Litigation Loans and Ethical Issues

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Champerty

Loans for the purpose of providing financial assistance to a plaintiff during litigation started raising ethical issues for attorneys 10-15 years ago. The market for these loans exists because, with some limited exceptions, an attorney may not provide financial assistance to a client[1] and traditional lenders often avoid such loans as too risky.

Although these loans can present a number of ethical issues, one of the primary issues relates to whether attorney involved with the loan is participating in a champertous transaction. Champerty is a type of maintenance,[2] but that distinction isn't important in relation to the ethical issue. I will refer to "champerty" throughout this article. The important consideration, from an ethical perspective is that champerty is contrary to public policy. As a result, an attorney who participates in a legal matter that involves champerty engages is conduct prejudicial to the administration of justice. Under Rule 4-8.4(d), such conduct is professional misconduct that can result in disciplinary action.

Not all loans run the risk of constituting champerty. A loan which the client must repay, regardless of success in the litigation, would not constitute champerty, as long as the lender does not receive an interest in the litigation in some other way. Frequently the lenders use the terms "recourse" and "nonrecourse" loan. It is better to look at the client's obligation to repay rather than to get caught up in this terminology. If the client isn't obligated to repay unless the suit is successful, attorneys should avoid participation in the loan process.

Confidentiality and Privilege

Some lenders require the client to consent to disclosure of information about the case by the attorney. In some situations, this is fairly innocuous information that could easily be obtained from the court record or demand letter. However, sometimes the information sought includes information that the other side does not possess and may even include opinions and mental impressions that would be protected from discovery. Obviously, in the second situation, the risks associated with disclosing the information are greater. However, in either situation, the attorney should first analyze the potential that the court may interpret the disclosure as waiver of privilege and to what extent the court may deem the privilege waived. This legal analysis must be performed and communicated to the client as a part of the duties of competence[3] and communication,[4] prior to an agreement to disclose. Even if the client has made this agreement without the attorney's knowledge, the attorney must advise the client on this issue as soon as the attorney becomes aware.

If the client instructs the attorney to agree to the disclosure, after the attorney advises the client of any concerns, the attorney may follow the client's instructions.[5] The attorney should advise the client to insist on a confidentiality promise from the lender.

Payment to Lender

The lender usually insists that the attorney agree to pay the lender directly from the proceeds. Before agreeing to this obligation, the attorney must have the client's consent. The attorney must explain to the client that the client will not just be able to change his or her mind, later. If the client subsequently instructs the attorney not to pay the lender from the recovery, the attorney must hold the funds in trust until the client and lender resolve the dispute or the attorney interpleads the funds.

If the attorney did not agree to pay the lender directly from the proceeds but the client agreed that the client would instruct the attorney to do so, the attorney may only pay the lender if the client consents. However, the attorney must determine whether it appears that the lender has an interest in the funds. This interest may take the form of a contractual lien[6] or any other reasonable claim with a legal basis. If the attorney believes that the lender has a reasonable legal claim to an interest in the funds, the attorney must hold the funds in trust until the client and lender resolve the dispute or the attorney interpleads the funds. If the attorney believes that the lender has no reasonable legal interest in the funds, the attorney must follow the client's instructions.

Conclusion

Missouri attorneys may not participate in litigation loans that involve champerty. Even if a loan does not involve champerty, the attorney must be sure to address issues of confidentiality and privilege with the client. Further, the attorney must inform the client of the limitations on the client's options to refuse repayment of the loan from the proceeds of the case.

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[1] Rule 4-1.8(e): A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:
(1) a lawyer may advance court costs and expenses of litigation, including medical evaluation of a client, the repayment of which may be contingent on the outcome of the matter; and
(2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

[2] *Schnabel v. Taft Broadcasting Co., Inc.*, 525 S.W.2d 819, 823 (1975): The doctrines of champerty and maintenance were developed at the common law to 'prevent officious intermeddlers from stirring up strife and contention by vexatious and speculative litigation which would disturb the peace of society, lead to corrupt practices, and prevent the remedial process of the law'. [citations omitted]. Maintenance is defined as 'an officious intermeddling in a suit which in no way belongs to one, by maintaining or assisting either party, with money or otherwise, to prosecute or defend it'. [citation omitted]. Champerty, a species of maintenance, consists of an agreement under which a person who has no interest in the suit of another undertakes to maintain or support it at his own expense in exchange for part of the litigated matter in the event of a successful conclusion of the cause. [citation omitted]. As delineated, the law of champerty and maintenance is in force in [citation omitted], and in Kansas as well. [citation omitted].
[3] Rule 4-1.1.
[4] Rule 4-1.4.
[5] Rule 4-1.6.
[6] *See, Ford Motor Credit Co. v. Allstate Ins. Co., 2 S.W.3d 810 (1999); Marvin's Midtown Chiropractic Clinic, L.L.C. v. State Farm Mut. Auto. Ins. Co., 142 S.W.3d 751 (2004).*