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THE RISK MANAGER

A QUARTERLY NEWSLETTER BY LAWYERS MUTUAL INSURANCE COMPANY OF KENTUCKY

DO YOUR CLIENTS' LITIGATION FUNDING CONTRACTS VIOLATE KENTUCKY'S CHAMPERTY PROHIBITION?

KENTUCKY COURTS *have long recognized the common law doctrine of champerty. …. As Kentucky's highest court has noted: At common law champerty is defined to be a bargain by the terms of which a person having otherwise no interest in the subject matter of an action undertakes to carry on the suit at his own expense or to aid in so doing in consideration of receiving, in the event of success, some part of the land, property or money recovered or deriving some benefit therefrom. (Boling V. Prospect Funding Holdings, LLLC, 2017 BL 104180, W.D. Ky., Civil Action No. 1:14-CV-00081-GNS-HBB, 3/30/17.)*

ABA/BNA Lawyers' Manual on Professional Conduct's April 5, 2017 Current Reports in writing about *Boling v. Prospect Funding Holdings* led with the headline:

"LAWSUIT FUNDING ILLEGAL IN KY, FED JUDGE SAYS IN SETBACK TO LITIGATION FINANCE INDUSTRY."

Nationally, public policy on third-party funding of law suits evolved from the strict application of champerty to a cautious approval of lawyers assisting clients in getting third-party funding if ethics requirements are met. The national trend is to reduce, not increase champerty, especially in civil litigation matters. Some states specifically revoked champerty laws and others take a relaxed view of litigation funding, if seen in the best interest of the client. Boling reverses this trend for Kentucky lawyers.

CONTINUED ON PAGE 2

RISK MANAGING WITHDRAWAL FOR A CLIENT'S FAILURE TO PAY FEES

Lawyers are not required to provide free legal services to clients who fail to pay the agreed fees and may move to withdraw. While withdrawal for failure to pay fees is permissible, a lawyer must do so carefully to avoid malpractice claims and ethics complaints. The recent ABA Ethics Formal Opinion 476 *Confidentiality Issues when Moving to Withdraw for Nonpayment of Fees in Civil Litigation* (12/19/2016) provides sound guidance for withdrawing from a civil suit under the supervision of a judge.

The opinion compares a lawyer's duty of confidentiality when moving for withdrawal for failure to pay fees with a court's need for sufficient information to rule on the motion. The permissive authority to withdraw is contained in ABA Model Rule 1.16 in the following paragraphs:

> [5] the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled;
>
> [6] the representation will result in an unreasonable financial burden on the lawyer or has been rendered unreasonably difficult by the client;
>
> Comment [8] to the rule reinforces this authority: A lawyer may withdraw if the client refuses to abide by the terms of an agreement relating to the representation, such as an agreement concerning fees or court costs ….

[Editor's Note: *Kentucky Rule of Professional Conduct SCR 3.130, 1.16 [5] and [6], and Comment [8] are identical to the Model Rule.*]

CONTINUED ON PAGE 3

INSIDE THIS ISSUE:

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LLITIGATION FUNDING

CONTINUED FROM FRONT PAGE

Boling was burned when a gas can exploded. He was in a coma for six months, had full thickness burns over 40% of his body, and spent six months in the hospital. Boling and his wife sued the gas can manufacturer.

During the litigation the Bolings borrowed money from two lenders secured by Boling's prospective recovery from the gas can manufacturer. Five different loans were made for a total of $30,000. The terms of the original loan provided that the funds were for the necessities of life or medical care. The agreements further recognized that the funds were needed so Boling would have time to seek justice through the courts or negotiations. The lender specifically provided in the loan contract that it "wishes to make an investment and purchase the Proceeds in the Plaintiff's Action …." The loans were to accrue interest at the rate of 4.99% a month. On June 19, 2014 Boling filed suit for a declaratory judgment that the loan agreements were unenforceable under Kentucky law. The Court calculated that as of August 22, 2014 the amount owed the lender was $340,405.

