



New York State Bar Association  
Committee on Professional Ethics

Opinion 1145 (3/7/2018)

**Topic:** Litigation financing; conflicts of interest

**Digest:** Neither the lawyer nor the lawyer’s firm may represent a client in litigation funded by a litigation financing company in which the lawyer is an investor.

**Rules:** 1.7; 1.8 (a), (e), (f) & (i), 1.10(a), (d)

## FACTS

1. The inquirer is the managing partner of a law firm that represents plaintiffs in commercial litigation. The inquirer sometimes refers clients to a litigation financing company (the “Company”) that provides money to the clients in exchange for a percentage of the prospective recovery.

2. The Company is structured as a limited partnership that privately raises money from qualified investors, among whom the inquirer seeks to be a direct and substantial one. The Company invests in a variety of lawsuits, including some brought by the inquirer’s clients, and others brought by persons not represented by the inquirer. Investment decisions are made by a registered investment advisor. Neither the inquirer nor the inquirer’s firm represents clients in their negotiations with the Company on the terms of the financing arrangements.

## QUESTION

3. May a lawyer or the lawyer’s firm represent a client in litigation funded by a litigation finance company in which the lawyer is an investor?

## OPINION

4. The terms “alternative litigation finance” or “third-party litigation finance” refer to the funding of litigation activities by entities other than the parties themselves, their counsel, or other entities with a preexisting contractual relationship with one of the parties, such as an indemnitor or a liability insurer. These transactions are generally between a party to the litigation and a funding entity and involving an assignment of an interest in the proceeds from a cause of action. These activities have become increasingly prominent in recent years, leading to significant attention in the legal and popular press, scrutiny by state bar ethics committees, and scholarly commentary.

ABA Commission on Ethics 20/20, Informational Report to the House of Delegates (Dec. 2011) (“ABA Report”) at 1 (footnotes omitted); *see also, e.g.*, Ethics Committee of the NYSBA Commercial and Federal Litigation Section, “Report on the Ethical Implications of Third-Party

Litigation Funding” (2013); N.Y.C. Formal Op. 2011-2; A. Sebok, “*Litigation Investment and Legal Ethics: What Are the Real Issues?*,” 55 *Canadian Bus. L. Journal* 111 (2014).

5. In two previous opinions, we have considered issues arising from alternative litigation finance based on the former New York Code of Professional Responsibility (the “Code”). N.Y. State 769 (2003); N.Y. State 666 (1994). Both opinions analyzed issues of legal ethics but noted that this Committee does not opine on issues of law such as the legality of alternative litigation financing arrangements, and we repeat that caveat here. Here, we focus on the specific ethics issues presented in the inquiry; we do not revisit in any detail the ethical considerations applicable to alternative litigation financing generally.

6. In N.Y. State 666, we opined that a lawyer may ethically refer a client to a litigation financing company, while noting that the lawyer must be careful not to compromise confidentiality by disclosing information to the lending institution without the client’s informed consent. In N.Y. State 769, we added that, subject to various limitations, a lawyer may ethically represent a client in negotiations with the litigation financing company and charge an additional fee for doing so. Both opinions also stated limitations relevant to the current inquiry that are set forth in the analysis below.

7. That the inquirer seeks to be a direct and substantial investor in the Company is of consequence. We do not address other situations, such as when a lawyer’s investment occurs indirectly through intermediate entities, of which the lawyer may not even be aware.

8. The lawyer’s proposed investment in the Company implicates at least four conflict-of-interest rules. We will first discuss two provisions – Rules 1.8(a) and 1.7(a)(2) – which the requisite disclosure and consent could potentially satisfy, and will then discuss two other provisions that we think preclude the proposed conduct in all circumstances.

