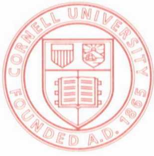

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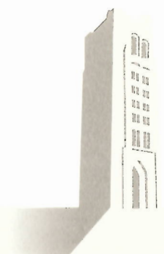
September 27, 2017

Ms. Rebecca A. Womeldorf
Secretary of the Committee on Rules of Practice and Procedure
Administrative Office of the United States Courts
One Columbus Circle, N.E.
Washington, D.C. 20544

Dear Ms. Womeldorf:

A June 1, 2017, letter from the U.S. Chamber Institute for Legal Reform and numerous allied organizations (collectively, "the Chamber") proposes an amendment to Rule 26(a)(1)(A) of the Federal Rules of Civil Procedure to require disclosure of third-party litigation funding in every civil case. Among other reasons the Chamber gives for mandatory disclosure is that it is necessary to enable district courts to carry out a function of "safeguarding legitimate, ethical civil litigation practices" by lawyers appearing before them. Chamber Letter, p. 10. Simply put, the Chamber seeks to enlist federal judges as monitors and enforcers of lawyer professional responsibility, a role that has traditionally been entrusted to state courts of last resort and agencies under their supervision.

Briefly on our qualifications: We both teach professional responsibility, at Cardozo (Sebok) and Cornell (Wendel) Law Schools, and we both have written extensively in this field. Wendel is a co-editor of a leading law school casebook, Geoffrey C. Hazard, et al., *The Law and Ethics of Lawyering*, now in its 6th edition, and is the sole author of a widely adopted student textbook, *Professional Responsibility: Examples and Explanations*, now in its 5th edition. He has been a member of the drafting committee for the Multistate Professional Responsibility Examination (MPRE) since 2007. Sebok is also a frequently cited scholar on third-party litigation funding, including its effect on the attorney-client relationship. He has taught and lectured about litigation finance internationally. He is a member of the American Law Institute, for which he serves as an Advisor for the forthcoming Restatement of Torts (Third), Intentional Torts to Persons, and is the Co-Director of the Jacob Burns Center on Ethics in the Practice of Law at Cardozo Law School.

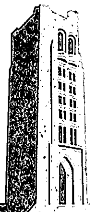


We also served as co-Reporters to the American Bar Association's Ethics 20/20 Commission Working Group on Alternative Litigation Financing, and were co-drafters of the Commission's White Paper on this subject. The Ethics 20/20 Commission invited the submission of written comments and live testimony from interested parties regarding, among other things, the impact of third-party litigation funding on the compliance by lawyers with their ethical obligations. After considering public comments and extensive internal discussion, the Commission decided that the existing framework of state-based rules of professional conduct was sufficient to prevent any risks to the lawyer-client relationship created by third-party funding. The Commission therefore directed us to prepare a guidance document explaining any ethical issues implicated by third-party funding and their treatment by the disciplinary rules. After approval by the ABA House of Delegates, the White Paper was released and is available at https://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf

We write as scholars of legal ethics and professional responsibility, with a particular interest in third-party litigation funding. We both serve as outside ethics counsel to commercial litigation funding companies – Sebok for Burford Capital LLC, and Wendel for Bentham IMF and Longford Capital Management, LP. However, we submit this comment solely in our individual capacities. We have not reviewed this comment with any industry actor, nor have we been compensated for preparing this submission. But we do rely on many years of experience with leading players in the commercial litigation funding industry to support our contention that third-party litigation funding does not create risks for the lawyer-client relationship that cannot be mitigated by the conscientious application of existing state disciplinary rules.

I. Role of State Courts in Attorney Regulation

Lawyers often speak loosely about being admitted to "the bar," but strictly speaking that is incorrect. Lawyers are admitted to practice in a state by a state court – generally the court of last resort, although in New York it is the Appellate Divisions of the Supreme Court. State appellate courts have the inherent authority, as a matter of state constitutional law, to admit lawyers to practice in a state, to formulate and administer rules of professional responsibility, and to establish a system of lawyer discipline. *See* Restatement (Third) of the Law Governing Lawyers § 1, cmt. c (2000) (hereinafter "Restatement"); Charles W. Wolfram, *Modern Legal Ethics* §2.2.2 (1986) (hereinafter "Wolfram"). Lawyers may be required to join a state bar association when they are admitted to practice (a so-called "unified" or "integrated" bar), or may elect join one of several voluntary bar associations, but it is the state judiciary, not the organized bar, that



adopts, investigates, and enforces remedies for lawyer misconduct. Wolfram § 2.3. Most states have adopted disciplinary rules based on the American Bar Association's Model Rules of Professional Conduct, but the authority to regulate is inherent in the state judiciary; the ABA has no regulatory authority. Lawyers who violate rules of professional conduct adopted by a state court may be subject to discipline ranging from a reprimand to permanent disbarment. *See* Restatement § 5.

