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Finding New Alternatives to Litigation Financing

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Recently the *New York Times* reported that Counsel Financial, a Buffalo company financed by Citigroup, invested \$35 million for lawsuits brought by Ground Zero workers, hoping for a big chunk of any potential settlement or jury award. The lawsuit ultimately settled for \$712.5 million. And the lenders earned about \$11 million on their investment. Counsel Financials investment is part of a larger trend of third party investors looking for new ways to invest in this down economy. In fact, we are seeing more and more investors, including large banks and hedge funds, turning to the potential for huge returns from consumer litigation and mass torts. But before plaintiffs' attorneys rush to accept this new source of capital, they should be careful to avoid ethical pitfalls and protect their clients.

In another recent article, the *New York Times* reported on the dangers of litigation funding for those plaintiffs who borrow. The article focuses on plaintiffs who have lost their homes or are struggling with illness. For example, one plaintiff, who was debilitated by a stroke and facing eviction, borrowed \$9,150 from Oasis Legal Finance. Eighteen months later, he received an initial settlement payment of \$27,000 but owed Oasis the bulk of it or \$23,588.

Until recently, third party litigation financing has been nearly non-existent in the United States. So, with the advent of this new trend, the American Bar Association is now studying whether third party investments in lawsuits, in the form of loans to lawyers or financing arrangements with clients, may run afoul of ethical rules governing attorney conduct. The ABA has formed a working group to examine the impact on legal ethics of alternative litigation financing. Among other issues, the group will investigate whether lawyer loans pose a threat to an attorney's professional independence, whether they damage the attorney-client relationship and whether disclosing case details to a lender violates rules of confidentiality and privilege. The ABA sought comments on these issues, requesting that they be sent to the working group by Feb. 15.

While the ability to share the risks of litigation may seem appealing to plaintiffs' attorneys, this kind of funding presents several serious issues and ethical concerns that should be considered prior to signing any financing agreement. First, when discussing the case with a potential investor, attorneys should be careful not to disclose confidential information or documents that are subject to the attorney-client privilege. Disclosure of confidential information to a third party could waive the attorney-client privilege, which could pose enormous ethical issues.

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Second, obtaining funding from a third party investor could undermine an attorney's control over his or her lawsuits. Attorneys, as representatives of their clients, need to maintain complete control of their lawsuits and not allow third parties to dictate settlement decisions. Unlike investors, who have no fiduciary duties to the client, attorneys should protect the interests of their clients when prosecuting their cases and not allow third party lenders to interfere with their legal judgment.

Third, attorneys should be careful not to violate California Rule of Professional Conduct 1-320 and Rule 5.4 of the Model Rules of Professional Conduct, which provide that a lawyer or law firm cannot share fees with a non-lawyer, with a few exceptions. To avoid violating such rules, attorneys should scrutinize the language of the agreement. An agreement that allows for payment of a portion of the attorney fees to the lender will probably be considered fee sharing with a non-lawyer. However, an agreement that is constructed as a traditional loan or a purchase agreement, such as the purchase of proceeds of the client's claim, will likely be consistent with the rules of professional conduct. Attorneys who willfully violate any of the California Rules of Professional Conduct are subject to discipline by the State Bar by public or private reproof or suspension from practice for up to three years. See Business and Professions Code Section 6077.

With that being said, in certain cases, litigation financing can be advantageous to plaintiffs' lawyers and their clients. In today's tough economy, many attorneys and law firms are finding it more economically challenging to fund their cases beyond the traditional contingency fee model. That's why finding alternative ways to finance litigation has become more appealing than ever for attorneys and clients alike. For many potential plaintiffs, litigation is not a viable option unless a contingency lawyer agrees to take on the case and risks. But when attorneys are unable to fund those cases, these potential plaintiffs are unable to pursue their claims unless a third party investor provides the capital. This type of funding allows clients who have limited financial resources but have been seriously injured as a result of the wrongful act of another to retain legal representation without having to pay for attorney fees and costs up front. This is no different from the big corporate defendants in lawsuits who have insurance companies that provide funding for litigation expenses.

Obtaining third party financing levels the playing field, allowing smaller firms with fewer resources to stand a chance against larger opponents with deep pockets and unlimited resources. In fact, litigation funding enables attorneys to take bigger cases than they otherwise would not be able to take. For the new attorney or law firm, litigation financing can be especially helpful.

While obtaining alternative litigation financing can help plaintiffs' lawyers - and maybe can even be the deciding factor between taking a good but costly case and not taking it - lawyers need to keep in mind the various issues and ethical concerns that arise with such funding. At the end of the day, we are lawyers and our priority should always be protecting the interest of our clients. If that means not accepting third party investments, so be it.