How Commercial Litigation Funding Can Help Small Firms and Solo Practitioners

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By David Gallagher

This article is the second of a two-part series covering the burgeoning topic of litigation funding. The first was published in the Spring 2016 issue of *Big News for Solo & Small Firms*. It provided a brief introduction to two forms of commercial litigation funding that can help solo practitioners and small firms. This article covers some of the ethical questions that arise in connection with litigation funding, focusing specifically on some of the California Rules of Professional Conduct that directly or indirectly implicate litigation funding.

RULE 1-320 FINANCIAL ARRANGEMENTS WITH NON-LAWYERS: "FEE-SPLITTING"

Rule 1-320 provides in part that "neither a member nor a law firm shall directly or indirectly share legal fees with a person who is not a lawyer." If and when the rule against fee-splitting applies to a litigation funding arrangement depends on whether it is (1) a single-case funding arrangement between the funder and the client, or (2) a portfolio funding arrangement between the funder and a law firm. These two forms of commercial litigation funding were described in the first article of this series.

In a single-case funding arrangement, it is the client, not the attorney, who enters into the litigation funding agreement, and the funder's investment return comes strictly from the client's recovery, not from the attorney's fees. No portion of the legal fees goes directly or indirectly to the funder. Therefore, the rule against fee-splitting does not apply.

In a law firm portfolio funding arrangement, however, it is the law firm (either a solo practitioner, a small firm, or a larger firm) that enters into the funding agreement, and the funder's investment return comes from the law firm's contingency fees in the cases included in the portfolio. As a result, the rule against fee-splitting needs to be considered carefully.

Typically, the only revenue a law firm has is its legal fees. The rule against fee-splitting cannot be interpreted categorically to prohibit a law firm from using its fee revenue to pay third parties for goods or services, or no law firm would be allowed, e.g., to buy furniture or rent office space. The same principle holds true with respect to the law firm paying for financial products. Clearly, a law firm is permitted, e.g., to take out a line of credit with a bank, and to pay down the line of credit with its legal fee revenues, notwithstanding the rule against fee-splitting. Similarly, a law firm is permitted to obtain litigation funding and later to repay the funding, along with an investment return on the funding.

Courts and scholars have concluded that litigation-funding arrangements with law firms do not violate the rule against fee-splitting, if the arrangements do not compromise the attorneys' exercise of independent professional judgment, the protection

of which is the purpose of the rule. Two key features of ethically permissible law firm funding arrangements that help to protect the attorneys' exercise of independent professional judgment are:

> (1) an express provision that the funder has no right to control litigation strategy or settlement decisions, and
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> (2) the inclusion of multiple matters in the funded portfolio—typically three or more—to ensure that the funder's investment return will not be tied to any particular client matter.

Bentham's Investment Managers are attorneys, but even if this were not the case, the rule against fee-splitting with non-attorneys would not apply to Bentham's law firm funding arrangements, for the reasons explained above.

FINANCIAL ARRANGEMENTS WITH NON-LAWYERS: "REFERRAL FEES"

Rule 1-320 also provides in part that "a member shall not compensate, give, or promise anything of value to any person or entity for the purpose of recommending or securing employment of the member or the member's law firm by a client, or as a reward for having made a recommendation resulting in employment of the member or the member's law firm by a client." Litigation funders frequently refer cases to attorneys, but attorneys should not offer, and funders should not accept, referral fees from attorneys. A funder to whom a case is referred by a non-attorney may appropriately pay a referral fee to the non-attorney referrer.

AGREEMENTS RESTRICTING A MEMBER'S PRACTICE

Rule 1-500 provides in part that "a member shall not be a party to or participate in offering or making an agreement, whether in connection with the settlement of a lawsuit or otherwise, if the agreement restricts the right of a member to practice law." As discussed above, an attorney should not enter into an agreement with a litigation funder unless the agreement expressly provides that the funder will have no right to control litigation strategy or settlement decisions.

CONFIDENTIAL INFORMATION OF A CLIENT

Rule 3-100 provides in part that "a member shall not reveal information protected from disclosure by Business and Professions Code section 6068, subdivision (e)(1) without the informed consent of the client." Section 6068 in turn provides that it is a duty of a member "to maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client."

No attorney should disclose confidential client information to a litigation funder without client consent. In order for that consent to be informed, the attorney should advise the client of the risk that a disclosure to a funder might be deemed a waiver of the attorney-client privilege. To be sure, there is a strong argument to be made that the disclosure of attorney-client privileged information to a litigation funder is not a waiver of the privilege under Evidence Code section 952. Section 952 protects communications with third parties "to whom disclosure is reasonably necessary for the transmission of the information or the accomplishment of the purpose for which the lawyer is consulted." To date, however, California courts have not decided the issue of whether disclosure of privileged information to a funder waives the privilege, and decisions on this issue in other jurisdictions have varied. In an abundance of caution, the recommended course is to advise clients not to disclose attorney-client privileged information to a funder.

In contrast, the related issue of whether the *attorney work-product* protection is waived by disclosure to a funder, while also an issue that has not been decided in California, has been definitively resolved in other jurisdictions. Disclosure of attorney work-product to a funder under a confidentiality agreement is not a waiver of the work-product protection because the disclosure does not make it substantially more likely that the defendant will obtain the protected material. *See*, *e.g.*, *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F.Supp.3d 711 (N.D.Ill. 2014). Accordingly, an attorney and client can comfortably share work-product with a funder to aid the funder's evaluation of the case, subject to an appropriate non-disclosure agreement.

FAILING TO ACT COMPETENTLY

Rule 3-110 provides in part that "a member shall not intentionally, recklessly, or repeatedly fail to perform legal services with competence." Clients are increasingly asking their attorneys for advice about litigation funding. In order to advise clients competently, attorneys should acquire "sufficient learning and skill" on the subject, as required by Rule 3-110.

CONCLUSION

Collaborating with a litigation funder allows a law firm to increase revenues, realization rates, and profits; to grow new business; and to cover operational and expansion costs, while taking on measured risk. Clients who collaborate directly with litigation funders are also able to pursue claims they otherwise might not be able to afford, while obtaining working capital to maintain their business, hire top counsel, and avail themselves of the resources needed to bring cases against deep-pocketed defendants. As litigation funding becomes more utilized, it is important for lawyers to understand how to use it as a resource without conflicting with the ethical rules.

Please note that Bentham offers CLE courses to firms and legal departments free-of-charge on both the basics of funding and the ethics of funding.