Is it Time to Permit Lawyers to Finance Health & Other Personal Expenses During Litigation

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I. Rule 1.8(e) in Kansas:

Rule 1.8(e):

A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:
(1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and
(2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

Comment:

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Lawyers may not subsidize lawsuits or administrative proceedings brought on behalf of their clients, including making or guaranteeing loans to their clients for living expenses, because to do so would encourage
clients to pursue lawsuits that might not otherwise be brought and because such assistance gives lawyers too great a financial stake in the litigation. These dangers do not warrant a prohibition on a lawyer lending a client court costs and litigation expenses, including the expenses of medical examination and the costs of obtaining and presenting evidence, because these advances are virtually indistinguishable from contingent fees and help ensure access to the courts. Similarly, an exception allowing lawyers representing indigent clients to pay court costs and litigation expenses regardless of whether these funds will be repaid is warranted.

The origin of Rule 1.8(e) lies in the politics of medieval England. At that time, lawyers were often hired by wealthy individuals to bring lawsuits against their enemies and, coupled with bribery and intimidation of judges,¹ thereby using the courts as a means of harassing rivals. In order to prevent such lawsuits the crimes of champerty, barratry, and maintenance were developed:

Maintenance, champerty and barratry are closely related but are not identical. “[P]ut simply, maintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome; and barratry is a continuing practice of maintenance or champerty.” Osprey, Inc. v. Cabana Ltd. P’ship, 532 S.E.2d 269, 273 (S.C. 2000) (quoting In re Primus, 436 U.S. 412, 424 n.15 (1978)).²

In effect, these common law doctrines were designed to prevent what we now call abuse of process and frivolous lawsuits by restricting the right to bring a suit to the true parties

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² Id. at 10.
in action and prohibiting the assignment of law suits to those who were otherwise “strangers” to the action. Initially, as well, these prohibitions were applied both to members of the Bar and to non-lawyers. The continuing distaste for unnecessary and frivolous litigation has been a perennial issue for the Bar and Bar leaders have spoken out against such activities for centuries. Abraham Lincoln, for instance, stated:

"Discourage litigation. Persuade your neighbors to compromise whenever you can. Point out to them how the nominal winner is often a real loser---in fees, expenses, and waste of time. As a peacemaker the lawyer has a superior opportunity of being a good man. There will still be business enough."\(^3\)

Interestingly, Rule 1.8(e) does not prohibit a lawyer from making any advances to a client. Instead, lawyers “may make or guarantee” loans to clients for “court costs and litigation expenses, including the expenses of medical examination and the costs of obtaining and presenting evidence...” The reasons for granting lawyers the right to make such advances are that they “are virtually indistinguishable from contingent fees and ensure access to the courts. Another exception is for “indigent clients” in regard to whom advances need not necessarily even be repaid.

The difficulty with the current Rule 1.8(e) from the perspective of individual clients, particularly those who are plaintiffs in tort litigation involving physical harm to the plaintiff, is that Rule 1.8(e) does not permit lawyers to make loans to cover medical expenses or living costs during the period before a case is finally resolved either by settlement or in court. This means that many clients who have suffered injuries requiring medical assistance and which preclude the client from working full-time will find that they are under substantial financial pressure to get a quick settlement to a case, even if such settlement is far less than they might otherwise receive if they had the time and resources to pursue their claims further. Many individuals in such a circumstance will simply opt to take the first settlement amount offered. To the degree this happens, such plaintiffs have, in effect, been denied free access to the courts. Further, these plaintiffs’ cases are often not really the type of frivolous cases that champerty and related doctrines targeted, although some might be.

I. The Litigation Financing Industry

As is often the case, when a potentially lucrative market opens up, an industry designed to serve the market quickly develops. This is precisely what has happened in the past few years as regards lending money to individual plaintiffs to assist them in pursuing their cases in court.\textsuperscript{4}

\textsuperscript{4} There has also been rapid growth in lenders who finance commercial litigation; see, for example, C. Langford, “Betting on the Client: Alternative Litigation Funding is an Ethically Risky Proposition for Attorneys and Clients,” U.S.F.L.Rev. (2105), pp. 237ff. at 237-238. I will not be discussing commercial litigation funding in this CLE presentation.
Indeed, there are now a sufficient number of litigation financing companies to have formed a trade group, the American Litigation Financing Association. Among the best known of the members is Oasis Financial and Lake Whillans. These and other litigation financial companies will provide funding for plaintiffs who cannot otherwise bring a meritorious suit [hereafter I will refer to such funding as “LF”].