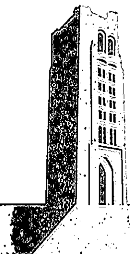
Trial-level courts of general jurisdiction, both state and federal, have a different type of inherent power than the highest state appellate courts. This species of inherent power is related to the common-law authority to punish contempts, but also includes the right to insist upon silence and decorum in the courtroom, to vacate judgments procured by fraud, and to dismiss for *forum non conveniens*. *See, e.g.*, *Chambers v. NASCO, Inc.*, 501 U.S. 32, 43-44 (1991). Courts have relied upon this type of inherent authority to craft remedies for lawyer misconduct that directly affects the conduct of the proceedings.[1] Much of the law governing conflicts of interest is grounded in this form of inherent authority. Early, influential decisions applied the remedy of disqualifying counsel for one of the parties owing to its concurrent or prior representation of another party. *See, e.g.*, *T.C. Theatre Corp. v. Warner Bros. Pictures*, 113 F. Supp. 265 (S.D.N.Y. 1953); *Emle Indus., Inc. v. Patentex*, 478 F.2d 562 (2d Cir. 1973); *Cinema 5, Ltd. v. Cinerama, Inc.*, 528 F.2d 1384 (2d Cir. 1976); *IBM Corp. v. Levin*, 579 F.2d 271 (3d Cir. 1978). It is now recognized that the remedies crafted by these courts was dependent upon the inherent power of judges to regulate the conduct of lawyers appearing before them, as well as the courts' authority to issue injunctions and similar orders. *See* Restatement § 6, cmt. i.

It is extremely important to recognize the distinction between regulation attorney misconduct *in general* by the state appellate courts of and the exercise of inherent authority to regulate the conduct of lawyers having an impact on a pending proceeding. One difference is that for example, that a court can refer to legal principles other than those contained in the rules of professional conduct of a lawyer's state of admission.[2] Another

[1] For example, a court may exclude evidence developed through an investigation outside the scope of the discovery process that involves communication with a party represented by counsel, *see, e.g.*, *Niesig v. Team I*, 558 N.E.2d 1030 (N.Y. 1990), or makes use of deceptive tactics, *see, e.g.*, *Midwest Motor Sports v. Arctic Cat Sales, Inc.*, 347 F.3d 693 (8th Cir. 2003); *In re Air Crash Disaster Near Roselawn, Indiana*, 909 F. Supp. 1116 (N.D. Ill. 1995).

[2]

> The district court has primary responsibility for controlling the conduct of attorneys practicing before it. Although the ABA does not establish rules of law that are binding on this Court, it is the Court's prerogative to disqualify counsel based on contravention of the ABA Model Rules. . . . This is true, despite the fact that neither this Court's Local



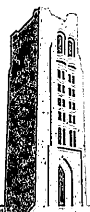
difference is the remedy involved. The state appellate courts can impose a range of sanctions relating to the practice of law such as suspensions and even disbarment, while attorney misconduct in the courtroom may result in a range of injunctive and monetary remedies. Trial courts are essentially on their own (subject to appellate precedent to the contrary) in crafting rules of conduct with respect to pending proceedings.

More to the point of our objection to the Chamber's proposal, the court's exercise of inherent authority over the conduct of the pending litigation is *not* for the purpose of protecting clients or the public generally, or ensuring high standards of ethical conduct by lawyers. That responsibility is vested in state appellate courts. As the New York Court of Appeals explained, in an opinion that remains influential today, state disciplinary rules have "a different provenance and purpose" than procedural rules governing the conduct of the parties and their counsel. *Niesig v. Team I*, 558 N.E.2d 1030, 1032 (N.Y. 1990). Disciplinary rules "embody[] principles of ethical conduct for attorneys as well as rules for professional discipline." *Id.* As such, they may strike a different balance among the policy considerations underlying the rule. *Id.* at 1033. The kind of inherent power involved in cases like *Niesig* is exercised for the purpose of protecting the integrity of the adversarial system and the litigation process, insofar as it affects the rights of the parties to a pending proceeding. Trial courts, including federal district courts, do not have a roving commission to regulate the ethics of the legal profession. That function is reserved to the highest courts of the admitting jurisdictions of lawyers, who adopt and enforce rules of professional conduct.

