knowledge of the consequences”

NHRPC 1.7(b)

Thus, under a 1.7(b) analysis, a lawyer must first determine whether, in the context of the present inquiry, the decision to involve a client in a non-recourse lawsuit financing program might be adversely affected by the lawyer's responsibilities to a third party or to the lawyer's own interests. If and only if the lawyer satisfies this first inquiry can the lawyer then inquire of the client whether participation in such financing is warranted.

For years, this Committee has adopted a “harsh reality” test in measuring when it is appropriate to seek consent of a client to a possible conflict. This position has been reflected not only in a number of Committee opinions, but also in the way in which the New Hampshire Supreme Court has viewed conflicts analysis. *See* discussion of opinions and cases at LAWCARD Opinion, pp. 3-4. Under this test, “a lawyer attempting to resolve such an issue should ask himself or herself whether, if a disinterested lawyer were to look back at the inception of this representation once something goes wrong, would the lawyer seriously question the wisdom of this representation or question whether there had been full disclosure to the client prior to obtaining the consent”. LAWCARD Opinion at p. 3; *see also* other opinions cited therein.

Utilizing this analysis, it is easy to conjure up instances where participation and involvement in non-recourse lawsuit financing would be unethical. For example, if the attorney sought to refer a client to a non-recourse lawsuit financing program to provide funding to assist that attorney's own personal cash flow demands or business needs, or to pay that attorney fees and costs which the attorney originally agreed to defer but now wants (or needs) to collect, then involvement and participation in the program would be impermissible. Likewise, if the irrevocable letter from the client instructing payment to be released to the funding source after legal fees, costs, expenses and other properly perfected prior liens is constructed to oblige counsel to pay irrespective of legitimate disputes between the client and the funding source, an irreconcilable conflict exists. At the other end of the spectrum, the analysis becomes more difficult if, for example, the client himself or herself discovered the program and asked the attorney for advice about applying for such financing. If, for example, the client fully understood the costs of the financing, the conditions under which such financing would be extended, the disclosure about the case which the attorney would be asked to undertake, and the real impacts on any potential recovery the client might achieve, it would be difficult to bar attorneys, based on professional conduct rules, from participating. This is true, even if the lawyer were to receive some benefit from the extension of such financing, such as a client's voluntary reimbursement of litigation expenses or the receipt of monies to pay attorney's fees in costly litigation in which the attorney and client

agreed to an hourly fee. It would appear, however, that before participating in any non-recourse lawsuit financing program, the lawyer must be absolutely convinced that it is in the client's best interests and that the client can clearly articulate how and why such interests are so well-served.

If a client is "on the fence" about participating, an attorney should be mindful that under the New Hampshire Rules of Professional Conduct, an attorney should only seek consent to a potential conflict once the client has "actual knowledge of the consequences that could occur as a result of the lawyer's divided loyalty". See New Hampshire Comments to NHRPC 1.7 discussing the "informed consent" standard of disclosure in NHRPC 1.7(b)(2). Thus, merely providing some form of explanation about the program is insufficient, if the client does not fully understand the consequences — especially if the lawyer will receive some benefit from the extension of such financing. As paraphrased from the LAWCARD Opinion, this standard seems to present sound practical considerations to an attorney pondering involvement in such financing programs since the context in which such involvement might be contemplated is likely to occur in the charged atmosphere of a lawsuit that is several months old and in the throes of discovery and substantial investments of time. LAWCARD Opinion at p. 5.

Thus, lawyers need to be careful in discussing all aspects of such financing with the client, including available alternatives, the costs and impacts of such financing, the ramifications on a potential recovery and other important considerations. If a lawyer is unable or unprepared to undertake such careful discussion, or the client is not, for any reason, including economic duress, able to fully understand and appreciate the lawyer's advice, then participation in such non-recourse lawsuit financing is unethical.

Rule 1.6 and Attorney-Client Privilege

It is also important to note that in the context of explaining to the client the consequences of participation in non-recourse lawsuit financing, the client should understand that by virtue of the questions asked of attorneys about the case, the client must release the attorney from his/her obligations to keep information learned about the client and the case confidential as it applies to the funding source and/or broker. See NHRPC 1.6. The client must also understand that there may be no remedy if the funding source or broker voluntarily or involuntarily discloses this information to the disadvantage of the client at some later date, in spite of contrary assurances in the program's advertising and contracts. Likewise, the client should understand that there is a possible waiver of the attorney-client privilege through the disclosure of information about the case to the third party broker or financing source seeking to extend such financing. While discussions of privilege go beyond the rules of professional conduct, attorneys must be sure the client is at least aware of the possible waiver through disclosure, and the potentially harmful consequences.

