Helping Clients Overcome Financial Hurdles Mid-Litigation

By Charles Agee and Collin Cox

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In a perfect world, litigation budgets and any determinations as to how these budgets will be funded would naturally occur at the beginning of a case. Enter COVID-19 to disrupt almost every aspect of our daily lives and business operations, including litigation and how clients are paying for it. What happens when a client, in the middle of litigation, no longer has the financial ability to continue prosecuting a worthy case?

In perilous economic times like these, we expect this situation to prove prevalent across numerous industries.

Even for clients that are not in financial duress per se, abandoning litigation in progress could be tempting as a cost-cutting measure because, while the potential value of the case is not recognized as an asset on a company's books, the litigation expenditures most certainly are. Those expenses will continue to negatively impact the bottom line until the case is resolved. Without careful consideration of their alternatives, clients could squander a high-value future recovery for pennies on the dollar simply out of a desire to control costs.

Aside from abandoning quality cases, clients essentially have two alternatives that enable them to stanch the bleeding from litigation expenditures while simultaneously preserving valuable litigation assets.

First, clients can modify their fee arrangement with litigation counsel from an hourly rate (or other cash-based structure) to a contingent fee or hybrid hourly-contingent fee arrangement. Second, clients can obtain third-party litigation funding to fund any portion of the budget that the client is obligated to pay.

In most instances, where litigation funding is in play, clients can deploy some combination of these two alternatives. But without supplemental outside funding, a law firm's primary option is to suggest a contingency fee arrangement.

So, what can a lawyer do to help a client navigate these alternatives in the middle of litigation? The protocols a lawyer should observe differ somewhat between these two alternatives. Lawyers are thus well-advised to be prepared to tailor their approach depending on which alternative (or combination thereof) the client wishes to consider.

Conversion to Contingent Fee Arrangement

Consistent with a lawyer's fiduciary obligations, it may be possible to modify the terms of the engagement so that the interests of all parties remain aligned and the case continues — without alerting your litigation opponent to any change at all.

For good reason, the law discourages lawyer-driven attempts to modify engagement letters after they are executed. There are legitimate concerns about lawyers taking advantage of a case that has developed favorably to renegotiate an agreement that could procure more revenue — or potential revenue — to the firm.

An obvious example would be a lawyer who suggests, after favorable summary judgment or pretrial rulings, that perhaps a client might be interested in switching to a contingency fee. Effectively, lawyers in those circumstances have de-risked a case to the point where the firm faces a more favorable value proposition.

Judges view such alterations with understandable skepticism. As attorney Douglas R. Richmond notes: "Courts do not favor lawyers' efforts to change their fee agreements in the course of a representation."[1]

This is consistent with the fundamental principle that attorneys must take great care to ensure they have no unfair advantage over their clients.[2] As the Texas Supreme Court wrote in Hoover Slovacek LLP v. Walton:

When interpreting and enforcing attorney-client fee agreements, it is not enough to simply say that a contract is a contract. There are ethical considerations overlaying the contractual relationship. ... [W]e hold attorneys to the highest standards of ethical conduct in their dealings with their clients. The duty is highest when the attorney contracts with his or her client or otherwise takes a position adverse to his or her client's interests.[3]

At no time, even when negotiating a fee agreement, can a lawyer lose sight of the client's interests. Basketball legend John Wooden is noted for saying, "The true test of a man's character is what he does when no one is watching." For lawyers negotiating fee agreements, an ethical fee deal — in other words, the only acceptable form of fee deal — is one the lawyer would be comfortable sharing openly.

Of course, every client is different. And because the course of a case can span several years, clients' needs can change drastically in that time. The company you represent at the beginning of the case may not be in the same position at the end.

So there are times when a sophisticated client, perhaps concerned with the continued financial obligations of an hourly fee relationship, might itself suggest a change to the terms of engagement, or want to explore such an opportunity. Although there are important guideposts for such a consideration, certainly nothing prohibits such a client-driven change. And should such circumstances arise, lawyers need to know their options.

A critical first step is the negotiation and execution of a new engagement letter.[4] The new letter can (and should, to avoid later controversy) state that the alteration of the fee arrangement was at the client's direction.

The American Bar Association Model Rules of Professional Conduct specify that the lawyer also should ensure that the client has had the opportunity to consult separate counsel as to the propriety of and implications for the change.[5] (And clients should take advantage of that opportunity to get a second opinion.)

The new engagement letter also should specify that the client-driven modification was supported by consideration given to both sides.[6] The new letter also should make clear that the original engagement letter, which should be identified and perhaps made an exhibit for reference (not substantive) purposes, is superseded in all respects.[7]

It is critical in these negotiations that the lawyer avoid any potential suggestion that the client was the victim of any undue influence. The touchstones are full disclosure to the client and the client's informed consent.[8]

Although different jurisdictions present different considerations, many jurisdictions focus on the sophistication of the client: The more sophisticated the client, the more likely an alteration is to be upheld, especially if the alteration is shown to have come at the client's suggestion.[9] It also is prudent to include language noting the client's sophistication — and that the client has made a sophisticated decision — in the new engagement letter.