The Chamber asserts that third party funding "threaten core ethical" principles that "undergird our civil justice system" and that this threat justifies the disclosure rule they propose. This claim, to the extent that the word "ethical" refers to the rules attorney regulation described above, is based on two assumptions. First, that third party funding *in general* is more likely to lead attorneys to violate their professional responsibilities as set out in their states. And second, that to the extent that third party funding leads attorneys to violate their professional responsibilities as set out in their states (a claim we deny) the federal rules of procedure for a trial court should be used to address this threat to professional responsibility. We believe that the Chamber has failed to prove either assumption.

Rules nor the Rules of Professional Conduct of the State Bar of California expressly refers to the ABA Model Rules.

Securities Investors Protection Corp. v. Vigman, 587 F. Supp. 1358, 1362 (C.D. Cal. 1984) (with lengthy procedural history not relating to disqualification order).



II. Third Party Funding and the Risk of Violations of Professional Obligations by Attorneys

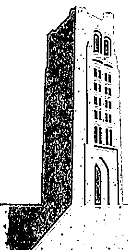
Violation of professional obligations by attorneys occur despite the fact that most attorneys strive to uphold the obligations imposed on them by the jurisdiction where they have been admitted to practice. The fact that violations of professional obligations *may* occur in the course of a transaction is not, in itself, a reason for the federal courts to address that kind of transaction. The ground for asking the federal courts to address the risk of ethical impropriety in third party funding is that there is some clear relationship between ethical impropriety and third party funding. The Chamber alleges such a connection, but we remain unconvinced based on the evidence it has presented. The Chamber's allegation is based on the putative appearance of ethical impropriety in three areas of professional responsibility.

A. Control Over the Conduct of Litigation

Critics of third-party litigation funding, including the Chamber in its submission, often invoke the image of the funder as a puppet master, secretly controlling the actions of the plaintiff and its counsel. An Australian High Court case generally known as *Fostif* approved a funding agreement that provides for extensive control by the funder over the conduct of the litigation, including retaining and discharging counsel, tactical decision-making, and acceptance or rejection of settlement offers. *See Campbells Cash and Carry Pty Limited v Fostif Pty Ltd* [2006] HCA 41. The Chamber seems to be suggesting that third party funding contracts seek to smuggle foreign concepts of third-party control into the attorney-client relationship in American cases.

Every attorney licensed in an American jurisdiction is obliged to obey certain rules designed to insure that the attorney's loyalty remains with her client. These rules include variations of Model Rule 1.2 (client determines objectives and scope of representation) and Model Rule 5.4 (guaranteeing the professional independence of the attorney). At their core, these obligations are not waivable by the client. Furthermore, the law of third party funding in the states does not permit clients to contract with funders to waive these obligations.

Certainly, as the Chamber knows, the mere fact that an attorney's client wishes to engage in third party funding in a jurisdiction where it is permitted under the local law does not increase the risk that the client's control over her attorney will be weakened. In New York, for example, the Bar Association of the City of New York noted that the rules of professional responsibility provide clear guidance to attorneys whose clients seek third party funding in the same way that these rules provide clear guidance to attorneys in other

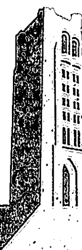


situations where third parties may seek to influence attorneys. *See* The Association of the Bar of the City of New York Committee on Professional Ethics, Formal Opinion 2011-2.

Furthermore, there are several well-established features of American law that prevent litigation funders from asserting control over critical decisions in litigation. These include:

- *Champerty concerns.* As discussed in the ABA Ethics 20/20 Commission's White Paper on alternative litigation finance, acquiring an interest in a litigant's cause of action is permitted, notwithstanding traditional restrictions on champerty, in many American states. However, even in states in which there is no longer a per se prohibition on champerty, a transaction may be deemed champertous and therefore voidable if the party acquiring the interest engages in "intermeddling" in the litigation, including seeking to control decision-making by the party and its lawyer. *See, e.g., Am. Optical Co. v. Curtiss*, 56 F.R.D. 26, 29–32 (S.D.N.Y. 1971) (agreement limiting litigant's control over whether to sue violated Fed. R. Civ. P. 17(a) requirement of suit brought by real party in interest); *Kraft v. Mason*, 668 So. 2d 679, 682 (Fla. Dist. Ct. App. 1996) ("officious intermeddling" is an element of champerty). One Florida appellate court deemed a funder a "party" for the purposes of a fee-shifting statute because of the extent of control the funder exercised over the litigation. *See Abu-Ghazaleh v. Chaul*, 36 So. 3d 691, 693 (Fla. Dist. Ct. App. 2009) (disapproving of transaction where funder had right under financing agreement "to approve the filing of the lawsuit; controlled the selection of the plaintiffs' attorneys; recruited fact and expert witnesses; received, reviewed and approved counsel's bills; and had the ability to veto any settlement agreements.").