Boling provides a thorough analysis of the status of champerty in Kentucky including public policy and ethics considerations. The following extracts from the opinion provide an overview of the opinion:

- The borrowed money was explicitly intended to sustain Boling financially while he pursued his suit against the gas can manufacturer. Thus, these loans unquestionably aided Boling's prosecution of his case.
- [N]either party has identified any specific pronouncement by Kentucky's highest court addressing whether agreements granting security interests in prospective tort claims would be enforceable under Kentucky law.
- When evaluating an undecided question of Kentucky law, a federal court sitting in diversity must make "the best prediction, even in the absence of direct state precedent, of what the Kentucky Supreme Court would do if it were confronted with [the] question."
- Kentucky still recognizes the doctrine of champerty, and the reasoned decision in *Stice* explains why the Kentucky Supreme Court would likely reach the same conclusion. *(see Incline Energy, LLC v. Stice, No. 3:09-CV-58-H, 2009 WL 1975038, W.D. Ky., July 6, 2009.)*

LITIGATION FUNDING ALSO POTENTIALLY DISCOURAGES SETTLEMENT BECAUSE AN INJURED PARTY MAY BE DISINCLINED TO ACCEPT A REASONABLE SETTLEMENT OFFER WHERE A LARGE PORTION OF THE PROCEEDS WOULD GO TO THE FIRM PROVIDING THE LOAN.

- These types of funding arrangements can permit third parties to influence the settlement decision-making process by removing or diluting control of the tort victim. Litigation funding also potentially discourages settlement because an injured party may be disinclined to accept a reasonable settlement offer where a large portion of the proceeds would go to the firm providing the loan. Under those circumstances, a plaintiff could feel compelled to try the case and ultimately run the risk of receiving no recovery for his or her injuries.
- In light of the undecided question of Kentucky law at issue, the Court concludes that the Kentucky Supreme Court would hold that the Agreements violate Kentucky public policy and the statute proscribing champerty for the reasons articulated in *Stice*. Because

CONTINUED ON PAGE 7

"WHETHER ZEAL OR MODERATION BE THE POINT WE AIM AT, LET US KEEP FIRE OUT OF THE ONE, AND FROST OUT OF THE OTHER." *Joseph Addison*

RISK MANAGING WITHDRAWAL

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The opinion next addressed the requirements of Model Rule 1.6, Confidentiality of Information, that a lawyer must consider in making a withdrawal motion for non-payment of fees. It was reasoned, "that specific information should not be required with respect to a motion to withdraw for nonpayment of legal fees" based on Comment [3] to Rule 1.16:

> The court may request an explanation for the withdrawal, while the lawyer may be bound to keep confidential the facts that would constitute such an explanation. The lawyer's statement that professional considerations require termination of the representation ordinarily should be accepted as sufficient. ….

Editor's Note: *Kentucky Rule of Professional Conduct SCR 3.130, 1.16 Comment [3] is identical to the Model Rule.*

The opinion then considered the scope of the judicial inquiry of the withdrawal motion, noting that courts have wide discretion in ruling on motions to withdraw. This analysis includes case examples of the range of rulings judges have made on how much information they required. The opinion concluded by offering stepped guidance for lawyers to comply with confidentiality duties depending on the judge's requirements:

> "Thus, in order to comply with Rule 1.6, a lawyer who has a good faith basis for withdrawal under Rule 1.16[b][5] and/or 1.16[b][6], and who complies with the applicable procedural prerequisites of the court for such motions, could:
>
> (1) initially submit a motion providing no confidential client information apart from a reference to "professional considerations" or the like;
>
> (2) upon being informed by the court that further information is necessary, respond, when practicable, by seeking to persuade the court to rule on the motion without requiring the disclosure of confidential client information, asserting all non-frivolous claims of confidentiality and privilege; and if that fails;
>
> (3) thereupon under Rule 1.6[b][5] *(Rule 1.6[b][3] in Kentucky)* submit only such information as is reasonably necessary to satisfy the needs of the court and preferably by whatever restricted means of submission, such as *in camera* review under seal, or such other procedures designated to minimize disclosure as the court determines is appropriate.
>
> If the court expressly orders the lawyer to make further disclosure, the exception in Rule 1.6[b][6] *(Rule 1.6[b][4] in Kentucky)* for disclosures required to comply with a court order will apply, subject to the lawyer's compliance with the requirements of Comment [15]." (*Rule 1.6, Comment [11] in Kentucky*).

