

Draft # 6, Submitted for June 7, 2019 Meeting

*Bomse
Deitz
Bundy
Fields
Dilworth

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 a lawyer 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. Both types of funding are non-recourse. 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. 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 create 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 informed consent to disclose confidential information and take appropriate steps to limit the risks to the client that the disclosure will effect a waiver of attorney-client privilege or work product protection such as having the funder sign a non-disclosure agreement, taking other steps to maintain the confidentiality of the shared materials, appropriate labeling of shared materials.¹

¹ 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

44
45
46 **AUTHORITIES**

47 **INTERPRETED:** Rules 1.1, 1.4, 1.6, 1.7(b), and 1.8.6 of the Rules of Professional Conduct
48 of the State Bar of California.^{2/}
49
50

51 **STATEMENT OF FACTS**
52

53 Scenario #1: Lawyer represents Client with personal injury claim who is in need of money for
54 living expenses. Lawyer advises Client that she may qualify for litigation funding and provides
55 client with a list of funders that Lawyer's clients have used. The funder has an arrangement by
56 which it pays the attorney \$500 for each referral. At Client's request, Lawyer reviews the
57 agreement and explains its terms carefully, emphasizing that the interest rate on the loan is high
58 and that there is also a large administrative fee and that the client might be able to get a bank
59 loan at a lower rate. Despite this advice, Client enters into the funding agreement.
60

61 Scenario #2: Client, a company asserting a patent claim, is interested in litigation funding to
62 avoid tying up its cash in legal fees. Lawyer has extensive experience with third party funding
63 and recommends a funder with which the firm has worked previously. Funder asks for a memo
64 assessing the strengths of Client's case. Lawyer tells funder that it will seek Client's consent.
65 Lawyer advises Client there is some modest risk that sharing the memo could waive applicable
66 privileges, that the risk is lessened if the information is communicated under a non-disclosure
67 agreement ("NDA") and that Client must also consider that the funder will probably not fund
68 without receiving Lawyer's assessment of the strength of the claims. Client considers the advice
69 and authorizes Lawyer to share the memo. Because of prior good experience with Lawyer,
70 Funder agrees to fund Client's case. Lawyer is able to negotiate a better than standard deal for
71 client because of its relationship with the funder. Under the terms of the deal, funder funds a
72 portion of Lawyer's fees (the Lawyer is on a partial contingency) and pays litigation expenses.
73 The funder has the right to cease funding if it disagrees with the direction of the litigation. The
74 funding agreement also gives funder the right to review and approve any change in counsel,
75 which approval will not be unreasonably withheld. Over the course of the litigation, funder's
76 employees communicate regularly with Lawyer. Client does not actively participate in the
77 litigation, instead leaving the case to its counsel to handle, because Client is busy running its
78 business.
79
80

81 **INTRODUCTION: LITIGATION FUNDING AND ITS ANTECEDANTS**
82

83 In this opinion, we consider the ethical issues an attorney may face when representing a client
84 that has entered into a contract with a litigation funder. Litigation funding is the practice where a

discussion in this opinion is limited to the ethical issues that arise in funding arrangements where
the funder provides funds directly to the client.

^{2/} 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.

85 third party unrelated to the lawsuit provides funds to a plaintiff involved in the litigation in return
86 for a portion of any financial recovery.

87
88 The type of third party litigation funding addressed by this opinion is a relatively recent
89 development in the United States, although more common and accepted elsewhere.³ The ethics
90 and social utility of this type of litigation funding is the subject of debate. Some have raised
91 concerns that litigation funding will lead to frivolous lawsuits or that vulnerable clients may be
92 forced to accept unfair deals.⁴ Others argue that permitting litigation funding in the United
93 States promotes access to justice and/or diversifies thinking about litigation.⁵

94
95 Other arrangements by which an individual or entity other than the client shoulders the expense
96 of legal fees—such as contingency fee arrangements and liability insurance—are well
97 established in the United States, however. These arrangements also present ethical issues. For
98 example, in a contingency fee arrangement, the lawyer has a personal financial interest in the
99 outcome of the case that could lead to a conflict of interest between the lawyer and client.
100 Because such arrangements are perceived to serve an important policy function—providing
101 access to the legal system to those without substantial resources to pursue a claim—they have
102 been authorized and widely accepted. COPRAC 1987-94 (“[I]n California, our Legislature has
103 decreed that contingency fee agreements, which otherwise involve inherent conflicts of interests
104 (as arguably do other forms of attorney compensation) are exempt from the effect of conflict of
105 interest rules because of public policy.”).

