Financing Litigation: A Lawyer's Duties When a Client Seeks Financial Assistance

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Introduction

Attorneys often face questions about whether and how they may financially assist a client while a client's case is pending or contemplated. These questions may involve: (1) whether a lawyer may loan a client money for living expenses during the representation; (2) whether a lawyer may borrow money from a bank to advance litigation expenses on behalf of a client; and (3) whether a lawyer may refer a client to a third-party financing company to obtain financial assistance to cover living expenses or the lawyer's fees and litigation expenses.

The circumstances that give rise to the question are usually compelling. For example, in contingency fee matters, a client may have a strong case resulting from an accident in which the client was seriously injured. The client, however, may be behind on their bills and in financial distress because of the injuries. Without financial assistance, the client may feel pressured to settle for short money, and the lawyer may be inclined to loan the client money with the expectation that the lawyer will be paid back out of the judgment. Similarly, a client experiencing financial distress may seek an advance from a lawyer after the case has settled but issuance of the insurer's check is temporarily delayed. Additionally, clients may seek advice from lawyers about obtaining financial assistance from third parties to help them pay the lawyer's fees, litigation expenses, or even the client's living expenses during the pendency of the case.

Rule 1.8(e): A Lawyer May Not Give or Loan Money to a Client

Regardless of the compelling nature of the client's situation any lawyer who advances funds to a client for anything other than court costs and expenses of litigation violates Mass. R. Prof. C. 1.8(e). This prohibition is absolute; it leaves no wiggle room. Mass. R. Prof. C. 1.8(e) provides as follows:

> A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:
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> (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.

As noted in Comment 10 to Rule 1.8, there are two primary rationales for the existence of this rule. First, if an attorney provides financial assistance to a client it might encourage a client to pursue lawsuits that have dubious merit. Additionally, an attorney providing such financial assistance would have a financial stake in the litigation that could affect the attorney's judgment

and a conflict of interest may arise. Even when the lawyer's judgment has not been compromised, it is likely a client will be very unhappy if he or she receives little or no additional money from the settlement after the lawyer deducts the funds advanced. *See Private Reprimand No. 87-15 and 87-16*, 5 Mass. Att'y Disc. R 503 (1987) (lawyers' advances totaled over $9,400 on a case that settled for $12,000).

In recent years, the Board of Bar Overseers has disciplined lawyers for violating Rule 1.8(e) in various circumstances. In *Admonition No. 18-35*, an attorney represented a client in a partition action in which the co-owner of the property sought to partition the property and the client wanted to buy it. The Land Court ordered that the property be sold, and the net proceeds held in escrow for later distribution to the parties. The lawyer loaned his client some of the money he needed to purchase the property expecting to be paid back when the client received his portion of the equity that would later be divided between the client and the co-owner in the partition action. He received an admonition for violating Rule 1.8(e) with a requirement that he attend a CLE course on ethics. In *Admonition 09-16*, a lawyer represented a client in a personal injury matter. He made several loans to the client for living expenses to be paid back out of the client's settlement award. While the Board recognized that the lawyer made the loans out of concern for the client's well-being, the lawyer was admonished for violating Rule 1.8(e). *See also Admonition 06-28* (attorney in landlord-tenant action loaned client money to obtain an apartment).

In addition to ethical implications, providing financial assistance to clients can be a very costly mistake for a lawyer. For example, in *Admonition 06-12,* an attorney representing a client in a civil matter co-signed with his client's wife a $50,000 loan to post bail in the client's unrelated criminal matter. After the client defaulted on his court appearance, the bail was forfeited, his wife defaulted on the loan, and the client then refused to repay the loan money to the lawyer. The lawyer ended up repaying the entire loan, with interest, from his personal funds, and received an admonition for violating Rule 1.18(e).

As lawyers may advance litigation expenses on behalf of their clients, some lawyers may question whether it is ethical to take a loan out for that purpose. While there is no prohibition on doing so, lawyers should be mindful that they will be liable to pay back the loan even if the client does not obtain a favorable judgment. Lawyer's must, therefore, consider whether their liability on the loan could compromise their independent professional judgment in pursuing the case. Further, a lawyer may obtain the loan only after full consultation with the client. *See MBA Advisory Opinion No.* 83-7.