This opinion is highly recommended professional reading for both Kentucky lawyers and judges. Just Google the citation.

Our risk management advice for withdrawal is:

1. **Know the Rules.***
   Paragraph [b][5]]of Kentucky Rule of Professional Conduct 1.16 provides that withdrawal is permissible for cause if the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled….

   Paragraph [d] of Rule 1.16 provides that a lawyer withdrawing must take steps to protect the client's interest. These steps include:

   - giving reasonable notice of withdrawal,
   - allowing time for retention of another lawyer,
   - promptly returning papers and property to which the client is entitled, and
   - refunding any advance payment of fees that have not been earned.

2. **Understand the Malpractice Exposure When Withdrawing.**
   Act of Withdrawal: The risk of an unjustified act of withdrawal is that the client will be considered abandoned by the lawyer. The lawyer is then exposed to liability for a claim for all damages proximately caused by the unjustified withdrawal as well as bar discipline. A Kentucky lawyer was disciplined for an unjustified withdrawal when he abruptly closed an Eastern Kentucky office without notifying a client.

   Manner of Withdrawal: There is a risk even when a lawyer has justifiable grounds for withdrawal, if the withdrawal is done in a manner that does not adequately protect the

CONTINUED ON PAGE 4

MODERATION IN TEMPER IS ALWAYS A VIRTUE, BUT MODERATION IN PRINCIPLE IS ALWAYS A VICE. *Thomas Paine*

RISK MANAGING WITHDRAWAL

THE FIRST LINE OF DEFENSE IS A COMPLETE FILE WITH A COMPREHENSIVE DISENGAGEMENT LETTER. THIS IS THE BEST EVIDENCE FOR SHOWING COMPETENT AND ETHICAL PRACTICE IN TERMINATING A CLIENT.

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interests of the client. An Ohio lawyer was disciplined for failing to arrange for another lawyer to represent one of her clients. The lawyer received court permission to withdraw, citing deterioration of the attorney-client relationship, the client's failure to communicate with her, and the client's failure to pay her fees as grounds for termination. She, however, never specifically told her client she was withdrawing. The unrepresented client then received an unfavorable judgment based on a divorce decree that contained an error.

3. **Risk Manage Withdrawal Carefully.**
   - Always do a complete file review just before filing a suit. This is often the last clear chance to terminate a non-paying client without complications. Once a matter is before a court withdrawal becomes much more problematic.
   - Whenever possible withdrawal should be a clean break – a clear-cut decision with the client's agreement in writing. Use a disengagement letter that:
     - Confirms that the relationship is ending with a brief description of the reasons for withdrawal.
     - Provides reasonable notice before withdrawal is final.
     - Avoids imprudent comment on the merits of the case.
     - Indicates whether payment is due for fees or expenses.
     - Recommends seeking other counsel.
     - Explains under what conditions the lawyer will consult with a successor counsel.
     - Identifies important deadlines.
     - Includes arrangements to transfer client files.
     - If appropriate, includes a closing status report.
   - After sending the disengagement letter, carefully follow through on the duty to take necessary steps to protect the client's interest and comply with all representations in the disengagement letter. This avoids a malpractice claim over the manner of withdrawal.
   - A complete copy of the file must be retained. A client from whom you have withdrawn has a high potential to file a malpractice claim or bar complaint. The first line of defense is a complete file with a comprehensive disengagement letter. This is the best evidence for showing competent and ethical practice in terminating a client.

* From KBA *Bench & Bar* article *"How To Fire A Client"* available at **LMICK.com**. Go to Resources, click on Bench & Bar Articles page, and click on the article.

