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**THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
FORMAL OPINION INTERIM NO. 14-0002
ALTERNATIVE LITIGATION FUNDING**

ISSUES: What ethical obligations arise when an attorney represents a client whose case is being funded by a litigation funder?

DIGEST: Two types of third party litigation funding have emerged over the last 20 or so years: consumer litigation funding, which provides funds to a plaintiff with personal injury claims typically for personal use rather than to fund their case, and commercial litigation funding, which typically involves advancing significant amounts to the plaintiff to pay litigation expenses or otherwise. [insert footnote: Within commercial funding, there are also arrangements by which the lawyer or law firm is funded rather than the client, often in the form of portfolio funding for a group of cases. The discussion in this opinion is limited to the ethical issues that arise in funding arrangements where the funder provides funds directly to the client.] Both types of funding are non-recourse, meaning that if the plaintiff does not recover money in settlement or judgment, nothing is owed to the funder. This opinion addresses the ethical issues that arise for lawyers whose clients enter into such funding arrangements. The principal ethical issues are maintaining independent judgment and complying with the lawyer's duty of confidentiality. While there is nothing unethical about a lawyer in good faith recommending that a client consider litigation funding, if the lawyer has a material interest in the client obtaining funding, the lawyer must disclose that interest and seek the client's informed written consent prior to advising on the subject. In commercial funding arrangements, the funding agreement will likely be negotiated. If the client asks the lawyer to represent him or her in such negotiations, the lawyer should consider whether he has the experience or learning required as well as whether the lawyer has any personal interest that creature a conflict. If there are, the lawyer must address those through communication and informed consent. If the funder seeks client confidential information, the lawyer must advise the client of the risks of disclosure, obtain the client's consent to disclose confidential information

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and take available steps to limit the risks to the client that the disclosure will effect a waiver of attorney-client privilege or work product protection.

AUTHORITIES

INTERPRETED: Rules 1.1, 1.4, 1.6, 1.7(b), and 1.8.6 of the Rules of Professional Conduct of the State Bar of California.^{1/}

STATEMENT OF FACTS

Scenario #1: Lawyer represents client with personal injury claim who is in need of money for living expenses. Lawyer advises client that she may qualify for litigation funding and provides client with a list of funders that lawyer's clients have used. The Funder has an arrangement by which it pays the attorney \$5,000 for each referral. At client's request, attorney reviews the agreement and explains its terms carefully, emphasizing that the interest rate on the loan is high and that there is also a large administrative fee and that the client might be able to get a bank loan at lower rates. Despite this advice, the client enters into the funding agreement.

Scenario #2: Client, a company asserting a patent claim, is interested in litigation funding to avoid tying up its cash in legal fees. Lawyer has extensive experience with third party funding and recommends a Funder with which the firm has worked previously. Funder asks for a memo assessing the strengths of Client's case. Lawyer tells Funder that it will seek Client's consent. Lawyer advises client there is some modest risk that sharing the memo could waive applicable privileges, that the risk is lessened if the information is communicated under a non-disclosure agreement and that Client must also consider that the Funder will probably not fund without receiving Lawyer's assessment of the strength of the claims. Client considers the advice and authorizes Lawyer to share the memo. Because of prior good experience with Lawyer, Funder agrees to fund Client's case. Lawyer is able to negotiate a better than standard deal for client because of its relationship with the Funder. Under the terms of the deal, Funder funds a portion of Lawyer's fees (the Lawyer is on a partial contingency) and pays litigation expenses. The Funder has the right to cease funding if it disagrees with the direction of the litigation. Funding agreement also gives Funder the right to review and approve any change in counsel, which approval will not be unreasonably withheld. Over the course of the litigation, Funder's employees, who have JD's and are former litigators, communicate regularly with Lawyer. Client's management does not actively participate in the litigation, instead leaving the case to its counsel to handle, because they are busy running their business.

