

1 THE STATE BAR OF CALIFORNIA  
2 STANDING COMMITTEE ON  
3 PROFESSIONAL RESPONSIBILITY AND CONDUCT  
4 FORMAL OPINION INTERIM NO. 14-0002  
5 ALTERNATIVE LITIGATION FUNDING

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7 **ISSUE:** What ethical obligations arise when a lawyer represents a client whose  
8 case is being funded by a third-party litigation funder?

9 **DIGEST:** Two types of third-party litigation funding have emerged over the last  
10 several years: consumer litigation funding, which provides funds to a  
11 plaintiff with personal injury claims, typically for personal use rather than  
12 to fund their case, and commercial litigation funding, which typically  
13 involves advancing funds to pay a plaintiff's litigation expenses or  
14 otherwise. Both types of funding are non-recourse.<sup>1/</sup> This opinion  
15 addresses the ethical issues that arise from such funding arrangements.  
16 The principal ethical issues are maintaining independent professional  
17 judgment and complying with the lawyer's duty of confidentiality. In  
18 commercial funding arrangements, the funding agreement will likely be  
19 negotiated. If the client asks the lawyer to represent him or her in such  
20 negotiations, the lawyer should consider whether the lawyer has the  
21 experience or learning required as well as whether the lawyer has any  
22 personal interest that creates a conflict. If so, the lawyer must address  
23 those by a written disclosure that describes the relevant circumstances  
24 and material risks and then obtain the client's written consent. If the  
25 funder seeks client confidential information, the lawyer must advise the  
26 client of the risks of disclosure and obtain the client's informed consent  
27 to disclose confidential information to the funder. The lawyer should also  
28 take appropriate steps to limit the risks to the client that the disclosure of  
29 such information will effect a waiver of attorney-client privilege or work  
30 product protection which may include having the funder sign a non-  
31 disclosure agreement, appropriate labeling of shared materials as  
32 confidential or taking other steps to maintain the confidentiality of the  
33 shared materials.

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<sup>1/</sup> Within commercial funding, there are also arrangements where the lawyer or law firm is funded rather than the client, often in the form of portfolio funding for a group of cases.

34 **AUTHORITIES**

35 **INTERPRETED:** Rules 1.1, 1.4, 1.6, 1.7(b), and 1.8.6 of the Rules of Professional Conduct  
36 of the State Bar of California.<sup>2/</sup>

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**STATEMENT OF FACTS**

39 Scenario 1: Lawyer represents Client with personal injury claim who is in need of money for  
40 living expenses. Lawyer advises Client that Client may qualify for litigation funding and provides  
41 Client with a list of funders that Lawyer's clients have used. At Client's request, Lawyer reviews  
42 the agreement and explains its terms carefully, emphasizing that the interest rate on the loan is  
43 high, there is also a large administrative fee, and Client might be able to get a bank loan at a  
44 lower rate. Despite this advice, Client enters into the funding agreement.

45 Scenario 2: Client, a company asserting a patent claim, is interested in litigation funding to  
46 avoid tying up its cash in legal fees. Lawyer has extensive experience with third-party funding  
47 and recommends a funder with which the firm has worked previously. Prior to agreeing to fund  
48 the case, Funder asks for a memo assessing the strengths of Client's case. Lawyer tells Funder  
49 that Lawyer will seek Client's consent to share this information. Lawyer advises Client there is  
50 some risk that sharing the memo could waive applicable privileges, that the risk is lessened if  
51 the information is communicated under a non-disclosure agreement ("NDA"), and that Client  
52 must also consider that Funder will probably not fund the case without receiving Lawyer's  
53 assessment of the strength of the claims. Client authorizes Lawyer to share the memo. Because  
54 of prior good experience with Lawyer, Funder agrees to fund Client's case (the Client, in turn, is  
55 responsible for paying Lawyer's legal fees). Lawyer is able to negotiate a better than standard  
56 deal for Client because of Lawyer's relationship with Funder. Under the terms of the deal,  
57 Funder funds a portion of Lawyer's fees (the Lawyer is on a partial contingency) and pays  
58 litigation expenses. Funder has the right to cease funding if it disagrees with the direction of the  
59 litigation. The funding agreement also gives Funder the right to review and approve any change  
60 in counsel, which approval will not be unreasonably withheld. Over the course of the litigation,  
61 Funder's employees communicate regularly with Lawyer.

