

# Amended DR 5-103(B): Advancing And Paying Litigation Expenses

BY ROY SIMON

**A** midst all the press and distress about the new and amended lawyer advertising rules that took effect on February 1, 2007, little has been said about a part of the rules package that has no obvious relationship to advertising and solicitation: DR 5-103(B). Nor has the legal press said much about the significant August 2006 amendments to New York Judiciary Law § 488, which the courts have incorporated verbatim in DR 5-103(B). This article discusses the context and potential impact of the amendments to §488 and DR 5-103(B). My analysis may surprise you. (It surprised me.)

## Former DR 5-103 and Its Background

Perhaps you dimly recall the common-law doctrines of champerty and maintenance. "Champerty" defined an agreement between attorney and client under which the attorney paid the costs of the client's suit in return for a portion of the damages awarded, and "maintenance" referred to giving money to a client so that he could afford to keep a suit going rather than cave in to a settlement. In other words, the doctrine of champerty prohibited an attorney from advancing the costs and expenses of litigation in exchange for a contingent fee, while the doctrine of maintenance prohibited an attorney from advancing living expenses or other financial assistance to a client to enable him to hold out for a fair settlement or for a judgment after trial. Originally, both champerty and maintenance were regarded as crimes.

In tandem, champerty and maintenance were thought to cause two problems. Champerty enabled clients to bring litigation they would not have brought if they had been required to shoulder the costs and expenses of litigation on their own. Maintenance enabled clients to continue litigating their cases long after they should have settled. The increased number of suits resulting from champerty and the increased length of suits resulting from maintenance had both public and private costs. The public cost was a strain on the courts (more cases). The private cost was higher legal bills and lower settlement leverage for defendants litigating against plaintiffs who received financial help from their lawyers.

Today, the crime of champerty has been abolished or cut back in virtually every American jurisdiction. Attorneys routinely advance the costs and expenses of litigation in exchange for a contingent fee, and various statutes and court rules expressly permit contingent fees except in criminal and domestic relations matters. The rationale for allowing lawyers to finance litigation in exchange for a contingent fee is expressed in EC 5-6, which notes that "the advancing or guaranteeing of payment of the costs and expenses of litigation by a lawyer may be the only way a client can enforce a cause of action ...."

But DR 5-103(B) of the New York Code of Professional Responsibility, as amended effective February 1, 2007, continues to prohibit maintenance. Specifically, DR 5-103(B) provides, in pertinent part, as follows:

(b) While representing a client in connection with contemplated or pending litigation, a lawyer *shall not advance or guarantee financial assistance to the client*, except that:

(1) A lawyer representing an indigent or pro bono client may pay court costs and reasonable expenses of litigation on behalf of the client;

(2) A lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter.... [Emphasis added.]

In other words, apart from paying the costs and expenses of litigation (if the client is indigent or pro bono) or advancing those same costs and expenses (if the client is not indigent or pro bono), a lawyer who represents a client in planned or pending litigation may not "advance or guarantee financial assistance to the client ...."

The basic rule just quoted - that a lawyer who represents a client who contemplates or brings litigation must not "advance or guarantee financial assistance to the client" - is not new. The very same wording was in the former version of DR 5-103(B) before it was changed on February 1, 2007. So, what is new in the amended version of DR 5-103(B)? Quite a bit - but the changes are all in the exceptions.

### **Indigent and/or Pro Bono Clients**

The old version of DR 5-103(B) provided: "Unless prohibited by law or rule of court, a lawyer representing an *indigent client on a pro bono basis* may pay court costs and reasonable expenses of litigation on behalf of the client." (Emphasis added.) Thus, a lawyer could not "pay" court costs and litigation expenses unless the client was "indigent" (a term not defined in the Code of Professional Responsibility) and the lawyer was representing the indigent client on a "pro bono" basis (meaning "at no fee and without expectation of a fee" - see EC 2-25). Both conditions had to be met.

Thus, under the old version of DR 5-103(B), a lawyer who expected to receive a contingent fee (or any fee) was prohibited from paying the costs and expenses of litigation even if the client was dirt poor. A personal injury lawyer, for example, could not "pay" litigation expenses unless the client was both indigent and pro bono.

To understand the word "pay" as it used in the old rule, we need to juxtapose it against the phrase "advance or guarantee" in the other exception to DR 5-103(B). A lawyer "advances" the money when he pays litigation expenses (like the court reporter's fee, the expert's fee, and the costs of an independent medical examination) from the lawyer's own account, with the understanding that the client will eventually repay the advances. A lawyer "guarantees" litigation expenses when he tells the vendor (or expert, or doctor, or investigator, etc.), "My client can't afford to pay you now, but don't worry - if the client doesn't pay you eventually, I promise that I will pay your bill." In contrast, to "pay," necessarily means the payment of those expenses by the lawyer with the understanding that the client will not repay the lawyer at the end of the day. The lawyer is paying, and the client does not expect or agree to reimburse him.

