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# Legal Capital:
# Law Firm Risk Management in Litigation Funding

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As litigation has grown more expensive, "litigation funding" has evolved considerably. Law firms have long had lines of credit to fund operations generally. In fact, a WSBA advisory opinion from 1986 was painted against the backdrop of a law firm pledging its accounts receivable as a part of a bank loan to the firm. It's also nothing new for clients to use financial tools ranging from credit cards to mortgages to pay for legal services. In recent years, however, specialized litigation funding companies have emerged offering to underwrite specific cases. In some variants, the borrower is the law firm. In others, the borrower is the client. Because the latter is one of the most common current models, this column focuses on a funding scenario where an independent funding company agrees with the client to underwrite the client's lawsuit in return for a share of the client's recovery.[1] Although generally permitted, litigation funding can present law firms with difficult conflict and confidentiality issues.

***Conflicts***

Conflicts between the business interest of a lawyer and the interest of the client can occur in many ways when litigation funding is involved. The conflicts typically arise under RPC 1.7(a)(2) and are triggered when the lawyer's professional judgment on behalf of the client may be materially limited by the

lawyer's own business interest. These conflicts are inevitably fact-specific and can range from the lawyer's interest in accelerating payment by having the client use financing vehicles that are not necessarily in the client's best interest to disputes over settlement funds between the client and the funder. A recent ABA ethics opinion—Formal Opinion 484 (2018)—catalogs many conflict scenarios arising from litigation funding and merits close review by lawyers whose clients are considering this option.

The most corrosive potential conflict, however, occurs when the litigation funding company attempts to direct the way the lawyer handles a case on behalf of a client. New York City Bar ethics opinion 2011-2 (2011) surveys several litigation funding conflicts and focuses on this one in particular, noting (at 7) that it "raise[s] the specter that a financing company, armed with information regarding the progress of the case, may seek to direct or otherwise influence the course of the litigation."

RPC 2.1 articulates our fundamental duty to exercise independent professional judgment on behalf of clients. RPCs 1.8(f) and 5.4(c) echo this general duty in the specific setting of being paid by a third-party. RPC 1.2(a), in turn, reserves to the client the sole authority to settle. In short, although the funding may be coming from a third-party, the case belongs to the client.

***Confidentiality***

As a part of its evaluation of whether to underwrite a case, a litigation funding company may want access to confidential strategy and other sensitive material normally shielded from discovery by the attorney-client privilege or the work product rule. In most instances, the funder will want this information from the lawyer rather than the client.

RPC 1.6(a) generally requires a client's informed consent to disclose confidential information. "Informed consent," in turn, is defined by RPC 1.0A(e) as including an explanation by the lawyer of the material risks of proposed action. The material risks of sharing confidential information with a litigation funding company potentially include waiver of privilege or work product protection.

Because privilege and work product address different aspects of confidentiality, their treatment in the litigation funding context has also varied.

Privilege under RCW 5.60.060(2)(a) and its federal common law counterpart are designed to protect confidential communications between lawyer and client. Ordinarily, voluntary disclosure of a privileged communication constitutes waiver. Moreover, as Professors Aronson and Howard put it (at 9-9) in *The Law of Evidence in Washington*: "[P]rivilege cannot be redeemed once it has been waived."

At the same time, Washington's state and federal courts have both articulated an exception to waiver when otherwise privileged communications are shared with another person relevant to a common claim or defense:

- "The 'common interest' doctrine provides that when multiple parties share confidential communications pertaining to their common claim or defense, the communications remain privileged as to those outside their group." *Sanders v. State*, 169 Wn.2d 827, 853, 240 P.3d 120 (2010).

- "The common interest . . . privilege applies where (1) the communication was made by separate parties in the course of a matter of common interest or joint defense; (2) the communication was designed to further that effort; and (3) the privilege has not been waived." *Avocent Redmond Corp. v. Rose Electronics, Inc.*, 516 F. Supp.2d 1199, 1203 (W.D. Wash. 2007).

With a litigation funding company, the argument is that confidential information is being shared to advance the client's case. *In re International Oil Trading Company, LLC*, 548 B.R. 825, 832-33 (Bankr. S.D. Fla. 2016), for example, took this approach. Application of the common interest doctrine in the litigation funding context, however, is not assured. In *Leader Technologies, Inc. v. Facebook, Inc.*, 719 F. Supp.2d 373, 375-77 (D. Del. 2010), the court determined privilege had been waived and ordered production of materials that the plaintiff had provided to litigation funding companies. In reaching a similar conclusion on the common interest doctrine, the court in *Miller UK Ltd. v.*

*Caterpillar, Inc.*, 17 F. Supp.3d 711, 732 (N.D. Ill. 2014) (emphasis in original), observed pungently: "A shared rooting interest in the 'successful outcome of a case' . . . is not a common *legal* interest."

CR 26(b)(4) and its federal equivalent, in turn, are intended to protect a lawyer's work product in the form of mental impressions, analysis and related confidential written materials compiled during or in anticipation of litigation. Reflecting this distinction from privilege, work product may be shared with a third person without necessarily triggering waiver. The Washington Supreme Court in *Kittitas County v. Allphin*, 190 Wash.2d 691, 710, 416 P.3d 1232 (2018), quoted the Restatement (Third) of the Law Governing Lawyers (2000), approvingly on this point:

> "'Effective trial preparation often entails disclosing work product to coparties and nonparties. Work product, including opinion work product, may generally be disclosed to the client, the client's business advisers or agents . . . and other professionals working for the client, or persons similarly aligned on a matter of common interest.'"

Courts, therefore, have generally accorded litigation funding materials more protection under the work product rule than the attorney-client privilege. The court in *Miller*, for example, extended protection to litigation funding materials under the work product rule that the court had concluded did not qualify for similar protection under privilege. Like privilege, however, treatment of work

product in this context has not been uniform. In *Haghayeghi v. Guess?, Inc.*, 2016 WL 9526465 at *2 (S.D. Cal. Mar. 21, 2016) (unpublished), for instance, the court cited general Ninth Circuit authority on both privilege and work product in ordering production of litigation funding materials. Although not exact, the analytical dividing line often turns on the stated purpose for seeking the materials. In *Miller*, for example, the court was not persuaded by the defendant's asserted need for the materials to support its defense of "champerty." In *Haghayeghi*, by contrast, the court placed considerably more weight on the argument that funding materials were needed to assess the suitability of an individual to serve as a potential class representative.

The ambiguity surrounding the discoverability of litigation funding materials suggests three steps for lawyers and their clients considering this avenue. First, lawyers should discuss with their clients under RPC 1.6(a) that there is an inherent—but not precisely quantifiable—risk in sharing any confidential information with potential litigation funders. Second, although written confidentiality agreements with potential litigation funders are not necessarily required, court decisions imply that such agreements will improve the odds that materials will qualify for at least work product protection. Finally, even with client consent and a written confidentiality agreement, lawyers should carefully weigh

the material included and, absent unusual circumstances, not provide either direct attorney-client communications or extremely sensitive work product revealing key strategies. The safest course is often to only share information that has already been disclosed in public court filings or associated discovery provided to the litigation opponent that is not otherwise subject to a protective order.

**ABOUT THE AUTHOR**

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[1] By focusing on this common model, lawyers who are evaluating other models—such as borrowing arrangements directly between the law firm and the litigation funder or a law firm that is considering establishing its own lending affiliate—should carefully examine the risks associated with the particular lending mechanism proposed.