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The Rules of Professional Responsibility and Legal Finance: A Status Update

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INTRODUCTION

Legal finance occurs when a third party funds a stranger's attorney's costs and/or other legal expenses.[1] Legal finance is the

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1. The literature on this topic is large and growing. *See* Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268, 1270 (2011); Cassandra Burke Robertson, *The Impact of Third-Party Financing on Transnational Litigation*, 44 CASE W. RES. J. INT'L L. 159, 161 (2001); Anthony J. Sebok, *Betting on Tort Suits After the Event: From Champerty to Insurance*, 60 DEPAUL L. REV. 453, 468 (2011); Paul Bond, *Making Champerty Work: An Invitation to State Action*, 150 U. PA. L. REV. 1297, 1298

alternative to the self-financing of legal services by a party.[2] The distinction between legal finance and self-financing turns on the source of funding for legal representation and does not affect to whom the funded lawyer owes his or her duty; regardless of who pays the lawyer, a lawyer owes a duty to pursue the ends of their client as defined by the rules of contract and professional responsibility.[3] If an insurer indemnifies Smith for his costs involved in bringing a lawsuit under a first-party legal expenses insurance policy, the insurer is engaging in legal finance, and the lawyer paid with the insurer's funds owes duties to Smith, who is the client.[4] By contrast, when Smith simply pays for legal representation out of his own assets,

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(2002); Terrence Cain, *Third Party Funding of Personal Injury Tort Claims: Keep the Baby and Change the Bathwater*, 89 CHI.-KENT L. REV. 11, 11–12 (2014); Marc J. Shukaitis, *A Market in Personal Injury Tort Claims*, 16 J. LEGAL STUD. 329, 329 (1987); Nora Freeman Engstrom, *Lawyer Lending: Costs and Consequences*, 63 DEPAUL L. REV. 377, 379 (2014) [hereinafter Engstrom, *Lawyer Lending*]; Nora Freeman Engstrom, *Re-Re-Financing Civil Litigation: How Lawyer Lending Might Remake the American Litigation Landscape, Again*, 61 UCLA L. REV. DISCOURSE 110, 112 (2013); W. Bradley Wendel, *Paying the Piper but not Calling the Tune: Litigation Financing and Professional Independence*, 52 AKRON L. REV. 1, 1 (2018) [hereinafter Wendel, *Paying the Piper*]; W. Bradley Wendel, *Litigation Trolls*, 12 N.Y.U. J.L. & BUS. 725, 726, 729 (2016); W. Bradley Wendel, *Alternative Litigation Finance and Anti-Commodification Norms*, 63 DEPAUL L. REV. 655, 655 (2014); J. Maria Glover, *Alternative Litigation Finance and the Limits of the Work-Product Doctrine*, 12 N.Y.U. J.L. & BUS. 911, 911 (2016); Elizabeth Chamblee Burch, *On Regulatory Discord and Procedure*, 11 N.Y.U. J.L. & BUS. 819, 819 (2015); Deborah R. Hensler, *The Future of Mass Litigation: Global Class Actions and Third-Party Litigation Funding*, 79 GEO. WASH. L. REV. 306, 320 (2011) [hereinafter Hensler, *Future of Mass Litigation*]; Deborah R. Hensler, *Third-Party Financing of Class Action Litigation in the United States: Will the Sky Fall?*, 63 DEPAUL L. REV. 499, 499 (2014) [hereinafter, Hensler, *Third-Party Financing of Class Action Litigation*]; Victoria A. Shannon, *Harmonizing Third-Party Litigation Funding Regulation*, 36 CARDOZO L. REV. 861, 861 (2015); Victoria Shannon Sahani, *Judging Third-Party Funding*, 63 UCLA L. REV. 388, 390 (2016); Victoria Shannon Sahani, *Reshaping Third-Party Funding*, 91 TUL. L. REV. 405, 405 (2017).

2. Victoria Shannon Sahani, *Rethinking the Impact of Third-Party Funding on Access to Civil Justice*, 69 DEPAUL L. REV. 611, 612 (2020) ("[T]hird-party funding can be simply defined as a financial arrangement between a party involved in a dispute and an outside entity through which the party seeks funding for its legal representation instead of self-financing.").

3. MODEL RULES OF PRO. CONDUCT r. 1.2(a) (AM. BAR ASS'N, 2020) (establishing lawyer's duty to pursue client's objectives of representation); MODEL RULES OF PRO. CONDUCT r. 1.8(f) (AM. BAR ASS'N, 2020) (limiting conditions under which a lawyer may accept compensation from a third party to represent a client). *See also* Stephen Gillers, *Waiting for Good Dough: Litigation Funding Comes to Law*, 43 AKRON L. REV. 677, 680 (2010) ("We allow non-lawyers to pay lawyers to represent clients . . . . Of course, we tell the lawyer to remember who the real client is: . . . .").

4. *See* MODEL RULES OF PRO. CONDUCT r. 1.8 cmt. 14.

Smith is not engaging in legal finance since the funds did not come from a third party with the understanding that they would be used for Smith's legal expenses.[5] This Article is about the content of the duties owed to the client if legal finance occurs and how and if they vary.

Legal finance is rapidly growing in the United States, and it is reasonable to ask whether the law of lawyering and the rules of professional conduct adequately protect clients, the public, and provide clear guidance to lawyers.[6] This Article does not offer any easy answers to this question but argues that the focus of concern for policy makers and lawyers may not be where bar associations and the media have suggested in recent years. Concerns about preserving client confidentiality and, by extension, preserving privilege, while real, are probably overblown since the current rules and doctrines provide a vehicle for allowing clients to manage, through informed consent, the costs and benefits of sharing information with potential funders.[7] Concerns about funders interfering with lawyers' independence of professional judgment and by extension, the guarantee of competent and zealous representation of clients are also probably overblown since in most cases (especially consumer legal finance) the interests of client and funder are aligned and are best served by allowing legal professionals to do what they were retained to do—to secure the client's objectives.[8]

In theory, legal finance can come from a wide range of third parties in various ways. Banks can provide legal finance, when, for example, a party borrows in order to pay for lawyers and expenses for upcoming litigation.[9] When a bank lends to a party whose ability to repay depends on the outcome of the funded litigation, its collateral is that litigation, and it assumes a default risk that mirrors the borrower's litigation risk.[10] But parties have historically found it very

5. First-party legal costs insurance is not the same thing as a party paying its own legal expenses out of pocket for the same reason that "self" insurance (in contrast to first-party insurance) is not really insurance. *See* Mark Geistfeld, *Should Enterprise Liability Replace the Rule of Strict Liability for Abnormally Dangerous Activities?*, 45 UCLA L. REV. 611, 625 (1998) (stating that self-insurance is "a euphemism for not purchasing insurance").

6. *See* Hensler, *supra* note 1, at 320.

7. *See* discussion *infra* Subpart II.B.1.

8. *Id.*

9. *See* Suneal Bedi & William C. Marra, *The Shadows of Litigation Finance*, 74 VAND. L. REV. 563, 574 (2021) (explaining that "traditional debt" in litigation finance "imposes an absolute duty to repay the loan at set time intervals and usually requires collateral other than litigation proceeds").

10. *See* David J. Kerstein & Wendie Childress, *Legal Finance Industry*, BLOOMBERG L.: PRAC. GUIDANCE (Jan. 2, 2020), https://pro.bloomberglaw.com/brief/practical-guidance-litigation-finance-industry/ (defining litigation finance as "any transaction in which a legal claim is used as collateral to secure financing from an outside party").

difficult to secure loans backed only by the litigation funded by the loan, for a variety of reasons, including the difficulty banks have evaluating lawsuits as collateral.[11] The lack of a market for bank loans secured by litigation suggests that the definition of legal finance has another element: the repayment to the third party by the client is contingent on the outcome of the legal services that were funded.[12] In legal finance, the funded party "does not have to repay the funder if it loses the case or does not recover any money."[13]

It is no surprise then that one of the most common forms of legal finance is the contingent fee, where a lawyer advances his or her own time and money for expenses on a non-recourse basis.[14] Legal finance by lawyers is a familiar feature of American law with a well-developed body of ethics rules, statutes, and case law regulating under what circumstances lawyers can finance a client's matter, how much can be earned through the financing, and how a lawyer can enforce a security interest in a client's proceeds.[15] Legal finance by lawyers is facilitated

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11. *See* Douglas R. Richmond, *Other People's Money: The Ethics of Litigation Funding*, 56 MERCER L. REV. 649, 650 (2005) ("[M]ost traditional lenders are unwilling to lend money with only a potential litigation recovery as collateral because such loans are deemed to be too risky."); Mariel Rodak, *It's About Time: A Systems Thinking Analysis of the Litigation Finance Industry and Its Effect on Settlement*, 155 U. PA. L. REV. 503, 505 (2006) ("[T]raditional lenders [refuse] to recognize pending litigation as an asset when determining qualification for borrowing.").

12. *See* Bedi & Marra, *supra* note 9, at 574 ("Virtually all litigation finance transactions are 'nonrecourse,' meaning the funder's return is secured only by proceeds from the funded case(s)."). However, "[t]here are some exceptions to this rule," noting that one major litigation finance firm, Burford, "acquires assets whose value may increase due to litigation . . . where there is underlying asset value to support the position, in addition to potential value from legal or regulatory proceedings." *Id.*

13. Sahani, *Judging Third Party Funding*, *supra* note 1, at 392. *See also* Zeqing Zheng, *The Paper Chase: Fee-Splitting vs. Independent Judgment in Portfolio Litigation Financing of Commercial Litigation*, 34 GEO. J. LEGAL ETHICS 1383, 1384 (2021) ("Litigation finance, also known as litigation funding, is defined as the financing of litigation by third parties on a non-recourse basis, meaning that lender only demands repayment and interest payment when there are profits.").

14. *See* Peter Karsten, *Enabling the Poor to Have Their Day in Court: The Sanctioning of Contingency Fee Contracts, a History to 1940*, 47 DEPAUL L. REV. 231, 259 (1998) ("Contingency fee contracts were sanctioned by mid-nineteenth century American jurists, some of whom were impressed by their potential for efficiency, more of whom decided that they were necessary from a humane perspective, as the only way poor men or women would gain their day in court."); Marc Galanter, *Anyone Can Fall Down a Manhole: The Contingency fee and its Discontents*, 47 DEPAUL L. REV. 457, 475 (1998) ("The contingency fee lawyer is not only the client's advocate but the banker who finances his case.").

15. *See* Herbert M. Kritzer, *The Wages of Risk: The Returns of Contingency Fee Legal Practice*, 47 DEPAUL L. REV. 267, 286 (1998); Ankur Parekh & Jay R.

by banks who make recourse loans to lawyers so they can advance their own time and expenses in contingent-fee agreements.[16] Sometimes contingent fees and conventional lending by banks to clients for litigation are combined when a lawyer treats the cost of financing expenses associated with a client's case as an expense that it will advance and recover in the event of any proceeds flowing from the case; under such an agreement, the lawyer is acting as the client's agent and obtaining financing on behalf of the client for which the lawyer is responsible if the case fails.[17] What all these forms of legal finance have in common is that the financing party is the client's lawyer.

In addition to the contingent fee, other forms of legal finance involve a financing party who is not the client's lawyer. The most common of these involves non-recourse advances between a capital provider and a party which are used to pay for attorney's costs or other expenses.[18] One step removed from this is a form of legal finance that involves non-recourse advances between a capital provider and a lawyer, secured by a single or a portfolio of contingent-fee contracts between the lawyer and his or her client(s).[19]

This Article will focus on the last two forms of legal finance—where the financing party is not the client's lawyer. Legal finance, as the term is used in this Article, will refer to (1) a commercial transaction (2) involving the payment of money by a layperson ("the payor") to a (3) plaintiff or a lawyer representing a plaintiff ("the payee") (4) where subsequent payment to the payor is contingent on the outcome of a legal matter in which the payee is involved, either as a party or legal counsel.[20] This excludes, therefore, legal finance

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Pelkofer, *Lawyers, Ethics, and Fees: Getting Paid Under Model Rule 1.5*, 16 GEO. J. LEGAL ETHICS 767, 776–777 (2003).

16. *See* Stephan Landsman, *Introduction: The Changing Landscape of the Practice, Financing and Ethics of Civil Litigation in the Wake of the Tobacco Wars*, 51 DEPAUL L. REV. 183, 203–04 (2001) (comparing commercial bank lending to contingent fee firms).

17. *See* Engstrom, *Lawyer Lending: Costs and Consequences*, *supra* note 1, at 398 ("[S]ome lawyer lenders facilitate the passing of financing charges from lawyers onto lawyers' clients.").

18. *See* Gillers, *supra* note 3, at 689.

19. *See* Engstrom, *Lawyer Lending: Costs and Consequences*, *supra* note 1, at 394 (quoting an offer of non-recourse legal finance by a funder) ("The funding that Augusta Capital provides is entirely contingent . . . . If, as to a particular case, no recovery is obtained, then the lawyer is not obligated to repay any portion of the funding provided by Augusta Capital for that particular case or any fee to Augusta."); Zheng, *supra* note 13, at 1387 ("Through portfolio financing, third-party litigation finance firms contract with law firms directly and then provide funding for a portfolio of litigation or arbitration matters that range from three to forty cases at a time.").

20. AM. BAR ASS'N, ABA BEST PRACTICES FOR THIRD-PARTY LITIGATION FUNDING 1, 10 (Aug. 2020),

motivated solely by a charitable interest, defense-side legal finance, and conventional (or recourse) loans secured by other assets that may be affected by the outcome of litigation.[21] The exclusion of these forms of legal finance does not mean that they are not genuine forms of legal finance.[22] The exclusion of these forms is motivated by a practical concern: The narrow version of legal finance discussed in this Article captures the forms of legal finance offered to the vast majority of Americans today.[23] The purpose of this Article is practical, and, as such, this review of the professional responsibilities of lawyers serving the vast majority of Americans seeking legal finance will be most effective if the scope of the survey is limited to legal finance instantiated by elements (1)–(4) above.[24]

I. GENERAL CONSIDERATIONS

While various forms of legal finance have been employed, discussed, and debated since the early years of English common law, legal finance has been a fixture of American law only for the past thirty years.[25] The first evidence of an organized market can be found in the development of companies that sought out plaintiffs in relatively small value personal injury claims such as automobile accidents, workplace injuries, and landowner liability cases (but not employment discrimination, medical malpractice, or consumer

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https://www.americanbar.org/content/dam/aba/administrative/news/2020/08/2020-am-resolutions/111a.pdf.

21. *See, e.g.*, Lili Levi, *The Weaponized Lawsuit Against the Media: Litigation Funding as a New Threat to Journalism*, 66 AM. U. L. REV. 761, 761, 765 (2017) (charitable legal finance); Adam J. Levitin, *Bankruptcy Markets: Making Sense of Claims Trading*, 4 BROOK. J. CORP. FIN. & COM. L. 67, 74–75 (2009) (alternative assets trading on outcome of litigation). *See also* NorCal Tea Party Patriots v. Internal Revenue Serv., No. 1:13cv341, 2018 WL 3957364, at *2 (S.D. Ohio Aug. 17, 2018) (recognizing the important role of litigation funders in public interest litigation).

22. Recent surveys of legal finance, most notably the ABA Best Practices, cover everything from conventional client-directed legal finance to "revenge funding." This Article has a more modest goal. *See* AM. BAR ASS'N, ABA BEST PRACTICES FOR THIRD-PARTY LITIGATION FUNDING 1 (Aug. 2020), https://www.americanbar.org/content/dam/aba/administrative/news/2020/08/2020-am-resolutions/111a.pdf.

23. *Id.*

24. This Article is part of a larger project detailing the law surrounding legal finance. *See* Anthony J. Sebok, *White Paper on Mandatory Disclosure in Third Party Litigation Finance*, *in* SELECTED PAPERS ON LITIG. FIN. DISCLOSURE RULES (Center on Civil Justice, NYU School of Law, 2020) (forthcoming); Anthony J. Sebok, *Sources of Attorney's Duties to Third Parties in the Litigation Funding Context*, *in* HANDBOOK ON THIRD-PARTY FUNDING IN INT'L ARB. (Nikolaus Pitkowitz, ed., Juris Publishing, 2018); Anthony J. Sebok, *Litigation Investment and Legal Ethics: What are the Real Issues?*, 55 CANADIAN BUS. L.J. 111 (2014).

25. *See* Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61, 73 (2011).

fraud).[26] Companies offered "pre-settlement" funding through direct advertising to individuals who already had representation and were interested in obtaining funds in advance of the resolution of their claims, something which their lawyers were prohibited from doing and which conventional lending institutions would not do. This market is now known as the "consumer legal finance" market.[27]

Subsequent to the development of the consumer legal finance market, another market developed oriented towards business litigation involving much more complicated and expensive legal proceedings.[28] The development of this market, known as "commercial legal finance," proceeded along parallel tracks in various common law legal markets, but especially in the United Kingdom and the United States, as well as commercial arbitration in various venues around the world involving commercial entities with connections to the United Kingdom and United States legal markets.[29] Over the past twenty years, commercial legal finance has grown in size in both the United Kingdom and United States to the point where it probably exceeds consumer legal finance in terms of market size.[30]

Finally, in other jurisdictions, such as Australia, Canada, the Netherlands, as well as a handful of other European systems, legal finance in class actions or group litigation has attracted private capital.[31] Australia, in particular, has a highly developed class action legal finance market.[32] There is some overlap between the class action and commercial legal finance sectors. The largest class action

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26. *See* Paul H. Rubin, *Third-Party Financing of Litigation*, 38 N. KY. L. REV. 673, 673 (2011); Susan Lorde Martin, *Litigation Financing: Another Subprime Industry that has a Place in the United States Market*, 53 VILL. L. REV. 83, 87–88 (2008).