106
107 Similarly, the duties of confidentiality and loyalty to a client may conflict with the obligation to
108 report significant developments to a third-party liability insurer under the so-called “tripartite
109 relationship.” An example: when an attorney learns facts in confidence that the attorney believes
110 may negatively affect an insured client’s eligibility for coverage. Even in a tripartite relationship,
111 a lawyer may not take action detrimental to the interests of the client, which includes the
112 disclosure of information detrimental to a client’s interests. (See, e.g., *Purdy v Pacific Auto Ins.*
113 *Co.* (1984) 157 Cal.App.3d 59, 76; *Gafcon Inc. v. Ponsor & Assoc.* (2002) 98 Cal.app.4th 1388,
114 1411-1412.)

115
116 The purpose of this opinion is not to enter the normative debate about litigation funding but
117 rather to provide guidance to attorneys as to the ethical issues that arise when dealing with third
118 party funding.

119
120

³ Third-Party Litigation Funding in Australia and Europe, 8 J.L. Econ. & Pol’y 451(2012)

⁴ See e.g. *Betting on the Client: Alternative Litigaiton Funding Is An Ethically Risky Proposition for Attorneys and Clients*, 49 U.S.F. L. Rev. 237. ADD CITES

⁵ 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;

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 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 450.⁶ Such laws should not be a barrier to a litigation funder enforcing a litigation funding contract in California.

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

⁶ 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.

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). Moreover, when informed consent 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 reflects the recognition 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 be vigilant in keeping 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. 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. This opinion stands for the proposition that 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 it 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. In order for the client's consent to be informed, the lawyer must inform the client about the "material risks, including any actual and reasonably foreseeable adverse consequences" sharing privileged communications or work product 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, Client with a personal injury claim entered into a funding agreement to pay his living expenses while his lawsuit is ongoing. Lawyer recommended that Client explore litigation funding but also, after reviewing the terms of the funding agreement, advises Client accurately about the downsides of the funding including that Client might be able to get a bank loan at a lower rate. Lawyer did not disclose to Client that Lawyer will receive a \$500 referral fee. Did Lawyer meet his ethical duties in each of these steps?

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

First, there is nothing unethical about a 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 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 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 Lawyer 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 facts state that Lawyer receives a \$500 payment from the funder if Client enters into the agreement. Lawyer thus has a personal interest in Client entering into the funding agreement that presents a significant risk that Lawyer's ability to provide independent advice to Client will be materially limited. Accordingly, Lawyer must comply with Rule 1.7(b). Lawyer must disclose to referral fee to Client (i.e. the relevant circumstances) and all material risks including the fact that Lawyer's personal interest in receiving the fee may interfere with Lawyer's ability to provide independent advice to Client. Furthermore, in providing this information to Client, the Lawyer must explain the matter to the extent reasonably necessary to permit Client to make an informed decision. Rule 1.4(b).⁸

In addition to obtaining informed written consent, Rule 1.7(d) requires that Lawyer reasonably believe that Lawyer can provide Client with diligent and competent representation notwithstanding the 1.7(b) conflict. In this scenario, Lawyer must reasonably believe that the fee from the funder 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 Lawyer improperly tried to influence the client to enter into a funding agreement--to the contrary, it appears that Lawyer appropriately highlighted the negative consequences.

Scenario 2

In scenario 2, Lawyer advises Client on choice of funder and negotiates the funding contract on behalf of client. Does 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 paying the law

⁸ In a prior opinion, this Committee concluded that receiving a referral fee from an insurance agent for referring the client constituted a business transaction with a client requiring the lawyer to comply with Rule 1.8.1 (formerly 3-300). COPRAC 1995-140. Here, the Committee concludes that compliance with Rule 1.7(b) provides sufficient protection for the client. The Committee notes that when its prior opinion was written, the then-current Rules of Professional Conduct would have only required that the lawyer disclose a financial relationship with a third party. Under those circumstances, requiring compliance with Rule 3-300 was the only way to ensure that the lawyer provide a fulsome disclosure to the client.

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"). In addition, 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 a client about a 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 a lawyer to get paid its fees. On the other hand, if a 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. Lawyer also engages 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.⁹ That is because work-product protection is only subject to waiver

⁹ 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).

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 NDA, 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 Lawyer’s ethical duty to safeguard confidential information. However, particularly because case law still developing, Lawyer should also inform 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.¹⁰

Finally, throughout 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

Opportunities exist to contract with litigation funders. Attorneys 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

¹⁰ Compare *In re International Oil Trading Co., LLC*, 548 B.R. 825 (Bankr. SD Cal., 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”).

348 law such as whether disclosures to funders waive any protections. The lawyer must obtain the
349 client's informed written consent before providing any client confidential information.
350