62 Scenario 3: Same facts as Scenario 2, except under the funding agreement, Funder pays  
63 Lawyer's legal fees directly for the representation of Client.

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<sup>2/</sup> Unless otherwise indicated, all references to rules in this opinion will be to the Rules of Professional Conduct of the State Bar of California in effect as of November 1, 2018.

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**INTRODUCTION: LITIGATION FUNDING AND ITS ANTECEDANTS**

Litigation funding is the practice where a third party unrelated to the lawsuit provides funds for litigation in return for a portion of any financial recovery. In this opinion, we consider the ethical issues an attorney may face in representing a client where litigation funding is involved.

The type of third-party litigation funding addressed by this opinion is a relatively recent development in the United States, although more common and accepted elsewhere.<sup>3/</sup> The ethics and social utility of this type of litigation funding are the subject of debate. Some have raised concerns that litigation funding will lead to frivolous lawsuits or that vulnerable clients may be forced to accept unfair deals.<sup>4/</sup> Others argue litigation funding in the United States promotes access to justice and/or diversifies thinking about litigation.<sup>5/</sup>

The purpose of this opinion is not to enter the normative debate about litigation funding but rather to provide guidance to attorneys as to the ethical issues that arise when dealing with a case that involves third-party funding.

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<sup>3/</sup> Barker, *Third-Party Litigation Funding in Australia and Europe* (2012) 8 J.L. Econ. & Pol'y 451.

<sup>4/</sup> See, e.g., Langford, *Betting on the Client: Alternative Litigation Funding Is An Ethically Risky Proposition for Attorneys and Clients* (2015) 49 U.S.F. L.Rev. 237.

<sup>5/</sup> See, e.g., Steinitz, *Whose Claim Is This Anyway? Third Party Litigation Funding* (2011) 95 Minn. L.Rev. 1268 (hereafter *Whose Claim*); DeStefano, *Nonlawyers Influencing Lawyers: Too Many Cooks in the Kitchen or Stone Soup* (2012) 80 Fordham L.Rev. 2791.

DISCUSSION

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81 **Legality**

82 In some states, agreements between a litigant and a stranger to the litigation by which the  
83 stranger pursues or assists in pursuing the litigant’s claim and in return receives part of any  
84 recovery are prohibited under laws against champerty and maintenance. These are legal  
85 doctrines dating from the Medieval England that developed to prevent feudal lords from  
86 financing other individuals’ legal claims against the financier’s political or personal enemies.

87 Courts in states with laws against champerty and maintenance have considered whether  
88 litigation funding arrangements violate those laws. See *Charge Injection Technologies, Inc. v. E.I.*  
89 *DuPont De Nemours & Company* (2016) 2016 WL 937400 (finding that litigation funding  
90 contract did not violate Delaware’s common law prohibition on champerty and maintenance  
91 because the funder did not exercise control over litigation); *Maslowski v. Prospect Funding*  
92 *Partners LLC* (2017) 890 N.W.2d 756 (finding that litigation funding agreement was  
93 unenforceable by Minnesota law against champerty).

94 California has never recognized prohibitions against champerty or its variants. See, *In re Cohen’s*  
95 *Estate* (1944) 66 Cal.App.2d 450 [152 P.2d 485]. Such laws should not be a barrier to a litigation  
96 funder enforcing a litigation funding contract in California.<sup>6/</sup>

97 **Duty of Competence and Duty to Communicate**

98 A lawyer has a duty to provide competent representation, which includes applying the learning  
99 and skill reasonably necessary to perform legal services. Rule 1.1(b). A lawyer also has a duty to  
100 communicate with the client about the means by which to accomplish the client’s objectives in  
101 the representation. Rule 1.4(a). To the extent the client’s ability to accomplish its objectives  
102 depends on the client’s ability to fund the litigation or fund the client’s personal expenses while  
103 proceeding with the litigation, the lawyer’s representation of the client may involve advising  
104 the client as to whether litigation funding would assist in accomplishing the client’s goals. Such  
105 advice would likely need to include a discussion of the pros and cons of obtaining litigation  
106 funding and alternatives, if any.

