ETHICAL CONCERNS AND RECOMMENDATIONS REGARDING ALTERNATIVE LITIGATION FUNDING RELATIONSHIPS

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MEMORANDUM

To: Managing Partner, Back, Toald & Ways, LLP
From: General Counsel
Date: March 3, 2017
Re: Ethical Concerns and Recommendations Regarding ALF Relationships

INTRODUCTION

Two factions of partners at Back, Toald & Ways, LLP (“the Firm”) disagree about whether and to what extent the Firm should work with litigation funding companies (“LFCs”). The Firm is reevaluating its policy that restricts its association with LFCs and is considering the possibility of becoming involved with LFCs and more specifically, whether one of its partners should accept a position as general outside counsel with Ivonna Urmonie Inc., one of the nation’s largest LFCs.

This memorandum sets out the ethical concerns regarding these potential engagements. It recommends that the Firm change its policy to allow for engagements with LFCs, and it recommends certain limitations on such engagements in order to comply with the Model Rules of Professional Conduct. Then, it evaluates the potential engagement of a Firm partner as outside general counsel with Urmonie and recommends that the firm decline representation of Urmonie if it wishes to represent the clients Urmonie finances.

I. EVALUATION OF LFC POLICY AND RECOMMENDED CHANGES

A. Potential Conflicts of Interest Should Not Prevent Firm Engagement with LFCs
If the Firm begins engaging with LFCs, a potential conflict of interest could arise when lawyers recommend such companies to clients and execute litigation funding agreements ("LFAs") between clients and the LFCs because these arrangements impact the lawyers’ own financial interest, which may not always align with the client’s best interest. However, this potential conflict could be easily mitigated and should not prevent the Firm from engaging with LFCs.

Rule 1.8 of the Model Rules of Professional Conduct prohibits a lawyer from acquiring “pecuniary interest” adverse to the client unless certain requirements are met. MODEL RULES OF PROF’L CONDUCT r. 1.8(a) (AM. BAR ASS’N 2017) [hereinafter MODEL RULES]. These conditions include that the transaction and its terms are “fair and reasonable to the client” and “fully disclosed,” and that the client provides written, signed informed consent “to the essential terms of the transaction and the lawyer’s role.” MODEL RULES r. 1.8(a)(1)–(3). Informed consent can only occur “after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to” the proposed actions. MODEL RULES r. 1.0(e).

In considering how the Firm should approach its relationship with LFCs while maintaining compliance with the Model Rules, it is important to keep in mind that LFCs increase access to the courts for clients who may not otherwise be able to afford litigation. With that, in lieu of the current policy prohibiting relationships with LFCs, the Firm can instead take measures to allow for LFC engagement while ensuring compliance with Rule 1.8.

Therefore, when an alternative litigation financing arrangement would benefit a client—and therefore satisfies the “fair and reasonable” requirement of Rule 1.8(a)(1)—
the lawyer involved in the litigation should disclose his financial interest to the client if he is recommending an LFC and should obtain the client’s informed consent after providing a thorough explanation of the “material risks and reasonably available alternatives,” in accordance with the Rule 1.8. That way, the lawyer fulfills his ethical duties, and the client can obtain LFC funding. To further avoid a conflict of interest, the lawyer should recommend that the client consult with outside counsel to execute the LFA between the client and the LFC.

B. Client Control over Litigation

LFAs vary in form but sometimes provide LFCs the ability to approve settlements, hire and fire the plaintiff’s counsel, and obtain reports from counsel detailing litigation strategy. The details of these agreements implicate a variety of ethical considerations that must be considered and managed before the Firm engages with LFCs. The first concern is the client’s maintenance of control over the litigation and the lawyer’s corollary duty to pursue the client’s goals and provide advice accordingly. However, this concern can be mitigated and should not prevent the firm from engaging with LFCs.