A Lawyer Should Proceed with Caution in Referring a Client to Third-Party Financers

Given Rule 1.8(e)'s prohibition on lawyers lending money to their clients, lawyers may consider referring clients to financial assistance companies for help paying for living expenses, a lawyer's fee, and litigation expenses. The American Bar Association describes third-party or alternative litigation funders as "individuals or organizations that provide capital used to support litigation-related activities, or to support clients' ordinary living expenses during the pendency of

litigation."[1] Third-party litigation funding has become more common in recent years, as it may increase access to justice for clients who are financially unable to pay the costs of pursuing legal action. When considering these arrangements, however, a lawyer must carefully consider the relevant ethical obligations.

ABA Formal Opinion 484 addresses traditional loan financing where a client may obtain a loan that the client would have to pay back regardless of the outcome of the case.[2] Some state ethics committees have addressed other arrangements such as "non-recourse loans" or alternative financing arrangements where a litigant obtains funding in exchange for a percentage of the judgment the client receives.[3] In some of the alternative arrangements the financer pays the litigant who, in turn, pays the legal fees and litigation expenses to the lawyer. In other arrangements, the financer pays the lawyer's bills directly. The ethical considerations relating to traditional and alternative arrangements are similar. In considering whether to refer clients to sources of financial assistance in connection with litigation, a lawyer must be sure to comply with several applicable rules of professional conduct, as described below.

A lawyer referring a client to a third-party financer must explain the arrangement such that the client can make an informed decision about the representation as required by Mass. R. Prof. C. 1.4(b). For example, the lawyer must explain their relationship with the finance company or broker, including any fees flowing between the two. The lawyer needs to explain how the lawyer's fees are to be paid under the arrangement (i.e. will the finance company pay the lawyer directly or will it disburse the money to the client to pay the lawyer?). Regardless of who pays the lawyer, the lawyer should counsel the client of the benefits and risks of third-party funding, including the risk that the client may receive less of the award or settlement in the case than expected because the litigation funder must be paid back first. As applicable, the lawyer should ensure the client understands all the terms including whether the loan company will provide information to the lawyer and whether the lawyer will charge any additional fees. Further, the lawyer should warn the client that a third-party financing arrangement may affect the

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[1] ABA Commission on Ethics 20/20 White Paper on Alternative Litigation Financing, Available at: https://www.americanbar.org/groups/professional_responsibility/committees_commissions/standingcommitteeonprofessionalism2/resources/ethics2020hompeage/

[2] *A Lawyer's Obligations When Clients Use Companies or Brokers to Finance the Lawyer's Fee,* American Bar Association, Formal Opinion 484, November 27, 2019.

[3] *See, e.g.*, Illinois State Bar Association, Opinion No. 19-02, April 2019, Available At: https://www.isba.org/ethics/byyear; The State Bar of California Standing Committee on Professional Responsibility and Conduct, Professional Opinion Interim No. 14-0002, *Litigation Third-Party Funding*, Available at: http://www.calbar.ca.gov/About-Us/Our-Mission/Protecting-the-Public/Public-Comment/Public-Comment-Archives/2019-Public-Comment/Proposed-Formal-Opinion-Interim-No-14-0002-Alternative-Litigation-Funding; *Alternative Litigation Funding*; The Association of The Bar Of The City Of New York Committee on Professional Ethics, Formal Opinion 2011-2, Available at: https://www.nycbar.org/member-and-career-services/committees/reports-listing/reports/detail/formal-opinion-2011-2-third-party-litigation-financing; *Third-Party Litigation Financing*; Florida Bar Ethics Opinion 00-3 March 15, 2002 (surveying other jurisdictions pronouncements), Available at: https://www.floridabar.org/etopinions/etopinion-00-3/

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client's rights and available remedies with respect to recouping legal fees in a future dispute with the lawyer. While the specifics will depend on the terms of the alternative financing arrangement, the client must at least be aware that future disputes relating to fees will involve the terms of both the lawyer's fee agreement and the contract with the financer, and that the financer may have rights and remedies as well.

If a lawyer is to receive the fee directly from a third-party financer, the lawyer must obtain the client's informed consent, ensure there is no interference with the lawyer's professional judgment, and protect confidentiality, as required by Rule 1.8(f). Regardless of who provides the payment to the lawyer the lawyer cannot allow the lender to interfere in the professional judgment of the lawyer pursuant to Mass. R. Prof. C. 1.8(f) and 5.4(c). Nor can the lawyer permit the financer to interfere with the client's choice to accept or reject a settlement under Rule 1.2(a).

