



ISBA Professional Conduct Advisory Opinion

Opinion No. 19-02
April 2019

Subject: Litigation Third Party Funding

Digest: A lawyer who won a verdict for a client in litigation that is being appealed may allow the client to obtain financing and assist the client in obtaining financing from a third party during the pendency of such litigation. Although the Rules do not prohibit the lawyer's assistance or cooperation, the lawyer's assistance and cooperation are governed by several ethical limitations including the lawyer's duty to render independent professional judgment and candid advice to the client free of third party interference, to maintain confidentiality of the client's information and to obtain the client's informed consent for the lawyer's disclosure of any information to the finance company.

References: *The Law and Ethics of Lawyering Fifth Edition*, Geoffrey C. Hazard, Jr., et. al. . (Foundation Press, 2010).

Illinois Rules of Professional Conduct 1.0 (e), 1.2 (a), 1.2 (c), 1.4 (a)(5), 1.4(b), 1.6, 1.8 (e), 1.8 (f), 2.1, 2.3, 4.1(a), 5.4 (c).

New York City Bar Association, Formal Opinion 2011-2: *Third Party Litigation Financing*, June 1, 2011.

American Bar Association Commission on Ethics 20/20 Informational Report to the House of Delegates, December, 2011.

ISBA Advisory Opinion No. 92-9 (1993).

Miller UK Ltd. and Miller International Ltd. v. Caterpillar, Inc., Case No. 10 C 3770 in the United States District Court, Northern District of Illinois, Eastern Division, Memorandum Opinion 1/6/14, Jeffrey Cole, Magistrate Judge.

John L. Ropiequet, *Legal and Ethical Issues for Consumer Litigation Funding*, 68 Consumer Finance Law Quarterly Report 4 (2014).

FACTS

A lawyer won a verdict for a client. The defendant filed an appeal and stated its intention to appeal through every level possible. The client is in ill health which causes the client to incur medical expenses and threatens the client's life expectancy. A finance company contacts the client and lawyer offering to "purchase" from the client a specific dollar amount of the verdict or a settlement in the lawsuit by paying funds to the client now. Pursuant to an agreement with the finance company, the client agrees to pay back to the finance company a set amount from the verdict or settlement proceeds in the lawsuit. Such repayment will include a premium to compensate the finance company for its risk in making the purchase secured solely by proceeds from the lawsuit. If nothing is recovered from the lawsuit by the client, no amount is owed by the client to the finance company. For example, the finance company might pay the client \$50,000 now for a lien or promise of payment of up to \$75,000 from the amount paid to the client under the verdict or settlement, but will receive no payment if the verdict is overturned and the lawsuit is abandoned. The client's lawyer is not a party to the sale and does not receive any proceeds of the sale. The lawyer does not under any circumstance owe any amount to the finance company. The finance company has no rights to control any settlement, strategy or any other aspect of the litigation. The lawyer provides no guarantees to the finance company other than, pursuant to the client's instructions, an acknowledgement of the lien upon the client's proceeds from the litigation granted by the client to the finance company. In some instances, the lawyer may deliver a written undertaking to the client that the lawyer will comply with an irrevocable direction from the client to hold the client's litigation proceeds for the finance company's benefit.

QUESTIONS

1. Can the lawyer allow such sale or assist the client in a sale of part of the verdict?
2. Since the sale would be for a specific amount to be paid only out of the verdict or settlement, does this "nonrecourse" arrangement violate any ethical rule?
3. If the finance company's offer to the client was in the form of a nonrecourse loan rather than a purchase of a specific dollar amount of the verdict, would this change the opinions with respect to questions 1 and 2 above?

ANALYSIS

Third party financing for litigants has grown to serve litigants' needs to cover living, medical and other basic expenses during the pendency of litigation which may last several months or years. Third party financing generally consists of either a nonrecourse loan with interest or a purchase from the litigant by the financing company of a specific amount or a percentage interest in the proceeds of the litigation or settlement. The lender is compensated for the financing by either an agreed interest rate or a premium paid to the lender from the litigant's recovery. In absence of payment from the verdict or settlement, the lender has no recourse against the borrower litigant. For the purpose of this opinion, we are assuming that litigation funding agreements are legal. The legality of litigation funding agreements is beyond the scope of this opinion and by issuing this limited advisory opinion, the ISBA is not taking any position concerning such legality.