- *Control over settlement.* The exclusive right of the client to accept or reject settlement offers is another central principle in the law of lawyering. "The requirement that an attorney's advice to the client be 'independent' means that if the defendant in a civil case makes an offer to settle that is conditioned on a waiver of attorneys' fees, the lawyer must communicate the offer and render objective advice about its merits that is independent of the lawyer's own interests in protecting the fee." *ABA/BNA Lawyers' Manual on Prof'l Conduct* ¶ 41:1609 (citing numerous ethics opinions). The ethical obligation to preserve a client's control over settlement is maintained by parallel requirements in state law concerning third party funding. Courts will carefully scrutinize contractual provisions that have the effect of limiting or burdening the client's exclusive right to make decisions regarding settlement. Control over settlement, for example, is one difference that Florida invokes to distinguish between third party funding contracts that it will enforce as



> opposed to those it will not enforce. *Compare Brown v. Dyrnes*, 109 So. 2d 788 (Fla. Dist. Ct. App. 1959) (control sought and contract held to be void) *with Kraft v. Mason,* 668 So. 2d 679, 682 (Fla. Dist. Ct. App. 1996) (no control sought and contract found in accord with public policy). We accordingly advise our clients in the third-party funding industry that attempting to exercise any control over settlement would raise concerns for both the lawyers of the funded party and any court reviewing the enforceability of the contract.

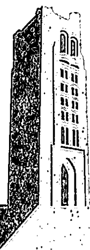
These considerations are well understood, both by commercial litigation funders and by lawyers representing claimants in funded litigation. Both of us have reviewed numerous commercial litigation funding agreements, all of which specifically disclaim any attempt by the funder to exert any control over the conduct of the litigation by counsel. Mandatory disclosure of third-party financing is not warranted on this ground because there is nothing to discover. Reputable commercial financing firms are not calling the shots in litigation. They protect their investment by extensive due diligence and transactional structures that do not interfere with the lawyer-client relationship.

B. Sharing Fees with Non-Lawyers

Model Rule 5.4(a), a version of which is in effect in every jurisdiction except for the District of Columbia, prohibits sharing legal fees with non-lawyers. The prohibition on fee-splitting protects clients and society against three dangers.

- First, the prohibition of fee-splitting with non-lawyer employees and agents serves the goal of preventing the unauthorized practice of law (UPL). *See O'Hara v. Ahlgren, Blumenfeld & Kempster*, 127 Ill. 2d 333, 342 (1989) (fee-splitting arrangements facilitate UPL).

- Second, the prohibition of fee-splitting with non-lawyer employees and agents serves the goal of preventing the impermissible solicitation of clients. *See* Wolfram § 16.5. For typical solicitation cases involving "runners" or "cappers" *see, e.g., In re Nelson*, 1 Cal. State Bar Ct. Rptr. 178 (Review Dept. 1990); *Danzig v. Danzig*, 904 P.2d 312 (Wash. Ct. App. 1995). The underlying concern in the runner/solicitation cases is that there will be a bidding war among lawyers paying for client referrals. *See, e.g., Crawford v. State Bar*, 7 Cal. Rptr. 746, 355 P.2d 490 (1960); *see also McIntosh v. Mills*, 117 Cal. Rptr. 3d 66, 74 (Cal. Ct. App. 2004) (summarizing purposes of fees-splitting rule and citing numerous cases). The rule appears to be implicated most frequently today in the context of referral arrangements and the compensation of client-development consultants and in-house employees. *See, e.g., Son v. Margolius, Mallios, Davis, Rider & Tomar*, 709 A.2d 112 (Md. Ct. App. 1998);



In re Rappaport, 588 N.Y.S.2d 436 (App. Div. 1992); *Trotter v. Nelson*, 684 N.E.2d 1150 (Ind. 1997); *State Bar of Texas v. Faubion*, 821 S.W.2d 203 (Tex. 1991); *In re Anonymous Member of the South Carolina Bar*, 367 S.E.2d 17 (S.C. 1988); Penn. Bar Op. 2004-3 (2004); Fla. Bar Op. 02-1 (2002); N.C. Bar Op. 147 (1993); N.Y. State Bar Op. 927 (2012); N.Y. State Bar Op. 727 (2000).