Under the old version of DR 5-103(B), the lawyer could "pay" the expenses only if the client was both indigent and pro bono. The amended version of DR 5-103(B), however, permits a lawyer to pay court costs and litigation expenses when representing "an indigent or pro bono client." It's sufficient to meet either condition. If a lawyer is representing a client who has some money (perhaps a not-for-profit or public service organization, or a middle class or wealthy client raising constitutional issues), the lawyer

may ethically pay the litigation costs and expenses as long as the representation is pro bono. In other words, a lawyer handling a matter on a pro bono basis may pay the court costs and expenses even if the client can afford to pay them.

In the same way, a lawyer representing an indigent client may pay the litigation expenses even if the representation is not pro bono. For example, a lawyer may pay (not merely advance) litigation expenses even if the client has agreed to pay a contingent fee, or a relative is paying the lawyer's fee, or if the lawyer fully expects to win a court-awarded fee under a fee-shifting statute. If the client is indigent, the pro bono element is no longer necessary.

### **Repayment of Court Costs and Litigation Expenses: Contingent or Not?**

The old version of DR 5-103(B) permitted a lawyer to "advance or guarantee the expenses of litigation, including court costs, expenses of investigation, expenses of medical examination, and costs of obtaining and presenting evidence, *provided the client remains ultimately liable for such expenses.*" (Emphasis added.) Thus, a lawyer could pay the bills for litigation expenses (including but not limited to "court costs, expenses of investigation, expenses of medical examination, and costs of obtaining and presenting evidence"), or a lawyer could "guarantee" that she would personally be responsible for paying those bills if the client did not pay them, but only if the client agreed to remain "ultimately liable" for those expenses. In other words, the client had to promise to pay the lawyer back for any advances, or for any money the lawyer paid out-of-pocket to make good on a guarantee. The lawyer was not allowed to say to the client, "You don't have to pay me back unless your settlement is large enough to cover the expenses. If you don't obtain enough money to cover the court costs and litigation expenses, I will cover the shortfall."

In contrast, the amended version of DR 5-103(B), permits a lawyer to advance court costs and expenses of litigation and to make repayment by the client "contingent on the outcome of the matter." This is exactly what the old version prohibited. Under the old version, a lawyer could not make repayment contingent on how much money the client recovered in the action. The old version required a lawyer's retainer agreement or letter of engagement to say that the client would remain "ultimately liable" for the costs and expenses of litigation no matter how the case came out. Win or lose, the old version demanded that the client stay on the hook for every dollar of litigation expense.

Also, in the amended version of DR 5-103(B), the courts deleted the phrase "including court costs, expenses of investigation, expenses of medical examination, and costs of obtaining and presenting evidence" as examples of "the expenses of litigation" that lawyers were able to advance or guarantee.

### **What Difference Does It All Make?**

Do the amendments to DR 5-103(B) (1) and (2) make any difference? Let's see.

First, I am confident that the courts did not intend to change the meaning or scope of the phrase "expenses of litigation" by stripping away the examples ("court costs, expenses of investigation, expenses of medical examination, and costs of obtaining and presenting evidence"). The old rule introduced those examples with the word "including," which always meant that the list was illustrative but not exhaustive. This interpretation was well known, and lawyers generally agreed on what fell within the reach of litigation expenses, so there was little point in keeping the examples in the rule. Deleting those obvious examples makes no practical difference.

On a more substantive point, consider the amendment covering indigent "or" pro bono clients. Lawyers now have the right, ethically speaking, to "pay" (without any right to repayment) the costs and expenses of litigation when a client is either indigent or pro bono. But will anyone take advantage of this new right? If a client is not indigent, why would the lawyer "pay" the litigation costs and expenses rather than asking the client to pay them, or repay them? Perhaps wealthy lawyers will pay for public relations purposes, or because tracking expenses and sending a bill costs more than the expenses themselves (at least in small pro bono cases), but those situations are pretty limited.

The real significance of the indigent "or" pro bono formulation is clear if we imagine what the situation would have been if the courts had not amended the companion exception (the "advance or guarantee" provision) to allow repayment of costs and expenses to be "contingent on the outcome of the matter." If the amended version of DR 5-103(B) still required clients to remain "ultimately liable" for litigation expenses (as under the old version), some personal injury lawyers and other contingent fee lawyers would take advantage of the new language by simply paying the litigation costs and expenses outright for all indigent clients. Paying litigation expenses for poor clients may seem harmless, but there was a twofold rationale behind the old rule requiring the client to remain ultimately liable.