"TOO GREAT A **PREOCCUPATION WITH MOTIVES** (ESPECIALLY ONE'S OWN MOTIVES) IS LIABLE TO LEAD TO TOO LITTLE CONCERN FOR **CONSEQUENCES**." *Katharine Whitehorn*

RISK MANAGING THE RELEASE AND DESTRUCTION OF CLIENT FILES

Over the years we published several articles on client file risk management. In those articles we covered the following considerations on how to properly close, return, and destroy client files:

- The importance of using letters of engagement and closing letters in informing clients of firm file retention and destruction procedures.
- What documents, paper and electronic, constitute the client file that must be given to the client.
- How long a lawyer should store former client files.
- Screening requirements before disposition of a file for retention of original documents or other documents that cannot be replaced.
- Protecting client confidentiality when disposing of files.

If you are just now developing a file retention and destruction policy or need to review your file risk management procedures, we recommend that you review the following articles available on Lawyers Mutual's Website. Go to **LMICK.com**, click on Resources, click on Subject Index, go to Files, and read these articles:

- KBA Ethics Opinion E-436 Provides Updated Guidance on Retention and Disposal of Closed Client Files: *KBA E-436 (5/17/2013)* addresses one of the more demanding management requirements of law practice – what to do with closed client files. The opinion includes ethics, policy, and practical advice on this issue.
- The Secret Life of Client Files
- The Amazing Client Electronic File: *The 2009 Kentucky Rules of Professional Conduct Bring Electronic Documents in from the Cold*

Even with an effective file risk management policy it is surprising how many unusual questions about them arise. The following are examples of special situations:

FORMER LAWYER REQUESTS RETURN OF FORMER CLIENT'S FILE:

- A New York lawyer was the successor lawyer for a client who filed a bar complaint against the former lawyer. In transferring the representation to the successor lawyer the former lawyer apparently failed to keep a copy of the file. The former lawyer requested that a copy of the file be returned for defense of the bar complaint. The client refused consent for release of the file.
- The New York State Bar Association Committee on Professional Ethics in Opinion 1094 (5/6/2016) reasoned, "a lawyer may reveal or use confidential information to defend the lawyer against an accusation of wrongful conduct." This gives a lawyer the right to retain copies of the file to defend against a bar complaint. "Had the former counsel retained a copy of the file, there is no question that he/she would have had the right to access that file for purposes of defending against the ethics complaint…." But Rule 1.6(b)(5) gives a lawyer only the right to retain the client's file – it does not give a former counsel an independent right to obtain the file after relinquishing it. …. Here, the client has refused consent to allow the former counsel access to the file. The situation thus falls squarely within the definition of 'confidential information' in Rule 1.6(a), which includes information that the client "has requested be kept confidential."

The Committee concluded "Nothing in the Rules of Professional Conduct permits or requires a lawyer to provide a client's file to the client's former lawyer in the face of the client's instructions to the contrary, unless an exception to the duty of confidentiality applies.

WHAT ETHICS DUTIES DOES A LAWYER HAVE IF CLIENT FILES ARE ACCIDENTLY DESTROYED?

The City of New York Bar Association Committee on Professional Ethics in Formal Opinion 2015-6, 2015 concluded:

> When client files are destroyed in an accident or disaster, an attorney may have an ethical obligation to notify current and former clients. Where the destruction of a client file compromises the lawyer's ability to provide competent and diligent representation to the client, the lawyer must take reasonable steps to reconstruct the file sufficiently to allow the lawyer to provide such competent and diligent representation or must notify the client if he

CONTINUED ON PAGE 6

"APOLOGIZING DOESN'T ALWAYS MEAN YOU ARE WRONG AND THE OTHER PERSON RIGHT. IT JUST MEANS YOU VALUE YOUR RELATIONSHIP MORE THAN YOUR EGO." *Author Unknown*

RELEASE AND DESTRUCTION OF CLIENT FILES

WHEN CLIENT FILES ARE DESTROYED IN AN ACCIDENT OR DISASTER, AN ATTORNEY MAY HAVE AN ETHICAL OBLIGATION TO NOTIFY CURRENT AND FORMER CLIENTS.

CONTINUED FROM PAGE 5

> is unable to do so. The lawyer must also notify the current or former client if an accident or disaster compromises the security of confidential information.

The opinion includes a thorough analysis of this question with helpful guidelines on how to deal with the numerous issues that arise when files are destroyed. It is readily available on the Internet – just Google the citation.