- Third, the prohibition of fee-splitting with non-lawyer employees and agents serves the goal of preventing non-lawyer interference with an attorney's professional judgment. As Comment [1] to Rule 5.4 states, the limitations in the rule "are to protect the lawyer's professional independence of judgment." *See, e.g.* Lawrence J. Fox, *Accountants, the Hawks of the Professional World: They Foul Our Nest and Theirs Too, Plus Other Ruminations on the Issue of MDPs*, 84 Minn. L. Rev. 1097, 1106 (2000) (arguing that Rule 5.4 guards against "interference by non-law trained masters who wish us to take short cuts to maximize profits"). Ethics opinions barring fee splitting with non-lawyer agents emphasize that there is a risk that, when a lawyer's agent's earnings are contingent on the outcome of a case on which he works, he may act against the client's interests by directing (or otherwise causing) the attorney to invest time and other resources among multiple clients based on which case promises the greatest reward and not what would be required under the attorney's obligation to provide competent representation. *See* Tex. Disciplinary Rules of Prof'l Conduct R. 5.04 cmt. 1 *and* D.C. Bar Op. 322 (2004).

The Chamber's bare allegation that third party funding raises special concerns relating to fee-splitting do not connect third party funding with the concerns outlined above. Funders are capital providers, like banks, and transact directly with clients, not the clients' attorneys. They do not offer to work for attorneys and split a fee with them. Funders do not seek to earn referral fees and do not seek to "sell" client referrals to attorneys. And, as noted above, funders are prohibited under the state laws of champerty to seek to take control of a client's litigation decisions, so they are not in a position to interfere with an attorney's ability to communicate her independent legal judgment to her client.

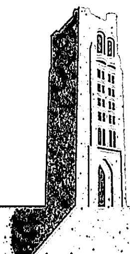
The Chamber's letter fails to draw a connection between the main purpose of the prohibition on fee-splitting and third party funding because the Chamber fails to recognize that third party funding is a form of financing. The fee-splitting rule cannot be applied rigidly or formalistically to law firm financing transactions, because even something as ordinary and pervasive as interest payments on a commercial line of credit must, by

definition, involve the sharing of legal fees with a non-lawyer.[3] Similarly, paying financing charges to a credit card issuer would involve the sharing of legal fees with a non-lawyer, yet these payments are universally permitted. *See, e.g.*, Cal. State Bar Formal Op. 2007-172 (permitting lawyers to accept payments of fees by credit card, even though the attorney makes a payment out of the earned fees by means of a service-charge debit, notwithstanding literal violation of California fee-splitting rule); Or. Bar Op. 2005-133 (2005) (establishing credit facility to pay lawyers' fee, in return for 10% financing charge, does not violate Rule 5.4(a)); Ill. Bar Op. 92-9 (1993) (same result as Oregon opinion, on a similarly structured transaction). Law firms may even, with appropriate safeguards, take out a loan to finance the expenses of litigation and pass the interest expense along to the client. *See, e.g., Chittenden v. State Farm Mut. Auto. Ins. Co.*, 788 So.2d 1140 (La. 2001); Mich. Op. RI-332 (2003); N.Y. State Bar Ass'n Op. 754 (2002); Kent. Bar Op. E-420 (2002); Ariz. Bar Op. 01-07 (2001); L.A. County Bar Op. 499 (1999); Ill. Bar Op. 94-06 (1994).

No one seriously contends that ordinary financing transactions such as these violate the fee-splitting rule. *See* Geoffrey C. Hazard, Jr. & W. William Hodes, *The Law of Lawyering* (3d. ed. supp. 2011) § 45.5, Illus. 45-1; Doug Richmond, *Other People's Money: The Ethics of Litigation Funding*, 56 Mercer L. Rev. 649, 677 (2005) ("Of course there is no prohibition against attorneys borrowing from banks to finance their practices. No courts or disciplinary authorities have ever suggested that attorneys who finance aspects of their practices with bank loans "share" or "split" their fees with the banks when they make loan payments."). Significantly, a recent ethics opinion of the New York City Bar approved of third-party litigation financing without mentioning New York's version of Model Rule 5.4, except in the context of referral fees and in support of the proposition that "absent client consent, a lawyer may not permit the company to influence his or her professional judgment in determining the course or strategy of the litigation, including the decisions of whether to settle or the amount to accept in any settlement." *See* Ass'n of the Bar of the City of N.Y. Op. 2011-2 (2011).