27. *See* Steven Garber, *Alternative Litigation Financing in the United States: Issues, Knowns, and Unknowns*, RAND INST. FOR CIV. JUST. L., FIN., AND CAP. MKTS. PROGRAM 1, 1 (2010), https://www.rand.org/pubs/occasional_papers/OP306.html.

28. *Id.* at 1, 13.

29. *Id.*; *see* Steinitz, *supra* note 1, at 1278–82.

30. Westfleet Advisors, a U.S. commercial legal finance consultancy, published a review of the market in 2019. It estimated that in 2019, "$2.3 billion was committed to commercial litigation finance transactions with a nexus to the U.S." Charles Agee & Gretchen Lowe, *Litigation Finance Buyer's Guide*, WESTFLEET ADVISORS, 6 (2019), https://assets.website-files.com/5d3219df242257de8146924c/5dd813e3cd97761c9b70e0a0_Westfleet%20Buyers%20Guide%202019-11-17.pdf.

31. *Third Party Litigation Funding: Buying Trouble Across the Globe*, INST. FOR LEGAL REFORM (Apr. 7, 2022), https://instituteforlegalreform.com/third-party-litigation-funding-buying-trouble-across-the-globe/.

32. Jasminka Kalajdzic et al., *Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding*, 61 AM. J. COMPAR. L. 93, 96 (2013).

legal finance company in Australia, International Monetary Fund ("IMF"), entered the United States market and created a commercial legal finance subsidiary around 2010.[33] The largest United States commercial legal finance firm, Burford (which has a large presence in the United Kingdom as well) has entered the Dutch and German class action legal finance markets by creating subsidiaries in those legal systems to fund mass actions under the national laws of those countries.[34]

This Article will focus only on the obligations of lawyers practicing in the United States in connection with the legal finance markets that exist in United States jurisdictions. Foreign law, or the rules imposed by domestic or international arbitral bodies, will be relevant only to the extent that a United States lawyer is under a professional obligation imposed by an American jurisdiction while providing services connected with a matter in a foreign jurisdiction or in a domestic or international arbitral body.[35]

The law of lawyering and the rules of professional responsibility exist to promote the interests of clients and society.[36] They are not designed to protect the economic interests of the legal profession or to preserve the status of lawyers.[37] However, when talking about the interests of clients and the interests of society, a few caveats must be kept in mind. First, the interests of clients are not uniform and vary depending on the specific type of client and his or her circumstances. The law of lawyering and the rules of professional responsibility must be sensitive to the variation of the interests of clients.[38] Second, regardless of how they are defined, the interests of clients and society are not always in alignment.[39] The law of lawyering and the rules of professional responsibility must balance the interests of clients and the larger society in which clients pursue their interests.[40]

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33. *Id.*

34. *See Hausfeld and Burford Capital Announce 30 Million Euro German Venture*, HAUSFELD (Oct. 27, 2015 8:10 PM), https://www.globenewswire.com/news-release/2015/10/28/780627/0/en/Hausfeld-and-Burford-Capital-Announce-30-Million-Euro-German-venture.html; *Investor Presentation Capital Market Event*, BURFORD (Nov. 12, 2018), https://www.burfordcapital.com/media/1469/burford-master-capital-markets-slides_final.pdf.

35. *See* AM. BAR ASS'N, *supra* note 22, at 10.

36. *See* Thomas D. Morgan & Robert W. Tuttle, *Legal Representation in a Pluralist Society*, 63 GEO. WASH. L. REV. 984, 986 (1995).

37. MODEL RULES OF PRO. CONDUCT Preamble (AM. BAR. ASS'N 1983).

38. *See* William H. Simon, *Ethical Discretion in Lawyering*, 101 HARV. L. REV. 1083, 1105–06 (1988).

39. *Id.* at 1083–84.

40. *Id.* at 1144–45.

A. *The Interests of Clients*

The interests of clients have to be understood against the backdrop of the specific way in which legal services are funded in the United States. Because of the limited role of legal aid in the United States, a primary interest of clients (and society) is access to legal services in the private market.[41] While access to legal services is (arguably) less urgent in criminal matters, in civil matters, where legal aid is rare and legal services are priced as a marketable commodity, access to legal services is a matter of paramount concern when thinking about the architecture of the law of lawyering and the rules of professional responsibility in the United States.[42]

Once the relationship between client and lawyer is seen through the lens of the market economy, where legal services are provided to clients by lawyers who must also seek to make a profit from the lawyer-client relationship, additional concerns arise about the protection of clients' interests through the law of lawyering and the rules of professional responsibility. Regardless of the sophistication of the client, there is, as in any commercial relationship, a risk that one party to the transaction will take advantage of the other, either intentionally or through inadvertent conduct.[43] Typically, in the lawyer-client context, the greater risk is that the lawyer will take advantage of the client, although the risk that a client will take advantage of their lawyer exists as well.[44] Lawyers can take advantage of a client in a variety of ways, ranging from using confidential information for personal advantage to stealing from them, and the law of lawyering and the rules of professional responsibility are intended to address a wide range of these risks.[45]

One area of potential abuse of the trust that clients place in their lawyers is over the cost of legal services and other expenses. Clients may feel that their lawyers are recommending unnecessary services or unnecessary expenses or may come to regret the terms of a contingent fee agreement (or a fixed fee agreement) after seeing how much risk (or work) was actually borne (or performed) by the

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41. *See* Gillian K. Hadfield, *The Cost of Law: Promoting Access to Justice Through the (Un)Corporate Practice of Law*, 38 INT'L REV. L. & ECON. 43, 43 (2013) ("The ordinary family obtains no legal help or advice with legal problems . . . . We live in a law-thick world that people are left to navigate largely in the dark.").

42. "[M]any if not most American consumers are simply priced out of access to legal services, which results in eighty percent of low-income Americans and fifty percent of middle-income Americans facing their legal problems without a lawyer." Raymond H. Brescia, *Law and Social Innovation: Lawyering in the Conceptual Age*, 80 ALB. L. REV. 235, 242 (2016).

43. *See* MODEL RULES OF PRO. CONDUCT r. 1.8 cmt. 1 (AM. BAR ASS'N 1983).

44. *See* RESTATEMENT (THIRD) OF L. GOVERNING LAWS. § 16(3) (AM. L. INST. 2000).

45. *See* MODEL RULES OF PRO. CONDUCT r. 1.8 cmt. 1 (AM. BAR ASS'N 1983).

lawyer.[46] Various prophylactics in the law of lawyering and the rules or professional responsibility, such as the doctrine that the lawyer is a fiduciary of the client or the obligation to communicate (Rule 1.4), or not charge an unreasonable fee (Rule 1.5) are intended to mitigate these potential areas of abuse by lawyers, but the potential for conflict over the cost of legal services between lawyer and client can never be fully eliminated.[47]

B. The Interests of Society

The law of lawyering and the rules of professional responsibility do not only endeavor to protect the interests of clients, however they are defined. Lawyers have a special status in American society in that their professional regulation is much more independent of the state's police powers than many other professions.[48] Through the inherent power of the courts to regulate the legal profession, the power to discipline lawyers is delegated to organs of the bar with supervision by the courts and minimal intervention by the legislature.[49] This extraordinary autonomy is justified on a number of grounds, but ultimately, it must be justified in terms of the benefits provided to society that accrue by allowing the legal profession to be mostly self-regulating.[50]

The law of lawyering and the rules of professional responsibility address the risk of abuse by lawyers of the trust placed in them by their clients by emphasizing a lawyer's duty of loyalty to his or her client; this is reinforced by the risk of malpractice liability as well as the fiduciary relationship between lawyers and clients imposed by law.[51] On the other hand, in the United States, especially compared to other legal systems, the client-centric bias of the law of lawyering

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46. *See* RESTATEMENT (THIRD) OF L. GOVERNING LAW. § 35 cmt. c (AM. L. INST. 2000).

47. RESTATEMENT (THIRD) OF L. GOVERNING LAWS. § 16 cmt. b (AM. L. INST. 2000); MODEL RULES OF PRO. CONDUCT r. 1.4 (AM. BAR ASS'N 1983); MODEL RULES OF PRO. CONDUCT r. 1.5 (AM. BAR ASS'N 1983).

48. *See* K. N. Llewellyn, *The Bar's Troubles, and Poultices—and Cures?*, 5 LAW & CONTEMP. PROBS. 104, 115 (1938) ("[S]pecialized work, mass-production, cheapened production, advertising and selling—finding the customer who does not know he wants it, and making him want it: these are the characteristics of the age. Not, yet, of the Bar.").

49. *See* MODEL RULES OF PRO. CONDUCT, Preamble (AM. BAR ASS'N 1983).

50. *See* Rebecca Roiphe, *A History of Professionalism: Julius Henry Cohen and the Professions as a Route to Citizenship*, 40 FORDHAM URB. L.J. 33, 42–43 (2012) (discussing the emergence of the law as a distinct and protected profession in the late nineteenth century).

51. "Trust is facilitated by certain features of the professional form: the bar's implicit guarantee that all licensed lawyers have baseline competency; the ethics codes' assurances of loyalty, confidentiality, and other client protections; and lawyers' structural independence from outside pressures." Dana A. Remus, *Reconstructing Professionalism*, 51 GA. L. REV. 807, 849 (2017).

and the rules of professional responsibility has been criticized for encouraging an attitude among lawyers that their only duty is to help their clients achieve their ends without any regard to other social interests.[52] This approach is reinforced by Rule 1.2(b), which states a lawyer's representation of a client "does not constitute an endorsement of the client's political, economic, social or moral views or activities."[53]

The law of lawyering and the rules of professional responsibility place limits on a lawyer's freedom to pursue a client's ends.[54] For example, a lawyer may not counsel a client or assist a client in conduct that the lawyer knows is criminal or fraudulent (Rule 1.2(d)), and a lawyer must withdraw from representation of a client when the client will use his or her services or has used his or her services to perpetrate a crime or fraud (Rule 1.16(a)).[55] The law of lawyering and the rules of professional responsibility impose limitations that are loosely connected to promoting access to justice, such as Rule 5.6 (restrictions on the right to practice as a condition of settlement).[56]

It is clear, therefore, that the law of lawyering and the rules of professional responsibility can take into account society's interests even if that results in the frustration of clients' interests, even in cases where the clients' preferred course of action is not criminal or fraudulent or would not even clearly injure any identifiable person's interests. In addition to access to justice, another important social interest that has traditionally motivated the law of lawyering and the rules of professional responsibility is the concern about protecting the reputation and dignity of the profession.[57] Today, this concern is most clearly evident in limitations on advertising not related to false or misleading statements, but in the past, various limitations on the profession were more directly connected to concerns about preventing too much litigation, even if it were legitimate.[58] The efforts of the American Bar Association ("ABA") to prohibit the use of "runners" and "cappers" in the early twentieth century were as much about limiting the amount of personal injury litigation as they were about

52. *See* Katherine R. Kruse, *Lawyers, Justice, and the Challenge of Moral Pluralism*, 90 MINN. L. REV. 389, 390–91 (2005).

53. *Id.* at 415 n. 95.

54. *See* Stephen L. Pepper, *Counseling at the Limits of the Law: An Exercise in the Jurisprudence and Ethics of Lawyering*, 104 YALE L.J. 1545, 1547–48 (1995).

55. MODEL RULES OF PRO. CONDUCT r. 1.2(d) (AM. BAR ASS'N 1983); MODEL RULES OF PRO. CONDUCT r. 1.16 (a) (AM. BAR ASS'N 1983).

56. MODEL RULES OF PRO. CONDUCT r. 5.6(a) (AM. BAR ASS'N 1983).

57. *See* Fred C. Zacharias, *Effects of Reputation on the Legal Profession*, 65 WASH. & LEE L. REV. 173, 176–77 (2008); Fred C. Zacharias, *Reform or Professional Responsibility as Usual: Whither the Institutions of Regulation and Discipline?*, 2003 U. ILL. L. REV. 1505, 1514 n.43 (2003).

58. *See generally* Susan D. Carle, *Race, Class, and Legal Ethics in the Early NAACP (1910–1920)*, 20 LAW & HIST. REV. 97, 139–40 (2002).

preventing fraudulent cases from being brought.[59] Similarly, the statutes against champerty (and common law doctrines that paralleled those statutes) were about limiting the amount of litigation brought in society, not because that litigation was groundless, but because it was seen as harassing and unnecessary.[60]

With these considerations in mind, it is clear that the law of lawyering and the rules of professional responsibility cannot be applied to matters involving legal finance in a mechanistic fashion. While some requirements imposed on lawyers by the law of lawyering and the rules of professional responsibility may be straightforward, sometimes those requirements will require interpretation based on balancing the competing interests underlying the enterprise of regulating the legal profession.[61] Clients will view their interest in obtaining the financial resources to pursue their legal interests as paramount; sometimes this will align with their lawyers' interests in loyally promoting their clients' legal interests.[62] However, sometimes a lawyer's interests in ensuring that his or her client has sufficient financial resources might be rooted in more selfish concerns, and then the lawyer's efforts to help his or her client receive legal finance should be limited by concerns based on loyalty towards the client's other interests.[63] Similarly, sometimes a client's interest in obtaining resources to pursue litigation may conflict with a jurisdiction's policy of hostility to strangers engaging in "officious intermeddling."[64] In that case, the lawyer may have an obligation to counsel his or her client to abandon his or her pursuit of legal finance or to withdraw from the representation.[65]

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59. *See generally id.*

60. *See* Joshua G. Richey, Comment, *Tilted Scales of Justice? The Consequences of Third-Party Financing of American Litigation*, 63 EMORY L.J. 489, 503 (2013).

61. *See, e.g.*, Orintha E. Karns, *Two's Company, Three's a Crowd? The Implications of Attorney Liability to Non-Client Beneficiaries*, 5 WYO. L. Rev. 525, 537–39 (2005) (discussing the rationale for abolishing the privity requirement for whether a duty of care was owed to a non-client).

62. *See* David P. Atkins & Marcy Tench Stovall, *Litigation Funding: Ethical Considerations for the Plaintiff's Lawyer*, CONN. LAW., Jan.–Feb. 2017, at 25.

63. *Id.*

64. "A financier becomes an officious intermeddler when he or she offers unwanted advice or otherwise attempts to control the litigation for the purpose of stirring up strife or continuing a frivolous lawsuit." Osprey, Inc. v. Cabana Ltd. P'shp., 532 S.E.2d 269, 278 (2000).

65. For example, a lawyer should counsel a client to refuse any funding agreement that allows a funder to take control of any settlement, which would be seen as against public policy in every state or withdraw from representation if the client persists in granting the funder control. Arguably, this is what should have happened in the following cases. *See* Mize v. Kai, Inc., No. 17-CV-00915-NYW, 2018 WL 1035084, at *5 (D. Colo. Feb. 23, 2018); Carton v. Carroll Ventures, Inc., No. CIV 17-0037 KG/SCY, 2017 WL 8941281, at *4 (D.N.M. July

II. THE ETHICAL LANDSCAPE

A. *A Survey of the Problem*

Before any kind of comprehensive review of the duties imposed by the law of lawyering and the rules of professional responsibility on lawyers involved in any way in legal finance can occur, one last set of distinctions must be drawn. The general assumption behind legal finance is that the primary beneficiary is the claimholder and that for this reason, the legal funder is contracting with the claimholder.[66] This assumption is true as a historical matter, and conceptually, the most direct and obvious form of legal finance is between the claimholder and the funder.[67] Because the funder is directing money to the claimholder, who is a client of a lawyer, this form of legal finance is called "client-directed funding."[68] In this form of legal finance, the claimholder and the funder are counterparties to a contract; the contract is governed by the law of whatever jurisdiction is applicable (the parties may choose to be governed by the law of a jurisdiction other than where they have contracted), and the claimholder's obligations are contingent on certain conditions set out in the contract relating to the claimholder's litigation.[69] It is important to recognize that the law that directly controls legal finance is not the law of lawyering and the rules of professional responsibility, but the relevant domestic law of the jurisdiction that governs the conduct of the claimholder and the funder, neither of whom are acting as lawyers in connection to the contract.[70] The law of lawyering and

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10, 2017). Both cases discuss a funding scheme by a funding entity which funded discrimination cases brought under the Americans with Disabilities Act. Under the scheme, the funding agreement purported to limit the plaintiffs' ability to discontinue the litigation or settle without the funder's prior consent as well as to require plaintiffs to settle if so directed by the funder. The funding agreement also had the effect of awarding plaintiffs $50 per case with all other proceeds going to the funder and attorney.

66. *See* Maya Steinitz & Abigail C. Field, *A Model Litigation Finance Contract*, 99 IOWA L. REV. 711, 734–35 (2014).

67. *See* Peter Jarvis & Trisha Thompson, *The Case for Lawyer-Directed Funding in NY: Part 2*, LAW360 (Jan. 11, 2019, 1:55 PM), https://www.law360.com/articles/1117865/the-case-for-lawyer-directed-litigation-funding-in-ny-part-2.