DEALING WITH FILES OF MISSING, RETIRED, AND DECEASED LAWYERS

For many years what to do with the files of retired lawyers, deceased lawyers, or lawyers who abandoned their practice was a daunting task because there was so little guidance available. Thanks to the Kentucky Bar Association Taskforce on Closed and Abandoned Practices the Kentucky Bar now has *A Guide to Closing a Law Practice*. The *Guide* is available for download on the KBA Website – click on Resources and then on Closed and Abandoned Practices.

MAY A LAWYER RELEASE OLD, INACTIVE CLIENT FILES HAVING POTENTIAL HISTORIC INTEREST?

This novel ethics question occurred in Maine. The Maine Board of Overseers Professional Ethics Commission styled the question as "whether, and under what circumstances, a law firm may consider donating old, inactive legal files that may have historical significance to a library or educational institution." (*Opinion #213, Confidentiality Restrictions Concerning Old Inactive Client Files Having Potential Historical Significance April 6, 2016.*)

The Commission concluded:

> Despite the historical significance of the files, the answer to the inquiry is that the attorney's and the firm's obligations of confidentiality survive death. The attorney must conduct an examination of the files to ascertain that the information contained is not a "confidence" or "secret" of the client, in which case it may be disclosed. Alternatively, the attorney, based upon all of the information available, must be able to make a reasonably reliable determination that the original client consented to disclosure or that disclosure is authorized under Rule 1.6(a)(ii).

This opinion, in addition to its novel issue, is significant because it illustrates the long reach of a lawyer's fiduciary duty to protect client confidentiality. It is this duty that makes a lawyer more than just another agent.

MAY A LAWYER GIVE A COPY OF THE CASE FILE TO ONE JOINT CLIENT WHO INSTRUCTS THE LAWYER NOT TO INFORM THE OTHER JOINT CLIENTS OF THE REQUEST?

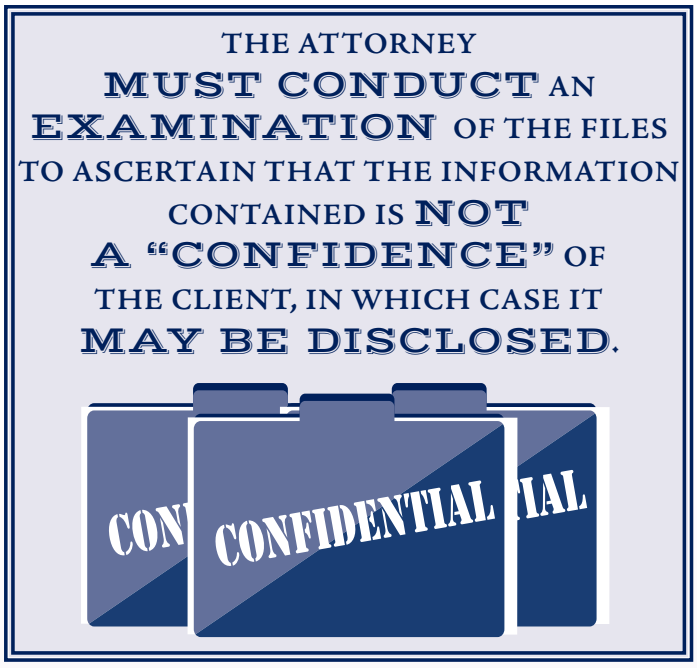
The New York State Bar Association Committee on Professional Ethics in Opinion 1070 (10/9/15) provided this useful analysis of the issue:

> In a joint representation, there is a presumption that the lawyer will share material information disclosed by one co-client in the matter with the other co-clients. But

CONTINUED ON PAGE 7

"MY LIFE SEEMS LIKE ONE LONG OBSTACLE COURSE, WITH ME AS THE CHIEF OBSTACLE." *Jack Paar*

RELEASE AND DESTRUCTION OF CLIENT FILES



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there are exceptions to this presumption, including where disclosure would violate an obligation to a third party or where the lawyer has promised confidentiality with respect to a disclosure. Normally, a client is entitled to full access to the client file, with narrow exceptions. However, if the co-client requesting the file asks the lawyer not to disclose the request to the co-clients, and the lawyer believes the request for the file is material to the other co-clients, then the lawyer may not comply and should counsel the requesting client that the lawyer may not honor the request unless the lawyer is permitted to disclose it to the co-clients. Keeping the request confidential is inconsistent with the expectation of joint clients that the lawyer will keep all of them informed of material developments in the case and with the lawyer's duty of loyalty to the other joint clients.

