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Professional Malpractice

Where Clients Borrow To Fund Suits, Malpractice Troubles May Follow

By Ronald L. Israel
and Scott W. Lichtenstein

Clients who seek to pursue legal claims but cannot afford it may turn to a lender willing to advance the necessary funds in exchange for a share of the settlement or judgment. While certain states have barred such loan agreements, New Jersey has not done so.

But various liability-related concerns might cause the claimant's attorney to take pause. (This does not relate to those situations in which the attorney, and not the client, obtains the loan, perhaps to cover expenses in a contingency fee or class-action lawsuit.)

Litigation loan agreements can contain different terms and conditions, but the nature of the loan is straightforward. The borrower-plaintiff will receive an advance of funds to be used in furtherance of his or her legal claim. In return, the loan company is entitled to share in the settlement or verdict. To that end, some repayment schedules provide for a percentage of the verdict, others provide for a lump sum, and still others utilize an algorithm that calculates the repayment amount by factoring in both the amount recovered and the length of the litigation. In many cases, the loan company's profit is contingent, which means that a decision adverse to the client requires the company to write off the entire loan.

Israel is a partner and Lichtenstein is an associate at Wolff & Samson in West Orange.

Courts that have considered the legality and enforceability of litigation loan agreements have issued divergent opinions. In doing so, many courts have found an opportunity to revisit the doctrines of maintenance and champerty.

Maintenance is the act of meddling in another's lawsuit despite having no legally cognizable interest in the litigation. Champerty is a type of maintenance where the "champertor" engages in maintenance for the purpose of sharing the claimant's winnings. By issuing a litigation loan, the company becomes involved in the lawsuit of a stranger (maintenance) for profit (champerty).

In 2003 the Ohio Supreme Court pronounced a litigation loan agreement void as a form of champerty and maintenance. *Rancman v. Interim Settlement Funding Corp.*, 789 N.E.2d 217 (Oh. 2003). Presented with the same issue, the Massachusetts Supreme Court ceased recognizing the champerty and maintenance doctrines, thus resolving to evaluate loan agreements based on their terms. *Saladani v. Righellis*, 687 N.E.2d 1224 (Mass. 1997). The South Carolina Supreme Court issued a similar ruling in *Osprey, Inc. v. Cabana Ltd. P'ship*, 532 S.E.2d 260 (S.C. 2000). And as the *Saladani* Court resolved to do, other courts have voided litigation loan agreements on grounds such as usury or unconscionability. *Odell v. Legal Bucks, LLC*, 665 S.E.2d 767 (N.C. Ct. App. 2008).

The New Jersey courts have not yet entirely decided on this issue, and it is difficult to predict which side our Supreme Court would take. Yet it is significant that New Jersey has long eschewed the laws of champerty and maintenance. *Sweeney v. Veneziano*, 70 N.J. Super. 185, 193 (App. Div. 1961). Therein is one possible leg upon which a litigation loan might stand, for better or worse.

The benefits and drawbacks of the litigation loan industry have been sufficiently treated within legal academia — but not necessarily from the perspective of the practicing attorney. The possibility that New Jersey courts will recognize the state as a proper home to litigation loan companies (subject to whatever usury rates or factors informing on unconscionability) might give one uncomfortable pause. After all, representing a client who has obtained a litigation loan ultimately translates to a third party having a financial interest in the quality of one's legal performance. This raises ethical and practical conundrums that warrant discussion.

Some litigation loan companies will approach the attorney for the attorney's signature or approval and some will not. An explicit agreement between the company and the attorney poses a threat of violating N.J. Rule of Professional Conduct 1.7(a)(2) by creating a risk that the representation of the client "will be

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materially limited by the lawyer's responsibilities to ... a third person or by a personal interest of the lawyer." Julia H. McLaughlin, "Litigation Funding: Charting a Legal and Ethical Course," 31 *Vermont L. Rev.* 615, 650-53 (2007).