68. To my knowledge, the first use of this term (and "client-directed funding") was Peter Jarvis & Trisha Thompson, *The Case for Lawyer-Directed Litigation Funding In NY: Part 1*, LAW360 (January 10, 2019, 3:07 PM), https://www.law360.com/articles/1117362/the-case-for-lawyer-directed-litigation-funding-in-ny-part-1.

69. *See* Robert Glenn, Note, *The Efficacy of Choice-of-Law and Forum Selection Provisions in Third-Party Litigation Funding Contracts*, 41 CARDOZO L. REV. 2243, 2248–49, 2256–57 (2020).

70. Client-directed legal finance can also occur in the context of arbitration. This has led to an effort among the international arbitration community to

the rules of professional responsibility become relevant, as a secondary matter, in that the claimholder's lawyer is obliged to insure that his or her client's legal interests are not affected by the contract with the funder and, to the extent that they are affected, that the client receives competent legal counsel about the effect of the contract on the client's legal interests.[71] In addition, the client may request the lawyer take certain steps on his or her behalf as a result of the contract with the funder, and the lawyer may not be able to comply with any given request related to the client's contract with the funder, or can comply only by taking certain affirmative steps required by the law of lawyering and the rules of professional responsibility.[72]

Client-directed legal finance must be distinguished from at least two other kinds of legal finance. The most important contrast is with legal finance in which the primary beneficiary of the funding is the lawyer, and the funder is contracting with the lawyer. Because the funder is directing money to the lawyer and not the lawyer's client, this form of legal finance is called "lawyer-directed finance."[73] In this form of funding, the lawyer and the funder are counterparties to the contract and the lawyer's client is not a party.[74] In fact, in theory, the client need not even know that the client has engaged in legal finance.[75] As in client-directed legal finance, the primary relationship is governed by a contract, which is governed by the law of whatever jurisdiction is applicable (the parties may choose to be governed by the law of a jurisdiction other than where they have contracted).[76] In the case of lawyer-directed legal finance, the lawyer's obligations are contingent on certain conditions set out in the contract relating to the lawyer's client's litigation.[77] The law of lawyering and the rules of

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develop voluntary rules that would govern the conduct of lawyers whose clients receive legal finance in international arbitrations. *See* INT'L COUNCIL FOR COM. ARB., REPORT OF THE ICCA-QUEEN MARY TASK FORCE ON THIRD PARTY FUNDING IN INTERNATIONAL ARBITRATION 196–77 (2018). The Queen Mary Report is the project of an international group of arbitration lawyers working under the auspices of an English institution. *Id.*

71. *See* Jarvis & Thompson, *supra* note 68.

72. *See generally* Joanna L. Storey, *The Ethics of Third-Party Litigation Funding*, THE BAR ASS'N OF S.F. (June 21, 2021), https://www.sfbar.org/blog/the-ethics-of-third-party-litigation-funding/.

73. *See* Jarvis & Thompson, *supra* note 68.

74. *Id.*

75. The New York City Bar Association's Working Group on Litigation Funding issued a report which includes, among other recommendations, two competing recommendations about amendments to N.Y.R.P.C. 5.4(a) to allow law firm financing. *See* N.Y.C BAR ASS'N, REPORT TO THE PRESIDENT BY THE NEW YORK CITY BAR ASSOCIATION WORKING GROUP ON LITIGATION FUNDING 20–33 (February 28, 2020), [hereinafter "WORKING GROUP REPORT"]. One ("Proposal A") would require the client's informed consent to the financing. *Id.*

76. *See* Glenn, *supra* note 69, at 2248–49.

77. *See* Jarvis & Thompson, *supra* note 68.

professional responsibility are relevant in legal finance much more immediately and urgently than in client-directed legal finance. This is for many reasons, the most obvious, as will be discussed below, is that legal finance is prohibited by the rule against fee-splitting (Rule 5.4(a)) and other policies intended to guard against interference with the professional independence of lawyers and the unauthorized practice of law.[78]

There is a third form of legal finance which is distinguishable from either client-directed legal finance or lawyer-directed legal finance. This third type involves legal finance for litigation in class actions or mass actions.[79] It could be called group-directed funding, although there is no established nomenclature. Unlike legal finance which has an easily identifiable history and market in the United States or legal finance which is the subject of a great deal of current debate (and therefore is also easy to identify), group-directed funding is hard to define and observe in the marketplace.[80] In contrast, in Australia, group-directed funding is easy to define and observe, since it is the primary form of legal finance in that legal system.[81] The vast majority of legal finance transactions involve funders, such as IMF, soliciting and purchasing contingent interests in small value securities claims which are then litigated by law firms that receive indemnification for expenses from the funder (the funder also will assume the responsibility of any adverse costs assessed against the class if the case fails).[82] Certain features of Australian class action law make this form of legal finance both efficient and necessary; the chief feature being that Australian class actions are "opt-in."[83] Since every class action in Australia requires some degree of individual contact with every potential claimholder, the infrastructure required to secure contracts with these individuals already has been built by law firms and other firms that specialize in outreach to potential counterparties.[84] The same is true in the Netherlands.[85] Ontario also has a well-developed procedure for investment in class actions, although its class action law follows the American "opt out" approach

78. *Id.*

79. *See, e.g.*, *Mass tort and litigation funding*, YIELDSTREET (July 6, 2017), https://www.yieldstreet.com/resources/article/mass-tort-and-litigation-funding/.

80. *See* AM. BAR ASS'N, *supra* note 22. For a good survey of the hurdles facing group-directed funding in class actions (and the possibility of overcoming them), *see* Brian T. Fitzpatrick, *Can and Should the New Third-Party Litigation Financing Come to Class Actions?*, 19 THEORETICAL INQUIRIES L. 109 (2018).

81. *See* Michael Legg et al., *The Rise and Regulation of Litigation Funding in Australia*, 38 N. KY. L. REV. 625, 631–33 (2011).

82. *See id.* at 626–33.

83. *See* GIAN MARCO SOLAS, THIRD PARTY FUNDING: LAW, ECONOMICS AND POLICY 46 (2019).

84. *See generally* Legg et al., *supra* note 81, at 626–33 (describing the funding relationship between claimant and funder in Australia).

85. *See* SOLAS, *supra* note 83, at 112–13.

which means that the consent of the class members to third-party investment requires judicial supervision.[86]

None of the well-established practices and legal doctrines that govern foreign group-directed funding are found in the United States.[87] Federal class action law says nothing about nonlawyers funding the class's legal action in exchange for a contingent interest in the proceeds.[88] While there is a very large and detailed common law emerging around the question of how federal courts should determine how much of the proceeds recovered by a class should be paid over to the class's lawyers, based in part on the risk that the lawyers took with their own capital, all of it assumes that third parties, if they play any role in funding class action litigation, do so through side agreements with the lawyers, and those side agreements are simply expenses borne by the lawyer and are revealed only when there is a motion for fees.[89] And yet, there have been arguments raised by defendants that where third-party funders offer capital on a non-recourse basis, the lawyers' decision to use this kind of funding is so significant that the defendants and the court should be made aware of it during the application for appointment of lead class counsel.[90] In the context of class action, proponents of disclosure have argued that the existence of group-directed funding is necessary for a court to evaluate the adequacy of class counsel under Federal Rules of Civil Procedure ("FRCP") 23(a)(4)'s adequacy-of-representation prerequisite.[91]

Outside the class action context, concern has been raised that clients and lawyers are receiving legal finance in mass actions that have been consolidated into Multidistrict Litigation ("MDL") under 28 U.S.C. § 1407.[92] Anecdotal evidence reflects that some plaintiffs

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86. *See* Kalajdzic et al., *supra* note 32, at 113–15.

87. *See* Hensler, *Future of Mass Litigation*, *supra* note 1, at 320–21.

88. *See* Fitzpatrick, *supra* note 80, at 115–123; Hensler, *Third-Party Financing of Class Action Litigation*, *supra* note 1, at 515–16.

89. *See* Tyler W. Hill, Note, *Financing the Class: Strengthening the Class Action Through Third-Party Investment*, 125 YALE L.J. 484, 495–96 (2016).

90. *See* The Litigation Funding Transparency Act of 2021, S. 840, 117th Cong. (2021). This bill has been introduced in each Congress since 2017. *See* S. 2815, 115th Cong. (2018).

91. *See* Aaseesh P. Polavarapu, Comment, *Discovering Third-Party Funding in Class Actions: A Proposal for In Camera Review*, 165 U. PA. L. REV. ONLINE 215, 233–34 (2017) (suggesting an affirmative duty on parties to disclose third-party funding agreements for *in camera* review). The argument has found support in Gbarabe v. Chevron Corp., 2016 U.S. Dist. LEXIS 103594 (N.D. Cal. Aug. 5, 2016), where a lawyer seeking appointment as lead counsel was required to disclose the terms of a commercial legal finance agreement. *Id.* at *2.

92. *See Request for Rulemaking to the Advisory Committee on Civil Rules*, LAW. FOR CIV. JUST. 10–11 (Aug. 10, 2017), http://www.lfcj.com/uploads/1/1/2/0/112061707/lcj_request_for_rulemaking_concerning_mdl_cases_8-10-17.pdf.

in MDLs engage in client-directed finance.[93] The policy concern behind disclosure in connection with MDLs is—according to its proponents—the risk that legal finance companies are financing so-called lead generators or aggregators.[94] The facts behind this concern are hard to evaluate, since the practices lumped under the terms "lead generator" or "aggregator" are vague and involve activities that may be performed by lawyers and nonlawyers.[95] In general, these third parties help lawyers seeking to participate in MDLs of other mass actions find clients.[96] Unlike class actions, which may provide for more transparency (in theory) because of the fiduciary-type power of a federal judge under FRCP 23, MDLs are relatively opaque.[97] The putative connection between disclosure of group-directed finance and MDLs is that if defendants and courts in MDLs can learn about the interest third parties have in lead generation, the risk of frivolous and fraudulent claiming will be reduced.[98] For this reason, the Lawyers for Civil Justice have proposed amending FRCP 26 so that "any third-party claim aggregator, lead generator, or related business or individual, who assisted in any way in identifying any potential plaintiff(s)" would be disclosed.[99]

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93. "This is not the first instance, nor likely the last, where defendants in a MDL mass tort case seek discovery directed to plaintiffs' litigation funding." *In re* Valsartan N-Nitrosodimethylamine (NDMA) Contamination Prods. Liab. Litig., 405 F. Supp. 3d 612, 614 (D.N.J. 2019).

94. *Id.*

95. *See* Paul M. Barrett, *Need Victims for Your Mass Lawsuit? Call Jesse Levine*, BLOOMBERG BUSINESSWEEK (Dec. 12, 2013), http://www.bloomberg.com/bw/articles/2013-12-12/mass-tort-lawsuit-lead-generator-jesse-levine-has-victims-for-sale (examining the mass tort lead generation business).

96. *See* Jason Rathod & Sandeep Vaheesan, *The Arc and Architecture of Private Enforcement Regimes in the United States and Europe: A View Across the Atlantic*, 14 U. N.H. L. REV. 303, 360 (2016) ("[A]ttorneys litigating these cases assemble large inventories, usually with the assistance of a cottage industry of lead generation and referral firms.").

97. *See* Elizabeth Chamblee Burch & Margaret S. Williams, *Judicial Adjuncts in Multidistrict Litigation*, 120 COLUM. L. REV. 2129, 2189–90 (2020).

98. *Request for Rulemaking to the Advisory Committee on Civil Rules*, LAW. FOR CIV. JUST. (Aug. 10, 2017) at 11–12, http://www.lfcj.com/uploads/1/1/2/0/112061707/lcj_request_for_rulemaking_concerning_mdl_cases_8-10-17.pdf. As the Advisory Committee on Federal Rules has observed, the Chamber's first efforts began in 2014. *See Agenda Book, Advisory Committee on Civil Rules*, U.S. COURTS (Oct. 5, 2021) at 371, https://www.uscourts.gov/rules-policies/archives/agenda-books/advisory-committee-civil-rules-october-2021 [hereinafter Agenda Book].

99. *See Request for Rulemaking*, *supra* note 98, at 12; *see also* Amanda Bronstad, *Federal Rules Advisory Panel to Eye Litigation Financing—Sort Of*, NAT'L L.J. (Nov. 8, 2017), https://www.law.com/nationallawjournal/sites/nationallawjournal/2017/11/08/federal-judicial-panel-to-consider-litigation-financing-sort-of/ ("A federal judicial

The Litigation Funding Transparency Act of 2021 (the "Act") would also require automatic disclosure of any agreement which provides for payment to a commercial third party contingent upon proceeds being generated in a case within the jurisdiction of 28 U.S.C. § 1407, the federal law governing MDLs.[100] The policy justification for extending the scope of disclosure beyond class actions to MDLs in the Act is not clearly stated by its sponsors, but supporters of the Act have suggested that group-directed finance in MDLs "allows hedge funds to . . . charge sky-interest rates—sometimes up to 200 percent—and leave plaintiffs [in MDLs] with settlements of just pennies on the dollar."[101] This is not an argument for the regulation of group-directed finance in MDLs *per se*, as opposed to disclosure in any federal case (which is what the proponents of changes to FRCP 26 have recommended) and it is not clear how disclosure would address any legal ethics violations that are connected to the financing of individual plaintiffs, since a federal judge has no authority to determine compensation for individuals in an MDL (although a judge can monitor the allocation of common benefit fees where there is an agreement by all parties to settle while a court retains jurisdiction under 28 U.S.C. § 1407).[102]

Where MDL lawyers contract directly with funders in order to raise capital to pay for the expenses of pursuing the MDL, the transaction is, technically, a type of legal finance.[103] Like in a class action, a court could take an interest in the fact that a law firm seeking a leadership role in an MDL needs (or wants) to receive third-party funding, and some courts have begun to require disclosure, either as part of the application for leadership or later in the proceeding.[104] Since courts have to approve settlements that specify the amount that MDL leadership firms take from other lawyers as part of the common benefit fund, an argument could be made that a court should know whether any portion of that common benefit is going to be diverted to a nonlawyer investor.[105]

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body plans to look into rules changes concerning disclosure of third-party financing of litigation—a move praised by the U.S. Chamber of Commerce—but the breadth of that probe could be limited.").

100. *See* Litigation Funding Transparency Act of 2021, S. 840, 117th Cong. § 3 (2021).

101. *See* Lisa A. Rickard, *Who's Behind the Curtain? Congress Needs to Require Third-Party Litigation Disclosure*, DES MOINES REG., June 4, 2018, at 2.

102. *See* Morris A. Ratner, *Achieving Procedural Goals Through Indirection: the Use of Ethics Doctrine to Justify Contingency Fee Caps in MDL Aggregate Settlements*, 26 GEO. J. LEGAL ETHICS 59, 59–60 (2013).

103. *See* Travis Lenker, *Law Firm with Litigation Finance Ties Takes on Opioid Crisis*, THE AM. LAW., May 7, 2018.

104. *See* D.N.J. Civ. R. 7.1.1.

105. *See* Maya Steinitz, *Follow the Money? A Proposed Approach for Disclosure of Litigation Finance Agreements*, 53 U.C. DAVIS L. REV. 1073, 1111 (2019).

It must be emphasized that group-directed finance is, for the moment, more a matter of academic interest than actual practice.[106] What makes the group-directed finance cases where the contract is between the lawyer and the funders different from legal finance in the non-mass context is the role of the tribunal.[107] It seems inevitable, in either the class or MDL context, that the court will have the opportunity, if not the desire (or legal mechanism), to review and perhaps revise the final fee earned by the lawyers based, in part, on the existence and terms of the third-party funding agreement.[108] Currently, to the extent that legal finance occurs, there is no mechanism for a court to review the terms of the contract between the lawyer and funder; it is seen as a private matter no different from a recourse loan document or the factoring of legal fees.[109] So far, efforts to amend the Federal Rules of Civil Procedure to address group-directed finance, specifically, have been met with skepticism.[110] Still the differences between group-directed finance and the mainstream of client-directed legal finance warrants treating group-directed finance, to the extent that it exists, as a separate phenomenon. For that reason, I will not include it in the analysis of the ethical rules applicable to lawyers whose clients secure legal funding.[111]

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106. *See generally* Elizabeth Chamblee Burch, *Financiers as Monitors in Aggregate Litigation*, 87 N.Y.U. L. REV. 1273 (2012); Myriam Gilles & Anthony Sebok, *Crowd-Classing Individual Arbitrations in a Post-Class Action Era*, 63 DEPAUL L. REV. 447 (2014); Charles R. Korsmo & Minor Myers, *Aggregation by Acquisition: Replacing Class Actions with a Market for Legal Claims*, 101 IOWA L. REV. 1323 (2016). This discussion should be kept separate from the topic of bank lending to lawyers involved in mass actions, which is a different form of financing. *See* discussion of "Phase Two" and "Phase Three" lending to lawyers, in Engstrom, *Lawyer Lending*, *supra* note 1, at 389–94.

107. *Cf.* FED. R. CIV. P. 23(h) (applying only to a "certified class action").

108. *Cf.* Frame v. Hillman, No. 01–CV–2193 H(LAB), at *4, *10 (S.D. Cal. Jul. 31, 2002) (reviewing the reasonableness of attorney's fees in light of a settlement agreement setting aside money to cover recovery in subsequent litigation and class counsel's promise to collect "the remaining balance of any award" from the subsequent litigation").