107 Furthermore, a lawyer representing a client in a matter funded by a litigation funder has an  
108 obligation to understand how the funding agreement impacts the litigation. If the client asks  
109 the lawyer to advise on or negotiate a litigation funding contract, the lawyer must either have  
110 the expertise to do so, obtain such experience, or decline to provide the requested advice  
111 regarding litigation funding. See Rule 1.1(c). But regardless of whether the attorney is advising a

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<sup>6/</sup> See also, Los Angeles County Bar Assn. Formal Opinion No. 500 (1999) [explaining that doctrines of champerty and maintenance have not been recognized by California courts, and the concerns raised by those doctrines are addressed by other protections including sanctions for frivolous lawsuits and malicious prosecution actions].

112 client on the funding contract, the lawyer must understand how the terms of the funding  
113 agreement impact decisions in the litigation.

114 **Candid Advice and Professional Independent Judgment**

115 Rule 2.1 provides that “[i]n representing a client, a lawyer shall exercise independent  
116 professional judgment and render candid advice.” This Rule dovetails with a lawyer’s duty of  
117 loyalty to a client, which generally prohibits a lawyer from allowing obligations owed or  
118 potentially owed to a third party to compromise the quality and soundness of advice offered to  
119 a client. See e.g. *Pollack v. Lytle*, 120 Cal.App.3d 931, 946 (1981) (explaining how the duty of  
120 loyalty to clients should not be diluted by obligations owed to third parties, as that would be  
121 inconsistent with an attorney’s duty to exercise independent professional judgment for the  
122 client). The lawyer must reasonably believe that the lawyer’s independent professional  
123 judgment will not be undermined, and that the lawyer can thus provide candid advice to the  
124 client regarding the subject matter of the representation.

125 Rule 1.7 prohibits a lawyer from representing a client if there is a significant risk that the  
126 representation will be materially limited by the lawyer’s relationships with a third person or the  
127 lawyer’s own interest without the lawyer’s informed written consent. Rule 1.7(b). The lawyer  
128 must also reasonably believe that the lawyer can provide competent and diligent  
129 representation notwithstanding the potential conflict or relationship with a third person. Rule  
130 1.7(d).

131 Rule 1.8.6 prohibits a lawyer from entering into an agreement for or accepting compensation  
132 for representing a client from one other than the client unless the client gives informed written  
133 consent, the lawyer complies with the lawyer’s duty of confidentiality, and the payment  
134 arrangement will not interfere with the lawyer’s independent professional judgment or with  
135 the lawyer-client relationship. The Rule would apply in an arrangement where the funder pays  
136 the lawyer directly. The Rule reflects the recognition that the source of the lawyer’s payment is  
137 likely to have influence over the lawyer. Litigation funding, like a third-party payor, introduces a  
138 third party with its own interests into the lawyer-client relationship, posing risks to the lawyer’s  
139 independent professional judgment and the relationship of confidence between the lawyer and  
140 client. The duty of loyalty and independent professional judgment require the lawyer to act in  
141 the client’s interest at all times and particularly where the client’s interest might depart from  
142 the funder’s.

143 The lawyer’s independent professional judgment may also be impaired if the funding  
144 arrangement imposes limitations on the how the case is litigated. Some ethics committees have  
145 suggested that there could be circumstances in which a funding agreement imposes such  
146 limitations on the attorney’s judgment that the lawyer might not be able to competently  
147 represent the client. ABA Commission on Ethics 20/20, Informational Report to the House of  
148 Delegates 23 (2012); Ohio Sup. Ct. Ethics Opn. No. 2012-3 (lawyer must ensure the alternative  
149 litigation funding company providing nonrecourse loan to client “does not attempt to dictate  
150 the lawyer’s representation of the client”). Others have suggested that such arrangements are  
151 permissible with client consent. Assn. of the Bar of the City of N.Y. Com. on Prof. and Jud.

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152 Ethics, Formal Opn. No. 2011-02 (client may “agree to permit a financing company to direct  
153 strategy or other aspects of a lawsuit” and the lawyer is not prohibited from acceding to the  
154 funder’s direction as long as the client consents); cf. ABA Formal Opn. No. 01-421 (lawyer hired  
155 by insurer to represent insureds may not comply with insurer’s guidelines or directives relating  
156 to representation if these would “impair materially the lawyer’s independent professional  
157 judgment”).