An attorney presented with such an agreement is also well cautioned to determine whether the agreement preserves the attorney's right and duty to act both on the client's behalf and adverse to interests of the litigation loan company.

This is because the risk-averse among us will imagine the possibility of additional malpractice liability to the litigation loan company, either directly or indirectly. Might a litigation loan company — a third party — maintain a malpractice lawsuit directly against an attorney? New Jersey law is no stranger to the concept of professional liability to third parties, even absent an agreement to provide professional services to that third party. For instance, New Jersey's Accountant Liability Act, N.J.S.A. 2A:53A-25, sets forward the conditions under which an accountant may be held liable to a nonclient third party under certain circumstances. Attorneys are somewhat more insulated from malpractice, a lawsuit for which generally requires that the plaintiff prove the existence of an attorney/client relationship. See *DeAngelis v. Rose*, 320 *N.J. Super.* 263 (App. Div. 1999) (guarantor of legal fees cannot sue attorney for malpractice where no attorney/client relationship was established between the guarantor and client).

That being said, one should ensure that the client's retainer agreement specifically excludes any other party — besides the client — from the attorney/client relationship. Where possible, that section should reference the loan company by name. Further, an attorney approached by the litigation loan company should see to it that the litigation loan agreement disclaims any presumption of an attorney/client relationship between the attorney and the company.

For similar reasons, it is in the attorney's best interest to explicitly exclude the loan company in two other areas of representation. First, the attorney should avoid disclosing any privileged information to the lender (usually to aid the lender's case evaluation), because a court might perceive the lender as a third party whose involvement has broken the information's privileged status. Second, in no way should the lender be afforded the right to coax or guide settlement decisions.

Despite such precautions, an attorney may still remain liable to a nonclient in various circumstances, even in the absence of an attorney/client relationship. Such a situation might arise in which the attorney provides advice upon which the attorney intends the nonclient to rely. See generally *Petrillo v. Bachenberg*, 139 N.J. 472, 474-95 (1995). Therefore, a prudent attorney ought to avoid even the appearance of inducing a loan company to grant a loan to the client.

The attorney should also refrain from making representations about the client's claim or about the attorney's own qualifications. This is doubly important where such statements risk violating N.J. RPC 2.3 (governing when a lawyer may evaluate a client's matter for the benefit of a third party) and 4.1 (requiring truthfulness in statements to third parties).

The prospect of indirect liability is somewhat more troubling. This is to say that any risk of malpractice liability to the client is magnified by the involvement of the loan company. One can only presume that a company seeking to profit from the success of another's casualty claim will be just as willing to profit from the success of the same claimant's legal malpractice action (depending on the basis of the malpractice action, perhaps rightly so). This would be all the more likely where the attorney's acts or omissions have perceivably resulted in a loss to the loan company.

Although one obvious method for avoiding indirect liability would be to insist that the loan company may not fund the client's subsequent malpractice action, this raises a very thorny issue. N.J. RPC 1.8(h)(1) forbids making "an agreement prospectively limiting the lawyer's liability to a client for malpractice" unless: 1) the client acts in derogation of the lawyer's advice, 2) the representation continues at the client's request, 3) such an agreement is lawful, and 4) the client signing such an agreement is represented by independent counsel.

While the RPC does not likely forbid precluding malpractice liability against a nonclient, an agreement with a loan company to "cut off" the client might constitute an attempt at limiting the lawyer's malpractice liability to that client. Then again, the text of this rule refers to such agreements as are made between the attorney and the client, not between the attorney and the client's bankroller.

For those who balk at the idea of a malpractice lawsuit initiated by a third-party litigation financier, consider this: Malpractice actions can be filed by anyone, regardless of merit. The inviolability of an adversary's position will not necessarily defray any costs incurred prior to having the litigation dismissed. Where an attorney represents a client whose funds are advanced by a litigation loan company, the attorney's best interests dictate prudence from the outset of the representation. ■