The Virginia State Bar's Standing Committee on Legal Ethics, when faced with a different issue concerning the application of Virginia's version of Model Rule 5.4(a) to an innovative financing agreement between a client and a lawyer, offered advice which we think other committees will heed. The opinion, Virginia Legal Ethics Op. 1783 (2003), considered a case in which an attorney was hired to collect on a promissory note that included a provision requiring payment of 25% of the principal balance as attorneys' fees in the event of a collection action. Because the lender had been paying the attorney on an hourly basis and the attorney proposed to reimburse the lender out of the proceeds of the

[3] Because law firms are prohibited from forming partnerships with non-lawyers, *see* Model Rule 5.4(b), any revenue of a law firm must come from attorneys' fees.

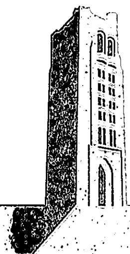


recovery, including the 25% attorneys' fee, the attorney was concerned that reimbursing the lender would violate the fee-splitting rule. The committee held that, on its face, this transaction involved splitting an attorney's fee with a client who was also, in effect, a third-party payor. It emphasized, however, that "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." The purpose is to avoid improper interference by third parties with the conduct of the litigation. The Committee noted that it had repeatedly emphasized that "[t]he primary purpose of Rule 5.4 is to prohibit nonlawyer interference with a lawyer's professional judgment and ensure lawyer independence." *Id.* (citing Va. Legal Ethics Op. 1744 (no violation of the fee-splitting rule in sharing portion of court-awarded fees with nonprofit organization)).

The most closely analogous authority on the application of Model Rule 5.4(a) to the specific context of third-party litigation financing is a series of ethics opinions from the Utah State Bar Ethics Advisory Committee. The Utah opinions employ the substance-over-form approach that characterize the only sensible analysis of the application of the fee-splitting rule to financing transactions. The permissibility of the transactions turns on whether they are structured in a way that creates the potential for a severe misalignment of interests between the funded law firm and the client.

The most relevant of the three opinions, Utah Bar Ethics Opinion 06-03, involved a loan by a third-party litigation financing company to a law firm, with a conditional obligation on the part of the lawyer to repay out of the proceeds of any judgment or settlement received. Because the obligation made reference to a single case for which the lawyer had borrowed from the third-party lender, there were foreseeable situations in which the lawyer would be better off financially if he lost the case and the client recovered nothing. For example, if the lawyer had borrowed $80,000 to finance $100,000 of litigation costs and expenses, and obtained a recovery of $100,000 for the client, the lawyer's obligation would be to repay the original $80,000, plus a funding fee of $80,000, for a total of $160,000. If, on the other hand, the lawyer "took a dive" in the case and recovered nothing for the client, the lawyer would be obligated to pay the lender nothing. The adverse incentive created by the presence of third-party financing was deemed an intolerable limitation on the lawyer's independence. On those narrow grounds, the opinion concluded that the investment violated the fee-splitting rule. The opinion noted, however, that a non-recourse financing arrangement in which it was it is "mathematically impossible for the lawyer to be able to reduce the lawyer's losses by obtaining no recovery for the client" would not violate Utah's prohibition on fee-splitting.

These authorities show that the fee-splitting rule cannot be applied literally or formalistically to financing transactions. An analysis that considers the substance of the



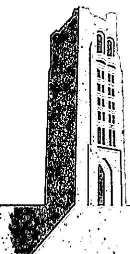
fee-splitting rule over its form focuses on the effect the financing transaction has on the lawyer's independence and professional judgment. The blanket disclosure requirement for which the Chamber is advocating is unsuited to this kind of highly fact-specific, rule-of-reason analysis. The putative concern about fee-splitting cited by the Chamber cannot be supported by reference to the small set of cases, like that described in Utah Opinion 06-03, in which a financing transaction creates an impermissible interference with a lawyer's independent professional judgment.

C. Conflicts of Interest

Lawyer independence is also regulated by conflict of interest rules promulgated by state appellate courts, and generally based on Model Rules 1.7, 1.8, and 1.9 (the major provisions governing conflicts of interest arising out of concurrent representation, personal interests of an attorney, and successive representation, respectively). The Chamber seems to be arguing that disclosure of financing transactions must be mandatory so that the district court can investigate the transaction to determine whether it creates impermissible conflicts of interest. As is the case with the fee-splitting rule, application of the conflicts rules is highly fact-specific, and would involve district judges in lengthy, often quite technical, and unnecessary investigations into the possibility of conflicts of interest. This burdensome requirement is particularly inappropriate when it is quite clear that the potentially adverse financial interests of a lawyer do not create conflicts of interest at all.