158 COPRAC does not reach a general conclusion that any particular degree of control is per se  
159 unethical. However, it is clear that where the funder has some degree of control of the  
160 litigation, the lawyer has an obligation to advise the client about the impact of such limitations  
161 on the lawyer’s representation. Rule 1.4; see also ABA Formal Opn. No. 01-421 (where lawyer  
162 represents insured and the insurer imposes limitations on the representation, lawyer must  
163 communicate limitations to the client early in the representation).

164 A lawyer’s duties are not dictated by the funding contract but by the lawyer’s ethical duties.  
165 ABA Formal Opn. No. 96-403 illustrates this principle in the context of an insurance agreement.  
166 The opinion considers the ethical obligations of an attorney retained by an insurer to represent  
167 the insured pursuant to a contract that gave the insured control over settlement within policy  
168 limits where the client objects to the proposed settlement. The ABA opined that the lawyer  
169 could not settle against his client’s wishes. Instead, the lawyer was obligated to discuss with the  
170 client, the client’s legal rights, explain the consequences of rejecting the settlement and let the  
171 client decide.

172 This opinion stands for the proposition that a litigation funding agreement may be a fact that  
173 impacts the advice the lawyer gives a client, but it does not alter the lawyer’s ethical obligation  
174 to pursue the client’s best interest. *Id.* (“Whatever the rights and duties of the insurer and  
175 insured under the insurance contract, that contract does not define the ethical responsibilities  
176 of the lawyer to his client.”) See also, Md. State Bar Ass’n, Comm. on Ethics Opn. No. 00-45  
177 (opining that where the client wishes to terminate a lawyer, the lawyer must abide by the  
178 client’s wishes regardless of whether the client’s terminating the lawyer is a breach of the  
179 funding agreement).

### 180 **Protecting Confidential Information**

181 In order to determine whether to invest in a case, funders will likely require information about  
182 the case at the outset. A prospective funder may ask for the attorney’s analysis of the merits of  
183 the case or other privileged materials. Once a funder has agreed to fund the case, that  
184 agreement will likely be memorialized in a contract which may reflect how the funder values  
185 the case which is likely to be based on the attorney’s analysis. As the case proceeds, there may  
186 continue to be communications between the funder and client or between the funder and the  
187 client’s counsel.

188 Rule 1.6 prohibits a lawyer from sharing confidential information without the client’s informed  
189 consent. In order for the client’s consent to be informed, the lawyer must inform the client  
190 about “the relevant circumstances and the material risks, including any actual and reasonably

191 foreseeable adverse consequences.” Such risks include the client’s adversary may seek to  
192 compel communications between the funder and the client or lawyer and a court may hold that  
193 the sharing effected a waiver of otherwise available evidentiary privileges.

194 **Application to Hypothetical Scenarios**

195 **Scenario 1**

196 In Scenario 1, Client with a personal injury claim entered into a funding agreement to pay his  
197 living expenses while his lawsuit is ongoing. Lawyer recommended that Client explore litigation  
198 funding, but also after reviewing the terms of the funding agreement, advises Client accurately  
199 about the downsides of the funding including that Client might be able to get a bank loan at a  
200 lower rate. Did Lawyer meet his ethical duties in each of these steps?

201 First, there is nothing unethical about a lawyer recommending a client consider litigation  
202 funding as long as there is no legal bar to the client entering into such a transaction. This  
203 Committee has previously opined that a lawyer may refer a client to a real estate broker to  
204 obtain a loan to be used for legal fees. Cal. State Bar Formal Opn. No. 2002-159. Similarly, a  
205 lawyer may ethically provide information and introductions to a litigation funder.

206 In Scenario 1, the Client asked the Lawyer to review the terms of the funding agreement and  
207 the Lawyer gave Client an independent and objective assessment. The fact pattern is silent on  
208 the Lawyer’s experience reviewing litigation funding agreements. The Lawyer must consider  
209 whether Lawyer has the skills necessary to advise the client and, if not, either tell Client it is  
210 outside the Lawyer’s expertise, obtain the necessary understanding of litigation financing in  
211 order to adequately advise Client regarding the agreement proposed, or consult with another  
212 lawyer he reasonably believe has the requisite expertise. Rule 1.1.