First, the "ultimately liable" language was intended to discourage plaintiffs from bringing litigation, or from continuing it. (Keep in mind that DR 5-103(B) applies only to lawyers representing clients in contemplated or pending "litigation," not in transactions or other non-litigation matters.) The costs and expenses of litigation might seem like small potatoes (especially compared to damages), but they were not necessarily small potatoes to a client who ultimately lost the case. A retainer agreement that expressly made the client remain "ultimately liable" for expenses was therefore an intimidating document, and some clients would not sign it.

As a practical matter, the "ultimately liable" language had meaning only for clients who lost their cases in court (whether after trial or on summary judgment), and thus received zero dollars in damages. (Plaintiffs who settled almost always did better than zero, and did not have to dig into their own pockets, because their lawyers hardly ever settled for less than the costs and expenses of litigation.) But if clients lost in court, lawyers usually ignored the "ultimately liable" language - at least with indigent clients because they couldn't get blood out of a turnip. If a plaintiff was indigent when suit began, then the plaintiff was nearly always still indigent after the suit resulted in a defense verdict. It was not worth a lawyer's time to sue a losing plaintiff for expenses even though the retainer agreement gave the lawyer that right by keeping the client "ultimately liable."

Clients, however, did not necessarily know this. Clients typically believed, based on the grapevine and the rumor mill, that every plaintiff was expected to sign a retainer agreement providing that he remain ultimately liable for the full repayment of the costs and expenses of litigation, even if he lost the case. This harsh fact (more illusion than reality) deterred many potential plaintiffs from asking lawyers to enforce their rights. Many would-be plaintiffs suffered in silence because they were risk-averse and could not risk losing everything they owned to finance a lawsuit. Even clients who hired lawyers often settled for too little. Defendants would eventually have paid more, but plaintiffs settled for a song because even a lowball settlement avoided the nightmarish risk of a disastrous double whammy - receiving nothing in damages and having to pay (or reimburse) the litigation expenses.

Another practical factor also entered into the mix. Many lawyers, especially in the overcrowded personal injury field, struggle to make ends meet. Upstate personal injury lawyers in particular feel the financial pinch. The sparse upstate population and the dearth of rural media outlets (compared to media-rich New York City and environs) make lawyer advertising less effective; upstate clients have to travel further than urban clients to see a lawyer (increasing the effective cost of hiring a lawyer); upstate juries are less generous (decreasing the expected benefits of hiring a lawyer); and everyday life upstate is generally safer (creating fewer personal injury clients). Even if the old version of DR 5-103(B) had allowed it, therefore, not all lawyers could have afforded to make repayment of litigation expenses contingent on the outcome of the litigation.

Indeed, many contingent fee lawyers could not even afford to advance the costs and expenses of litigation, and therefore insisted that clients pay the litigation expenses as they were incurred. Lawyers who made clients sign "pay-as-you-go" retainer agreements were happy with a rule that required all lawyers to hold clients ultimately liable for litigation expenses. The ultimate liability provision made it possible for pay-as-you-go lawyers to say to clients, "You have to pay the litigation expenses win or lose, so your bottom line will be the same whether you pay as you go or pay at the end. I wish I could make repayment contingent on the outcome of the case, but the ethics rules don't let me do that. The rules require me to hold you ultimately liable, so you are really better off paying the expenses as we incur them than letting the bills pile up until the case ends." How convenient. Not only did the old rule enable financially wobbly lawyers (shall I call them "indigent" lawyers?) to cow clients into paying litigation expenses by the month, but also prevented the competition (the well heeled lawyers with the big ad budgets) from advertising "No fees or expenses unless you recover." The ultimate liability rule in DR 5-103(B) may have been good for struggling lawyers (and rich defendants, who faced fewer lawsuits), but it was not good for clients, and it was not good for competition among lawyers.

Successful personal injury lawyers seeking a competitive advantage under the old rule would often have preferred to make repayment contingent on the outcome. They could then advertise, "If you don't win, you don't pay." But that slogan was misleading when the client remained "ultimately liable" for litigation expenses. As a second choice, the lawyers would often have agreed to pay litigation expenses outright rather than risk losing a client. Promising to pay the litigation expenses (without requiring repayment) would have been an investment in attracting clients. Lawyers seeking an edge would have advertised that they would pay litigation expenses for any client who could not afford to pay them (i.e., for any "indigent" client). But the old rule did not allow lawyers to "pay" (outright) the expenses of litigation unless clients were both indigent and pro bono. Paying litigation expenses for a pro bono client would have been a total loss - no fee and no repayment of litigation expenses.

### **A New Choice for Lawyers Representing Indigent Clients**

Fast forward to today. The new DR 5-103(B) gives lawyers who represent indigent clients on a contingent fee a choice: the lawyers may either "pay" the litigation expenses outright (and not seek repayment even if the client wins) or they may make repayment contingent on the outcome of the suit (seeking repayment only if the client wins or settles). Is that a real choice? Will any lawyers representing indigent clients voluntarily agree to pay the expenses outright instead of making repayment contingent on the outcome of the suit?

