

NEW HAMPSHIRE BAR ASSOCIATION  
Ethics Committee Formal Opinion INQUIRY # 1995/96-16  
**Formation of a limited liability company by several NH law firms  
for the purpose of purchasing discounted debt with the member law firms then  
seeking to collect the discounted debt on a contingent fee basis.**  
September 10, 1996

RULE REFERENCES:

- \*Rule 1.8(a)
- \*Rule 1.8(j)

SUBJECTS:

- \*Prohibited Transactions
- \*Fees
- \*Conflict of Interest

ANNOTATION:

A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may contract with a client for a reasonable contingent fee in a civil case. In this case, however, more than simply a contingent fee is involved. Because the lawyer also owns the subject matter of the litigation, the note, the transaction is prohibited.

I. QUESTIONS:

- A. Does the fact that the lawyer is working on a contingent fee basis in collecting the notes take this arrangement out of the prohibited transaction category?
- B. Does the fact that the lawyer's client in this case is another lawyer take this arrangement out of the prohibited transaction category?

II. FACTS:

The law firm of the inquiring attorney is considering a business arrangement in which that law firm and several others would form a limited liability company ("LLC"). The purpose of the LLC would be to purchase charged-off debt from banks and other lenders, and then seek to collect the debt. The LLC would take an assignment of the debt instrument directly from the lender, and would bring suit in its own name against the debtors on the debt instrument. The LLC would then hire one of its member law firms, on a contingent fee basis, to represent the LLC in these collection actions. Recoveries, net of legal fees, would constitute income of the LLC, and any profits would be distributed to the LLC's law firm members in proportion to their ownership interest in the LLC.

III. ANALYSIS:

Rule 1.8(j) states that a lawyer is prohibited from acquiring a proprietary interest in the cause of action or subject matter of a cause of action the lawyer is conducting for a client. The rule states two exceptions: one for reasonable contingent fee arrangements; and a second for a lien to secure payment of the lawyer's fees. In addition, Rule 1.8(e) allows lawyers to advance court costs and expenses of litigation contingent upon recovery in the law suit.

The ABA Model comments to Rule 1.8(j) reference the origin of this rule as the common law practices of "champerty" and "maintenance." Black's Law Dictionary defines champerty as "A bargain by a stranger with a party to a suit, by which such third person undertakes to carry on the litigation at his own cost and risk, in

consideration of receiving, if successful, a part of the proceeds or subject sought to be recovered... 'Maintenance' consists in maintaining, supporting, or promoting the litigation of another."

Neither recent New Hampshire decisions, nor recent decisions under Model Rule 1.8(j), address the facts presented by this inquiry. Two formal American Bar Association ("ABA") ethics opinions dating back to the 1930's and based upon Canon 10<sup>1</sup> do appear to deal with similar arrangements and clearly prohibit them. Formal Opinion 51 dated December 14, 1931, states that "[i]t is improper for an attorney to buy judgments, notes, and other choses of action from bankrupt estates for the purpose of collecting them for a profit." The ABA ethics committee felt that such a practice would stir up strife and litigation. The committee acknowledged that in prohibiting such a practice it was denying an opportunity to lawyers which was available to laymen. The committee nonetheless felt the practice of buying notes, both unethical and inconsistent with the dignity of the profession. Likewise, in Formal Opinion 176 dated February 19, 1938, the ethics committee held that it was improper for a lawyer to hold a part interest in an endeavor which purchased future interests in estates. In that arrangement the lawyer provided services to the enterprise by locating such interests and then identifying the legatees.

The prohibition against lawyers acquiring a proprietary interest in litigation has been carried forward into our current rules. Rule 1.8(j) is contained within Rule 1.8 which deals with conflicts of interest. Many of the other subsections of Rule 1.8 allow the client to waive the conflict following disclosure and sometimes independent advice. See, Rule 1.8(a), (b), (f), (g), (h) and (I). Nonetheless, Rule 1.8(j) is a prohibition and does not contain waiver provisions. If the principal reason for Rule 1.8(j) is to avoid conflict, then it seems unduly harsh to prohibit all such arrangements, since Rule 1.7(b) provides a more flexible vehicle to address conflicts of interest. In the case at hand it would seem possible for all parties involved to fully disclose and then waive potential conflicts. Apparently, however, the sense that such arrangements are inconsistent with the dignity of the profession has carried through in this rule.<sup>2</sup> In fact, two exceptions have already been established, one for contingent fees and one for a lien for attorneys fees. Both exceptions evidence the need for some flexibility in this rule. Having found no support in the cases, however, this committee is reluctant to carve out a new exception in this case.

#### IV. CONCLUSION:

Rule 1.8(j) prohibits the purchase of charged off notes by an LLC made up of several law firms and the use of those member law firms to pursue litigation to collect the charged off notes. Although the lawyers receiving the fee in this case are charging a contingent fee, they are still prohibited from participating in the purchase of notes because such a practice gives the lawyers an interest beyond the contingent fee collected. Since Rule 1.8(j) is designed to discourage practices such as champerty which promote litigation, the fact that the clients in this case are also lawyers does not provide an adequate policy reason to except such a practice from the rule's prohibition.

---

<sup>1</sup> Canon 10 contained language almost identical to the language of the present Rule 1.8(j). Canon 10 stated, "The lawyer should not purchase any interest in the subject matter of the litigation which he is conducting."

<sup>2</sup> In the proposed scenario the application of the rule appears arbitrary, nonetheless we are stuck with the rule and we are bound to apply it to prohibit this arrangement. As evidence of the arbitrariness of this rule, consider the following arrangements which are similar to the facts of this inquiry, but which do not trigger the prohibition of Rule 1.8(j). If a lawyer purchases a note and then pursues litigation on the note, or if a law firm purchases a note, and through one of its members, pursues litigation on the note, then Rule 1.8(j) does not apply because the lawyer and the client are the same person or entity. Further, if the LLC in this inquiry were to purchase the note and then engage independent counsel to pursue litigation on the note, then Rule 1.8(j) does not apply because the lawyer pursuing the litigation has no ownership of the note.