213 **Scenario 2**

214 In Scenario 2, Lawyer advises Client on choice of funder and negotiates the funding contract on  
215 behalf of Client. Does Lawyer have a conflict in providing these services? The facts state that  
216 the Lawyer has a preexisting relationship with Funder, that Funder will be partially paying the  
217 law firm’s fees and that certain terms of the funding agreement are advantageous to the law  
218 firm.

219 Under rule 1.7, if any of those circumstances or their combination creates a significant risk that  
220 Lawyer’s advice on the choice of funder or funding contract terms is materially limited by  
221 Lawyer’s own interests, Lawyer is required to advise Client of the facts and seek Client’s  
222 informed written consent. Rule 1.7(b). See also, *Santa Clara County Counsel Attys. Assn. v.*  
223 *Woodside* (1994) 7 Cal.4th 525, 546-47 [28 Cal.Rptr.2d 617] (lawyer must evaluate whether the  
224 relationship creates a “situation in which [he or she] might compromise his or her  
225 representation in order to advance the attorney’s own financial or personal interests”). Indeed,  
226 Lawyer owes Client a duty to communicate material facts concerning the representation. Rule  
227 1.4. Lawyer’s existing relationship with Funder is a material fact. In addition to obtaining

228 informed written consent, Rule 1.7(d) requires that Lawyer reasonably believe that Lawyer can  
229 provide Client with diligent and competent representation notwithstanding the Rule 1.7(b)  
230 conflict.

231 Rule 1.8.1 applies where a lawyer obtains a pecuniary (financial) interest *adverse to the client*.  
232 There is nothing adverse to a client about a lawyer getting paid for legal services. See Cal. State  
233 Bar Formal Opn. No. 2002-159, n.3 (“Although the lawyer does receive some benefit from the  
234 escrow arrangement—she is assured that there are funds available to pay her fees and costs—  
235 this is no different from the benefit the lawyer receives by requiring an advance fee and placing  
236 it in her trust account. The lawyer, by requiring an advanced fee, does not thereby come within  
237 rule 3-300.”). Thus, the Rule does not apply merely because the arrangement permits a lawyer  
238 to get paid its fees. On the other hand, if a lawyer owns a share in the litigation funding  
239 company, the funding arrangement would constitute a business transaction with the client and  
240 the lawyer would be obliged to comply with rule 1.8.1.

241 Scenario 3

242 This is the same as the prior Scenario, except that Funder pays Lawyer’s legal fees directly for  
243 the representation of Client.

244 Lawyer must not enter into an agreement, charge, or accept compensation for representing  
245 Client in this scenario, unless Lawyer ensures (a) there is no interference with Lawyer’s  
246 independent professional judgment or relationship with Client, (b) information is protected as  
247 required by Business & Professions Code section 6068(e)(1) and Rule 1.6, and (c) Lawyer  
248 obtains Client’s informed written consent as set forth in Rule 1.8.6(c). Rule 1.8.6(a)-(c).

249 Moreover, Rule 1.8.6 does not alter or diminish a lawyer’s obligations under Rule 5.4(c), which  
250 addresses financial arrangements with third parties. Rule 1.8.6, cmt. 5. In other words, in such a  
251 payment arrangement it remains paramount that Lawyer not permit the third party payor to  
252 direct or regulate Lawyer’s independent professional judgment or interfere with the lawyer-  
253 client relationship.

254 [PLEASE LET ME KNOW IF YOU THINK SCENARIO 3 IS OVER-SIMPLIFIED AND WHAT NUANCES  
255 YOU THINK WE SHOULD CONSIDER ADDRESSING HERE.]

256 Impact on Attorney’s Duty of Confidentiality

257 According to the facts of Scenario 2, Lawyer shares a legal analysis memo with Funder after  
258 Funder signed an NDA. Lawyer also engages in communications with Funder about the progress  
259 of the case. These activities implicate Lawyer’s ethical obligation to maintain the confidentiality  
260 of information learned in the course of the representation and to apply diligence, learning and  
261 skill to avoid adverse consequences, such as a waiver of privileges and protections to which the  
262 clients is entitled.