We may be surprised. Not all personal injury lawyers are struggling financially. Some are handsomely bankrolled from prior big verdicts. They can afford to make repayment of litigation expenses contingent on the outcome, and they are able to pay litigation expenses outright for indigent clients, at least in big cases. And if they can ethically do it, they can ethically advertise it. (More on this in a moment.) Imagine two ads for personal injury lawyers. One says, "You won't pay any litigation expenses unless you recover money." The other ad says, "If you are indigent, you won't pay any litigation expenses, period. We pay all litigation expenses for indigents, and you never have to repay us. Never." If you were down- and-out ("indigent"), which lawyer would you pick? If you were a lawyer with plenty of cash on hand, which ad would you choose? In most cases, the relatively paltry litigation expenses will be a small price to pay for landing a new client.

The next question is, may a lawyer advertise that she will pay all litigation expenses for an indigent client and never seek repayment? (Beyond doubt, lawyers may now advertise "no fees or expenses unless you recover," so we can skip that issue.) On this question, the new advertising rules are doubly new: the applicable provision itself is new, and it refers to new language in Judiciary Law § 488. Specifically, DR 2-101(P) provides:

(P) All advertisements that contain information about the fees charged by the lawyer or law firm, including those indicating that in the absence of a recovery no fee will be charged, shall comply with the provisions of Judiciary Law §488(3).

What is required to comply with Judiciary Law § 488(3)? Let's look at a legislative style version of Judiciary Law § 488 as it was amended (in pertinent part) in August 2006:

An attorney or counselor shall not:

2. By himself or herself, ... either before or after action brought, promise or give ... a valuable consideration to any person, as an inducement to placing, or in consideration of having placed, in his or her hands ... a demand of any kind, for the purpose of bringing an action thereon, or of representing the claimant in the pursuit of any civil remedy for the recovery thereof. But this subdivision does not apply to:
  - a. an agreement between attorneys and counselors, or either, to divide between themselves the compensation to be received;
  - b. a lawyer representing an indigent or pro bono client paying court costs and expenses of litigation on behalf of the client;
  - c. a lawyer advancing court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; or
  - d. a lawyer, in an action in which an attorney's fee is payable in whole or in part as a percentage of the recovery in the action, paying on the lawyer's own account court costs and expenses of litigation. In such case, the fee paid to the attorney from the proceeds of the action may include an amount equal to such costs and expenses incurred.
3. A lawyer that offers services as described in paragraphs b, c and d of subdivision two of this section [§ 488(2)] shall not, either directly or through any media used to advertise or otherwise publicize the lawyer's services, promise or advertise his or her ability to advance or pay costs and expenses of

litigation in such manner as to state or imply that such ability is unique or extraordinary when such is not the case.

Thus, to comply with § 488(3) - and hence to comply with DR 2-101(P) - a lawyer who advertises "the ability to advance or pay costs and expenses of litigation" must simply refrain from stating or implying that this ability is "unique or extraordinary." That's an easy standard to meet. As long as the ad does not say "unlike other firms" or "only at our firm" (or words to that effect), it may ethically promise either that the law firm will "advance" the costs and expenses of litigation contingent on the outcome or that the law firm will "pay" the costs and expenses of litigation for indigent clients.

We must address one final issue. What is the meaning of brand new DR 5-103(B)(3), which was taken verbatim from Judiciary Law § 488(2)(d)? The new provision says:

A lawyer, in an action in which an attorney's fee is payable in whole or in part as a percentage of the recovery in the action, may pay on the lawyer's own account court costs and expenses of litigation. In such case, the fee paid to the attorney from the proceeds of the action may include an amount equal to such costs and expenses incurred.

In my view, this provision means simply that a lawyer who advances \$10,000 in litigation expenses out of his own pocket may be repaid from the recovery by adding \$10,000 to the contingent fee, even if the "fee" would then exceed the statutory maximum fees set forth in court rules and in Judiciary Law § 474-a (capping contingent fees in medical, dental, and podiatric malpractice actions). Not an earthshaking change.

## **Conclusion**

The new advertising rules were designed, in part, to cut down on lawyer advertising and to place more restrictions on the major personal injury firms that have blanketed the airwaves and other media with aggressive ads. But if I were running a big personal injury firm, I would take maximum advantage of the new § 488 by advertising more, not less. My ads would say, "No expenses unless you recover for most clients. No expenses ever for indigent clients." Let's see if the "have-not" personal injury lawyers can match that offer. As usual, the rich will get richer.

The new advertising rules are extraordinarily complicated, and lawyers will use them in ways that will sometimes startle us. When the new advertising rules are combined with amended DR 5-103(B), they will surprise us even more - which reflects one law that neither the courts nor the legislature have power to amend: the law of unintended consequences.

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