NEW YORK STATE BAR ASSOCIATION
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Committee on Professional Ethics

Opinion 855 (3/14/11)

Topic: Conflict of interest; referral of clients to spouse's litigation financing company.

Digest: A lawyer conducting litigation for a client may not refer the client to a litigation financing company owned by the inquiring lawyer's spouse to provide financial assistance that the lawyer personally would be barred from providing.

Rules: 1.8(e), 1.8(i), 8.4(a).

QUESTION

1. When clients of a personal injury law firm have financing needs in connection with contemplated or pending litigation, may a lawyer at the firm refer such clients to a legal financing company formed by the lawyer's spouse for the purpose of advancing funds to clients?

OPINION

2. The inquirer practices law at a firm that handles personal injury cases. Clients of the firm are sometimes unable to pay living expenses or litigation expenses, and they may turn to a litigation financing company for help. The inquirer's spouse would therefore like to establish a litigation financing company to aid such clients, and the inquirer would like to refer clients to the spouse's litigation financing company.

3. This plan implicates provisions in the New York Rules of Professional Conduct (the "Rules") concerning financial assistance to clients, taking a proprietary interest in a client's matter, and violating a Rule of Professional Conduct through the actions of another.

Prohibitions in Rule 1.8

4. Rule 1.8 is entitled "Current Clients: Specific Conflict of Interest Rules." Rule 1.8(e), which is identical to DR 5-103(B) of the former Code of Professional Responsibility as amended in 2007, provides:

> While representing a client in connection with contemplated or pending litigation, a lawyer shall not advance or guarantee financial assistance to the client, except that:
>
> (1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter;
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> (2) a lawyer representing an indigent or pro bono client may pay court costs and expenses of litigation on behalf of the client; and
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> (3) a lawyer, in an action in which an attorney's fee is payable in whole or in part as a percentage of the recovery in the action, may pay on the lawyer's own account court costs and expenses of litigation. In such case, the fee paid to the lawyer from the proceeds of the action may include an amount equal to such costs and expenses incurred.

5. If the inquiring attorney had asked this Committee whether a lawyer could *personally* form a litigation financing company to advance funds to clients, the Committee would have concluded that such an act violates Rule 1.8(e). Under Rule 1.8(e), the inquirer personally could not advance funds to clients in the form of loans. As Comment [10] to Rule 1.8 provides:

> Lawyers may not subsidize lawsuits or administrative proceedings brought on behalf of their clients, including making or guaranteeing loans to their clients for living expenses, because to do so would encourage clients to pursue lawsuits that might not otherwise be brought and because such assistance gives lawyers too great a financial stake in the litigation.

6. Nor could the inquirer overcome the prohibition against giving financial assistance to a client by obtaining the client's informed consent. As observed in SIMON'S NEW YORK RULES OF PROFESSIONAL CONDUCT ANNOTATED 116 (West 2009 ed.), "Rule 1.8 . . . makes some personal interest conflicts non-consentable no matter how fully a lawyer discloses the potential for conflicts of interest that will harm the client." Rule 1.8(e) addresses a type of personal conflict of interest that is not waivable by the client and cannot be cured by the client's consent.

7. Likewise, a lawyer may not evade the prohibition on financial assistance to clients by purchasing an interest in a client's litigation instead of providing a loan.

Purchasing a proprietary interest would violate a different provision, Rule 1.8(i), which is substantially identical to former DR 5-103(A). Rule 1.8(i) states:

> 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, except that the lawyer may:
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> (1) acquire a lien authorized by law to secure the lawyer's fee or expenses; and
>
> (2) contract with a client for a reasonable contingent fee in a civil matter subject to Rule 1.5(d) or other law or court rule.

8. However, there is at least one legitimate route to avoiding the 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. In N.Y. State 666 (1994), a lawyer wished to refer a client to a financial institution that would lend the client money for living expenses. Repayment of the loan would be contingent on the successful resolution of the client's claim for personal injuries. The Committee concluded that "a mere referral to the lending institution would not be unethical per se," considering that the lawyer did not propose to "pay" or "advance" any part of the loan. "The lawyer's sole function would be to refer the client to a lending institution that then would assess the value of the claim and take a lien on its proceeds to secure the loan."

9. In N.Y. State 769 (2003), which specifically concerned the litigation financing industry, we acknowledged that a lawyer could ethically refer clients to a litigation financing company, but we added: "As we pointed out in N.Y. State 666 (1994), the lawyer cannot own any interest in the financing institution; any such interest would be prohibited by the Code."

Referring Clients to the Lawyer's Spouse

10. That background brings us to the question posed here. If a lawyer may ethically refer a client to a lending institution in which the lawyer has no interest for the purpose of obtaining a loan contingent on the outcome of the client's case, may a lawyer refer a client to a lending institution owned by the lawyer's spouse?

11. The Committee has 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. *See*, *e.g.*, N.Y. State 738 (2001) (referral to title abstract company in which spouse had an interest); N.Y. State 493 (1978), (lawyer or spouse as broker); N.Y. State 340 (1974) (lawyer and spouse as salesperson in a brokerage agency); N.Y. State 291 (1973) (lawyer or spouse with interest in a brokerage agency); N.Y. State 244 (1972) (lawyer and spouse real estate broker). For example, in N.Y. State 738 we asked: "May an attorney who represents clients engaged in real estate matters refer those clients to a title abstract company in which the attorney's spouse has an ownership interest?" We had stated in two previous opinions that a lawyer could not refer a real estate client to a title abstract company in which the lawyer personally owned an interest unless the abstract work was "purely

ministerial" and the lawyer obtained consent from the client after full disclosure. Noting the unified financial interests of husband and wife, and based on N.Y. State 244, N.Y. State 291, N.Y. State 340, and N.Y. State 493, we concluded in N.Y. State 738 that an attorney "may not refer a real estate client to a title abstract company for other than ministerial title work where the lawyer's spouse has an ownership interest in the abstract company."

12. We believe the same conclusion applies when a lawyer refers clients to a litigation financing company owned by the lawyer's spouse, at least to the extent the lawyer personally would be barred from providing financial assistance to a client. Moreover, referring clients to a litigation financing company owned by the lawyer's spouse would usually also implicate Rule 8.4(a), which provides: "A lawyer or law firm shall not: (a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another." Referring clients to the spouse's financing company would violate Rule 1.8(e) "through the acts of another," essentially using the spouse as a front for advancing improper financial assistance to a client for whom the lawyer is conducting litigation.

CONCLUSION

13. A lawyer may not refer a client for whom the lawyer is conducting litigation to a litigation financing company owned by the lawyer's spouse in order to advance financial assistance to the client based on the prospective recovery in that litigation if the lawyer personally would be barred from providing that financial assistance.

(18-10)