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263 Case law concerning whether funding agreements and communications with funders are  
264 privileged is still developing. Most but not all courts that have considered the question have  
265 held that work product does not lose its work product status because an attorney or client  
266 shares that work product with a funder either orally or in writing.<sup>7/</sup> That is because work-  
267 product protection is only subject to waiver based on disclosure to a third party where the  
268 disclosure “substantially increase[es] the possibility that an opposing party will obtain the  
269 information.” 2 Mueller & Kirkpatrick, *Federal Evidence* (4th ed. 2016) § 5:38; see also *Laguna*  
270 *Beach County Water Dist. v. Superior Court* (2004) 124 Cal.App.4th 1453, 1459 [disclosure  
271 operates as a waiver only where the otherwise protected information is divulged to someone  
272 with no interest in maintaining confidentiality]. Taking steps to ensure that the funder will keep  
273 all information it receives confidential such as by entering into a confidentiality agreement  
274 and/or marking documents appropriately will decrease the risk that a court will find that work  
275 product is waived. Such steps are therefore consistent with Lawyer’s ethical duty to safeguard  
276 confidential information. However, particularly because case law is still developing, Lawyer  
277 should also inform Client of the risks of waiver and obtain the Client’s consent. See Rule 1.6(a)  
278 (lawyer may not reveal client confidences without informed written consent in this context).

279 Under Scenario 2, Lawyer communicates frequently with the Funder about the case. Lawyer has  
280 an obligation to consider whether such communications may be discoverable, advise Client as  
281 to any risk of discoverability, take steps necessary to minimize the risk and ensure that the  
282 Client consents to disclosure. The few courts that have considered whether involving a funder  
283 in attorney-client privileged communications waives the privilege have split on the issue. Some  
284 courts, for example, have accepted the argument that such communications are protected from  
285 waiver by the common interest exception because the funder and client share a common legal  
286 goal.<sup>8/</sup>

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<sup>7/</sup> See, e.g., *Miller UK Ltd. v. Caterpillar, Inc.* (N.D. Ill. 2014) 17 F.Supp.3d 711, 738 (holding that sharing with funder did not waive work product because disclosure did not substantially increase the likelihood that an adversary would obtain the materials where claimant had oral and written confidentiality agreements with prospective and actual funders); but see *Leader Technologies, Inc. v. Facebook, Inc.* (D. Del. 2010) 719 F.Supp.2d 373, 376-77 (work product protection waived by sharing with funder). See also DeStefano, *Claim Funders and Commercial Claim Holders: A Common Interest or a Common Problem?* (2014) 63 DePaul L.Rev. 305 (favoring common interest attorney-client privilege and work product protection for collaborative work and communications between funders and claim holders); Giesel, *Alternative Litigation Finance and the Work-Product Doctrine* (2012) 47 Wake Forest L.Rev. 1083 (concluding that the involvement of alternative litigation financing entities in litigation should not affect work product privilege and materials evaluating litigation should enjoy protection).

<sup>8/</sup> Compare *In re International Oil Trading Co., LLC* (S.D. Fl. 2016) 548 B.R. 825 [62 Bankr.Ct.Dec. 145] (communications between funder, claimant and counsel protected by the attorney client privilege and the common interest exception to waiver as well as agency exception) with *Miller UK Ltd. v. Caterpillar, Inc.* (N.D. Ill. 2014) 17 F.Supp.3d 711, 738 (a client’s relationship to a litigation funder was merely “a shared rooting interest in the ‘successful outcome of a case’” and thus “not a common legal interest”).

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287 Finally, throughout the litigation, Lawyer must not allow the relationship with Funder to impair  
288 Lawyer's objectivity and loyalty to Client. Lawyer must remain cognizant that the company is  
289 the Client, not the Funder.

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## CONCLUSION

291 Opportunities exist to contract with litigation funders. Attorneys who represent clients that  
292 consider or take these opportunities must be cognizant of ethical considerations that are  
293 implicated. The lawyer is obliged to provide independent judgment not shaded by any third  
294 party with an interest in the outcome of the litigation. The lawyer must ensure competence in  
295 advising on litigation funding including staying abreast of relevant law, such as whether  
296 disclosures to funders waive any evidentiary protections. The lawyer must obtain the client's  
297 informed consent before providing any client confidential information.

298