For example, ordinary contingent fee financing involves a well-known conflict between the attorney's interest in maximizing his or her effective hourly rate and the client's interest in obtaining a larger judgment or settlement. This structural problem has never been treated as creating a conflict under Model Rule 1.7, *see* Hazard & Hodes, *supra* § 8.14.1, nor has the situation in which lawyers have incurred substantial indebtedness to a commercial lender to finance the representation of a client in a particular matter. Similarly, the U.S. Supreme Court refused to use the term "ethical dilemma" to refer to a settlement offer conditioned upon an agreement by the plaintiff's lawyer to waive a statutory entitlement to seek attorney's fees. *See Evans v. Jeff D*, 475 U.S. 717 (1986). Justice Stevens wrote:

> [A] lawyer is under an ethical obligation to exercise independent professional judgment on behalf of his client; he must not allow his own interests, financial or otherwise, to influence his professional advice. Accordingly, it is argued that a lawyer is required to evaluate a settlement offer on the basis of his client's interest, without considering his own interest in obtaining a fee; upon recommending settlement, he must abide by the client's decision whether or not to accept the offer.



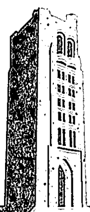
Lawyers are also under a professional obligation, and not regarded as subject to a conflict of interest or in an ethical dilemma under the rules, where they are paid by a liability insurer to defend the interests of an insured. Other provisions in the rules, such as the independence requirement of Model Rule 2.1 and the allocation of decision-making authority in Model Rule 1.2(a), ensure that the client's interests are protected. *See* Hazard & Hodes, *supra* § 45.3, at 45-6. It is a highly unusual situation in which the conflict between an attorney's financial interests and the obligation to provide independent advice to a client will be deemed so severe that it rises to the level of an ethical dilemma mandating separate treatment under the rules, as opposed to being merely one of the ways in which the obligation of professionalism can occasionally be demanding.

III. Amending Rule 26 To Address Alleged Violations of Professional Responsibility

As we have argued in the foregoing section, we do not believe that the Chamber has demonstrated that third party funding is associated with a special or salient risk of attorney misconduct. However, even if there were some concern with professional responsibility that arose from third party funding, we are skeptical that an amendment to the federal rules relating to disclosure of third party funding in litigation would effectively address the risk of attorney misconduct.

It bears repeating that the goals of the various states' rules of professional responsibility and the goals of rules of procedure (state or federal) are different. The rules of procedure are designed to promote justice by protecting the interests of the parties adverse to each other in litigation. The rules of professional responsibility are designed to protect the interests of clients to the extent that those interests can promoted through the legal system in ways that do not harm third parties, the courts, and society in general. Sometimes, of course, rules intended to serve ends in litigation overlap with the rules of professional responsibility. For example, the rules concerning the disqualification of counsel due to concurrent conflicts in federal courts borrow directly from the rules of concurrent conflict adopted by the various bar disciplinary bodies. *See, e.g. Richardson v. Hamilton Int'l Corp.*, 469 F.2d 1382, 1383-84 (3d Cir. 1972) (American Bar Association's Code of Professional Responsibility provided the content of Rule 11 of the Local Rules of the United States District Court for the Eastern District of Pennsylvania with regard to determining disqualification of a party plaintiff).

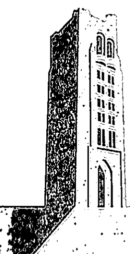
The Chamber is suggesting that the requirements of professional responsibility are so clear that it would be easy and costless for the federal rules to assist in their enforcement while pursuing others ends, such as balancing the interest of adverse parties in discovery.



But it is unlikely that the rules of professional responsibility would be reinforced by the proposed disclosure rule in a way that was either simple or costless.

To take but one example, we demonstrate above that the so-called concern with fee-splitting – as it connects up with third party funding – is really a concern with the risks that certain forms of financing would impermissibly interfere with lawyers' independent professional judgment. The problem with trying to assist the various states in their regulations of this kind of financing (assuming that the states need assistance, which we deny) is that the states do not agree over the definition of the form of financing that would impermissibly interfere with lawyers' independent professional judgment. One ethics committee in Ohio, for example, has taken the extreme position that any form of factoring of a legal fee is fee-splitting, even if the lawyer is offering to sell to a factor a fee that arises from a settlement approved by a court. *See* Advisory Opinion, Ohio Supreme Court's Board of Commissioners on Grievances and Discipline, Opinion 2004-2 (transaction violates Rule 5.4(a)). On the other hand, Utah, as seen above, does not consider the sale of a contingent fee prior to settlement in exchange for financing to be even a question of fee-splitting, but treats the question as one of a waivable conflict of interest under Rule 1.7(a)(2). As this range illustrates, there is no single national perspective on the so-called "problem" of fee-splitting as it relates to third party funding secured by an attorney's immature contingent fee. There is a diversity of interpretations among the states and the authorities charged with enforcing the prohibition on fee-splitting. *See* Anthony J. Sebok, *Unmatured Attorneys' Fees and Capital Formation in Legal Markets*, 2018 Ill. L. Rev. __ (forthcoming 2018). It hard to see how a federal rule can support all the various jurisdictions in their effort to ensure that attorneys are fulfilling their professional responsibilities if the rule will be necessarily either over- or under-inclusive in its characterization of the rule it is trying to reinforce.