Third party financing has developed partially in response to the restrictions of Rule 1.8 (e), limiting a lawyer's financial assistance to a client with respect to pending or contemplated litigation to advances of court costs and litigation expenses. *The Law and Ethics of Lawyering*, supra at page 964. Rule 1.8(e) states:

“A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, 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; and
- [2] a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.”

Notwithstanding the Rule 1.8 (e) prohibition against the lawyer's direct extension of financial assistance to the client, the lawyer's assistance to the client with respect to third party financing and continued representation of the client in litigation when the client has entered a third party financing arrangement do not per se constitute an ethical violation on the lawyer's part. This principle would be applicable regardless of whether the financing arrangement contemplates a nonrecourse loan or the purchase of a specific dollar amount from the litigation proceeds. Whether the financing is extended as a nonrecourse loan or a purchase of a specific dollar amount from the client's litigation proceeds, the elements of the financing are functionally identical. In both instances, funds are advanced to the client by the finance company during the pendency of litigation and the lender is repaid solely from the adversary's payment to the client of a verdict or settlement amount.

ISBA Advisory Opinion No. 92-9 (1993) stated that a lawyer “may ethically assist clients in obtaining loans **for payment of attorneys fees** [emphasis added] providing the attorney protects the client's confidences and meets his [or her] obligation of complete disclosure.” *ISBA Advisory Opinion*, supra at page 1. The Advisory Opinion distinguished such assistance with third party financing from the Rule 1.8 (e) prohibition against a lawyer's financial assistance to the client. In the Advisory Opinion facts, the lawyer was assisting the client with financing between the client and a third party (not prohibited under Rule 1.8 (e)) and the lawyer was not directly involved in making the loan or guaranteeing the loan (prohibited under Rule 1.8 (e)). The Advisory Opinion concerns a loan that was used to pay attorneys' fees. In the facts of this Opinion, the loan proceeds are paid directly to the client, not to the lawyer, without restrictions upon the client's use of the loan proceeds. The facts of this Opinion in which the lawyer does not receive the loan proceeds are more compelling to permit the lawyer's assistance with the financing since the financing considered herein does not directly benefit the lawyer.

In its Formal Opinion 2011-2: *Third Party Litigation Financing*, June 1, 2011, the New York City Bar Association addressed the lawyer's ethical restrictions when the lawyer's client receives unrestricted third party financing. The Association opined that it is not unethical per se for a lawyer to represent a client receiving such financing. However, the Association discussed several ethical restrictions upon the lawyer's conduct in such representation. Such ethical restrictions are enumerated below. The American Bar Association Commission on Ethics 20/20

Informational Report to the House of Delegates, February, 2011 is also in accord with this Opinion that a lawyer may represent clients concerning third party financing. The Report, while not raising ethical issues with respect to the sole fact of such representation, discusses several ethical obligations with which the lawyer must comply in rendering such representation.

The existence of third party financing is also contemplated and permitted by Rule 1.8 (f) which sets standards under which a lawyer can accept compensation for a client's representation from a person or entity other than the client. Rule 1.8 (f) states:

“A lawyer shall not accept compensation for representing a client from one other than the client unless: (1) the client gives informed consent; (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and (3) information relating to representation of a client is protected as required by Rule 1.6.”

There is no Rule prohibiting a lawyer from representing a client solely because the client is obtaining third party financing. Notwithstanding the absence of Rules prohibiting third party financing, there are several ethical issues and Rules which the lawyer must navigate while representing a client who is a party to a third party financing arrangement.

The lawyer's overall conduct with respect to the third party financing is governed by Rule 2.1, which provides in part:

“In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer...to other considerations such as...economic...factors, that may be relevant to the client's situation.”

Rule 2.1 compels a duty upon the lawyer to act solely in the client's interest in recommending to the client a financing entity (if such recommendation is requested by the client and the lawyer undertakes to make such recommendation) and counseling the client concerning the contractual terms between the client and the financing entity.