109. Indeed, there seems to have been no litigation about "third-party financing of class actions or derivative claims." Korsmo & Myers, *supra* note 106, at 1349.

110. In its latest review of the issue, the Advisory Committee chose to take no action, and adopted a memorandum which recommended that "the Committee will continue to monitor developments." *See* Agenda Book, *supra* note 98, at 371.

111. I hope to address group-directed legal finance in a future academic article.

B. The Application of the Rules to Legal Finance

1. Rules concerning the client – lawyer relationship

a. Competence (Rule 1.1)

The most basic duty a lawyer owes a client is competent advice in regard to the subject matter of the representation.[112] Regardless of whether the lawyer and client agree to extend the scope of representation to include advice and services broader than the original scope of representation (so as to include new matters that include legal finance), the lawyer owes the client competent advice to the extent that legal finance touches and concerns the current matter.[113] So, for example, if a jurisdiction permits an adverse party to move for dismissal if the client takes legal finance because doctrines of champerty are still in force, it is clearly within the scope of the current representation for the lawyer to recommend to the client that he or she refuse to accept third-party funds.[114] While a lawyer may not be a specialist in legal finance and competency does not require that the lawyer acquire specialist knowledge (unless holding him or herself out as such), a lawyer who accepts representation in an area of law that is touched by or concerned with a legal finance agreement must know at least enough to understand the consequences of the client taking legal finance.[115]

If the client does not extend the scope of representation to include counseling about legal finance, it is doubtful that the lawyer's duty of competency includes an obligation to inform the client about the possibility of funding.[116] Even if the client asks the lawyer for

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112. "According to the ABA Model Rules, competence is the primary consideration in evaluating the client-lawyer relationship." Susan R. Martyn, *Lawyer Competence and Lawyer Discipline: Beyond the Bar?*, 69 GEO. L.J. 705, 717 (1981).

113. *Cf.* MODEL RULES OF PRO. CONDUCT r. 1.4(b) (AM. BAR ASS'N 2020) ("A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation."); *id.* at r. 2.1 (in giving advice, a lawyer may refer to "other considerations" including "economic" ones).

114. *See* Toste Farm Corp. v. Hadbury, Inc., 798 A.2d 901, 906 (R.I. 2002); *see also* N.Y. State Bar Ass'n Comm. on Pro. Ethics, Op. 769 (2003) ("If what is proposed is illegal, then it would be unethical for an attorney to recommend the action or assist the client in carrying it out.").

115. *See* Maria-Vittoria Carminati, *Five Common Misconceptions About Litigation Funding*, ABA (February 22, 2022), https://www.americanbar.org/groups/litigation/committees/commercial-business/practice/2022/five-common-misconceptions-about-litigation-funding/ ("Thus, a basic working knowledge of this growing field can serve to benefit litigators of all backgrounds as well as the various clients they represent.").

116. *See* Complaint, Francis v. Mirman, Markovits & Landau PC, 180 A.D. 646 (N.Y. App. Div. 2020) (No. 29993/10).

advances for living expenses, which the lawyer is obliged under Rule 1.8(c) to refuse, the lawyer is not under an obligation to offer the client information about alternative sources of funds.[117] If the client asks the lawyer about legal finance or about a specific funder, the lawyer may respond but would have to determine, based on the context of the inquiry, whether the client is asking for a law-related service simply by asking for information or an opinion about a funder.[118]

Does the duty of competency extend to the lawyer informing the client of alternatives to fund litigation expenses which the lawyer is conventionally authorized to expend on the client's behalf? This is a question which has interesting (and important) theoretical dimensions, but it is moot in the consumer legal finance context, since lawyers in the personal injury space rarely—if ever—ask clients to provide funds for litigation expenses ex ante.[119] However, it is not inconceivable that a lawyer could offer a client a lower contingent fee in exchange for the client securing litigation expenses from a third-party funder. Given that, as a matter of practice, concessions on contingent fees are rarely offered in exchange for a client bearing the cost of legal expenses in his or her own case, there is no basis for asserting that a competent attorney has a duty to propose third-party funding as part of a menu of options that would include a lower contingent fee.

b. Scope of representation (Rule 1.2)

While there is no duty under Rule 1.1 for a lawyer to advise the client of the possibility of legal finance, if the client asks the lawyer to provide legal services in connection with legal finance, the lawyer may choose to extend the scope of representation to include all or some of the services requested by the client. The lawyer can refuse, and the lawyer can condition the extension on certain conditions such as certain limitations and payment.[120]

A lawyer may agree, for example, to assist the client with locating and obtaining legal finance by providing the name of a vendor and completing (or assisting in the completion of) an application that will be used by the funder. A lawyer may go further and provide advice about the terms of a legal finance contract. A lawyer might go even further and negotiate on behalf of the client with a funder about terms and even offer to participate in the modification of the legal finance

117. MODEL RULES OF PRO. CONDUCT r. 1.8(c) (AM. BAR ASS'N 1983).

118. The fact that the client is asking for information outside the scope of representation and is not paying for the service provided by the lawyer does not necessarily take it outside of Rule 5.7 since the definition of "law-related service" does not include renumeration paid by the client to the lawyer. *See* MODEL RULES OF PRO. CONDUCT r. 5.7(b) (AM. BAR ASS'N 1983).

119. *See* Jennifer Anglim Kreder & Benjamin A. Bauer, *Litigation Finance Ethics: Paying Interest*, 2013 J. PROF. LAW. 1, 22–23.

120. *See* N.Y. State Bar Ass'n Comm. on Pro. Ethics, Op. 769 (2003).

contract based on the client's stated ends. This final possibility is more theoretical than practical, since consumer legal finance companies do not have the resources to negotiate contracts on an individual basis or to amend contracts to reflect the outcome of negotiations with individual consumers.[121] Commercial legal finance contracts are the opposite: like commercial insurance policies, where "binders" are the result of active negotiation, commercial legal finance contracts are typically custom documents resulting from personal negotiation.[122]

A lawyer may request compensation for legal services in connection with the legal finance contract.[123] Where those services are clearly designated as supplemental to the original scope of representation, a lawyer may request additional compensation as long as the request complies with Rule 1.5 (b) ("Any changes in the basis or rate of the fee . . . shall also be communicated to the client.").[124] A lawyer should be aware of the consequences of providing services in connection with a legal finance contract and decide whether to limit their services accordingly or to extend representation under certain limitations and for fair compensation.[125] In addition to the risk of both discipline and malpractice for services that fail to meet the standard of care (in the eyes of a factfinder) or Rule 1.1 (in the eyes of a disciplinary committee), the cost in time and sometimes money of adequately meeting a client's needs in connection with a legal finance contract may be considerable.[126]

As mentioned earlier, if the client requests a review of the terms of a contract, the lawyer must spend some time learning enough about the market to provide this advice.[127] If the client requests that the lawyer actively negotiate with the funder, the lawyer will have to expend time and resources negotiating funding terms, including price, on behalf of the client. If the client requests that the lawyer determine what confidential materials should be provided to the funder in order to allow the funder and client to agree on whether to

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121. *See* Laina Miller, *The Difference Between Commercial and Consumer Litigation Funding and Why It Matters*, VALIDITY FIN., https://validity-finance.com/insights/commercial-consumer-litigation-funding-explained/ (last visited May 3, 2022).

122. *See id.*; Peter Nash Swisher, *Insurance Binders Revisited*, 39 TORT TRIAL & INS. PRAC. L.J. 1011, 1013, 1037 n.102 (2004).

123. *See* Ky. Bar Ass'n, Op. KBA E-432 (2011).

124. MODEL RULES OF PRO. CONDUCT r.1.5(b) (AM. BAR ASS'N 1983).

125. *See* N.Y. State Bar Ass'n Comm. on Pro. Ethics, Op. 1108 (2016).

126. *See* MODEL RULES OF PRO. CONDUCT r. 1.1 (AM. BAR ASS'N 1983).

127. *See supra* Subpart III-B, at 121 ("Regardless of whether the lawyer and client agree to extend the scope of representation to include advice and services broader than the original scope of representation (so as to include new matters that include legal finance), the lawyer owes the client competent advice to the extent that legal finance touch and concern the current matter." (footnote omitted)).

form a contract, the lawyer will have to expend time considering at what point the irreducible risks connected with disclosure of confidential material outweigh the benefits of the prospective legal finance contract. If the client asks the lawyer to perform services on behalf of the legal finance funder, such as completing a questionnaire about the client's case or communicating with the legal finance funder about the status of the case (especially alerting the legal finance in the event of a final order), all these responsibilities take time. Finally, as will be explored below in the discussion of Rule 1.15, even in a case where there is no disagreement between the client and the legal finance funder over the right of the funder to proceeds, the lawyer may be obliged to spend time negotiating between the legal finance funder and the client (as well as other persons who have an interest in the client's proceeds, such as other lienholders or assignees) if the proceeds are not sufficient to pay all persons with an interest in the proceeds (including, it must not be forgotten, the lawyer). All this can take time and are services for which the lawyer must decide, ex ante, whether the client will pay an additional fee.

Throughout this Article, various obligations relating to the lawyer's representation of a client who has secured legal finance are referenced and discussed in detail. However, most of these obligations would lack any foundation were the lawyer to establish from the outset that the scope of representation in the matter does not include any legal advice or services to the client with regard to the legal finance contract. Also, were the lawyer to decline to perform a service on behalf of the client, upon which a third party (e.g., the funder) could reasonably rely, the lawyer could eliminate any duty of care to that third party.[128]

Of course, such scrupulous refusal by a lawyer of any connection to a client's activities in connection with legal finance is unlikely for many practical reasons, and a client might well be justified in resenting a lawyer who refused to aid the client in the pursuit of a financing sought by the client for reasons which are both justified and common. (It should be noted that the lawyer is, in a very real way, insisting that the client retain a second lawyer, which clients may view as additional expense for no good reason.)[129] Nonetheless, while it is likely that no lawyer will completely refuse a request by the client

128. *See* RESTATEMENT (THIRD) OF THE L. GOVERNING LAWS. § 51(2) (AM. L. INST. 2000).

129. *See generally* Lisa G. Lerman, *Blue-Chip Bilking: Regulation of Billing and Expense Fraud by Lawyers*, 12 GEO. J. LEGAL ETHICS 205, 225 (1999) ("As long as some lawyers deceive their clients about how much time they are spending or what they are doing, all clients worry. If clients lose confidence that there is some objective basis for the amount they are billed, or if clients lose confidence that their lawyers are candid about the basis for their bills, who could fault clients who become suspicious, demanding itemization and compliance with restrictions?").

to extend the scope of representation to include matters relating to legal finance (as opposed to simply withdrawing from representation or suffering discharge), it is possible that a lawyer will tailor the extension of the scope of representation to reflect his or her specific comfort level with the additional time and liability exposure that the extension represents. The same can be said for the demand by the lawyer for compensation. While some lawyers may feel uncomfortable asking clients to pay additionally for an extension of the scope of representation to include matters relating to legal finance, others will, depending on the additional burden imposed by the extension, ask for additional payment for services relating to the client's legal matters relating to legal finance.

c. Communication (Rule 1.4)

If the analysis of the relation between legal services related to legal finance and the scope of representation entailed by representation unmodified by an extension of the scope of representation is correct, then communication about legal finance is not within the communications regulated by Rule 1.4.[130] In other words, unless separately and independently agreed to, the lawyer is not obliged under Rule 1.4(b) to reasonably consult with the client about legal finance because it is not a "means by which the client's objectives are to be accomplished."[131]

However, if the scope of representation is extended to include legal services related to legal finance, the obligations of communication are necessarily extended to the extent that the lawyer must consult with the client about the legal finance contract. Furthermore, if the client has authorized the lawyer to communicate with a legal funder, either as an extension of the legal services provided by the lawyer to the client or as an agent of the client in order to assist in the successful completion of a business transaction with the funder, the lawyer will be under a duty to inform the client about material facts concerning the legal finance contract about which the lawyer becomes aware in the course of representation.[132] So, for example, if the lawyer becomes aware of the fact that the funder intends to enforce contractual rights against the client with regard to the amount owed under the contract, notwithstanding new developments in the matter that would leave the client with little or nothing after the satisfaction of all liens and third-party contractual

130. *See* MODEL RULES OF PRO. CONDUCT r. 1.4(a)(2) (AM. BAR ASS'N 1983) ("A lawyer shall reasonably consult with the client about the means by which the client's obligations are to be accomplished.").

131. *Id.*

132. *See* MODEL RULES OF PRO. CONDUCT r. 1.4(a)(1) (AM. BAR ASS'N 1983) ("A lawyer shall promptly inform the client of any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(e), is required by these Rules.").

obligations, the lawyer is almost certainly under a duty to consult with the client as soon as reasonably possible about the possible conflict over limited funds. This is a duty independent from any other duty that might attach to the lawyer in these circumstances, such as a duty to take affirmative steps to negotiate on behalf of the client with the funder.

d. Fees (Rule 1.5)

If the legal finance contract is between the client and a third party, Rule 1.5 is not directly implicated.[133] It could only be implicated were the existence of the legal finance contract a factor in the fee earned by the lawyer, at which point the total fee would be subject to the test imposed by Rule 1.5(a).[134] As mentioned above, were the funds secured by the legal finance contract used to pay for litigation expenses that would otherwise be advanced by the lawyer, there could be grounds for complaint under 1.5(a) if the lawyer's contingent fee is the same as typically charged to similar clients who do not receive funding from third parties for litigation expenses.[135]

Rule 1.5 is implicated in the legal finance where the lawyer has extended the scope of representation to include legal services related to the legal finance contract itself.[136] As with any other fee, the lawyer may only charge a reasonable fee for those services.[137] Given that the services are typically in the form of advice about and execution of a contract with the funder, lawyers who represent clients in the consumer legal finance market should be careful about amending their standard contingent-fee agreements to accommodate the extension of the scope of representation. Since the service is advice on a contract, there is no economic rationale for structuring the payment on a contingent basis, although "bundling" the extra contract advice into the original contingent-fee contract may be more efficient because it avoids writing two agreements.

Finally, a lawyer who agrees to extend services to include negotiation on behalf of the client after the resolution of the client's litigation should be aware that Rule 1.5(d) requires reasonable notice to the client that the lawyer intends to charge for the extra services separately.[138] In both commercial and consumer legal finance, the extra services required after the resolution of the client's litigation may be considerable and may involve the lawyer in contentious

133. "A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses." MODEL RULES OF PRO. CONDUCT r. 1.5(a) (AM. BAR ASS'N 1983) (regulating attorney-client relationships).

134. *See* N.Y.S. Bar Ass'n Comm. on Pro. Ethics, Op. 1051 (2015).

135. *See supra* notes 124–27 and accompanying text.

136. *See* N.Y.S. Bar Ass'n Comm. on Pro. Ethics, Op. 769 (2003).

137. *See* Model Rules of Pro. Conduct r. 1.5(a) (AM. BAR ASS'N 1983).

138. *Id.* at r. 1.5(d).

negotiations with a new set of parties, including the funder.[139] While in many cases the lawyer's service on behalf of the client may involve nothing more than providing notice to the funder (as well as other parties who have a claim on the client's proceeds under Rule 1.15), in some cases the client may want the lawyer to negotiate a concession from the funder.[140] Again, while there is nothing unique about this request (which clients sometimes ask lawyers to do with holders of liens), the additional service may place new demands on the lawyer quite different from those he or she may have expected when the client first asked for representation or informed the lawyer that a legal finance contact was part of the matter.[141] Research I have done indicates that, in the consumer legal finance market, concessions are negotiated very frequently after the resolution of the client's litigation.[142] While there has been no specific research done on whether lawyers charge separately for acting on behalf of their clients in those cases where concessions have been secured, anecdotal evidence indicates that extra payment for post-judgment concessions in favor of the client is rare.[143] The same may not be true in the commercial legal finance market, but for different reasons. First, it may be the case that the proportion of cases which produce proceeds, far less than anticipated (as opposed to a zero-recovery due to a negative development), is smaller in the commercial market due to the more careful underwriting that market attracts. Second, it may also be that the fee structure negotiated by plaintiff's attorneys in commercial cases is more heterogenous than in the consumer sector. Thus, it may be efficient for lawyers facing a request that the scope of representation be extended to include post-judgment negotiations with the funder to modify the retainer agreement to reflect the extra services that they provide.

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139. *See* Steinitz, *supra* note 1, at 1327–30 (discussing possible reforms to the attorney-funder relationship).

140. "Upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person. Except as stated in this rule or otherwise permitted by law or by agreement with the client, a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such property." MODEL RULES OF PRO. CONDUCT r. 1.15(d) (AM. BAR ASS'N 1983).

141. *See* ABA Comm. on Ethics & Pro. Resp., Formal Op. 472 (2015) ("Communication with Person Receiving Limited-Scope Legal Services").

142. Ronen Avraham & Anthony Sebok, *An Empirical Investigation of Third-Party Consumer Litigant Funding*, 104 CORNELL L. REV. 1133, 1171 (2019).

