Avoiding Liability

Lender Funding Lawsuit Cannot Enforce Commitment by Counsel Representing the Client to Pay Lender Out of the Settlement Proceeds in His Escrow Account

By Jeffrey P. Lewis

Black's Law Dictionary defines champerty as "an agreement between a stranger to a lawsuit and a litigant by which the stranger pursues the litigant['s] claims as consideration for receiving part of any judgment proceeds." *Black's Law Dictionary 224* (7th ed. 1999). Agreements that are deemed champertous have been deemed unenforceable in Pennsylvania and in some other jurisdictions as contrary to public policy. The issues involved concern "the ill effects of a contract that gives a stranger a contingent interest in the outcome of litigation go well beyond encouraging people to sue or direct control of the litigation." *Prospect Funding Partners, LLC v. Williams,* No. 27-CV-13-8745, 2014 Minn. Dis. LEXIS 2 at *21. Such claims also implicate "the ill effects of a contract that gives a stranger a contingent interest in the outcome of litigation go well beyond encouraging people to sue or direct control of litigation." *Id.* at *21. Moreover, other ill effects of such an agreement include the prospect that that it "creat[es] a disincentive to settle and permit[s] strangers to profit from the litigation of others" and that it "permit[s] the funders to lend litigants money without regulations that cover loans and prohibit usurious interest rates…" *Prospect Funding Holdings v. Saulter,* — N.E.3d — (App. Ct. of Ill. 2018), 2018 Il App (1st) 171277 at *4. The defendant attorney ("Attorney"), however, raised what was at least an issue of first impression in Illinois — whether "an attorney's liability to a business that loans a client money to be repaid, plus fees and interest, from any settlement or judgment" is legally enforceable where the underlying loan from the lender to the lawyer's client is champertous.

Agreements that are deemed champtertous have been deemed unenforceable in Pennsylvania as well as in some other jurisdictions as contrary to public policy

In *Saulter,* the lender, a litigation financing firm, had loaned money to the client pursuant to a "purchase agreement" to fund the prosecution of a wrongful death action. In return, client would "sell" a portion of her lawsuit to lender, who in exchange would receive "a nonrecourse interest in any proceeds from the suit." The client had signed a "letter of declaration" in which she had instructed her lawyer to pay off lender in full from the proceeds of any recovery as well as his own fees before paying client. That letter also provides that any disputes concerning the "letter of declaration" "were to be heard in Hennepin County, Minnesota, and to be governed by Minnesota law." Moreover, the Attorney signed an "attorney acknowledgment agreeing to abide by [the letter]."

The wrongful death case settled, but both the client and the lawyer failed to pay lender. Lender thereafter sued both the lawyer and his client in Minnesota state court. The court dismissed the action against the lawyer on the basis that it lacked jurisdiction, "finding [attorney was] not a party to the purchase agreement so the forum selection clause did not apply to him." The client, however, allowed lender to enter a default judgment against her.

Thereafter, lender sued the Attorney in Illinois for breach of contract and professional negligence, among other claims. Lender claimed that the attorney had "breached his agreement to abide by his client's letter of direction and his fiduciary and professional duties by failing to maintain the settlement funds in his trust account to repay [lender]." The Attorney defended on the basis that the agreement was champertous under Minnesota law and therefore unenforceable and that he was not a party to the purchase agreement and, therefore, he could not be in breach. The trial court agreed with the defendant Attorney, granting his motion to dismiss. The trial court rejected lender's argument that the default judgment against client in Minnesota was a finding that the purchase agreement was valid subject to application of the full faith and credit clause under the United States Constitution, Article IV, § 1. The trial court also rejected the argument that the choice of law provision in the purchase agreement applies to the attorney since, again, he was not a party to that agreement. Finally, the trial court also rejected the argument that, since the Illinois Rules of Professional Conduct required that the Attorney should have maintained the settlement proceeds in his trust account because the question of entitlement thereto was disputed, lender can assert a claim for this violation.

The Appellate Court of Illinois affirmed the dismissal. It found that the trial court was not obligated to give full faith and credit to a default judgment entered in a Minnesota court, since it was not decided on the merits and was not directed to the attorney. Moreover, the court found that because the purchase agreement was unenforceable, because it created a champertous loan under Minnesota law, the letter of direction was also unenforceable because it was interdependent with the purchase agreement. For this reason, lender's status as a third party beneficiary under the purchase agreement was unenforceable. Finally, the court rejected the argument that lender could assert a claim under Illinois's version of the Rules of Professional Conduct for attorney's failure to hold the settlement funds in his trust account under Rule 1.15, where there was a dispute as to who was entitled to them. The court based this holding upon the premise that, per an express provision in the Rules themselves a "[v]iolation of a Rule should not itself give rise to a cause of action against a lawyer nor should it create any presumption in such case that a legal duty has been breached."

One justice specially concurred with the decision to affirm dismissal of lender's claim. In his view, the issue of whether the agreement was champertous need not be addressed to decide the case in Attorney's favor because the loan was clearly usurious under both Illinois and Minnesota law and, therefore, unenforceable on that basis. Moreover, he was "troubled" about the ethics of an attorney making a commitment to hold any settlement proceeds in his escrow account for the lender's benefit when he had no intention of honoring that commitment, even though he had a legal basis not to honor that commitment. In his view, "the fact that the victim of the breach of those commitments was a usurious lender should not lead us to overlook the serious ethical concerns presented by [attorney's] conduct." Accordingly, he joined with the other justices that attorney should be referred to Illinois's attorney disciplinary agency.

The lesson taught by this decision is that a litigation financing firm assumes the risk that it will not get the benefit of the bargain when it enters into a champertous agreement, even if the lawyer representing the plaintiff does not intend to honor the bargain.

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