INTRODUCTION: LITIGATION FUNDING AND ITS ANTECEDANTS

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

^{1/} 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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The type of third party litigation funding addressed by this opinion are relatively recent development in the United States, although more common and accepted elsewhere.² The ethics and social utility of this type of litigation funding is 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.³ Others argue that permitting litigation funding in the United States promotes access to justice and/or diversifies thinking about litigation.⁴

Other arrangements by which an individual or entity other than the client shoulders the expense of legal fees—such as contingency fee arrangements and liability insurance—are well established in the United States, however. These arrangements also present ethical issues. For example, in a contingency fee arrangement, the lawyer has a personal financial interest in the outcome of the case that could lead to a conflict of interest between the lawyer and client. Because such arrangements are perceived to serve an important policy function—providing access to the legal system to those without substantial resources to pursue a claim—they have been authorized and widely accepted. COPRAC 1987-94 (“[I]n California, our Legislature has decreed that contingency fee agreements, which otherwise involve inherent conflicts of interests (as arguably do other forms of attorney compensation) are exempt from the effect of conflict of interest rules because of public policy.”). Similarly, the duties of confidentiality and loyalty to a client may conflict with the obligation to report significant developments to a third-party liability insurer under the so-called “tripartite relationship.” An example: when an attorney learns facts in confidence that s/he believes may negatively affect an insured client’s eligibility for coverage. Even in a tripartite relationship, a lawyer may not take action detrimental to the interests of the client, which includes the disclosure of information detrimental to a client’s interests. (See, e.g., *Purdy v Pacific Auto Ins. Co.* (1984) 157 Cal.App.3d 59, 76; *Gafcon Inc. v. Ponsor & Assoc.* (2002) 98 Cal.app.4th 1388, 1411-1412.)

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 third party funding.

ANALYSIS

Legality

In some states, agreements between a litigant and a stranger to the litigation by which the stranger pursues or assists in pursuing the litigant’s claim and in return receives part of any

² Add cites re UK and Australia funding

³ See e.g. *Betting on the Client: Alternative Litigation Funding Is An Ethically Risky Proposition for Attorneys and Clients*, 49 U.S.F. L. Rev. 237. ADD CITES

⁴ See e.g. *Whose Claim Is This Anyway? Third Party Litigation Funding*, 95 Minn. L. Rev 1268 (April 2011) (hereafter *Whose Claim*); *Nonlawyers Influencing Lawyers: Too Many Cooks in the Kitchen or Stone Soup*, 80 Fordham L. Rev. 2791;

recovery are prohibited under laws against champerty and maintenance, legal doctrines dating from the Medieval England that developed to prevent feudal lords from financing other individuals' legal claims against the wealthy financier's political or personal enemies. *See Charge Injection Tech. v. DuPont*, 2016 WL 937400 *4 (Del. Sup. Ct. March 9, 2016) (finding that litigation funding contract did not violate Delaware's common law prohibition on champerty because the funder did not exercise control over litigation); *Malowski v. Prospect Funding Partners LLC*, 2017 WL 562532 (Ct of App. Minn. February 13, 2017) (finding that litigation funding agreement was prohibited by Minnesota law against champerty agreements). California has never recognized prohibitions against champerty or its variants. *See, In re Cohen's Estate* (1944) 66 Cal.App.2d 450.⁵ Such laws should not be a barrier to a litigation funder enforcing a litigation funding contract in California.⁶

Duty of Competence, Duty to Advise and Duty to Communicate

A lawyer has a duty to provide competent representation. Rule 1.1 Competence includes possessing the necessary learning and skill required for the representation. Competence "requires an attorney to keep abreast of changes in the law and its practice". COPRAC 2015-193. The lawyer also has a duty to communicate with the client about the means by which to accomplish the client's objectives in the representation. Rule 1.4. To the extent the client's ability to accomplish its objectives depends on the client's ability to fund the litigation or fund the client's personal expenses while proceeding with the litigation, the lawyer's representation of the client may involve advising the client as to whether litigation funding would assist in accomplishing the client's goals. Such advice would likely need to include a discussion of the pros and cons of obtaining litigation funding and alternatives, if any.

Furthermore, a lawyer representing a client in a matter funded by a litigation funder has an obligation to understand how the funding agreement impacts the litigation and advise the client. If the client asks the lawyer to advise on or negotiate a litigation funding contract, the lawyer must either have the expertise to do so, obtain it, or decline to provide the requested advice regarding litigation funding. *See* Rule 1.1(c). But regardless of whether the attorney is advising her client on the funding contract, she must understand the how the terms of the funding agreement impact decisions in the litigation.