143. See Jarrett Lewis, *Third-Party Litigation Funding: A Boon or Bane to the Progress of Civil Justice?*, 33 GEO. J. LEGAL ETHICS 687, 700 (2020).

e. Confidentiality (Rule 1.6)

As an agent of the client, a lawyer is authorized to reveal confidences reasonably necessary to secure the client's ends in the representation.[144] Since legal finance is not part of the ends for which the client has retained the lawyer, unless added as an end by the client and as part of the extension of the lawyer's scope of representation, a lawyer is not permitted to reveal confidences concerning the matter unless explicitly authorized to do so by the client.[145]

This means, for example, that the lawyer may not contact a potential legal funder without the client's permission and cannot offer information about a matter to a potential legal funder without the client's permission.[146] On the other hand, clients often approach lawyers about the possibility of legal finance, and, upon that initial contact, the lawyer is authorized, within reason, to communicate confidences to funders in order to achieve the client's ends, which now include investigating and possibly contracting for funding.[147]

Two questions remain once the ground for revealing confidences to a funder under Rule 1.6 is clearly established. First, how much, or to put it differently, what sort of confidentiality is reasonably related to the client's end? For the lawyer, a cautious approach would be to return to the client frequently to get explicit consent for every new type of confidence: that litigation is being considered (if it has not already been filed); the basis of the claim (if it is not already revealed in a complaint); the damages the client believes can be reasonably obtained; opinions about settlement; details about the claim that have not, and may not, be revealed in documents filed with the court; and other information obtained by the lawyer in the course of representation that may be important to a potential or actual funder, such as the financial condition of the client and the number and scale of claims against the client by secured and non-secured creditors. The second question is related to the first: to the extent that the client is authorizing the lawyer to communicate confidential information that would be protected from discovery under a privilege (either attorney-client or work-product), under what circumstances can it be said that the client has implicitly authorized the disclosure? The question implicates Rule 1.1 and Rule 1.4 because the lawyer is under an obligation to competently advise the client about choices that would affect the litigation, and the lawyer is under an obligation to communicate to the client with regard to decisions that would expose

144. *See* Model Rules of Pro. Conduct r. 1.6(a) (AM. BAR ASS'N 1983).

145. *See* AMERICAN BAR ASSOCIATION, ABA'S COMMISSION ON ETHICS 20/20, INFORMATIONAL REPORT TO THE HOUSE OF DELEGATES ON ALTERNATIVE LITIGATION FINANCE 31–32 (2011) [hereinafter Ethics 20/20 Report].

146. *See* N.Y.C. Bar Comm. on Pro. Ethics, Formal Op. 2 (2011).

147. Phila. Bar Ass'n Prof'l Guidance Comm., Advisory Op. 99-8 (2000).

the client to an increased risk that their litigation ends would not be achieved.[148] A client may well want to increase the risk that communications that would otherwise be unavailable to the adverse party would be made available as a result of the lawyer's authorized disclosures, but that is a decision which the client should make. The lawyer has a duty to inform the client about the choice, and the lawyer has a duty to competently assist the client in making the choice.[149] This latter duty involves the lawyer both giving accurate information to the client (and, to the extent possible, providing a prediction about the likelihood that a court could find the waiver of a privilege) as well as offering legal advice about whether it is advisable to risk the waiver (although, in the end, the decision whether to provide the communication to a funder belongs to the client).

f. Concurrent conflict of interest (Rule 1.7)

Legal finance contracts may generate a concurrent conflict of interest between a lawyer and client in two ways: concurrent representation and material limitation.

i. Concurrent representation

Concurrent representation occurs when the lawyer has a lawyer-client relationship with the funder in addition to the client.[150] In theory, nothing prevents a lawyer from having a "triangular" relationship with both the client and the funder, who have a contractual relationship with each other. The triangular relationship is similar to the triangular relationship between the lawyer, client, and the liability insurer who pays for the lawyer on behalf of the client per the terms of the liability contract purchased by the client from the insurer.[151] For example:

> [W]hen a lawyer represents Client A and Client B on the same matter, the scope of the representation of Client A can differ from the scope of the representation of Client B, absent a fatal conflict of interests. The possibility of tailoring the scope definition to each client exists because the definition is governed by agreement. The parties' agreement that the lawyer shall

148. *See* MODEL RULES OF PRO. CONDUCT r. 1.1, 1.4 (AM. BAR ASS'N 1983).

149. "A lawyer shall promptly inform the client of any decision or circumstance with respect to which the client's informed consent . . . is required by these Rules." MODEL RULES OF PRO. CONDUCT r. 1.4(a)(1) (AM. BAR ASS'N 1983).

150. *See* MODEL RULES OF PRO. CONDUCT r. 1.7(a) (AM. BAR ASS'N 1983).

151. *See, e.g.*, Purdy v. Pac. Auto Ins. Co., 203 Cal. Rptr. 524, 533 (Cal. Ct. App. 1984) ("In the case at bench, however, there were in fact two clients, the insurance carrier and the insured."); *see also* Douglas R. Richmond, *Lost in the Eternal Triangle of Insurance Defense Ethics*, 9 GEO. J. LEGAL ETHICS 475, 482 (1996) ("The dual client doctrine reflects the widespread recognition that insurance defense counsel represent both the insurer and the insured.").

> provide a broader range of services for one client than for the other is sufficient to create different scope definitions.[152]

What is true in the case of insurance contracts is certainly even more true in legal finance contracts. The problem with concurrent representation is, absent special rules (such as those developed in the common law of insurance contract interpretation), the emergence of a conflict in a triangular relationship with two clients is likely to force the lawyer to withdraw from representation of both client and funder.[153]

Assuming that the lawyer's primary client is the client seeking legal finance, a funder may seek to become the lawyer's secondary client in much the same way that a lawyer becomes the secondary client of a liability insurer while representing an insured—by express agreement.[154] But it is not clear when, if ever, this would happen in the real world. In most consumer legal finance, the funder is not seeking to establish a predicate to bring a malpractice action against the lawyer, and the lawyer would be disinclined to permit the creation of such a predicate (in the liability insurance context, these circumstances are often quite different).[155] The same is true in the commercial legal finance context, where commercial funders often rely entirely on their own employees (often, experienced lawyers) to evaluate the legal aspects of a client's case before and after funding it.[156] In conclusion, it is hard to imagine under what circumstances a

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152. Charles Silver & Kent Syverud, *The Professional Responsibilities of Insurance Defense Lawyers*, 45 DUKE L.J. 255, 290 (1995).

153. "Generally speaking, the law of professional responsibility does not distinguish between primary and secondary clients. It puts all clients on the same plane, absent an agreement explicitly allowing an attorney to prefer one client to another . . . . Outside the area of insurance defense, the norm is the No Subordination Rule (NSR), which forbids a lawyer from subordinating one client's interests to those of another without both clients' informed consent. Absent a waiver, a lawyer may advocate and pursue only courses of action that make both clients better off. When no available course of action satisfies NSR, the lawyer must withdraw and may not thereafter represent either client in the matter or in a dispute between the clients relating to the failed joint representation." *Id.* at 336.

154. The fact that the lawyer has communicated with the funder about the client's case (with the client's consent, of course) does not give rise to an attorney-client relationship, nor does the fact that the funder has a beneficial interest in the outcome of the client's matter. *See* RESTATEMENT (THIRD) OF THE L. GOVERNING LAW. § 75 cmt. c (AM. L. INST. 2000) ("Co-client representations must . . . be distinguished from situations in which a lawyer represents a single client, but another person with allied interests cooperates with the client and the client's lawyer.").

155. *See generally* Charles Silver, *Litigation Funding Versus Liability Insurance: What's the Difference?*, 63 DEPAUL L. REV. 617 (2014).

156. *Id.* at 620 ("Insurers use the underwriting process to weed out bad risks and policy limits to restrict their exposure to them. Funders use case

funder would seek to retain a lawyer to represent it in the same matter for which it has provided funding. However, if a funder seeks to retain a lawyer under such circumstances, then the lawyer must determine whether the risk of a future conflict is so great that the client (and funder) should not be asked to provide informed consent per Rule 1.7(b).[157] It would seem that in most cases the answer must be no.

ii. Material conflict of interest

A lawyer can avoid any confusion about whether he or she is engaged in a triangular relationship by clarifying to the funder that none of his or her acts or communications are legal services done on behalf of the funder.[158] Nonetheless, as Comment 8 to Rule 1.7 says,

> [e]ven where there is no direct adverseness, a conflict of interest exists if there is a significant risk that a lawyer's ability to consider, recommend or carry out an appropriate course of action for the client will be materially limited as a result of the lawyer's other responsibilities or interests."[159]

> "Other responsibilities" may include fiduciary duties, duties in contract, duties in malpractice owed to non-clients, and personal interests (usually financial).[160]

1. Fiduciary duties owed to both client and funder

Lawyers are often held to have fiduciary duties to their client and are sometimes held to owe fiduciary duties to non-clients as well.[161] Fiduciary duties between a lawyer and a funder might arise in one of two ways. First, the lawyer might owe the funder a duty to invite the funder to rely or trust that the lawyer will guard its interests while

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evaluations, limits on investment size, and plaintiffs' attorneys' willingness to handle claims on contingency to do the same.").

157. *See* MODEL RULES OF PRO. CONDUCT r. 1.7(b)(4) (AM. BAR ASS'N 1983).

158. *See* 1 RONALD E. MALLEN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 8:12 (2022 ed.); *see also* RESTATEMENT (SECOND) OF AGENCY § 15 (AM. L. INST. 1958) (stating that "an agency relation exists only if there has been a manifestation by the principal to the agent that the agent may act on his account, and consent by the agent so to act").

159. MODEL RULES OF PRO. CONDUCT r. 1.7 cmt. 8 (AM. BAR ASS'N 1983).

160. *See generally* MODEL RULES OF PRO. CONDUCT r. 1.7 cmts. 9–12 (AM. BAR ASS'N 1983).

161. *See* John F. Sutton, Jr., *The Lawyer's Fiduciary Liabilities to Third Parties,* 37 S. TEX. L. REV. 1033, 1033 (1996) ("Lawyers owe fiduciary duties to clients. Frequently, lawyers also have well recognized fiduciary relationships with nonclients."). *See also* RESTATEMENT (THIRD) OF THE L. GOVERNING LAWS. § 56 cmt. h (AM. L. INST. 2000).

handling the client's case prior to judgment or settlement.[162] This is extremely unlikely. Mere communication with the funder about the client's case does not in itself establish a fiduciary duty, nor does mere reliance by the funder on past acts by the lawyer.[163] Providing an opinion at the request of the client about the legal merits of the client's case does not create a fiduciary duty.[164]

Second, a lawyer might have a fiduciary duty to the funder arise after the client's case has resulted in proceeds, either as a result of judgment or (more commonly) settlement. Under Rule 1.15, which obliges a lawyer to hold the property belonging to third parties "in connection" with the representation of the client, a lawyer may have a fiduciary duty to a third party with a legal right to a property interest in the client's proceeds.[165] But since, by definition, a client has no right to property which belongs to a third party, there can be no conflict between any duty that arises from the operation of Rule 1.15 and Rule 1.7.[166]

The harder question is whether a lawyer can agree, in advance, to owe a fiduciary duty to a funder in connection with its claim to property produced in connection with the lawyer's representation of the client beyond the fiduciary duty imposed on the lawyer by Rule 1.15. This appears to have been what occurred in *Prospect Funding Holdings (NY), LLC v. Ronald J. Palagi, P.C., L.L.C.*[167] A funder sued a lawyer after the lawyer did not assist the funder in obtaining the funder's putative share of the proceeds due under its contract with the lawyer's client.[168] The funder argued that the lawyer was liable to it for breach of fiduciary duty based on a contract between the lawyer and the funder.[169] In an arbitration, enforced by a federal court, the lawyer was found to have breached a fiduciary duty based on a contract term imposed on him by his signing an "Irrevocable

162. *See* Galardi v. State Bar, 739 P.2d 134, 134 (Cal. 1987) ("It is well settled that an attorney may be disciplined for breach of a fiduciary duty owed to a nonclient.").

163. *See* Mintz v. Accident & Inj. Med. Specialists, PC, 284 P.3d 62, 69 (Colo. Ct. App. 2010) ("Where a [lawyer] has not undertaken a duty to act primarily for another's benefit in matters connected with the undertaking, the [lawyer] is not a fiduciary.").

164. It is possible that the lawyer might be liable for malpractice to a non-client, such as a funder, in connection with the opinion. This is discussed below.

165. *See* Conn. Bar Ass'n Comm. on Pro. Ethics, Informal Op. 95-20 (1995) ("Rule 1.15(b) imposes upon the lawyer a fiduciary duty to protect the 'interests' of those 'entitled to receive' funds or other property in the lawyer's possession.").

166. *Id.*

167. 410 F. Supp. 3d 1077 (D. Neb. 2019).

168. *Id.* at 1080.

169. *Id.*

Letter of Direction" at the same time his client signed a contract with the funder.[170]

There is some reason to be skeptical that a lawyer can add to the fiduciary duties imposed by Rule 1.15 or add any other fiduciary duties to the funder in connection with proceeds that arise from the lawyer's representation of the client.[171] The lawyer's only connection to the proceeds arises from the representation of the client, and the lawyer's duty to the client does not end until the proceeds to which the client has a right are obtained by the client (unless the scope of representation between the lawyer and client is limited).[172] While it is theoretically possible for a lawyer to assume by agreement additional fiduciary duties owed only to the funder, which are in alignment with the duties he or she already owes the client, the lawyer cannot assume any such fiduciary duties if there is a significant risk that the former will conflict with the latter. Beyond the requirements of Rule 1.15, which are mandatory and cannot be waived, it is hard to see, with regard to the proceeds from the client's matter, what additional duty of loyalty a lawyer could owe the funder that would not conflict with the primary duty to secure the client's proceeds.[173] This conclusion is supported by dicta in decisions that have considered the range of non-contractually based fiduciary duties of a lawyer to those with a legitimate claim to a client's proceeds:

> [O]ur conclusion is consistent with the strong policy disfavoring "any rule that would interfere with the attorney's primary duty of robust representation of the interests of his or her client." . . . In other words, a rule creating a fiduciary relationship between an attorney and a third party claiming an interest in the funds of the attorney's client would jeopardize "a

170. A similar claim against a lawyer was successful in Complaint at 23, Prospect Funding Holdings v. Ronald Bakal, Esq., No. 650172/17 (N.Y. Sup. Ct., Jan. 10, 2017).

171. *See* Fast Trak Inv. Co., LLC v. Sax, No. 4:17-cv-00257-KAW, 2018 U.S. Dist. LEXIS 81045, at *1, *3 (N.D. Cal. May 11, 2018) (lawyer agreed to act as a fiduciary of funder "to ensure that any proceeds due to [funder] were properly paid." Although the funder sued the lawyer for breach of fiduciary duty, the issue was not decided by the court).

172. Ohio Sup. Ct., Bd. Of Comm'rs on Grievances and Discipline, Op. 2004-2 (2004) ("A lawyer's legal representation of the client does not end upon reaching a settlement agreement but continues from settlement agreement through the time of receiving and disbursing the settlement money.").

173. Of course, a lawyer may still have a duty imposed by common law to take affirmative steps to assist a third party in securing property to which they have a right, notwithstanding the lawyer's duty of loyalty. *See, e.g.*, Phillips Chiropractic, Inc. v. Ennix, No. E045043, 2009 WL 2883514 (Cal. Ct. App. Sept. 10, 2009) (ordered not published; *see* Cal. Rules of Court) (lawyer held liable in conversion for failing to interplead client funds in dispute).

'central dimension' of the attorney-client relationship," namely, the attorney's duty of undivided loyalty to his or her client.[174]

2. Contract duties owed to both client and funder

Funders, especially in the consumer sector, often ask lawyers to make promises to perform certain services in connection with the funding agreements made with their clients. Sometimes these promises are memorialized by no more than a signature acknowledging that the client has issued to the lawyer an "Attorney Acknowledgement of the Irrevocable Letter of Direction," similar to a Letter of Protection.[175] In other cases, funders have asked lawyers to sign separate agreements that later are the basis for freestanding contractual obligations to the funder.[176] Prospect Funding, a consumer funder, asserted in its complaint in a suit against a lawyer that the lawyer and his firm contracted to do certain things to ensure that the funder would be paid, independent (or in spite of) the client.[177] The funder alleged that the lawyer (and his law firm) were "contractually obligated" to the funder to perform certain acts, including to ensure that the funder "was to be paid by [the client's] attorney . . . out of the funds received from the Personal Injury Action prior to any disbursements being made to" the client.[178] On the basis of this putative contract, the funder sued the lawyer.[179]

There is no doubt that lawyers may make contracts with third parties connected to their client. This can range from lawyers

174. Biller Assocs. v. Peterken, 849 A.2d 847, 853 (2004) (citations omitted).

175. *See, e.g.*, Maslowski v. Prospect Funding Partners, LLC, 890 N.W.2d 756, 759–60 (Minn. Ct. App. 2017). A lawyer may be liable in contract for promises made to a third party in a letter of protection issued at the direction of the client. *See* Conn. Bar Ass'n Comm. on Pro. Ethics, Informal Op. 95-20 (1995) ("Letters of protection issued by lawyers with client authority may create enforceable assignments. Some authorities hold that a lawyer is personally liable for paying funds to a client in the face of an assignment."). However, a lawyer cannot be held liable for a Letter of Protection which he or she did not acknowledge or sign. *See* Yorgan v. Durkin, 715 N.W.2d 160, 165–66 (Wis. 2006) (lawyer is not bound by a Letter of Protection given to a medical provider which the lawyer did not sign or send). Interestingly, one ethics committee has concluded that, although a lawyer can refer a client to a funder, the lawyer cannot sign a letter of protection to the funder, albeit this conclusion was not supported with reasoning. Fla. Ethics, Op. 00-3 (2002).