It is a prerequisite for such recommendation and counseling that the lawyer shall be competent with respect to third party financing issues. Rule 1.1 states that:

“A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.”

If the lawyer is unfamiliar with third party financing transactions, “he or she must either acquire the appropriate knowledge through reasonable study and preparation, associate with an experienced lawyer, or refer the client to another lawyer with established competence.” *American Bar Association Commission on Ethics 20/20, supra* at page 38.

Pursuant to Rule 1.2 (c) a lawyer could limit the scope of the lawyer's representation to exclude the lawyer's participation in selecting the finance company and negotiating the terms of

the finance agreement. Rule 1.2 (c) permits a lawyer to limit the scope of representation if “the limitation is reasonable under the circumstances and the client gives informed consent.”

When the lawyer provides counsel with respect to the litigation financing, the lawyer should address among other matters, the cost to the client of the financing including the possibility that the effective interest rate or premium is usurious under Illinois law or other applicable state law. N 1. In addition, the lawyer should analyze the client’s (and possibly the lawyer’s if so instructed by the client) obligations to share information with the finance company concerning the litigation. The lawyer should advise the client about the risks of waiving the attorney-client privilege and rights under the work product doctrine for communications between the client, the lawyer and the finance company. Currently, Illinois law is unsettled as to whether such communications are protected from discovery. N 2. The lawyer must review the finance company’s terms with the client to, among other matters, make certain that such terms do not compel the lawyer to engage in conduct which would violate the Rules. Rule 1.4 (a) (5) provides that:

“...(a) A lawyer shall:...(5) consult with the client about any relevant limitation on the lawyer’s conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.”

Most financing companies will engage in due diligence, before advancing financing. As part of this diligence process, the lawyer may be asked for factual information concerning the underlying case as well as opinions concerning legal matters at issue. There is a risk that such information supplied by a lawyer to a finance company will no longer be subject to the attorney-client privilege or the attorney work product doctrine. Any response by the lawyer to the finance company is subject to Illinois Rule 1.6 (a) which requires in part that:

“(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent....”

Informed consent is defined in Rule 1.0 (e). “In order to obtain informed consent, the lawyer must explain the risk of waiver of the privilege, advise the client whether the benefits of disclosure outweigh the risk, and advise the client of reasonably available alternatives.” *American Bar Association Commission on Ethics 20/20, supra* at page 36.

The lawyer’s response to the finance company also is subject to Rule 2.3 (a) which states that :

“A lawyer may provide an evaluation of a matter affecting the client for the use of someone other than the client if the lawyer reasonably believes that making the evaluation is compatible with other aspects of the lawyer’s relationship with the client.”

However, Rule 2.3 (b) requires that:

“When the lawyer knows or reasonably should know that the evaluation is likely to affect the client’s interests materially and adversely, the lawyer shall not provide

the evaluation unless the client gives informed consent.” to the delivery of such evaluation.

When a lawyer’s evaluation provided to a finance company could reasonably be expected to cause the company not to extend financing such result would in most instances be material and adverse to the client, thus requiring the client’s informed consent.

In addition, the lawyer’s responses and other communications with the finance company must comply with Rule 4.1 (a) which states in part:

“In the course of representing a client a lawyer shall not knowingly: (a) make a false statement of material fact or law to a third person...”

Although Rule 4.1 (a) contemplates communications with opposing counsel and courts, the Rule does not limit the scope of person or entity which could constitute a “third person”. Accordingly, a lawyer should adhere to this Rule in the lawyer’s communications with a finance company.

Most financing contracts require in some form that the lawyer advise the finance company concerning major occurrences in the underlying litigation and settlement offers. Such undertaking by the lawyer along with such advice to the finance company, without informed consent from the client, would violate Rule 1.6 (a). With a substantial financial interest in the outcome of the case, the finance company as a practical matter would find it difficult to refrain from influencing how the case will be handled, notwithstanding terms to the contrary in the finance company’s agreement with the client. While a client may not object to the finance company’s participation, absent the client’s informed consent, the lawyer must ignore the finance company’s interest in settlement or litigation strategy in order to render independent professional judgment and candid advice to the client in compliance with Rule 2.1. The lawyer shall not permit the finance company to direct or regulate the lawyer’s professional judgment as required by Rule 5.4 (c) which states in part:

“(c) A lawyer shall not permit a person who...pays the lawyer to render legal services for another to direct or regulate the lawyer’s professional judgment in rendering such legal services.”