Independent Professional Judgment

Rule 1.7 prohibits a lawyer from representing a client if there is a significant risk that the representation will be materially limited by the lawyer's relationships with a third party or the lawyer's own interest without informed written consent. Rule 1.7 (b). In circumstances where an attorney has an existing relationship with a litigation funder or personal interest in the funding

⁵ An arrangement that gives a funder significant control over litigation strategy may implicate the lawyer's duty of independent judgment even if it would not run afoul of non-existent prohibitions on champerty or maintenance.

⁶ Because litigation funding is clearly legal in California, COPRAC does not address whether, in the hypothetical scenario that it were not legal, a lawyer would violate his or her ethical duties by representing a client who had entered into a litigation funding agreement.

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arrangement, the lawyer must consider whether such interest or relationship requires written disclosure to the client and client consent. Rule 1.7 (c) (2). Finally, when informed consent or written disclosure is required, the lawyer must also comply with Rule 1.7 (d), which requires, among other things, that the lawyer reasonably believe that he can provide competent and diligent representation notwithstanding the potential conflict or relationship.

Rule 1.8.6. prohibits a lawyer from entering into an agreement for or accepting compensation for representing a client from one other than the client unless the client gives informed written consent, the lawyer complies with the lawyer's duty of confidential *and* the payment arrangement will not interfere with the lawyer's independent professional judgment or with the lawyer client relationship. While the rule will not apply in a funding arrangement if the funder pays the client, it is nonetheless instructive. The rule recognizes that the source of the lawyer's payment is likely to have influence over the lawyer. Litigation funding, like a third party payor, introduces a third party with its own interests into the lawyer client relationship, posing risks to the lawyer's independent judgment and the relationship of confidence between the lawyer and client. The duty of loyalty and of independent judgment require the lawyer keep the client's interest paramount, particularly where those interests might depart from the interests of the funder.

The lawyer's independent judgment may also be impaired if the funding arrangement imposes limitations on the how the case is litigated. At a minimum, the lawyer has an obligation to advise the client about the impact of such limitations on the lawyer's representation. NYC Bar Assoc. Formal Op 2011-02 (client may "agree to permit a financing company to direct strategy or other aspects of a lawsuit" and that as long as the client consents, the lawyer is not prohibited from acceding to the funder's direction); ABA Formal Ethics Op. 01-421 (2001) (where lawyer represents insured and the insurer imposes limitations on the representation, lawyer must communicate limitations to the client early in the representation).

Some ethics committees have suggested that there could be circumstances in which a funding agreement imposes such limitations on the attorney's judgment that the lawyer might not be able to competently represent the client. ABA Commission on Ethics 20/20 Informational Report, 23; Ohio Sup. Ct. Ethics Op. 2012-3 (2012) (lawyer must ensure alternative litigation funding company providing nonrecourse loan to client "does not attempt to dictate the lawyer's representation of the client").

In the insurance context, the ABA has opined that a lawyer may not comply with restrictions imposed on the representation by the insurer that interfere with the lawyer's independent professional judgment in representing the insured. ABA Formal Ethics Op. 01-421 (2001) (lawyer hired by insurer to represent insureds may not comply with insurer's guidelines or directives relating to representation if these would "impair materially the lawyer's independent professional judgment").

The lawyer's duties are not dictated by the funding contract but by the lawyer's ethical duties. ABA Formal Op. 96-403 illustrates this principle in the context of an insurance agreement. The opinion considered the ethical obligations of an attorney retained by an insurer to represent the insured pursuant to a contract that gave the insured control over settlement within policy limits

where the client objects to the proposed settlement. The ABA opined that the lawyer could not settle against his client's wishes. Instead, the lawyer was obligated to discuss with the client, the client's legal rights, explain the consequences of rejecting the settlement and let the client decide. The contract between the client and a third party relating to the conduct of litigation may be a fact that impacts the advice the lawyer give his client, but does not alter the lawyer's ethical obligation to pursue the client's best interest. Id. ("Whatever the rights and duties of the insurer and insured under the insurance contract, that contract does not define the ethical responsibilities of the lawyer to his client."). See also Md. State Bar Assoc. Comm. On Ethics 00-45 (opining that where the client wishes to terminate a lawyer, the lawyer must abide by the client's wishes regardless of whether the client's terminating the lawyer is a breach in the funding agreement).