176. *See, e.g.*, Complaint, Prospect Funding Holdings, LLC v. Flit, No. 1:16-cv-01101 (S.D.N.Y. 2016).

177. *Id.* at 23, 57.

178. *Id.* at 4.

179. A similar claim was made by the same funder against a lawyer in Prospect Funding Holdings, LLC v. Saulter, 102 N.E.3d 741, 741 (Ill. App. 2018). Upon failing to receive payment by the lawyer's client, the funder sued the lawyer for, among other things, breach of contract. The court dismissed the suit without reaching the lawyer's defense that there was no contract between him and the funder. *Id.*

contracting with providers of nonlawyer assistance on behalf of the client, where the lawyer is acting as the client's agent yet paying for the expense, to the so-called "captive" law firms in the liability insurance context, where a lawyer's interest in future assignments may depend on how a current client's matter is handled.[180] To be clear, the question discussed in this Subpart is not whether a lawyer may purport to make a contract with a funder that entails a violation of a duty under the Rules; clearly that conduct is prohibited.[181] The question is whether, consistent with the Rules, a lawyer whose client seeks funding can create a separate contractual obligation with a funder and identify the costs and benefits of this step, were it permissible.

The analysis here is similar to the analysis above in the context of additional fiduciary duties.[182] It is not obvious why a funder needs to form a separate contract with a lawyer to achieve its business objectives. Prior to the completion of the client's matter, the funder can receive the lawyer's assistance as an express or implicit agent of the client.[183] If the funder wants protection against the lawyer's carelessness, the protections provided by a malpractice action by the funder against the lawyer as a non-client, discussed below, should suffice.[184] If the funder is concerned about protection against the client's faithlessness after the completion of the client's matter, it is not clear what the lawyer can contractually promise to do beyond what the lawyer is obliged to do under Rule 1.15. A lawyer's primary duty to the client ensures that the lawyer cannot promise by contract to do more than what the lawyer is obliged to do under Rule 1.15: As Comment 4 says, a "lawyer should not unilaterally assume to arbitrate a dispute between the client and" the funder.[185] Given how slight the benefits are to either the client or the funder, it seems that

180. This is separate from the prohibition of interference in a lawyer's professional judgment. *See* MODEL RULES OF PROF. CONDUCT r. 5.4(c) (AM. BAR ASS'N 1983). Critics of the relationship between "captive" defense law firms and insurers argue that the promise of future legal work and the implied threat that follows may create a material conflict of interest for lawyers. *See* Douglas R. Richmond, *Walking a Tightrope: The Tripartite Relationship Between Insurer, Insured, and Insurance Defense Counsel*, 73 NEB. L. REV. 265, 274 (1994) ("Given the close-knit nature of insurance defense practice, a defense attorney who did not first protect an insurer's interest might well lose business.").

181. The enforceability of a contract between and lawyer and a third party in violation of a duty to a client is an important question, but it is outside of the scope of this Article. *See* SCF Consulting, LLC v. Barrack, Rodos & Bacine, 175 A.3d 273, 277 (Pa. 2017) ("[T]he standards of professional conduct for lawyers do not have the force of substantive law and . . . [the Court] was not inclined to 'allow our trial courts themselves to use the Canons to alter substantive law.'").

182. *See* discussion *infra* Subpart II.B.1.f.ii.1.

183. *See* Galardi v. State Bar, 739 P.2d 134, 137 (1987).

184. *See infra* note 196 and accompanying text.

185. MODEL RULES OF PROF. CONDUCT r. 1.15 cmt. 4 (AM. BAR ASS'N 2020).

the costs necessarily outweigh the making of such contracts, were they even possible. This seems to be the lesson of the lawyers who have sued in some of the cases discussed in this Subpart.[186]

3. Common law duties owed to both the client and the funder.

In addition to common law duties to clients, both for malpractice and breach of fiduciary duties, lawyers may have common law duties to non-clients.[187] Liability by the lawyer to a funder could be grounded on either the principles articulated in Restatement (Third) of the Law Governing Lawyers § 51 or Restatement (Second) of Torts § 552 (1977), depending on jurisdiction.[188] Both ground liability on negligent misrepresentation.[189] Were the lawyer to provide a representation material to the formation or performance of the funding contract which failed to meet the standard of care of a reasonable attorney, it is possible that the lawyer could be held liable for damages.[190]

So far, the risk of actions against lawyers by funders for negligent misrepresentation seems speculative. However, the more immediate question is not whether such causes of action could gain traction, but whether the possibility of claims in tort for negligent (or intentional) misrepresentation creates a personal interest such that a lawyer might be faced with a concurrent conflict of interest with his or her client. The answer to this question seems clearly to be no.

It is hard to imagine under what circumstances a lawyer's interest in satisfying a duty in tort in the course of representing a client seeking legal finance would conflict with the lawyer's duties to the client. While it may be the case that the client might prefer that the lawyer make representations to the funder that are not true, the client has no legitimate interest in the lawyer complying with a preference that results in a misrepresentation to the funder. The lawyer is obliged, first of all, to provide competent representation to the client under Rule 1.1, so the lawyer is obliged to make reasonable efforts to identify and correct misrepresentations the client wishes to make to the funder through the lawyer as agent.[191] Further, were the lawyer to discover that the client knowingly intended to communicate

186. *See* discussion *infra* Subpart II.B.1.f.ii.12.

187. RONALD E. MALLEN, LEGAL MALPRACTICE 870 (2020 ed.).

188. *See* Jay M. Feinman, *Liability of Lawyers and Accountants to Non-Clients: Negligence and Negligent Misrepresentation*, 67 Rutgers L. Rev. 127, 130, 136–37, 141–42 (2015). There are technical differences between the two, as well as terminological—the former is technically an action in malpractice, while the latter is not. *Id.*

189. *Id.* at 127, 136, 138–40, 153.

190. *See, e.g.*, Prudential Ins. Co. of Am. v. Dewey, Ballantine, Bushby, Palmer & Wood, 80 N.Y.2d 377 (Ct. App. N.Y. 1992).

191. Model Rules of Prof. Conduct r. 1.1 (AM BAR ASS'N 1983).

misrepresentations to the funder through the lawyer, the lawyer is obliged to refuse to do so under Rule 4.1.[192] If the lawyer could not avoid assisting the client in securing the funding and believed that the funder was relying on a material misrepresentation attributable to the lawyer (or made by using the lawyer's services), then under Rule 1.2(d) and 1.16(a), the lawyer must withdraw from the representation.[193]

Given the alignment in interests between a client, who can only expect a lawyer who complies with the Rules of Professional Responsibility, and the funder, who expects that the lawyer's representations reflect the lawyer's reasonable effort to make truthful representations as the client's agent, there is no conflict between the lawyer's duties in malpractice to the client and the lawyer's duties to the funder. So, there is no potential conflict between the lawyer's duty to the client and lawyer's "responsibilities" in tort, or personal interest in not being held liable in tort.[194]

4. Personal interests of the lawyer in conflict with the client

Of the various personal interests that a lawyer might have which could conflict with a client seeking funding, the chief risks come from the lawyer's "financial or other professional interests."[195] There is a high degree of interest in the question of whether a lawyer may receive a referral fee from a funder for recommending a client to the funder.[196] The consensus is that the answer is no, although it should be noted that there is no empirical evidence that either consumer or commercial legal funders pay lawyers for referrals.[197] Given that a lawyer cannot receive a referral fee, there is no need to analyze

192. *See* MODEL RULES OF PROF. CONDUCT r. 4.1 (AM. BAR ASS'N 1983).

193. MODEL RULES OF PROF. CONDUCT r. 1.2(d), 1.16(a) (AM. BAR ASS'N 1983).

194. The same analysis can be applied to the risk that the lawyer will be held liable in tort for failing to ensure that a lienholder with property in the client's proceeds receives payment. *See* Vincent R. Johnson, *The Limited Duties of Lawyers to Protect the Funds and Property of Nonclients*, 8 ST. MARY'S J. LEGAL MAL. & ETHICS 58, 74–78 (2018).

195. *See* GEOFFREY C. HAZARD JR., W. WILLIAM HODES & PETER R. JARVIS, THE LAW OF LAWYERING §12.27 (4th ed. 2015).

196. *See* AMERICAN BAR ASSOCIATION, BEST PRACTICES FOR THIRD PARTY LITIGATION FUNDING 5 (2020); N.Y.S. BAR ASS'N, REPORT ON THE ETHICAL IMPLICATIONS OF THIRD-PARTY LITIGATION FUNDING 5–7 (2013); N.Y.C. Bar Ass'n Comm. on Pro. Conduct, Formal Op. 2011-2 (2011); Ethics 20/20 Report, *supra* note 145 at 24–25.

197. For a sample of ethics opinions that suggest that it is unethical for a lawyer to receive a fee from a funder for referring a client, see generally Md. Bar Comm. on Ethics, Op. 1994-45 (1994); N.J. Advisory Comm. on Pro. Ethics, Op. 691 (2001); N.Y.C. Bar Ass'n, Formal Op. 2011-2 (2011) (referral fee prohibited if it would compromise lawyer's independence of judgment); Ohio Supreme Court Bd. of Comm'rs on Grievances and Discipline, Advisory Op. 2002-2 (2002).

whether the expectation of a referral fee from a funder could create a conflict of interest that could be waived under Rule 1.7(b).

The more likely source of conflict will come from the lawyer's unilateral economic interests and not from a formal quid pro quo in the form of a referral fee from the funder. Although little has been written about the lawyer's unilateral conflict of interest when a client considers whether to secure funding, the risks are clear. One source of the risk is that, where a client could not otherwise hire the lawyer without funding or would have to change the scope of representation without funding, the lawyer has a clear interest in the client securing funding. The risk is that the lawyer's independent professional judgment about whether and how the client takes funding will be influenced by the lawyer's personal interest in being retained or conducting the representation with as many resources as possible.[198] The conflict presented is similar to that posed when a client asks for a referral to a recourse lending institution.[199] It must be noted that, unlike commercial legal funding, the lawyer's conflict is mitigated by the fact that in consumer funding the lawyer has already agreed to work on a contingency.[200] This may explain the large number of ethics opinions which conclude that a lawyer does not face a significant conflict with his or her unilateral economic interest in a fee.[201] The committees reviewed the problem in the context of consumer funding; as the ABA Informational Report observed, the conflict is more subtle in commercial legal finance, where the lawyer may have a very strong interest in the client successfully obtaining funding.[202] In conclusion, this source of unilateral economic conflict of interest does not necessarily rise to a conflict of interest for the same reason that a lawyer whose client could not afford representation or as extensive a scope of representation unless the client borrows money is not automatically under a conflict of interest if their client asks them to assist in the process of deciding whether to take the loan.

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198. In one case, a judge speculated that without the funder's money, the client's "financial straits may have forced her to accept a lowball settlement offer . . . resulting in lower attorney fees"—and that raised "serious ethical concerns" about the lawyer's helping the client get funding. Prospect Funding Holdings, LLC v. Saulter, 102 N.E.3d 741, 751 (Ill. App. Ct. 2018) (Mason, J., concurring).

199. *See* Fla. Bar Ethics, Op. 00-3 (2002).

200. Susan Lorde Martin, *The Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed*, 10 FORDHAM J. CORP. & FIN. L. 55, 57 (2004).

201. *See* Ethics 20/20 Report, *supra* note 145, at 24 ("The majority of these opinions conclude that it is permissible to inform clients about funding companies, or to refer clients to ALF suppliers.").

202. *Id.* at 17. Of course, it is also the case that the client is in a much stronger position to independently evaluate the desirability of funding since often the client is itself the general counsel.

In the consumer sector, since the lawyer has already decided to help the client file suit before funding enters the picture, funding does not provide the lawyer with any immediate advantage and might, to the contrary, burden the lawyer, since the introduction of the funder adds a new (potentially unwelcome) lienholder against the client's recovery.[203] This reveals a different source of a conflict of interest. A lawyer's independent professional judgment about whether and how the client takes funding may be influenced by the lawyer's personal interest in *avoiding* conflict between the client and lienholders over the distribution of the client's proceeds if the resolution of the client's cases is smaller than anticipated or—worse yet—not enough to cover the attorney's fees and the various secured claims on the proceeds from third parties, including the funder.[204] Regardless of the practical reality of such concerns, it has no bearing on Rule 1.7, since it does not govern the lawyer's decision to create the lawyer-client relationship, only the lawyer's conduct afterwards.[205]

While the risk of a concurrent conflict based on a unilateral economic interest based on referral fees might seem speculative, there is one source of conflict based on a unilateral economic interest in the consumer legal finance market that deserves more attention than it currently receives—the role that lawyers play in negotiating concessions on behalf of their clients from funders after the completion of the client's matter. As I have demonstrated with Professor Ronen Avraham, funders often collect less than they are owed from clients—they grant what might be called "haircuts" to clients.[206] The details of this practice are beyond the scope of this Article, but the ethical implications of the practice bear on any analysis of the lawyer's potential conflicts under Rule 1.7.[207]

To understand the source of the conflict, it is crucial to recognize that some lawyers will have repeat contacts with the same funder.[208] Funders with whom the lawyer has repeat contacts provide the lawyer's clients with multiple benefits: "clients are significantly more likely to be approved for funding . . . they receive significantly better terms ex ante, and . . . they are significantly more likely to receive a haircut once they complete a case."[209] If the negotiation of any of these benefits for any one client—including the decision not to negotiate a haircut on behalf of any one client—is affected by the

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203. *See* Weaver, Bennett & Bland, P.A. v. Speedy Bucks, Inc., 162 F. Supp. 2d 448, 451 (W.D.N.C. 2001) (because of funding, client rejected settlement recommended by lawyer).

204. Herbert M. Kritzer, *Lawyer Fees and Lawyer Behavior in Litigation: What Does the Empirical Literature Really Say*, 80 TEX. L. REV. 1943, 1965 (2002).

205. *See* MODEL RULES OF PROF. CONDUCT r. 1.7 (AM. BAR ASS'N 1983).

206. Avraham & Sebok, *supra* note 142, at 1143.

207. *Id.* at 1175–79.

208. *Id.* at 1165.

209. *Id.*

lawyer's practice of negotiating haircuts for his or her other clients, then Rule 1.7 is triggered.[210] If, for example, the lawyer is only able to secure the best terms for some clients, but not others, then there is a "significant risk" that the decision by the lawyer to secure the best terms for one affects his or her ability to secure those terms for another.[211] Further, if the lawyer's ability to secure the best terms for some clients but not others is determined by his or her desire to maintain good relations with the funder, then his or her decision not to pursue the best terms for one client means that the lawyer's personal interests affects his or her other clients.[212]

Even more so than with referral fees, a lawyer who leverages his or her repeat player status with a funder to benefit some clients can comply with their obligation under Rule 1.7 by securing client consent to the potential personal conflict as provided for under the rule.[213] This conflict is one which should be consentable and is unlikely to interfere with the lawyer's competent and diligent representation of any of his or her clients. It would be fair if the lawyer disclosed to clients upon being retained, that if they received funding with the aid of the lawyer, there was a chance that they would not enjoy the same opportunity to receive favorable terms that were enjoyed by other clients similar to them represented by that lawyer. This is a trade-off that a client can decide to take or leave.

g. Other conflicts of interest (Rule 1.8)

i. Where the lawyer has an ownership interest in the funder

According to Hazard, Hodes, & Jarvis, "[most] of the situations addressed by Rule 1.8 could be analyzed satisfactorily under Rule 1.7(a)(2)" because it prohibits a lawyer's self-interest from materially limiting the representation unless, under certain conditions, the client provides consent.[214] This is certainly the case for most conflicts arising from a client's pursuit of funding, since the funding only is a topic of interest for the lawyer because a current client seeks it.[215]

The first source of conflict of interest arises from the rare situation where the lawyer has an ownership interest (or some other beneficial interest) in the client's funder.[216] The initial Rule 1.7 conflict would be analyzed the same way as the conflicts above; the

210. *Id.* at 1178.

211. N.Y. Bar Ass'n Comm. on Prof. Ethics, Op. 769 (2003) ("[T]he lawyer may wish to tout the ability to refer clients to the financing institution as a means of attracting clients.").

212. Avraham & Sebok, *supra* note 142, at 1178.

213. MODEL RULES OF PROF. CONDUCT r. 1.7 (AM. BAR ASS'N 1983).

214. *See* HAZARD ET AL., *supra* note 195, at § 12.2.

215. *Id.* Excluded from this discussion are cases where a lawyer may have a personal interest in a funding transaction sought by a former client.