9. Rule 1.8(a) of the New York Rules of Professional Conduct (the “Rules”) sets forth requirements that must be met when a lawyer enters into a business transaction with a client. This specific regulation, rather than the general conflicts provisions of Rule 1.7(a), governs the lawyer’s conduct when a lawyer engages in a business transaction with a client. N.Y. State 1055 ¶ 13 (2015). Such a business transaction occurs when a client obtains funding from a source in which the lawyer has a financial interest, which funding will be used in part to pay the lawyer’s fees. *See* N.Y. State 769 (citing the Code’s predecessor to Rule 1.8(a) as one of bases for concluding that “the lawyer cannot own any interest in the financing institution”). The two other conditions to trigger Rule 1.8(a) are that the lawyer and client “have differing interests” in the transaction and that “the client expects the lawyer to exercise professional judgment therein for the protection of the client.” Whether those circumstances are present will depend on the facts of particular cases. Here, we assume their presence, because the Company and the client have differing interests in the terms of the financing arrangements, *see* Rule 1.8, Cmt. [4C] (Rule 1.8(a) applies when lawyer obtains financial interest in client’s claim except as Rules otherwise allow), and because the lawyer’s financial stake in the Company could give rise to the client’s reasonable expectation that the lawyer is exercising professional judgment on the client’s behalf, *see* N.Y. State 769 (“an unsophisticated client may reasonably assume that by facilitating the transaction, the lawyer is also endorsing the entering into of the proposed transaction and/or the terms thereof”); *cf.* N.Y. State 1055 n. 1 (2015) (client expectation likely when, for example, client has no other counsel, and the lawyer is acting for the client in the underlying matter).

10. When Rule 1.8(a) applies, then the transaction must be “fair and reasonable to the client.” This is a fact-intensive inquiry, N.Y. State 913 ¶ 11 (2012), for which we lack data to opine. Assuming the inquirer satisfies this standard, then the inquirer may meet the other requirements of Rule 1.8(a) by complying with the obligations to make full disclosure in a writing, using language the client may reasonably understand, including the lawyer’s role in the transaction; to advise the client, and to provide the client the opportunity, to seek independent legal counsel; and to obtain informed consent in a writing the client signs. Rule 1.8(a) (1) - (3).

11. If the client is not to be represented by the inquirer in the litigation, but rather by another lawyer in the inquirer’s firm, the inquirer’s financial interest would still give rise to a conflict by imputation. Rule 1.10(a) (“While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rule 1.7, 1.8 or 1.9, except as otherwise provided therein.”). Thus, even if the client is represented by another lawyer in the inquirer’s firm, that representation, together with the inquirer’s investment in the Company, would trigger the restrictions of Rule 1.8(a). But the imputed restriction could, in appropriate circumstances, be satisfied by informed consent and by meeting the other requirements of Rule 1.8(a)(1) - (3).

12. If the inquirer fully complies with Rule 1.8(a), then the inquirer must still abide by Rule 1.7(a) in connection with the ongoing representation of the client. N.Y. State 1139 ¶ 15 (2017). Rule 1.7(a)(2) provides that a lawyer shall not represent a client if a reasonable lawyer would conclude that “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,” unless the affected client gives informed consent confirmed in writing. The inquirer’s personal and financial interest in the Company could create such a risk. For instance, the Company may have an interest in expediting (or prolonging) the litigation to enhance the value of the Company’s investment but which may not equate with the client’s interests in going to trial (or reaching an early settlement). A continuing duty exists to protect the client from this risk. Nevertheless, in our view, this conflict may be adequately disclosed and waived under Rule 1.7(b) if the other requirements of Rule 1.7(b) are fulfilled. Rule 1.10 imputes this conflict to other lawyers in the inquirer’s firm, but, like the underlying conflict, such an imputed conflict could be adequately disclosed and waived to allow the lawyer’s firm to represent the client. *See* Rule 1.10(d).

13. There are, however, two other applicable Rules that informed consent cannot remedy. Rule 1.8(e) provides (subject to exceptions discussed below) as follows: “While representing a client in connection with contemplated or pending litigation, a lawyer shall not advance or guarantee financial assistance to the client.” Underlying this Rule are two concerns: first, that such financial assistance “would encourage clients to pursue lawsuits that might not otherwise be brought,” and second, that “such assistance gives lawyers too great a financial stake in the litigation.” Rule 1.8, Cmt. [10].

14. The other provision (again subject to exceptions discussed below) is Rule 1.8(i): “A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client.” This rule, too, “is designed to avoid giving the lawyer too great an interest in the representation. In addition, when the lawyer acquires an ownership

interest in the subject of the representation, it will be more difficult for a client to discharge the lawyer if the client so desires.” Rule 1.8, Cmt. [16].

15. We believe that the proposed conduct would violate both of these Rules. A violation of Rule 1.8(e) arises because the payments from the Company would constitute “financial assistance to the [inquirer’s] client.” We recognize that the inquirer would not be the only investor in the Company, and that the inquirer’s client would not be the only litigant funded by the Company, but these facts do not alter the reality that money from the inquirer would be paid as financial assistance to the inquirer’s client. Nor does it matter that the money is routed first as an investment in a limited partnership and only thereafter as litigation funding. *See* Rule 8.4(a) (lawyer shall not violate the Rules “through the acts of another”); Phila. Op. 91-9 (“an attorney generally may not loan funds directly to a client, nor may an attorney indirectly do so through a finance company in which such attorney has an interest.”); *cf.* Fla. Op. 00-3 (2002) (“an attorney may not indirectly loan funds to clients in connection with pending litigation through a nonprofit corporation funded by attorney contributions.”).