Where an LFA includes the ability to approve settlements, it removes control from the client and discretion from the attorney, potentially compromising the attorney’s ability to comply with his ethical duties. This is especially true because most litigation financing companies are focused primarily, if not solely, on profit, while a party to a lawsuit may wish to seek (and their attorney may pursue) nonpecuniary relief. MODEL RULES r. 2.1 (“In 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.”); MODEL RULES r. 1.2(a) (“[A] lawyer shall abide by a client’s decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued. A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation.”) Additionally, “[a] lawyer shall abide by a client’s decision whether to settle a matter,” MODEL RULES r. 1.2(a), meaning a lawyer is ethically bound to the client’s choice. However, this becomes complicated when the client’s choice regarding settlement is bound by the LFA.

The Model Rules do not apply to LFCs because they are not attorneys or law firms. However, the client’s agreement with the LFCs can impact, and potentially limit, the Firm’s flexibility in litigation. Therefore, the firm must ensure that clients’ agreements with LFCs allow the Firm to comply with its ethical obligations. See generally MODEL RULES. Maya Steinitz, Whose Claim Is This Anyway? Third-Party Litigation Funding, 95 MINN. L. REV. 1268, 1323–24 (2011) (arguing that third-party funding is conceptually different from contingency fee funding and that the client (and arguably, the attorney) “relinquishes full or partial ownership” over his claim in exchange for favorable financing). In practice, this means that the Firm should implement a policy that it will not engage with LFCs when the LFA’s removes client control over settlement decisions.

C. Terminating Representation

Similarly, the Firm should implement a policy that it will not engage with LFCs when the LFA permits the LFC to fire plaintiff’s counsel. Under Rule 1.16, a lawyer must cease representing a client if “the lawyer is discharged,” except under specified
circumstances. *Model Rules* r. 1.16(a)(3). A comment to Rule 1.16 states: “A client has a right to discharge a lawyer at any time, with or without cause, subject to liability for payment for the lawyer’s services.” *Model Rules* r. 1.16(a)(3), cmt. 4.

Therefore, if a client discharges a lawyer, but the LFA calls for the lawyer’s continued representation, an ethical conflict ensues. The attorney would need to cease representation to comply with Rule 1.16, but enforcement of the LFA would require continued representation. Because of this, the Firm should require that clients have the freedom to fire their attorneys in any LFC-funded litigation. However, the LFCs can contract with the client to *hire* attorneys of their choosing. There is no Model Rule that would prevent this; it is only the firing of counsel that presents an ethical dilemma.

**D. Duty of Confidentiality and Attorney-Client Privilege**

1. Confidentiality

The Firm should comply with potential requests from LFCs to obtain reports regarding litigation strategy, pursuant to such entities’ LFAs with clients, as long as the Firm obtains informed consent from the clients. Even with informed consent, there remains an issue of attorney-client privilege waiver, discussed below, but that issue should not prevent Firm attorneys from complying with requests for litigation strategy reports as long, as the client has provided informed consent.

Rule 1.6 imposes a duty of confidentiality, meaning a lawyer cannot disclose “information relating to the representation” unless the client provides informed consent (or other, unrelated circumstances are met). *Model Rules* r. 1.6(a). Therefore, at minimum under Rule 1.6, a lawyer must not disclose information about litigation strategy to a LFC without obtaining the client’s informed consent. As noted above, informed
consent can only occur after counsel provides an explanation of “material risks of and reasonably available alternatives” to the client about the proposed actions. **Model Rules** r. 1.0(e). Therefore, in order to obtain informed consent regarding information disclosure to LFCs in this context, a lawyer would have to explain the risk of waiving attorney-client privilege, discussed below.

Additionally, Rule 2.3 explicitly permits lawyers to provide evaluations to third parties if the lawyer “reasonably believes” the evaluation is compatible with the representation. **Model Rules** r. 2.3(a). When a lawyer “knows or reasonably should know” that the evaluation is likely to materially adversely impact the client’s interest, he must obtain client’s informed consent before providing the evaluation. **Model Rules** r. 2.3(b). Information disclosed pursuant to Rule 2.3 is “protected by Rule 1.6.” **Model Rules** r. 2.3, cmt. 5.