Protecting Confidential Information

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

Rule 1.6 prohibits a lawyer from sharing confidential information without the client's informed consent. A lawyer must obtain the client's informed consent before sharing confidential information with a funder. In order for the client's consent to be informed, the lawyer must inform the client about the risks such sharing may entail including the risk that its adversary may seek to compel communications between the funder and the client or lawyer and a court may hold that the sharing effected a waiver of otherwise available evidentiary privileges.⁷

Application to Hypothetical Scenarios

Scenario 1

In scenario one, a client with a personal injury claim enters into a funding agreement to pay his living expenses while his lawsuit is ongoing. The lawyer recommends that the client explore litigation funding but also, after reviewing the terms of the funding agreement, advises the client accurately about the downsides of the funding. The lawyer did not disclose to the client that he will receive a referral fee. Did the lawyer meet his ethical duties in each of these steps?

First, there is nothing unethical about the lawyer recommending a client consider litigation funding as long as there is no legal bar to the client entering into such a transaction. This Committee has previously opined that a lawyer may refer a client to a real estate broker to obtain

⁷ The Standing Order For All Judges of the Northern District of California, Contents of Joint Case Management Statement requires disclosure of any person or entity that is funding prosecution of a claim or counterclaim in a proposed class, collective or representative action.

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a loan to be used for legal fees. Formal Op. 2002-159. Similarly, a lawyer may ethically provide information and introductions to a litigation funder.

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

The next question is whether there is anything that will impair his ability to give the client independent advice that is solely in the client's best interest. The facts state that the Lawyer receives a \$5,000 payment from the Funder if the client enters into the agreement. Rule 1.7 requires the Lawyer to consider whether the Lawyer's personal interest in receiving a payment presents a significant risk that the Lawyer's advice to the client will be materially limited. There are probably payments that are small enough to not pose a risk that the advice on whether to enter into a funding agreement will be materially impaired. For example, the fact that a funder takes a lawyer out to lunch is unlikely to materially impair a lawyer's judgment. A substantial cash payment likely will create that significant risk, requiring the attorney to disclose the payment and to obtain the client's informed written consent.. This has the salutary effect that the client can evaluate the lawyer's advice in light of that information. See also COPRAC 1995-140 (payment to lawyer for referral to insurance agent must be disclosed per former Rule 3-310(B)(4) because lawyer has personal financial interest and lawyer must comply with Rule 3-3-300).

In addition to obtaining any required informed written consent or disclosure, Rule 1.7(d) requires that the Lawyer reasonably believe that the Lawyer can provide the client with diligent and competent representation notwithstanding the potential for conflict. In this scenario, the Lawyer must reasonably believe that such payment does not undermine his independent judgment in advising the client on whether to obtain funding. There is nothing in the fact pattern that suggests that the Lawyer improperly tried to influence the client to enter into a funding agreement--to the contrary, it appears that the Lawyer appropriately highlighted the negative consequences.

Scenario 2

In scenario 2, the Lawyer advises client on choice of funder and negotiates the funding contract on behalf of client. Did Lawyer have a conflict in providing these services? The facts state that the Lawyer has a preexisting relationship with Funder, that Funder will be partially pay the law firm's fees and that certain terms of the funding agreement are advantageous to the law firm. Under Rule 1.7, if any of those circumstances or their combination creates a significant risk that Lawyer's advice on the choice of funder or funding contract terms is materially limited by Lawyer's own interests, Lawyer is required to advise the client of the facts and seek the client's consent. *See also* Santa Clara Counsel Attys v. Woodside, 7 Cal. 4th 525, 546-47 (1994) (lawyer must evaluate whether the relationship creates a "situation in which [he or she] might compromise his or her representation in order to advance the attorney's own financial or personal

interests”). Even if Lawyer concludes that there is no conflict, Lawyer owes Client a duty to communicate material facts concerning the representation. Lawyer’s existing relationship with Funder is a material fact.

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

Impact on Attorney’s Duty of Confidentiality: According to the facts of Scenario 2, Lawyer shares a legal analysis memo with Funder after Funder signed an NDA and engaged in communications with Funder about the progress of the case. These activities implicate Lawyer’s ethical obligation to maintain the confidentiality of information learned in the course of the representation and Lawyer’s obligation to apply diligence, learning and skill to avoid adverse consequences such as a waiver of privileges and protections to which the clients is entitled.