Generally, these companies work within fairly standardized parameters. In most cases the financing will be on a non-recourse basis. Virtually every lender will require that a would-be borrower provide them with sufficient information so that they can assess the likelihood of success in the suit. Second, they generally require the buyer to waive any lawyer-client confidentiality so that the lawyer may provide them any information about the suit that the lender demands both before initiation of the loan and during the course of the suit. Some lenders will require that the borrower give them some degree of control over strategic decisions about the suit, up to an including settlement decisions. Often the lender will require that the borrower’s lawyer disburse the amount due to the lender immediately upon receiving proceeds from a settlement or court judgment. Often the lender will require an actual assignment of the borrower’s ownership interest in the litigation, although this can be legally problematic under the champerty doctrine, or, at the least, the lender will take a security

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5 www.americanlegalfin.com
6 www.oasisfinacial.com
7 www.Lakewhillans.com
9 See, below, Sec. III.A.
interest in the borrower’s future proceeds from the case. Virtually in every case the lender will require the borrower—and sometimes the borrower’s lawyer, to sign a written contract clearly delineating all of the requirements.

In almost all cases, the cost of litigation financing to the borrower will be, by most standards, excessive. Cases that have been litigated have involved onerous interest rates on a par with those charged by the most notorious “payday” loan companies. In many cases, the total amount the borrower must repay the lender will leave the borrower with little or no net proceeds from the suit after the borrower and the lawyer are paid.

II. **Legal Issues with Litigation Financing of Individual Plaintiffs**

During the past decades courts and commentators have raised a number of issues regarding litigation financing both in theory and practice. Among these issues are the applicability of champerty and maintenance prohibitory laws, usury laws, privilege and work product doctrine, and contract unconscionability.

A. **Champerty and Maintenance**
Although champerty and maintenance are medieval doctrines they still remain live issues in a number of states, including Kansas, and nationally. Fundamentally the issue of whether a litigation loan to an individual plaintiff will be considered to violate prohibitions against champerty and maintenance will depend upon such factors as the form of the loan, i.e. whether there is an actual assignment and whether the creditor has effective control of the litigation.

B. Usury

In states which retain usury laws, such as Kansas, if the litigation finance contract is deemed to be a loan for purposes of the application of usury laws, then it is quite possible that the financing arrangement may involve a usurious rate. According to Carol Langford interest rates “can vary from 2.5 to 15%, compounded monthly.” Such rates could easily violate usury laws. Although litigation finance companies attempt to structure their transactions so as to avoid characterization as loans, they are, at times, unsuccessful in this endeavor.

10 See, eg., American Law Institute, Restatement of the Law. Contracts. 2d (1979), Sec. 547; see also, In the Matter of the Protest of Lyerla, Kathy L. Living Trust for the Tax Year 2011 in Johnson County, Kansas, Docket No. 2012-3110-PR (2012). Nevertheless, it would appear that some companies are willing to make LF loans available in Kansas; see, http://presettlementfundings.com/pre-settlement-loans-kansas/.
11 See, Julia H. McLaughlin, “Litigation Funding: Charting a Legal and Ethical Cours4e,” Vt. L. Rev., v. 31, pp. 615ff. at 639-640; and, see, eg., Charge Injection Technologies, Inc. v. E.I. Dupont..., Superior Court of the State of Delaware, Docket Number N07C-12-134 JRJ (March 9, 2016).
12 For usury rates in Kansas see the Secretary of State’s website, http://www.kssos.org/pubs/pubs_finance_rates.html.
C. Evidentiary Issues: Privilege and Work Product Doctrine

In many litigation loan contracts, the lender requires that it be provided with detailed information both before making the loan and during the litigation process. Often the client who needs the loan will feel that she has no choice but to consent to the terms of the contract and either will provide the required information to the lender herself or will instruct her lawyer to do so. By sharing this information with a third-party lender both lawyer and client risk that they will have waived either privilege or work-product immunity.\textsuperscript{14}

D. Unconscionability

Even in jurisdictions which either do not have usury statutes or do not characterize a litigation funding transaction as a loan, there remains the possibility that excessively high returns to the litigation funding company may run into the contractual doctrine of unconscionability. In such a case, a court might well invalidate a funding agreement.