Comment [2] to Rule 5.4 indicates that Rule 5.4 (c) would apply even if the third party is not paying the lawyer stating:

“This Rule also expresses traditional limitations on permitting a third party to direct or regulate the lawyer’s professional judgment in rendering legal services to another.”

With respect to settlement, the lawyer shall act solely upon the direction of the client as required by Rule 1.2 (a) which provides in part:

“A lawyer shall abide by a client’s decision whether to settle a matter...”

The client's decision is subject to the lawyer explaining matters to the client to the extent reasonably necessary to permit the client to make informed decisions regarding the representation, including strategy and settlement as required by Rule 1.4 (b) which states:

“(b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.”

CONCLUSION

In conclusion, the Committee is of the opinion that a lawyer's representation of a client who is contemplating or receiving litigation financing is not unethical per se provided that in such representation, the lawyer heeds the ethical Rules discussed herein.

Professional Conduct Advisory Opinions are provided by the ISBA as an educational service to the public and the legal profession and are not intended as legal advice. The opinions are not binding on the courts or disciplinary agencies, but they are often considered by them in assessing lawyer conduct.

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Notes

1. The common law doctrines of champerty, maintenance and barratry have been applied in at least a couple jurisdictions to void litigation financing agreements. “[P]ut simply, maintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome; and barratry is a continuing practice of maintenance or champerty.” *Osprey, Inc. v. Cabana Ltd Partnership*, 532 S.E.2d 269 (S.C. 2000) (quoting *In re Primus*, U.S. 412,424 (1978)).

In *Rancman v. Interim Settlement Funding Corp.*, 99 Ohio St. 3d 121, 789 N.E.2d 217 (2003) the Ohio Supreme Court held that a litigation financing agreement was void because of champerty and maintenance. The Court stated, “[A] lawsuit is not an investment vehicle. Speculating in lawsuits is prohibited by Ohio law. An intermeddler is not permitted to gorge upon the fruits of litigation.” *Id.* At 125. The Rhode Island Supreme Court issued a ruling similar to *Rancman* in *Toste Farm Corp. v. Hadbury, Inc.*, 798 A.2d 901 (R.I. 2002).

Although Illinois is one of only a few states that have laws specifically prohibiting barratry and maintenance, 720 ILCS 5/32-11 and 720 ILCS 5/32-12 (2009), there has been no case in recent decades where a non-lawyer has been successfully prosecuted under these statutes.

It has been argued in a few jurisdictions that litigation funding constitutes a loan, notwithstanding that the obligation to repay the debt is contingent upon a recovery in the litigation and is not absolute. If the funding is a loan, usury laws could limit the amount of interest which could be recovered and the financing entities could be required to comply

with consumer lending laws in the respective jurisdictions. In Illinois, there has not been a case or legislation determining whether litigation funding is a loan subject to Illinois usury laws .

2. In the case of *Miller UK Ltd. and Miller International Ltd. v. Caterpillar, Inc.*, Case No. 10 C 3770 in the United States District Court, Northern District of Illinois, Eastern Division, Memorandum Opinion 1/6/14, the Magistrate Judge engaged in an extensive and complex analysis concerning the waiver or non-waiver of the attorney client privilege and work product doctrine by communications among the plaintiff, its attorney and its finance company. The Magistrate Judge's analysis was fact specific to numerous discovery requests filed by the defendant seeking to discover, among other things, communications between the plaintiff, its attorney and the plaintiff's finance company. Accordingly, although providing an extensive analytical framework for evaluating each request, the decision did not provide binding precedent concerning whether any such communications are privileged and not subject to discovery. Also in that case, the Court held that the subject litigation funding did not violate the Illinois maintenance and champerty statutes.