216. *See* N.Y. Bar Ass'n Comm. on Prof. Ethics, Op. 1145 (2018).

closest analogy would be to the situation where the lawyer receives a referral fee from the funder.[217] But, unlike in the referral fee case, even if the lawyer could satisfy the demand of Rule 1.7, he or she would still need to address the additional requirements of Rule 1.8(a).[218] A lawyer may enter into a business transaction with a client or knowingly acquire "an ownership, possessory, security or other pecuniary interest adverse to a client"[219] only after giving the client clearly understandable written disclosure of the terms of the transaction, along with written advice to consult independent legal counsel and a reasonable opportunity to do so and to obtain the client's informed consent to the terms of the transaction and the lawyer's role in it, in a writing signed by the client. [220]

However, even if the 1.8(a) conflict can be resolved by informed consent, it may be that the lawyer is still prohibited from representing the client because of other limitations in Rule 1.8 that are not waivable. New York State Bar Opinion 1145 argues that a lawyer could not have an ownership interest in a funder with whom a current client transacts business because such a business transaction would violate Rule 1.8(e), which prohibits the lawyer from providing financial assistance to a client in connection with pending or contemplated litigation except under limited circumstances, and Rule 1.8(i), which prohibits a lawyer from acquiring a proprietary interest in the client's cause of action or subject matter of litigation except under limited circumstances.[221] The ABA's Commission on Ethics 20/20 White Paper provides some support for this conclusion.[222] It is possible that Texas, because it has not adopted all of the comments to its version of Rules 1.8 in the Texas Disciplinary Rules of Professional Conduct, would permit a lawyer to own the client's funder.[223]

Second, it must also be noted that it is likely that were a lawyer to avoid a concurrent conflict under Rule 1.7 by providing funding to a client on a matter which the lawyer does not represent the client, he or she would still have to comply with Rule 1.8 and probably Rule 5.7 as well.[224] Rule 5.7, which discusses law-related services,

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217. HAZARD ET AL., *supra* note 195, at § 12.2.

218. N.Y. Bar Ass'n Comm. on Prof. Ethics, Op. 1145 ("If the inquirer fully complies with Rule 1.8(a), then the inquirer must still abide by Rule 1.7(a) in connection with the ongoing representation of the client." (citing N.Y. Bar Ass'n Comm. on. Prof. Ethics, Op. 1139 (2017))).

219. MODEL RULES OF PROF. CONDUCT r. 1.8(a) (AM. BAR. ASS'N 1983).

220. *Id.*

221. N.Y. Bar Ass'n Comm. on Prof. Ethics, Op. 1145 (2018) ("We believe that the proposed conduct would violate both of these Rules.").

222. *See* Ethics 20/20 Report, *supra* note 145, at 19–20.

223. *See* Tom Adolph & Andrew Spangler, *Ethics and Alternative Financing for Patent Litigation*, *in* STATE BAR OF TEXAS, 9TH ANNUAL ADVANCED PATENT LITIGATION COURSE Ch. 17 at 10 (2013).

224. MODEL RULES OF PROF. CONDUCT r. 5.7 cmt. 9 (AM. BAR ASS'N 1983):

approaches the issue from the perspective of a lawyer who provides a law-related service in the context of a discrete transaction, where the client purchases the service from the lawyer in a transaction separate from the lawyer's representation.[225] The question that arises when a lawyer provides funding for a client for a matter in which the lawyer is not representing the client is whether there is a risk that the typical client would "fail[ ] to understand that the services [the funding] may not carry with [it] the protections normally afforded as part of the client-lawyer relationship."[226] The answer is clearly yes, and the lawyer—either directly or through an agent of the funder—must take the appropriate precautions to clarify to the client that the lawyer, as an owner of the funder, does not owe to the client the duties that attach to the attorney-client relationship.[227]

ii. Where the lawyer does not have an ownership interest in the funder.

It might be argued that, in those much more common cases where a lawyer does not have an ownership interest in the funder, the lawyer must still take care not to violate those prohibitions in Rule 1.8 concerning either financial assistance to a client or accepting compensation from a third party.[228] I agree with the ABA's Commission on Ethics 20/20's White Paper, which significantly discounted the applicability of Rule 1.8(e) to a lawyer whose client transacts with a funder in whom the lawyer has no financial interest.[229] The reason for this is obvious. As the Committee on Professional Ethics of the New York State Bar Association said in response to a similar question with regard to a lawyer referring a client to a recourse lending institution, "the lawyer does not propose

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> A broad range of economic and other interests of clients may be served by lawyers' engaging in the delivery of law-related services. Examples of law-related services include providing title insurance, financial planning, accounting, trust services, real estate counseling, legislative lobbying, economic analysis, social work, psychological counseling, tax preparation, and patent, medical or environmental consulting.

Id. There is no reason that legal funding would not also fall within this class of activities.

225. *See* State Bar of Ariz., Formal Op. 05-01 (2005) (applying Rule 5.7 to referral of client to investment service in which the lawyer has a financial interest).

226. *See* MODEL RULES OF PROF. CONDUCT r. 5.7 cmt. 9 (AM. BAR ASS'N 1983).

227. *Id.* at r. 5.7(a)(2) (the lawyer must take "reasonable measures to assure that a person obtaining the law-related services knows that the services are not legal services and that the protections of the client-lawyer relationship do not exist.").

228. *Id.* at r. 1.8(e).

229. *See* Ethics 20/20 Report, *supra* note 145, at 19 (2011).

to 'pay' or 'advance' any part of the loan" or funding advance.[230] The lawyer is not, therefore, providing financial assistance to the client, even though the client is receiving funds from a third party to whom the lawyer provided a referral of the client.[231] The claim that the lawyer needs to take into account Rule 1.8(f) is even less plausible. The rule is clearly intended to apply to situations where a third party pays some or all of the lawyer's fees. The typical situations in which this rule would apply are prepaid legal service plans, family arrangements where parents secure counsel for their children, and, of course, liability insurance—all quite different from the funding context.[232] The funder is not the party paying the lawyer since the funder is providing funds to the client, who is paying the lawyer.[233] This is true even if the funder pays the lawyer's legal fees directly at the direction of the client.[234] The funder no more "pays" the lawyer than a bank "pays" a lawyer when directed by a client to wire money to the lawyer from the client's bank account.

iii. Interference with the lawyer's independence of professional judgment

One reason why some commentators may be tempted to assume that Rule 1.8(f) applies to the typical funding contract is that it imposes a serious, non-waivable limitation on lawyers who receive payment from third parties.[235] Rule 1.8(f)(2) prohibits "interference with the lawyer's independence of professional judgment or with the client-lawyer relationship."[236] While this limitation has little or no application to lawyers whose clients secure legal finance, it illustrates the larger point that an important constraint on lawyers whose clients secure legal finance is that a lawyer must ensure that the legal funder does not interfere with the lawyer's professional judgment.[237]

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230. N.Y. Bar Ass'n Comm. on Prof. Ethics, Op. 666 (1994). *See also* Fla. Bar Ethics, Op. 00-3 (2002) (suggesting lawyer's role should be limited to providing factual information).

231. N.Y. Bar Ass'n Comm. on Prof'. Ethics, Op. 666 (1994).

232. *See* HAZARD ET AL., *supra* note 195, at §12.13.

233. Avraham & Sebok, *supra* note 142, at 1135.

234. *Id.*

235. *See* Margaret Fonshell Ward, *Third Party Litigation Funding – The Perils to Attorneys*, PRO. LIAB. COMM. NEWSL. (Int'l Ass'n Def. Council), Apr. 2014, at 2 ("The sources of most perils to the attorney are Rules 1.8(e) and 1.8(f) of the Rules of Professional Responsibility[.]").

236. MODEL RULES OF PRO. CONDUCT r. 1.8(f)(2) (AM. BAR ASS'N 1983).

237. *See* David H. Levitt with Francis H. Brown III, *Third Party Litigation Funding, Civil Justice and the Need for Transparency*, DRI CTR. FOR L. & PUB. POL. (2018) at 5 ("reported decisions confirm that there are some occasions where the terms of the TPLF agreement did indeed give the TPLF company at least some measure of control").

III. RULE 5.4 AND LEGAL FINANCE

Rule 5.4 has multiple prohibitions designed to protect the professional independence of lawyers. Rule 5.4(d), which prohibits nonlawyers from employing lawyers, is primarily based on the concern that nonlawyers will tell lawyer-employees how to practice law.[238] Rule 5.4(b), which prohibits nonlawyers from forming partnerships with lawyers, was based on the concern that nonlawyers, who do not have obligations as officers of the court and lack training and socialization in the ethical values of the legal profession, would exert control over the professional judgment of lawyers.[239] Rule 5.4(a) prohibits nonlawyers from "sharing" fees with lawyers.[240] Rule 5.4(c), which explicitly prohibits third parties from "directing" or "regulating" a lawyer's professional activity on behalf of his or her client, does not fit easily with the foregoing prohibitions, since it extends beyond addressing different ways that commercial concerns can affect how lawyers serve their clients, although it is clear that it is very much connected to that concern.[241] It is with Rule 5.4(c) that I will begin my analysis.

A. Rule 5.4(c) and legal finance

Rule 5.4(c) is the "direct corollary" to Rule 1.8(f).[242] Still, its scope is broader than Rule 1.8(f) because it enjoins more than interference with independence of professional judgment; it prohibits that another "direct or regulate" the lawyer's professional judgment.[243] It also applies to situations beyond those where a third party pays the lawyer; it extends to one who "recommends, employs, or pays" the lawyer.[244] My position on Rule 5.4(c) is different than my position on Rule 1.8(f). Rather than parse whether the rule applies to lawyers whose clients secure funding, I would concede that the rule applies, since as a general matter, the entire architecture of the Rules, and the general trend of the law of lawyering has been to strictly prohibit

238. *See* Edward S. Adams & John H. Matheson, *Law Firms on the Big Board?: A Proposal for Nonlawyer Investment in Law Firms*, 86 CAL. L. REV. 1, 6–10 (1998).

239. Bruce A. Green, *The Disciplinary Restrictions on Multidisciplinary Practice: Their Derivation, Their Development, and Some Implications for the Core Values Debate*, 84 MINN. L. REV. 1115, 1140–41 (2000).

240. *See* Anthony J. Sebok, *Selling Attorney's Fees*, 2018 U. ILL. L. REV. 1207, 1221–22 (2018).

241. *See* Green, *supra* note 239, at 1142.

242. *See* HAZARD ET AL., *supra* note 195, at §48.09. Rule 5.4(c) says: "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." MODEL RULES OF PRO. CONDUCT r. 5.4(c) (AM. BAR ASS'N 1983).

243. *Id.*

244. *Id.*

interference with a lawyer's independence of professional judgment.[245] Rule 5.4(c) cannot be waived by the client under any circumstance (informed consent is no cure), so no lawyer could participate in the making of a legal funding agreement which requires the client to instruct the lawyer to allow the funder to interfere with the lawyer's independent professional judgment.[246]

The more likely question that arises in connection with Rule 5.4(c) is whether the existence of a standard legal funding agreement with a client raises new or elevated risks of interference with independence of professional judgment such that a lawyer is obliged to take additional steps to prevent a violation of Rule 5.4(c). The answer to this question, in my opinion, is that it depends on the facts of each funding transaction but that there is no reason to presume that a lawyer will violate Rule 5.4(c) *simply* because the client has secured funding.[247] Courts have taken the same view.[248] If anything, the case law reveals that lawyers have attacked a funder that interfered with the lawyer's advice to the client.[249] For the same reason that I think that concerns over Rule 1.8(f) are overblown in connection with legal finance, I conclude that Rule 5.4(c) also poses no special ethical concerns for lawyers whose clients secure legal finance.

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245. *See generally* Wendel, Paying the Piper, *supra* note 1; *see also* Bruce A. Green, *Lawyers' Professional Independence: Overrated or Undervalued?*, 46 AKRON L. REV. 599 (2013).

246. *See* State Bar of Mich., Op. RI-321 (2000) (finding that a financing agreement that placed restrictions on an attorney's ability to manage the litigation created an "impermissible conflict of interest" and interfered with the attorney's exercise of professional judgment).

247. As Prof. Stephen Gillers put it:

> This [assumes that] . . . [l]awyers are weak. Funding companies are strong. Lawyers want them to fund future plaintiffs. Funding companies will not do that if the lawyers fail to follow their coded instructions to do what is best for the funding companies. A funding company's interests conflict with the plaintiff's interest. . . . This argument proves too much. A similar argument can be made when a lawyer gets an even modest amount of work from insurance companies to represent their insureds.

Gillers, *supra* note 3, at 691.

248. *See, e.g.*, *In re* Valsartan N-Nitrosodimethylamine (NDMA) Contamination Prods. Liab. Litig., 405 F. Supp. 3d 612, 615–16 (D.N.J. 2019) ("Although defendants raise a parade of horribles that could or may arise from litigation funding agreements, none has occurred here. Nor is there any reason to believe that anything untoward will occur in the future.").

249. *See* Weaver v. Speedy Bucks, Inc., 162 F. Supp. 2d 448, 451 (W.D.N.C. 2001) (lawyer sued funder for inducing client to reject lawyer's independent professional advice).

B. Rule 5.4(a) and legal finance.

Rule 5.4(a) prohibits a lawyer from "sharing fees with a nonlawyer."[250] It is intended to prohibit "*any* financial arrangement in which a nonlawyer's profit or loss is directly related to the successfulness of a lawyer's legal business."[251] It has various rationales, but it is clear that it is intended to serve two overarching purposes—to protect clients from a nonlawyer's interference with their lawyer's independence of professional judgment and to prevent the unauthorized practice of law by nonlawyers.[252]

While it might be argued that the rationales behind Rule 5.4(a) are already served by other rules—such as Rule 1.8(f), Rule 5.4(c), and Rule 5.5(a)—it is a separate rule as well. The reason I raise the rationales behind Rule 5.4(a) is that they may help illuminate when legal finance agreements involve a violation of Rule 5.4(a) and therefore are prohibited (note that Rule 5.4(a) in non-waivable by the client).

Rule 5.4(a) does not come into play in the most typical form of legal finance, which is client-directed. That is because there is no possibility of the lawyer sharing fees with the funder when the client agrees to sell a contingent interest in his or her recovery.[253] Rule 5.4(a) is directly involved in lawyer-directed legal finance.[254] In lawyer-directed legal finance, the funder does not buy a contingent interest in the client's expected proceeds.[255] The lawyer, in exchange for capital, which can be used for any purpose (although often for expenses associated with the representation of one or more clients), agrees to repay that capital, plus an additional payment, only if one or more client matters produce fees.[256] The contract is with the lawyer and the client may not (in fact often, does not) know that the lawyer has taken funding.[257]

For those who believe that lawyer-directed legal finance violates Rule 5.4(a), the argument turns on the rationale of protecting lawyers' independence of professional judgment.[258] I believe that, to the extent

250. MODEL RULES OF PRO. CONDUCT r. 5.4(a) (AM. BAR ASS'N 1983).

251. HAZARD ET AL., *supra* note 195, at §48.04 (emphasis in original).

252. *Id.* at §48.03.

253. This is not strictly true since a lawyer could agree to reduce his or her fee by the same amount that the client pays to the funder in the event of a recovery. However, that is a highly unlikely arrangement.

254. *See* Zheng, *supra* note 13, at 1390.

255. *See* AM. BAR ASS'N, ABA BEST PRACTICES FOR THIRD-PARTY LITIGATION FUNDING 4 (2020).

256. *See* Richmond, *supra* note 11, at 663 ("It is apparent that litigation funding agreements, in which a litigation financier advances funds to an attorney rather than a party, are not champertous.").

257. *See id.* at 663–64.

258. *See* Assn' Bar City of N.Y. Comm. on Pro. Ethics, Formal Op. 2018-5, at 5–6 ("Rightly or wrongly, the rule presupposes that when nonlawyers have a

that Rule 5.4(a) should be read in light of its purpose, this conclusion is too simple.[259] Clearly, to the extent that a lawyer-directed legal finance agreement permits the funder to "direct or regulate" the lawyer's professional judgment, it not only violates Rule 5.4(a) but also Rule 5.4(c). An argument can be made that where the structure of a lawyer-directed legal finance agreement misaligns the lawyer's incentives so that he or she will act against the client's interest because of the terms of the agreement with the funder, that it violates not only Rule 5.4(a) but also Rule 1.7(a)(2).[260]

Elsewhere I have argued that lawyer-directed legal finance agreements are a form of factoring and threaten lawyers' independence of professional judgment no more (or less) than recourse lending which is clearly permitted under Rule 5.4(a).[261] Recently, the New York City Bar Association ("NYCBA") Committee on Professional Ethics concluded that all lawyer-directed legal finance agreements violate New York's version of Rule 5.4(a) (which is identical to Model Rules of Professional Conduct Rule 5.4(a) in all relevant respects).[262] What is a lawyer to make of these divergent conclusions? Even the authors of NYCBA Opinion 2018-5 conceded that New York courts were enforcing contracts between lawyers and funders which were clearly lawyer-directed legal finance agreements.[263] The simplest explanation of the current situation is that there is a gap between the "law on the books" and the "law in action" in New York (as well as other jurisdictions).[264] As Roy Simon, the author of the leading treatise on the Rules of Professional Responsibility in New York has observed:

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stake in legal fees from particular matters, they have an incentive or ability to improperly influence the lawyer."); *see also* Tex. Comm. on Prof. Ethics, Op. 467 (1990).

259. *See* Va. State Bar Standing Comm. on Legal Ethics, Legal Ethics Op. 1783 (2003) (the "application of Rule 5.4(a) must move beyond a literal application of language of the provision to include also consideration of the foundational purpose for that provision").

260. *See* Utah State Bar Ethics Advisory Op. Comm., Ethics Op. 06-03 (2006), which permitted one lawyer-directed legal finance agreement but not others, based on Rule 5.4(a) and Rule 1.7(a)(2).

261. *See* Sebok, *supra* note 240.