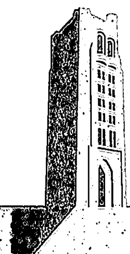
It is instructive to see how courts have responded to invitations by parties to incorporate claims about violations of the prohibition on fee-splitting in cases where contingent fees have been financed and disputes have arisen over obligations to pay. In numerous cases where debtors have raised the argument that their obligations were based on contracts that violated public policy because they were based on violations of obligations of professional responsibility, the courts have eschewed any invitation to consider the effect of their decision on the promotion of the rules of professional responsibility and looked narrowly at the underlying contract. In *Santander Bank, N.A. v. Durham Comm. Capital Corp.*, Civil Action No. 14-13133-FDS, 2016 U.S. Dist. LEXIS 5430 (D. Mass. Jan. 15, 2016), for example, the court held that Massachusetts Rules of Professional Conduct were relevant its analysis of whether earned fees could be sold given the limitations of Rule 5.4(a), the court analyzed the argument only in terms of its relevance to Massachusetts contract interpretation, and not in terms of how its decision would



address or affect the risk of attorney misconduct. The same analysis can be seen is other cases that refused to hold finance agreements void because they allegedly involved impermissible forms of fee-splitting. *See, e.g. Lawsuit Funding, LLC v. Lessoff*, 2013 WL 6409971 at *5 (NY Sup. Crt. 2013 *and PNC Bank v. Berg*, 1997 WL 529978, at *10 n.5 (Del. Super. Ct. 1997). The court in one Texas case was very blunt about the relevance of allegations that impermissible fee-splitting would be rewarded in its review of the enforceability of finance agreement: "any alleged violation of the Disciplinary Rules does not necessarily establish a cause of action 'nor does it void an otherwise valid contract executed outside of the attorney-client relationship.'" *Counsel Fin. Servs., L.L.C. v. Leibowitz*, 2013 Tex. App. LEXIS 9252, 2013 WL 3895331, at *24 (Tex. App. 2013), *reh'g overruled* (2013), *rev. den.* (2014)) (citation omitted).

Courts keep claims about violations of the rules concerning fee-splitting at arms-length for a reason, which is that they recognize that even in their own jurisdiction the enforcement of the obligations of attorneys in connection with financing litigation involves unsettled ethical principles which they are not equipped to evaluate. If it is this difficult for state courts to adopt and apply rules within their own jurisdiction, it seems to us to be highly unlikely that claims about the application of the rules of professional responsibility to financing by third party funders are likely to be accurate. The burden is on the Chamber to explain how its proposal promotes the enforcement of the states' rules of professional obligations. The letter submitted by the Chamber does not even attempt to meet this burden — it assumes that any amendment to the federal rules that is consistent with one state's rules of professional responsibility, even if only of marginal benefit in that one state, justifies an amendment to the rules of procedure. That assumption is unproved and therefore we conclude that the Chamber has failed to meet its burden. Furthermore, for reasons stated in this letter, we think it is highly unlikely that they could ever meet its burden.

In conclusion, we would like to emphasize that we are writing only in response to the Chamber's assertion that its proposed amendment to Rule 26(a)(1)(A) of the Federal Rules of Civil Procedure to require disclosure of third-party litigation should occur so that "core ethical principles" in the legal profession will be protected. This claim is supported by two assertions. The first is that third party funding is currently causing lawyers to act in violation of their states' ethical obligations. The second is that the proposed amendment to the federal rules of civil procedure can help with the threat to professional ethics putatively identified by the Chamber. Our response is simple. First, we do not see any evidence – in the Chamber's letter or in our own experience – that third party funding is causing lawyers to act in violation of their states' ethical obligations. Second, we do not think that amending Rule 26 of the Federal Rules of Civil Procedure will help the states promote ethical conduct among their lawyers in connection with the concerns raised by



the Chamber. In the absence of a need for intervention and in the face of no evidence that the intervention recommended will actually help, we urge the Committee to reject the proposed amendment.

Sincerely,

Anthony J. Sebok
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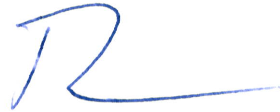
New York, NY 10011

Sincerely,



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