Although these and other potential legal problems with third party funding of individual plaintiffs’ lawsuits are primarily a concern for the funder, a lawyer representing a client must also be keenly aware of these issues both because she will not want to engage in any activities.

\textsuperscript{14}See, ABA, \textit{White Paper}, n.1, above, at 32-27. Of course, a lawyer may not provide client confidential information to a third-party absent client consent, KRPC Rule 1.6.
which may be illegal or violate ethical rules because of their illegality and, more importantly, because in many if not most situations a client will seek advice, even document review, from her lawyer about a potential third-party funding arrangement. Thus, lawyers whose clients are considering such arrangements must be extremely careful.

III. Ethical Issues in Litigation Financing

The American Bar Association Standing Committee on Ethics and Professional Responsibility has not yet issued a definitive opinion on the ethics of litigation financing. However, state ethics committees have begun to do so, especially those of the New York State Bar Association and the New York City Bar Association.¹⁵ These opinions as well as court decisions that have touched upon these issues, and law review articles all agree that a lawyer whose client plans to use litigation financing in order to pursue a case faces a number of ethical risks. Among the most serious of these ethical issues are:

1. Conflicts of Interest [KRCP 1.7-1.10]

2. Exercise of Independent Judgment [KRPC 2.1]

3. Business Transactions with Clients [KRPC 1.8(a)]

4. Client’s Right to Determine Settlement Issues [KRPC 1.2(a)]

5. Third Party Payments [KRPC 5.4(c) and 1.8(f)]\(^{16}\)

6. Lawyer Referrals to LF Companies

We may now look at each of these issues in turn.

1. **Conflicts of Interest**

   The most serious conflicts issues with LF arise in conjunction with KRPC 1.7(a)(2) which sets forth the rule regarding “indirect conflicts of interest”:

   a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

\(^{16}\) See, the discussion of these issues in ABA, *White Paper*, n. 1, above, at pp.15ff.
(2) there is a substantial risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer,

Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

The danger of violating KRPC 1.7(a)(2) will arise if the lawyer becomes involved with the litigation financing company in a role which might compromise his ability to provide competent unbiased advice as required by 1.7(a)(2). For instance, if a financing company were to pay the lawyer a referral fee as part of the transaction this might well give rise to problems. Similarly, if
the LF agreement gives the financing company the right to choose, retain, or fire counsel in the
case this, too, might give rise to a 1.7(a)(2) problem as well as an impermissible limitation on
the client’s right to fire the lawyer as required by KRPC 1.16(a)(3).17

2. Exercise of Independent Judgment [KRPC 2.1]

Rule 2.1 requires that a lawyer be an independent advisor and counselor and requires
that:

...[I]n representing a client, a lawyer shall exercise independent
professional judgment and render candid advice. In rendering advice, a
lawyer may refer not only to law but to other considerations such as
moral, economic, social and political factors, that may be relevant to the
client's situation.

LF presents a number of cases in which it may well be difficult for a lawyer to render such
independent advice. Of course, many of the conflicts situations mentioned above may also
cause a Rule 2.1 problem. NYCBA Formal Opinion 2011-02 cautions:

In providing candid advice, a lawyer should advise the client to consider
the costs and the benefits of non-recourse financing, as well as possible
alternatives.[12] With respect to costs, a common criticism of non-
recourse financing is that the fees charged to clients may be excessive
relative to other financing options, such as bank loans, thereby
significantly reducing the client's recovery.[13] A lawyer thus should bear
in mind the extent to which non-recourse financing will limit a client's
recovery. And before recommending financing companies, a lawyer
should conduct a reasonable investigation to determine whether

particular providers are able and willing to offer financing on reasonable terms. In addition, if a lawyer assists a client with non-recourse financing, the lawyer may wish to make clear that such assistance itself is not an endorsement of the financing company.