Case law concerning whether funding agreements and communications with funders are privileged is still developing. Most but not all courts that have considered the question have held that work product does not lose its work product status because an attorney or client shares that work product with a funder.⁸ That is because work-product protection is only subject to waiver based on disclosure to a third party where the disclosure “substantially increase[es] the possibility that an opposing party will obtain the information.”) 2 Christopher B. Mueller & Laird C. Kirkpatrick, *Federal Evidence* § 5:38 (4th ed. 2016). Taking steps to ensure that the funder will keep all information it receives confidential such as by entering into a non-disclosure agreement, confidentiality agreement and/or marking documents appropriately will decrease the risk that a court will find that work product is waived. Such steps are therefore consistent with

⁸ See e.g. *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711, 738 (N.D. Ill. 2014) (rejecting claim of common interest exception to waiver of attorney-client privilege but 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); see also *Mondis Tech., Ltd. v. LG Elecs., Inc.*, 2011 WL 1714304 (E.D. Tex. May 4, 2011) (no waiver of work product protection for documents shared with potential investors subject to non-disclosure agreements). But see *Leader Tech. Inc. v. Facebook, Inc.*, 719 F. Supp. 2d 373, 376-77 (D. Del. 2010) (work product protection waived by sharing with funder). See also Michele DeStefano, [Claim Funders and Commercial Claim Holders: A Common Interest or a Common Problem?](#), 63 DEPAUL L. REV. 305 (2014) (favoring common interest attorney-client privilege and work product protection for collaborative work and communications between funders and claim holders); Grace M. Giesel, [Alternative Litigation Finance and the Work-Product Doctrine](#), 47 WAKE FOREST L. REV. 1083 (2012) (concluding that the involvement of alternative litigation financing entities in litigation should not affect work product privilege and that materials evaluating litigation should enjoy protection).

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the lawyer's ethical duty to safeguard confidential information. However, particularly because case law still developing, Lawyer should also inform the client of the risks of waiver and obtain the Client's consent.

Under scenario 2, Lawyer communicates frequently with the Funder about the case. Lawyer has an obligation to consider whether such communications may be discoverable, advise Client as to any risk of discoverability, take steps necessary to minimize the risk and ensure that the client consents to disclosure. The few courts that have considered whether involving a funder in attorney-client privileged communications waives the privilege have split on the issue. Some courts have accepted the argument that such communications are protected from waiver by the common interest exception because the funder and client share a common legal goal.⁹ Finally, though out the litigation, Lawyer must not allow the relationship with Funder to impair Lawyer's objectivity and loyalty to Client. The fact pattern notes that Funder is in frequent contact with Lawyer whereas the Client is busy running its business. Lawyer must remain cognizant that the company is the client, not Funder.

CONCLUSION

Those with small individual claims and those with larger commercial claims have opportunities to contract with litigation funders either to address non-litigation driven financial needs and/or costs of litigation. Attorney who represent clients that consider or take these opportunities must be cognizant of ethical considerations that are implicated. The lawyer is obliged to provide independent judgment not shaded by any conflicting interests of a third party with an interest in the outcome of the litigation. The lawyer must ensure competence in advising on litigation funding including staying abreast of relevant law such as whether disclosures to funders waive any protections. The lawyer must obtain the client's informed consent before providing any client confidential information.

⁹ Compare *In re International Oil Trading Co., LLC*, 548 B.R. 825 (Bankr. SD Fal., 2016) (communications between funder, claimant and counsel protected by the attorney client privilege and the common interest exception to waiver as well as agency exception); *Devon It Inc., v. IBM Corp.* 2012 WL 4748160 (E.D. Pa) (attorney-client communications protected under the "common-interest" doctrine, which protects communications between parties with a shared common interest in litigation strategy); *Walker Digital, LLC v. Google, Inc.* (D. Del., Feb. 12, 2013, CV 11-309-SLR) 2013 WL 9600775, at *1 (finding that plaintiff and the funder shared a common interest, and both attorney-client privileged communications and work product applied to documents disclosed to the funder) with *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711, 738 (N.D. Ill. 2014) (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"); *Leader Tech. Inc. v. Facebook, Inc.*, 719 F. Supp. 2d 373, 376-77 (D. Del. 2010) (magistrate's order finding that common interest exception inapplicable "not clearly erroneous").