Additionally, if the lawyer refers a client to a company or loan arrangement in which the lawyer has a financial interest, the lawyer is entering into a business transaction with the client and must comply with the requirements of Mass. R. Prof. C. 1.8(a). Pursuant to Rule 1.8(a) lawyers must disclose their relationship and explain their role in the transaction including whether the lawyer is representing the client in the transaction with the lender; the lawyer must ensure that the terms of the arrangement are disclosed in writing to the client and are fair and reasonable to the client; and the lawyer must advise the client, in writing, of the desirability of seeking independent counsel before agreeing to the transaction. The lawyer must also obtain informed consent in writing signed by the client.

A lawyer may not be able to enter into an agreement with a litigation financier under which the lawyer's future payments to the financer are contingent upon the lawyer's legal fees, as this may violate Rule 5.4(a)'s prohibition on splitting fees with non-lawyers.[4] This would arise in a situation in which the financer pays the lawyer directly and requires the lawyer to repay the lender (rather than the client repaying the lender).

The lawyer must also comply with Mass. R. Prof. C. 1.6(a) with respect to protecting confidential client information. Confidentiality and privilege are significant concerns in these arrangements as a third-party financer (especially in non-recourse arrangements) may ask the lawyer for information on the value of the case, the likelihood of success, or even periodic status updates. If the lawyer intends to share any information with the financing company, the lawyer must obtain the client's informed consent. The lawyer must also counsel the client on whether sharing information with the financing company will result in a waiver of attorney-client privilege. Attorney-client privilege is a legal issue (as opposed to an ethical issue) and courts have ruled that clients waived privilege when they shared information about their case with a

[4] The Association of The Bar of The City Of New York Committee on Professional Ethics, Formal Opinion 2018-5: Litigation Funders Contingent interest in Legal Fees. Available at: https://www.nycbar.org/member-and-career-services/committees/reports-listing/reports/detail/formal-opinion-2018-5-litigation-funders-contingent-interest-in-legal-fees

litigation financing company.[5] Similarly, the attorney must ensure the arrangement does not pose a conflict of interest under Mass. R. Prof. C. 1.7(a)(2). For example, a conflict issue may arise if a lawyer offers the lender an opinion regarding the value of the case, given that the lawyer has a financial interest in the client obtaining financing.

As always, a lawyer must ensure the legal fee is reasonable pursuant to Mass. R. Prof. C. 1.5(a) and that that the basis of the fee and scope of representation are provided in writing pursuant to Rule 1.5(b). The Supreme Judicial Court noted in *Saladini v. Righellis*, 436 Mass. 231 (1997), "if an agreement to finance a lawsuit is challenged, we will consider whether the fees charged are excessive or whether any recovery by a prevailing party is vitiated because of some impermissible overreaching by the financier."

Finally, a lawyer must also be mindful of Mass. R. Prof. C. 1.2(c). If a lawyer does not want to advise the client on these financing arrangements but wants to suggest that a client consider litigation financing providers or arrangements, that lawyer must carefully limit the scope of representation under Rule 1.2(c). The lawyer should make clear that the scope of the representation does not include advising or representing the client in obtaining litigation financing. Otherwise, a client may enter a financing arrangement, at the lawyer's suggestion, believing that their lawyer has determined that doing so is in the client's interest.

Conclusion

As there will always be clients in financial need, these issues are a recurring ethical concern for lawyers. For the protection of clients, for the integrity of the bar, and to avoid entanglements with the bar discipline process, attorneys are urged to educate themselves on the requirements of Rule 1.8(e) prohibiting lawyers from lending money to clients. With respect to third-party funding arrangements, ABA Formal Opinion 484 notes, a lawyer should never recommend a finance company or broker to the client if the financing is not in the client's interests simply because the financing best assures payment or timely payment of the lawyer's fee.

[5] Langford, Carol (2015) "Betting on the Client: Alternative Litigation Funding is an Ethically Risky Proposition for Attorneys and Clients," *University of San Francisco Law Review*: Vol. 49: Iss. 2 , Article 1.
Available at: https://repository.usfca.edu/usflawreview/vol49/iss2/1 (discussing *Leader Technologies, Inc. v. Facebook, Inc.* 719 F. Supp. 2d 373 (D. Del. 2010) (finding the privilege waived with regard to documents provided to the litigation funder and compelling production of those documents)