And:

With respect to benefits, a lawyer should advise the client to consider whether, absent funding, the client would be unable to cover litigation or living expenses, or prematurely could be forced into a relatively disadvantageous settlement, effectively limiting his or her access to seek redress through the legal system.

Implicit in this advice is that a lawyer who is going to advise his client about a particular LF offer must be knowledgeable not only about the legal pitfalls involved in the offer, but, also, in the economics of the offer, alternative ways of acquiring funds, and the true cost of such funding both over the short and long term. This is not a minor burden. It is important to remember that while KRPC Rule 2.1 permits a lawyer to give types of non-legal advice the lawyer must still satisfy the KRPC Rule 1.1 that she be competent.

3. Business Transactions with Clients [KRPC 1.8(a)]

KRPC Rule 1.8(a) states:

A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which
can be reasonably understood by the client; and

(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and

(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

The ABA White Paper cautions lawyers that in certain circumstances a lawyer may run afoul of Rule 1.8(a):

Many ALF transactions are negotiated between the client and the supplier, with no involvement of the lawyer. Some transactions...where the lawyer represents the client in negotiations with the ALF supplier, and where the terms of the agreement may affect the rights the lawyer and client have, vis-à-vis one another, in the proceeds of any recovery. Such a case likely involves the lawyer acquiring a "pecuniary interest adverse to a client," triggering the requirements of Model Rule 1.8(a).18

In such cases, the White Paper advises that a lawyer will have to fully comply with the rather onerous requirements of Rule 1.8(a) including that the terms of any LF agreement in which the lawyer is involved be fair, that there be full disclosure of all terms to the client, advising the client in writing of the advisability of seeking independent counsel, and obtaining

18 ABA, White Paper, p.20.; see also, NYSBA Ethics Opinion 1051 (March 2, 2015) as regards the applicability of Rule 1.5 on LF agreements where the lawyer seeks to take a portion of loan proceeds in payment of her contingent fee.
informed consent in writing from the client.\textsuperscript{19} When one is dealing with tort plaintiffs many of whom may not be financially or legally sophisticated and who will be under significant pressure to get third-party financing in order to bring suit, these requirements will not be at all easy to fulfill.

4. Client’s Right to Determine Settlement Issues [KRPC 1.2(a)]

KRPC Rule 1.2(a) states:

A lawyer shall abide by a client's decisions concerning the lawful objectives of representation, subject to paragraphs (c), (d), and (e), and shall consult with the client as to the means which the lawyer shall choose to pursue. A lawyer shall abide by a client's decision whether to settle a matter.

A client's right to determine whether or not to settle is an absolute right and one of the most important aspects of the allocation of power between a lawyer and her client. Depending upon how an LF agreement is structured, it is possible that a court might determine that the agreement violated this basic ethical rule. While a client may decide to give certain control of litigation to a LF supplier, a lawyer must be very careful not to permit this contractual agreement to give her [the lawyer] control in place of the client in violation of KRPC 1.2(a).

\textsuperscript{19} \textit{Id.}, p.20.
A related problem that may arise in the context of the LF agreement relates to the client's absolute right to discharge an attorney pursuant to KRPC 1.16(a)(3) as mentioned above.

5. Third Party Payments [KRPC 5.4 (a) and (c) and 1.8(f)]

KRPC Rule 1.8(f) states:

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

KRPC Rule 5.4(a) states:

A lawyer or law firm shall not share legal fees with a non-lawyer, except that:
(1) an agreement by a lawyer with the lawyer's firm, partner, or associate may provide for the payment of money, over a reasonable period of time after the lawyer's death, to the lawyer's estate or to one or more specified persons.
KRPC Rule 5.4(c) states:

A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer’s professional judgment in rendering such legal services.

Third-party financing of litigation is neither new nor limited to the litigation financing industry. Indeed, it is a common practice in insurance defense cases. Nevertheless, lawyers who have clients using LF should be sure that the agreement between the client and the LF company does not contain provisions that might be deemed to involve fee-splitting. One should not assume that an LF agreement will necessarily conform to KRPC Rules 1.8(f) and 5.4(a) as they might when dealing with an established insurance company and long-tested documents.\(^{20}\)

Here, again, the lawyer must be concerned whether the terms of the LF agreement could be interpreted to limit her professional judgment and independence, and, thereby, limit her ability to provide competent representation for her client. For instance, if an LF agreement specifies that the lawyer must follow the directions of the LF financing company and that the lawyer may not follow the client’s directions during representation, this would be a serious problem under KRPC 5.4(c).\(^{21}\)

\(^{20}\) And, see, J. DiNardo, “Ethics of Litigation Financing,” n. 15, above, at. Pp. 10-11 for arguments that LF transactions do not violate these ethical rules.