16. There are three exceptions to Rule 1.8(e) that allow limited assistance to clients in certain circumstances. Rule 1.8(e) (1) (advances of “court costs and expenses of litigation”), (2) (making such payments for indigent or pro bono clients) and (3) (making such payments in contingency matters). In those cases, the benefits of helping assure access to the courts outweigh the perils of such limited assistance. *See* Rule 1.8, Cmt. [10]. But even then, assistance is limited to “court costs directly related to litigation,” such as “filing fees, expenses of investigation, medical diagnostic work connected with the matter under litigation and treatment necessary for the diagnosis, and the costs of obtaining and presenting evidence.” Rule 1.8, Cmt. [9B]. 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. *See* N.Y. City 2011-2 (for commercial cases such as those at issue here, if the claim appears meritorious, “the financing company will advance amounts to cover attorneys’ fees and the other costs of the litigation”).

17. This result is consistent with our prior opinions, based on the Code, which indicated that the lawyer “cannot own an interest in the lending institution, as that would indirectly constitute a loan by the lawyer to the client.” N.Y. State 666, *cited in* N.Y. State 769. Other jurisdictions agree. *See* N.J. Op. 691 (2001) (ethics rules do not prohibit lawyer from helping a client to obtain financial assistance from another “as long as the lawyer has no financial interest in the individual or entity which secures or provides that funding”); S.C. Op. 92-06 (approving attorney’s interest in a loan company given that “the company would not make loans to the attorney’s own clients”); Fla. Op. 00-3 (2002) (“The attorney shall not have any ownership interest in the funding company”); Phila. Op. 91-9 (“an attorney generally may not loan funds directly to a client, nor may an attorney indirectly do so through a finance company in which such attorney has an interest.”); ABA Report at 16, 19-20 (alternative legal financing may be subject to non-waivable conflict rule prohibiting lawyer from “providing financial assistance to a client”).

18. The proposed conduct would also violate Rule 1.8(i). By providing money to the inquirer’s client in exchange for a percentage of the prospective recovery, the Company would acquire a proprietary interest in the client’s claim. The inquirer, as a part owner of the Company, would also acquire such an interest, which the rule prohibits except in the cases of “a lien

authorized by law to secure the lawyer's fee or expenses," Rule 1.8(i)(1), or "a reasonable contingent fee in a civil case," Rule 1.8(i)(2). Neither of those exceptions would apply to the inquirer's financial stake in the Company. Even if a client is to compensate the inquirer by contingent fee, such a fee payment would be different from the percentage of a recovery that would ultimately be paid to the Company, and in part indirectly to the inquirer, in exchange for litigation financing. *See also* ABA Report at 16, 20 (alternative legal financing may be subject to non-waivable conflict rule prohibiting lawyer from "acquiring a proprietary interest in the client's cause of action").

19. As we have said, the imputation provisions of Rule 1.10(a) apply to violations of Rule 1.8. Thus, the preclusion of the proposed conduct by Rule 1.8(e) and Rule 1.8(i) would apply not only to clients whom the inquirer personally represents, but also to those represented by other lawyers associated in the inquirer's firm.

20. These restrictions are not subject to waiver. Rule 1.10(a) applies its imputation standard to any breach of Rule 1.7, 1.8, or 1.9, "except as otherwise provided therein." Rule 1.10(d) says that a "disqualification prescribed by this Rule [1.10(a)] may be waived by the affected client or former client under the conditions stated in Rule 1.7." In the context of prohibited transactions under Rule 1.8(e) or Rule 1.8(i), however, there is no negatively affected client or former client. The concept of waiver makes no sense. What is imputed is not a "disqualification," but rather an outright prohibition of the transaction in question. There are no informed-consent exceptions specific to Rules 1.8(e) and 1.8(i). Accordingly, the prohibitions of financial assistance to a client, and of acquiring a proprietary interest in the subject matter of litigation, are not subject to client waiver, and the same is true of those prohibitions as imputed.

## **CONCLUSION**

21. Neither the lawyer nor the lawyer's firm may represent the client in a litigation funded by a company in which one of the firm's lawyers is an investor in the litigation financing company providing the funds.

(31-17)