Conversion to Litigation Funding Arrangement

For situations where converting an hourly rate engagement to a contingent fee (or hybrid) engagement is appropriate for both the client and the lawyer, litigation financing can often be useful to bridge any disconnects between the client's desire for budgetary relief and the firm's appetite for placing its fees at risk.

Although some litigation funders will consider funding without any level of risk sharing by counsel, funders customarily prefer that some substantial portion of counsel's fees are at risk. So, lawyers with clients employing a combination of an alteration of the lawyer-client agreement alongside the introduction of a third-party litigation funder must account for this added complexity.

Lawyers can be more proactive in bringing the existence and potential applicability of funding to a client's attention — more so than the lawyer could comfortably suggest an alteration of their lawyer-client fee agreement. Nonetheless, it is well-established that certain conflicts and competence considerations exist for lawyers who represent a client in litigation and who may assist the client with their negotiations with a litigation funder.[10]

Any lawyer contemplating both advising their client on the litigation funding transaction and representing them in the litigation (and benefiting from any funding proceeds provided toward legal fees) should exercise caution to ensure they have sufficient expertise in the subject matter, should fully disclose the potential conflicts that may arise from the client's obligations under a funding agreement, and obtain the client's informed consent before proceeding. As with modifications to the lawyer-client agreement, the lawyer and client may be better served by ensuring that the client has independent counsel to advise them on these negotiations.

Aside from careful adherence to the lawyer's ethical responsibilities, lawyers who aim to excel at client service should make a point to be reasonably well-informed about the marketplace for litigation financing because their clients will often look to them for preliminary advice even if the client ultimately engages an independent adviser for the deal itself.

Along these lines, many clients and lawyers are unaware that approaching a funder during the pendency of litigation is not only possible, but is often more desirable than doing so prior to the commencement of litigation because presumably, more information is known about the facts and merits of the case, and the remaining duration of the case should be shorter.

Both of these elements should translate into lower risk for the funder, and thus, better pricing for the client. In fact, in the right circumstances, the funder may even be willing to reimburse some or all of the historical expenditures in the litigation, enabling the client to alleviate the budgetary pressures even further.

Another practical consideration is that clients should be careful to avoid signaling desperation to funders by virtue of requesting funding in the middle of litigation.

Running a competitive process among several suitable funders can minimize this risk for clients because doing so signals to the potential funders that the client will not be prey to any single funder's demands — a dynamic that often exists when clients limit their options. Approaching multiple funders, therefore, not only increases the likelihood of a successful transaction, it can also enable the client to close a transaction on their own terms.

Ultimately, a thoughtful approach to any restructuring of the attorney-client engagement agreement and the introduction of a litigation funder should result in financial alignment among the client, attorney and funder. This is a delicate balance, of course, and, as in any other complex business situation, substantial experience and good faith among the parties matters more than any particular tactics to achieve the desired outcome.

But, when done right, an appropriate restructuring in the middle of litigation can preserve the client's valuable litigation asset while simultaneously relieving their budgetary pressures, and the assistance of solution-driven litigation counsel in this endeavor can strengthen lawyer-client relationships for years to come.

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[1] Douglas R. Richmond, Changing Fee Agreements During Representations: What Are the Rules? Prof. Law., 2004, at 19.

[2] Weatherford v. Price, 532 S.E.2d 310, 315 (S.C. Ct. App. 2000) (citation omitted).

[3] Hoover Slovacek LLP v. Walton, 206 S.W.3d 557, 560-61 (Tex. 2006).

[4] N.Y. Comp. Codes R. & Regs. tit. 22, § 1215.1.

[5] Model Rule of Prof's Conduct Rule 1.8(a)(2).

[6] See, e.g., Passante v. McWilliam, 62 Cal. Rptr. 2d 298, 301-03 (Cal. Ct. App. 1997).

[7] One way to ameliorate some concern is to have an original engagement letter that includes provisions that allow the attorney to modify it under certain conditions.

[8] Under Rule 1.8(a) of the Model Code of Professional Responsibility, and the very similar California Rule 3-300, a lawyer may not enter into a business transaction with a client if they have differing interests from the client and if the client expects the lawyer to exercise professional judgment for the protection of the client, unless the client has consented after full disclosure. To rebut any concerns about a lawyer's undue influence or a lack of consideration, some courts require an attorney to present evidence that (1) he fully and fairly disclosed to the client all material facts affecting the proposed change in the fee agreement; and (2) changing the agreement is fair. See, e.g., Anderson v. Sconza, 534 N.E.2d 445, 448 (Ill. App. Ct. 1989).

[9] See, e.g., Welsh v. Case, 43 P.3d 445, 453 (Or. Ct. App. 2002) (upholding a modification, in part because of the sophistication of the client).

[10] See ABA Model Rules of Professional Conduct 1.1 and 1.7(a)(2).