In reviewing this opinion in Hinshaw & Culbertson's *The Lawyers' Lawyer Newsletter* (August 2016, Vol. 21, Issue 4) offered the following risk management advice:

> It is critical that law firms include express language in the engagement letter in all joint or multiple client representations explaining how confidential information will be treated as between or among the clients, and explaining the duty to keep all clients informed of material developments in the engagement, pursuant to Rules of Professional Conduct 1.4. Normally, the letter will explain that while all information will be confidential as to third parties, each or all of the clients will be entitled to all confidential information. If a different treatment is intended, it must be clearly expressed. Failing to include the appropriate language leads to the kind of situation addressed in this Opinion. When such a problem arises, precisely because the lawyer has information he should otherwise share but now cannot, an unwaivable conflict of interest exists and the lawyer or firm may have no choice but to withdraw, probably from representing both or all of the clients in the matter, pursuant to RPC 1.16.

(Editor's Note: *The Rules of professional Conduct cited above are consistent with the Kentucky Rules of Professional Conduct.*)

LLITIGATION FUNDING

CONTINUED FROM PAGE 2

the Agreements are therefore void, the Court will grant summary judgment in favor of Boling on this basis.

- Here, there is no question that Prospect charges interest on the funds advanced to Boling. The face of each Agreement provides for an interest rate of 4.99% per month, which is compounded every month to yield an annual effective interest rate of nearly 80%. Because the interest rate provided for in the Agreements violates KRS 360.010(1) (*Legal interest rate*), the Court will also grant summary judgment for Boling on this basis.

Boling provides a comprehensive review of champerty in Kentucky supported by extensive case and law citations. We urge all Kentucky lawyers to read it. We also recommend you review your client files for any indication of litigation funding arrangements that are unenforceable in Kentucky. This information should be an affirmative defense when a lender attempts to enforce such a contract.

THE RISK MANAGER
PUBLISHED BY LAWYERS MUTUAL INSURANCE COMPANY OF KENTUCKY

DEL O'ROARK
Newsletter Editor

"APOLOGIZE: TO LAY THE FOUNDATION FOR A FUTURE OFFENSE." *Ambrose Bierce*

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BOARD OF DIRECTORS UPDATE

DEPARTURES:

Doug Farnsley, Stites & Harbison, PLLC (Louisville) completes his three-year term in a director position reserved for KBA officers. Our thanks to him for his outstanding service to Lawyers Mutual and the Kentucky Bar Association.

ADDITIONS:

Douglas C. Ballantine, Stoll Keenon Ogden PLLC (Louisville), the incoming KBA Vice-President, joins the Board of Directors for a three-year term. We look forward to his contribution to Lawyers Mutual's continued success.

BAR SERVICE:

The Nominating Committee of the Kentucky Justice Association nominated Director Christopher L. Rhoads, Rhoads & Rhoads, PSC (Owensboro), for the office of Vice-President. The election is scheduled for Friday, September 15, 2017 during the KJA Annual Convention at Belterra Resort and Casino.

POSITION AVAILABLE

Lawyers Mutual is seeking candidates for the office of Executive Vice-President and Chief Executive Officer. This officer reports to the Board of Directors and is responsible for planning and directing all aspects of the company's objectives; overseeing its short term and long term profitability and growth; ensuring effective claims resolution; complying with all legal and regulatory insurance requirements; and managing the company's day-to-day operations and staff of eight. The successful candidate must possess a juris doctorate degree; be licensed to practice law; and have the skills to make presentations to groups and to motivate staff. Interested candidates should send a resume with salary request to President Ruth Baxter, P.O. Box 353, Carrollton, KY 41008 or **Rbaxter@cbkylaw.com** by August 30, 2017. For a complete job description go to **LMICK.com**.