Rule 1.8

Two final considerations are in order – both of which arise under NHRPC 1.8. First, to the extent that a lawyer knows or has reason to know he/she will obtain some form of benefit, such as payment of fees and costs, through the client's participation in non-recourse lawsuit financing, such an arrangement could well constitute a "business transaction" between the lawyer and

client⁵. Rule 1.8(a) prohibits business transactions between a lawyer and client or a lawyer's acquisition of an "ownership, possessory, security or other pecuniary interest adverse to a client unless:

1. the transaction and terms in which the lawyer acquires the interest are (i) fair and reasonable to the client, and (ii) agreed to by the client after consultation;
2. the client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and
3. the client consents in writing to the essential terms of the transaction.”

NHRPC 1.8(a).

One can easily see that this is a more rigorous standard than the conflict of interest analysis under NHRPC 1.7(b). Much like NHRPC 1.7(b), it requires full disclosure and informed consent by the client and substantial certainty that participation in non-recourse lawsuit financing is truly in the best interests of the client. But it also requires counsel to afford the client a reasonable opportunity to seek review by independent counsel, a written consent and overall fairness – when viewed from the client's eyes at the time that such financing is sought. The element of fairness should be viewed critically in instances where the lawyer will benefit from participation in non-recourse lawsuit financing, given some of the fees charged in such programs.

Finally, one must also be aware of NHRPC 1.8(e), which comes into play to the extent that such financing is used to pay for or underwrite, in whole or in part, fees and costs incurred by an attorney. That provision requires that although a non-recourse lawsuit funding source may be providing some or all of the capital needed to fund a lawsuit, the lawyer's duty of loyalty runs to the client – in spite of pressures that may be placed by the funding source to undertake different directions in the case because the client's risk turned out to be less advantageous than that which the funding source originally perceived.

CONCLUSION:

The Committee is unable to determine that participation in non-recourse lawsuit funding is *per se* unethical. However, an attorney contemplating involvement in such programs must be very cautious in advising his or her client to engage in such funding. Only through thoughtful and careful counseling and disclosure to the client can an attorney avoid the ethical pitfalls that exist.

The Committee strongly recommends that any lawyer considering the involvement of his or her client in such programs should carefully review not only this opinion, but also the LAWCARD Opinion.

ENDNOTES:

[1] One of the forms asks attorneys "what are your thoughts and feelings about your client and the client's case". This question is posed although in advertising, the attorney is told that he/she is not required to make any representations about the merits of the case or the value of the claim.

[2] One of the programs charged ten percent (10%) per month on any advance.

[3] See e.g. *Florida Bar Association, Opinion 00-3* (March 15, 2002); *Virginia State Bar Ethics Opinion 1155* (12/15/88); *Maryland State Bar Ethics Opinion, 89-15* (10/25/88); *New York State Bar Association, Opinion 666 (73-93)* (June 3, 1994); *Philadelphia Bar Association, Opinion 91-9* (May 1991); *South Carolina Bar Ethics Advisory Opinion 94-04*; *State Bar of Nevada, Formal Opinion No. 29* (8/7/03); *North Carolina State Bar 2000 Formal Ethics Opinion 4* (January 18, 2001); *New Jersey Supreme Court Advisory Committee of Professional Ethics, Opinion 691* (January 15, 2001). But see *Rancman v. Interim Settlement Funding Corp.*, 99 Ohio St.3d. 121 (2003) (relying on principles of champerty and maintenance); *State Bar of Michigan Opinion RI-321* (June 29, 2000).

[4] In the LAWCARD program, attorneys were also asked to opine that the attorney had no knowledge of facts that may result in an uncollectible account or unenforceable loan. Attorneys were also required to cooperate with LAWCARD in the investigation of the claim should the client assert a right not to pay in full. The Ethics Committee found this aspect of the program violative of NHRPC 1.6.

[5] This would be especially true if participation in non-recourse lawsuit financing was a condition of and built into the lawyer's fee agreement as a means to pay for the litigation.

NH RULES OF PROFESSIONAL CONDUCT:

NHRPC 1.6

NHRPC 1.7(b)

NHRPC 1.8(a)

NHRPC 1.8(e)

NH ETHICS COMMITTEE OPINIONS AND ARTICLES:

Confidentiality and Conflict of Interest: Use of LAWCARD to Finance Legal Fees, #1993-94/18
(November 17, 1994)

SUBJECTS:

Third-party financing

Conflicts of Interest

Harsh Reality Test

Confidentiality

Business Transactions

- **By the NHBA Ethics Committee**

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