Even though under Rule 2.3 the lawyer is often “impliedly authorized” to disclose information in the course of representation, **Model Rules** r. 2.3, cmt. 5, informed consent is necessary under Rule 1.6, as noted above, before disclosure of information to an LFC because there remains a risk of waiving attorney-client privilege, a possibility that would be “materially adverse” to the client’s interest. See **Model Rules** r. 2.3(b).

Therefore, the firm has two options when it comes to providing reports about litigation strategy to LFCs. It can either obtain the client’s informed consent before disclosing information about representation to an LFC or it could implement a policy prohibiting arrangements where LFAs call for the attorney to provide litigation strategy reports, in order to avoid the possibility of waiver altogether. The latter option is too restrictive, given that LFCs will reasonably want to know about the litigation they are
funding and that this type of arrangement genuinely helps many clients who otherwise could not afford litigation. Therefore, the Firm should comply with the first option and obtain the client’s informed consent before providing information about representation to an LFC.

2. Attorney-Client Privilege

Attorney-client privilege is subject to waiver where the privileged information is disclosed to a third party. Victoria Shannon Sahani, Judging Third-Party Funding, 63 UCLA L. REV. 388, 416 (2016). “There is currently no rule that includes the funder within the exceptions to waiver of evidentiary privileges; thus, privileged documents or information may become discoverable by the opposing side once the party discloses them to the funder.” Id. at 417; see Maya Steinitz, Whose Claim Is This Anyway? Third-Party Litigation Funding, 95 MINN. L. REV. 1268, 1324 (2011) (“Client communication with the financier--who is likely to insist on such communications as a means of monitoring its investment--breaks the attorney-client privilege.”). Therefore, there is a level of waiver risk involved when a firm shares privileged information with a LFC. Because of this, as an additional layer of protection on top of obtaining informed consent, the Firm should also ask a judge to memorialize the agreement to share privileged information and the maintenance of the privilege in a court order, id., and should make enforceable agreements during pretrial conferences about how such information should be handled, id. at 419. With such safeguards in place, in addition to the client’s informed consent, the Firm can mitigate the risks sufficiently to undertake disclosure to LFCs regarding litigation strategy.
II. EVALUATION OF ENGAGEMENT WITH URMONIE URMONIE AND RECOMMENDATIONS

A. Conflict of Interest Concerns

If a Firm partner were to accept a position as outside general counsel with Urmonie, the Firm would face a conflict of interest if it represented clients of Urmonie.

Under the Model Rules, a lawyer is prohibited from representing a client when there is a concurrent conflict of interest. MODEL RULES r. 1.7(a). A concurrent conflict of interest results when two clients’ interests are directly adverse, when there is a “significant risk” that representation of a client will be “materially limited” by the lawyer’s relationship with “another client, a former client or a third person or by a personal interest of the lawyer.” MODEL RULES r. 1.7(a)(1)–(2). Notwithstanding a concurrent conflict of interest, a lawyer may represent a client if he “reasonably believes” he can provide “competent and diligent representation” to all clients involved, “the representation is not prohibited by law,” “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 “each affected client gives informed consent, confirmed in writing.” MODEL RULES r. 1.7(b)(1)–(4).

By serving as outside general counsel to Urmonie, the Firm partner effectively represents the LFC. Under Model Rule 1.10, conflicts of interest are imputed to all lawyers at the Firm. MODEL RULES r. 1.10(a). Further, clients of Urmonie would be directly adverse to Urmonie during their contract negotiations because they would be on opposite sides of the negotiation and because, in most cases, the division of monetary rewards is a zero-sum negotiation between the client and the LFC. While they both have similar interests in the success of litigation, they are nonetheless adverse to each other.
during contract negotiations. Therefore, if the Firm were to represent both the LFC and its clients, it would be representing adverse parties, resulting in a conflict of interest under Rule 1.7. This conflict would be especially pronounced because (1) Urmonie expressed interest in hiring the Firm to evaluate parties’ claims for potential LFAs—whereby the client’s and the LFC’s interests are at odds, requiring separate representation, (2) Urmonie hired the firm to review settlements for approval, which would make it impossible for the firm to simultaneously consider its client’s and the LFC’s best interest in the same settlement, and (3) because Urmonie wants the firm to recommend new counsel when current counsel underperforms, which would create pressure for the firm to find that other attorneys were underperforming and to take on the clients itself or would cause the firm to avoid recommending new counsel where it serves as counsel.