262. *See* Ass'n Bar City of N.Y. Comm. on Pro. Ethics, Formal Op. 2018-5, 1.

263. *Id.* at 6. Numerous courts have upheld the lawyer-directed legal finance agreement. *See* Couns. Fin. Servs. v. Leibowitz, No. 13-12-00103-CV, 2013 Ct. App. Tex. LEXIS 9252, at *24–29 (July 25, 2013); RDLF Fin. Servs., LLC v. Esquire Cap. Corp., 2012 NY Slip Op 50373(U) (N.Y. Sup. Ct. 2012); Cousins v. Pereira, No. 09 Civ. 1190, 2010 U.S. Dist. LEXIS 136139 (S.D.N.Y. Dec. 22, 2010); U.S. Claims, Inc. v. Yehuda Smolar, PC, 602 F. Supp. 2d 590, 595–96 (E.D. Pa. 2009); U.S. Claims, Inc. v. Flomenhaft & Cannata, LLC, 519 F. Supp.2d 515, 518–20 (E.D. Pa. 2006); Douglas v. Benton, 7 Misc. 2d 872 (N.Y. Sup. Ct. 1957).

264. See Roscoe Pound, *Law in Books and Law in Action*, 44 AM. L. REV. 12, 14–15 (1910) (introducing the distinction).

> By rejecting several attacks on litigation funding agreements and expressly holding that pledging future fees to a litigation funding company does not constitute improper fee sharing, New York courts appear to have created what I call a "litigation funding exception" to Rule 5.4(a).[265]

Professor Simon's observation is not merely a specific example of Legal Realism in action; it is a description of the evolution of legal principles expressed in changing legal practice. The concerns that animated the original version of Rule 5.4(a) were different in their specifics in the early twentieth century than the concerns addressed by the NYCBA Opinion 2018-5.[266]

A brief review of the history of Rule 5.4(a) is helpful here. It can be traced to a variety of rules in the ABA Code of Professional Responsibility (1969).[267] These Code sections, in turn, descended from the 1928 ABA Canons of Professional Ethics revised in 1933 and 1937).[268] Here, the critical original prohibition on fee-splitting was Canon 34, which stated "No division of fees for legal services is proper, except with another lawyer, based upon a division of service or responsibility."[269] The original concerns that motivated Canon 34 had to do with the protection of clients from the possibility that nonlawyers, by "sharing" fees with lawyers, would be bribing lawyers to take matters which ought to have gone to another, more appropriate lawyer.[270]

In the 1980s, the process that led to the adoption of the current Rule 5.4 had its roots in a very different concern, which was the debate over whether lawyers should be allowed to include nonlawyers in their practice.[271] This sparked a period of intense debate that culminated in a showdown at the 1983 Midyear Meeting, where the ABA rejected the repeal of the Code's prohibition on nonlawyers

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265. ROY D. SIMON JR., N.Y. RULES OF PRO. CONDUCT § 5.4:4 (2021).

266. *See infra* notes 269–80 and accompanying text.

267. *See* MODEL CODE OF PRO. RESP. Canon 3 (AM. BAR ASS'N 1980).

268. *Model Rules of Professional Conduct*, AM. BAR ASS'N, https://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/ (last visited July 18, 2022).

269. MODEL CODE OF PRO. RESP. Canon 34 (AM. BAR ASS'N 1980).

270. *See* James M. Fischer, *Why Can't Lawyers Split Fees? Why Ask Why, Ask When!*, 6 GEO. J. LEGAL ETHICS 1, 11 (1992). Fisher cites contemporary arguments by scholars like Julius Cohen which led to Canon 34:

> The splitting of fees between lawyers and laymen is improper for the same reason that it is improper to pay a bonus to a buyer for getting him to give you an order, but in the case of the lawyer it is more serious, because [he is] "an officer of the court."

Id. (quoting JULIUS COHEN, THE LAW: BUSINESS OR PROFESSION? 228–29 (rev. ed. 1924)).

271. *See* Charles W. Wolfram, *Comparative Multi-Disciplinary Practice of Law: Paths Taken and Not Taken*, 52 CASE W. RES. L. REV. 961, 970–971 (2002).

having an ownership interest in the organization in which a lawyer practices or managerial authority over a lawyer.[272]

One should not overread the lesson of 1983 (and the subsequent battle over multidisciplinary practice in 1999).[273] All that recent history shows is that in the early eighties the ABA consciously debated and rejected fee-sharing to the extent that it allows nonlawyers to control or direct a lawyer's practice of law. But this is a very different type of concern than the concern over whether a lawyer may transfer to a nonlawyer a financial interest in an expected fee (whether it is by means of a non-recourse loan or by factoring unearned fees), and regardless of the policy pros and cons of this latter issue, such a transfer does not comprise a partnership, or an employment relationship, or a de facto partnership, and has never been the explicit focus of any version of the Rules, from 1928 to today.[274]

The reaction to NYCBA Opinion 2018-5 supports my argument that Rule 5.4(a) cannot be read formalistically as prohibiting lawyer-directed legal finance.[275] Within months of the publication of the opinion, after it had been subject to some skeptical reviews,[276] the NYCBA formed a working group, tasked with evaluating "whether Rule 5.4, as interpreted in [NYCBA Opinion 2018-5], well serves the professional community and the public, or whether the Rule should be revised to reflect contemporary commercial and professional needs and realities."[277] The working group proposed two versions of revisions to Rule 5.4, both providing that lawyers could engage in

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272. *Id.* The ABA House of Delegates "rejected the Kutak Commission's proposed radical revision of the text of Rule 5.4 [and] replaced that text with the prohibitions already stated in the 1969 ABA Model Code of Professional Responsibility." *Id.*

273. *See* John H. Matheson & Edward S. Adams, *Not "If" but "How": Reflecting on the ABA Commission's Recommendations on Multidisciplinary Practice*, 84 MINN. L. REV. 1269, 1283 (2000).

274. *See* Sebok, *supra* note 240, at 1213–14.

275. *See* Zheng, *supra* note 13, at 1393 (describing a "drastic shift in position of NYCBA" recogniz[ing] the possibility that, as a matter practice, the policies that justified the adoption of Rule 5.4(a)'s particular language in 1982 did not necessarily entail that language's literal extension to lawyer-directed finance.").

276. *See, e.g.*, Anthony Davis & Anthony Sebok, *New Ethics Opinion on Litigation Funding Gets It Wrong*, N.Y.L.J., Aug. 31, 2018, at 3; Andrew Strickler, *Funders Decry NYC Bar's Litigation Finance Warning*, LAW360 (Aug. 10, 2018), https://www.law360.com/articles/1071768/print?section=legalethics; Allison Chock et al., *Curiouser and Curiouser! A Review of the NYCBA's Ethics Opinion on Litigation Funding*, BENTHAM IMF (Sept. 11, 2018), https://omnibridgeway.com/insights/blog/blog-posts/blog-details/global/2018/09/11/curiouser-and-curiouser!-a-review-of-the-nycba-s-ethics-opinion-on-litigation-funding.

277. *See* WORKING GROUP REPORT, *supra* note 75, at 23.

lawyer-directed legal finance, albeit under different conditions.[278] Both revisions prohibit litigation funder's direct or indirect participation in the decision-making process of funding entities, require some form of notice to clients, and refer to other safeguards created by the Rules, such as Rule 1.6 and Rule 1.7, to address potential conflicts of interests between attorneys and funders.[279]

Finally, it is significant that recently the Arizona Supreme Court has chosen to rescind Rule 5.4 in its entirety, in part because it recognized that it was not necessary to achieve the goal of protecting lawyers' independence of professional judgment from nonlawyers with whom they have financial relations.[280] Utah has followed suit in a temporary fashion through a "regulatory sandbox."[281] In the case of Arizona, the story of Rule 5.4(a) has completed the circle started in 1928: The Arizona Supreme Court now requires nonlawyers to submit to a robust regulatory regime intended to constrain the influence of nonlawyer partners and investors in legal service providers, while leaving lawyers to freely contract with nonlawyers for lawyer-directed finance.[282] I conclude, therefore, that while there is reason for concern by a lawyer about his or her compliance with Rule 5.4(a) when engaged in lawyer-directed legal finance, it is not *per se* prohibited.

The fact that lawyer-directed funding is permissible under Rule 5.4(a) does not mean that it does not raise novel issues of concern from the perspective of the law of lawyering. Whenever lawyers pursue financing, whether recourse or non-recourse, there is a risk that the negative financial consequences of the financing decisions will affect

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278. *Id.* at 24.

279. *Id.* at 24–31.

280. *See* Order Amending the Arizona Rules of The Supreme Court and The Arizona Rules of Evidence, No. R-20-0034 (Ariz. Sup. Ct. August 27, 2020); *see also* Anthony Sebok & Bradley Wendel, *A Likely Tipping Point for Nonlawyer Ownership of Law Firms*, LAW360 (September 25, 2020), https://www.law360.com/articles/1313678.

281. *See* Lyle Moran, *Utah's High Court Proposes Nonlawyer Ownership of Law Firms and Wide Ranging Reforms*, ABA J. (Apr. 27, 2020), https://www.abajournal.com/news/article/utahs-high-court-proposes-wide-ranging-legal-industry-reforms [https://perma.cc/U5QR-JMQ6]; *see also To Tackle the Unmet Legal Needs Crisis, Utah Supreme Court Unanimously Endorses a Pilot Program to Assess Changes to the Governance of the Practice of Law*, UTAH CTS. RECENT PRESS NOTIFICATIONS (Aug. 13, 2020), http://www.utcourts.gov/utc/news/2020/08/13/to-tackle-the-unmet-legal-needs-crisis-utah-supreme-court-unanimously-endorses-a-pilot-program-to-assess-changes-to-the-governance-of-the-practice-of-law/ [https://perma.cc/3UEJ-E4WS].

282. *See* Maya Steinitz, *The Partnership Mystique: Law Firm Finance and Governance for the 21st Century American Law Firm*, 63 WM. & MARY L. REV. 939, 983–990 (2022).

clients.[283] The key point to remember is that the ethical obligations of lawyers who engage in lawyer-directed financing, from this perspective, is the same as that faced by lawyers who engage in more conventional forms of recourse-lending financing.[284] Still, with the growing acceptance of lawyer-directed finance, the sheer volume of new entrants into the market may create temporary distortions.

One recent example is the practice of Pravati Capital, a law firm finance company that provides both recourse and non-recourse financing to lawyers.[285] Based on documents filed in actions to enforce arbitration awards, it appears that Pravati provides non-recourse financing to lawyers at a cost that is, in effect, much higher than comparable recourse loans.[286] This lawyer-directed financing is secured by a portfolio of the lawyer's cases which, according to these documents, include easily-triggered covenants that convert the financing to recourse loans secured by all the income the lawyer receives from any source.[287] Some of these contracts included provisions which required the lawyer to pay interest on an additional "interest reserve" taken out on behalf of Pravati to guarantee that the lawyer had funds to pay it back—a very peculiar requirement from a lawyer-directed financing firm which expected the lawyers it financed to succeed in their efforts for their clients.[288] The fact that lawyers, who are sophisticated professionals, fell for these sharp lending practices, is cause for concern—but without more information, it would be premature to judge the competency of these lawyers too

283. *See* John Morley, *Why Law Firms Collapse*, 75 BUS. LAW. 1399, 1402–03 (2020).

284. *See* Milton C. Regan, Jr., *Lawyers, Symbols, and Money: Outside Investment in Law Firms*, 27 PENN ST. INT'L L. REV. 407, 427 (2008) (comparing the risks of recourse lending and non-recourse law firm investment).

285. *See* Debra Cassens Weiss, *Litigation Funder's Contracts Leave Some Lawyers Owing Double The Amount Borrowed*, ABA J. (Nov. 18, 2021), https://www.abajournal.com/news/article/litigation-funders-contracts-leave-some-lawyers-owing-double-the-amount-borrowed.

286. See Valerie Bauman & Roy Strom, *Clients Cry Foul Over Litigious Litigation Finance Company*, BLOOMBERG L. (Nov. 17, 2021), https://news.bloomberglaw.com/business-and-practice/clients-cry-foul-over-litigious-litigation-finance-company?context=search&index=0.

287. *Id.* According to the Bloomberg investigation:

> A former Pravati employee . . . said the company would often deem lawyers to be in default due to a lack of reporting. Under the terms of Pravati's agreements, a default converts the deal to a recourse loan—triggering repayment whether the underlying cases win or lose. "You probably will not find a single example of what was non-recourse and then it staying as non-recourse," the former employee said.

Id.

288. *See* Complaint & Demand for Jury Trial, The Williams L.G., P.L.L.C v. Am. Arb. Ass'n, No. 2:21-cv-00149-GMS (D. Ariz. Jan. 27, 2021).

harshly.[289] Other high-profile bankruptcies by lawyers who have borrowed heavily from non-recourse, lawyer-directed finance firms are cause for concern.[290] But the response should not be to view lawyer-directed financing as inherently more likely to lead lawyers to act unethically in connection with their clients' matters, but rather to address the underlying conditions which lead some lawyers—mostly solo practitioners, many helping underserved parts of the community—to seek subprime financial products that place their practices at risk.[291]

CONCLUSION

In this Article I have identified two areas where potential ethical issues may arise that may require additional attention from bar committees and regulators and perhaps even additional regulation. First, too little attention has been paid to the fact that funders seek to bind lawyers with agreements intended to protect the funder's interest in receiving their property held by the lawyer after the resolution of their clients' matters. This is especially true in the case of consumer legal finance, where the client may not fully appreciate the acknowledgements and side contracts that lawyers are asked to sign at the same time the client contracts with the funder. These agreements create the potential for conflict similar to the triangular relationship between client, lawyer, and liability insurer. I am optimistic that, in the same way the courts, ethics committees, and stakeholders involved were able to develop legal and contractual responses to the problem of the "dual loyalty" of defense lawyers retained on behalf of insureds by insurers, responses can be developed here. The first step to developing a response is to clearly identify the problem; that is the purpose of this Article. The next step is to

289. *See* Bauman & Strom, *supra* note 286. Law professor Jody Kraus observed in connection with Pravati's contracts, "[these lawyers] are some of the most sophisticated people on the planet, if they can't negotiate this contract for themselves, what the hell are they doing for their cases?" *Id.*

290. *See* Stephanie Francis Ward, *Risky Business: More Firms Embrace Litigation Financing, but Pitfalls Abound*, ABA J. (Feb. 1, 2022), https://www.abajournal.com/magazine/article/risky-business (linking non-recourse lending to the financial problems of well-known lawyers Thomas Girardi and John Pierce, while noting that "both recently have been accused of unethical behavior"); *see also* Andrew Strickler, *Girardi Crash Fueled by Lender Cash, 'Celebrity' Borrowing*, LAW360 (Dec. 1, 2021), https://www.law360.com/pulse/articles/1444030/girardi-crash-fueled-by-lender-cash-celebrity-borrowing (three litigation lenders say they are collectively owed more than $25 million by an insolvent Girardi Keese).

291. Jack A. Guttenberg, *Practicing Law In the Twenty-First Century In a Twentieth (Nineteenth) Century Straightjacket: Something Has To Give*, 2012 MICH. ST. L. REV. 415, 481 (2012) ("The traditional law firm practice model requires that firms are either self-funded . . . or the firm must borrow from outside sources, usually banks.").

consider both short-term and long-term solutions. This Article offers no in-depth recommendations; however, it does make clear that a lawyer should be wary about assuming either fiduciary or contractual obligations to a funder in the course of assisting his or her client in securing funding. Not only must a lawyer take care to ensure that, if such a contract creates a waivable material concurrent conflict of interest that they receive informed consent, but also he or she must evaluate a practical point of view of the risk of litigation that might arise from assuming those obligations, even with the client's consent.

Second, too little attention has been paid to the fact that lawyers in the consumer legal finance market are repeat players with funders. This can work to their clients' benefit, since established relationships between lawyers and nonlegal professionals can produce lower costs for the products the client seeks, including a product as esoteric as legal finance. However, as with other areas of nonlegal products associated with the client's matter, there is a risk that a lawyer will leverage his or her client's specific transaction with a funder to maximize advantages for future clients. I have suggested that this might be the case where lawyers secure better terms for some clients from funders, especially in the negotiation of discounts or "haircuts" offered by funders to reduce the payment owed under the funding contract. This is a potential area of concern which may not be adequately addressed by the current law of lawyering and rules of professional conduct, and which may be best addressed by consumer protection law.[292]

292. For an exploration of the role of consumer protection in consumer legal finance, see generally Ronen Avraham et al., *The MDL Revolution and Consumer Legal Funding*, 40 REV. LITIG. 143 (2021) and Ronen Avraham et al., *The Mysterious Market for Post-Settlement Litigant Finance*, 96 N.Y.U. L. REV. ONLINE 181 (2021). *See also Lawsuit Lending: Hearing Before the N.Y. State S. Standing Comm. on Consumer Prot.*, 2018 Sess. (N.Y. 2018) (statement of Maya Steinitz, Visiting Professor of Law at Harvard Law School, Professor of Law at University of Iowa School of Law) and Maya Steinitz, *Letter to the Hon. Sen. Ort (NYS Senate) Regarding Litigation Finance (Lawsuit Lending)* (Univ. of Iowa Legal Studies Research Paper No. 18-15, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3238148 (arguing for a 50 percent minimum recovery requirement by addressing both the economics of the requirement and the normative arguments for it).