\(^{21}\) Id., p. 9.
6. Lawyer Referrals to LF Companies

In many cases a potential plaintiff will not know about the possibility of going to an LF company to obtain a loan for living, medical, or other expenses that a lawyer may not ethically advance pursuant KRCP 1.8(e). In such cases may a lawyer advise her client to seek out such financing and/or recommend specific LF companies? Further, may a lawyer accept a referral fee from an LF company in such a situation?

The answer to the last question is a fairly clear “no.” For a lawyer to accept a referral fee from an LF company as a result of sending them a client would violate several ethics rules. On the other hand, most states who have opined on the issue of whether a lawyer may make a referral to an LF financing company have answered with a cautious, somewhat limited “yes.”

One state, New York, has also opined that a lawyer may take a fee for advising a client on the terms of an LF financing agreement. At a minimum a lawyer who is going to do a referral should take care that she has no present or future financial or other interest in the LF financing company which she recommends and should, also, be confident that the recommended

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22 See, eg., Florida Ethics Opinion 00-03 (March 15, 2002), State Bar of Michigan Ethics Opinion RI-321 (June 29, 200); NYSBA Ethics Opinion 769 (November 4, 2003); Di Nardo, n. 15, above, pp. 8-9.
23 See, eg., Florida Ethics Opinion 00-03 (March 15, 2002), State Bar of Michigan Ethics Opinion RI-321 (June 29, 200); NYSBA Ethics Opinion 769 (November 4, 2003); Di Nardo, n. 15, above, pp. 8-9.
24 NYSBA Ethics Opinion 769.
agreement is both legal in its terms and does not violate any of the ethical rules as discussed above.

It should be quite obvious that so long as Rule 1.8(e) prohibits a lawyer making loans to clients for other than litigation expenses, clients will need to turn to other sources, including LF financing companies. Thus, many of the legal, economic, and fairness issues discussed above will have an impact on these agreements and the lawyers and clients involved. A number of commentators believe that the current situation, in fact, discourages potential plaintiffs with valid and worthwhile cases from seeking redress in the courts. Thus, I will conclude this program with a brief discussion of some of the alternatives to our present situation that have been suggested.

IV. Some alternatives to Our Current LF Situation

The growth of the LF industry and the many problems associated with it have led a number of people to suggest that some alternative for financing individual plaintiffs’ living, medical and other non-litigation expenses be developed.25 First, of course, we might amend existing Rule 1.8(e) to permit lawyers to make loans for purposes other than litigation costs to

individual plaintiffs. The primary arguments in favor of such amendment are that the danger of that this would increase baseless lawsuits is minor. In fact, there are already rules in place to bar frivolous lawsuits. Such an amendment might well increase the number of lawsuits by individual plaintiffs, but, presumably, if the rules barring frivolous lawsuits are working effectively, any increase would be in legitimate claims. This should be seen as a positive development and evidence of increased access to the courts by people who had otherwise been unable to bring suit because of financial inability. Indeed, a limited exception to the general rule of KRPC Rule 1.8(e) for indigent clients already exists.

V. Conclusion

For the moment Rule 1.8(e) prohibits lawyers from lending non-litigation expenses to individual plaintiffs. This has led not only to discouraging some plaintiffs with valid legal claims from pursuing these claims, but also led to the rise of a new, relatively unregulated and, in the opinion of some commentators, problematic industry. Whatever one may think of the LF industry, lawyers who become involved in LF transactions must use extreme caution to ensure that they do not run afoul of various laws and the Rules of Professional Conduct. I have only

27 Id., p. 488.
28 Permitting loans made to such clients to be non-repayable.
touched upon the surface of the many issues that arise in individual plaintiffs’ use of third-party litigation and I urge any lawyers who are involved with this type of funding to make themselves expert on the potential problems they may encounter.