These potential conflicts could not be resolved by satisfying the factors of Rule 1.7(b), listed above, because the interests between an LFC and its clients regarding settlement discussions, funding of litigation, and choice of counsel are simply too adverse for an attorney to provide “competent and diligent” representation to both. Therefore, the Firm should either forgo the opportunity to serve as outside general counsel for Urmonie, or it should implement a policy prohibiting representation of Urmonie’s clients. Either option would preserve the firm’s “loyalty and independent judgment” and avoid the potential future need for withdrawal from representation. MODEL RULES r. 1.7, cmt. 1. The first option—refusing to represent Urmonie—would be more desirable if the Firm wishes to begin engaging more regularly with LFCs, which would require it to advocate for clients who might be adverse to Urmonie or other LFCs. That way, it could freely recommend the best provider to its clients, acting in the clients’ best interest without
considering its own financial and fiduciary ties. See MODEL RULES r. 1.3, cmt. 1 (“A lawyer must also act with commitment and dedication to the interests of the client and with zeal in advocacy upon the client's behalf.”).

B. Professional Independence of a Lawyer

Potential associations between the Firm and LFCs, especially regarding a partner’s potential engagement as outside general counsel for Urmonie, raise the issue of professional independence. Rule 5.4 states that a lawyer may not “share legal fees with a nonlawyer” (absent certain circumstances). MODEL RULES r. 5.4(a). Further, a lawyer shall not permit a third party financier to “direct or regulate” the legal services the lawyer provides. MODEL RULES r. 5.4 (c); id. r. 5.4, cmt. 1 (“Where someone other than the client pays the lawyer’s fee or salary, or recommends employment of the lawyer, that arrangement does not modify the lawyer’s obligation to the client.”). Rule 1.8(f) states that a lawyer shall not accept compensation for representation from a third party unless the client provides informed consent, there is “no interference with the lawyer’s independence of professional judgment or with the client-lawyer relationship,” and information is protected pursuant to Rule 1.6. MODEL RULES r. 1.8(f)(1)–(3).

Considering both Rule 5.4 and 1.8(f), the firm should only engage with LFCs where such entities do not assert control over the representation and where they contract directly with the client. See The Rise Of 3rd-Party Litigation Funding, LAW 360 (Jan. 21, 2011, 2:06 PM), https://www.law360.com/articles/218954/the-rise-of-3rd-party-litigation-funding. However, the potential arrangement between the Firm’s partner and Urmonie would run afoul of such a policy and would likely run afoul of the aforementioned Rules if the firm were to provide legal representation to financial clients.
of Urmonie. Not only would this create a conflict of interest, as described above, but it would relatedly interfere with the lawyer’s independent judgment because Urmonie, the source of the Firm’s compensation, would be potentially driving the decisions of the litigation, removing the lawyer’s discretion and potentially leading to a violation of Rule 5.4.

CONCLUSION

In conclusion, the Firm should change its policy to permit engaging with LFCs. Further, the Firm should recommend LFCs to clients, when doing so would benefit a client and would not cause a conflict of interest. To avoid a conflict of interest, the Firm should recommend that the client consult with outside counsel to execute the LFA between the client and the LFC.

Additionally, the Firm should not engage with LFCs when the LFA removes client control over (1) settlement decisions, or (2) the ability to fire counsel. However, the Firm should comply with requests from LFCs to obtain reports regarding litigation strategy, as long as the Firm obtains informed consent from its clients.

Regarding the Firm’s representation of Urmonie—if the Firm plans to engage more regularly with LFCs and recommend them to clients, and especially if the firm plans to represent clients of Urmonie, it should refuse to represent Urmonie. Alternatively, the Firm could agree to represent Urmonie but implement a policy against representing its clients.