Third-Party Litigation Funding Explored by the Section

By James M. Wicks

The Section has embarked on a study of the ethical and legal ramifications of third-party litigation funding ("TPLF"). On April 16, 2013, the Section unanimously adopted a *Report on the Ethical Implications of Third-Party Litigation Funding* prepared by the Committee on Ethics and Professionalism. It is available on the Section's website; and, while not recommending a particular position, the Report provided a framework for a panel discussion of the topic at the Section's Spring Meeting.

The Report provides a useful overview of what TPLF involves, namely, providing funding to a party to pursue a lawsuit in return for a share of any damages award or settlement. TPLF takes various forms, the most popular of which is either consumer funding or large-scale commercial or corporate financing. Funding for litigation has been in existence for many years in this and other countries. A fundamental question, however, is whether such arrangements are in fact "loans" at all.

In New York, the Association of the Bar of the City of New York issued Formal Opinion 2011-2 identifying the key ethical concerns involved with TPLF. Opinion 2011-2 takes the view that "[i]t is not unethical per se for a lawyer to advise on or be involved with such arrangements." However, the City Bar cautions against five potential pitfalls, including: (i) the potential illegality of the TPLF arrangement; (ii) issues with the attorney failing as an advisor; (iii) possible conflicts of interest; (iv) failure to obtain a waiver of privilege; and (v) losing control over the proceeding.

According to the Report, many states have considered and approved of third-party litigation financing, so long as certain disclosures are made. In addition, the U.S. Chamber of Commerce's Institute for Legal Reform ("ILR") raised a critical analysis of TPLF, particularly large-scale corporate TPLF, as opposed to consumer funding. The ILR takes the position that commercial litigation finance should be subjected to federal regulation under the Federal Trade Commission, similar to the regulation of the securities markets by the Securities and Exchange Commission.

The Report identifies and examines recurring themes that have developed through case law, ethics opinions, bar association reports, and legislation throughout the country. Although many issues and sub-issues exist, there seem to be five principal issues surrounding the discussion: first, champerty and maintenance; second, attorney-client privilege and confidentiality; third, conflicts of interest; fourth, control over the proceedings; and fifth, fee-sharing with non-lawyers.

Regarding champerty and maintenance, some states have not adopted any prohibitions and, therefore, would not prohibit TPLF: Arizona, California, Connecticut, Massachusetts, New Jersey, New Hampshire, New Mexico, South Carolina, and Texas. Other jurisdictions today have abandoned champerty restrictions. Several states, however, still recognize champerty, and thus possibly TPLF prohibitions, such as Minnesota and Delaware. New York takes a more progressive view, adopting a more lenient stance towards its application.

Maintaining confidentiality and privilege is critical in litigation. However, it is important to TPLF lenders and their investors to fully understand the risk in which they are investing. As with due diligence in any corporate transaction, the more information gathered, the better one can assess the risk. Accordingly, the lender often requires the lawyer to release client information. But do these disclosures involve waivers of confidentiality and privilege that require the client's consent? The Report identifies the cases and other legal authorities addressing this very sensitive issue.

The Report also addresses the concern over who has "control" of the proceeding. Mere payment by a third party of legal fees for another has traditionally not entitled the payor to obtain information ordinarily protected by client confidentiality. Nonetheless, TPLF may cause some confusion as to who actually owns the claim, who controls the lawsuit, and how conflicts between competing directions of the funder and the client should be resolved.

Finally, fee-sharing or fee-splitting is an issue often raised by critics of funding arrangements. In New York, a lawyer may not share legal fees with a non-lawyer under the Rules of Professional Conduct. Where does this leave TPLF? Is it really fee-sharing with a non-lawyer? The Report identifies the current authorities that address this issue.

The Committee on Ethics and Professionalism expects to further explore this issue and, if possible, articulate a reasoned view to be adopted by the Section.