

Clients Need Not Pay Expenses In Federal Class Actions

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New York's DR 5-103(B) provides as follows:

A lawyer may 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].

Notwithstanding this clear direction, Southern District Judge Denise L. Cote has determined that the rule does not apply in a federal securities class action. *In re WorldCom Inc. Securities Litigation*, S.D.N.Y., No. 02 Civ. 3288 DLC, 10/24/03.

Plaintiffs claimed that WorldCom and its associates had disseminated false and misleading information that misled investors as to the true value of WorldCom securities and asked for class certification. Some of the defendants responded that the plaintiffs were not proper class representatives because they had not agreed to repay the expenses of the litigation, in violation of DR 5-103(B). Plaintiffs claimed that the Private Securities Litigation Reform Act of 1995 does not require named or lead plaintiffs to bear the costs of litigation, and that DR 5-103 (B) is inapplicable in a federal securities class action.

Judge Cote agreed with the plaintiffs. She said:

Here, strong federal interests require that the repayment of expenses provision in DR 5-103 be disregarded....At the same time, the underlying goal of DR 5-103 - that litigation be controlled by the client, not the attorney - is fully protected.

Judge Cote recognized that DR 5-103 is the heir to established principles which dictate against providing lawyers with financial incentives to promote litigation. These principles were originally embodied in the doctrines of maintenance and champerty.

The federal act controlling securities litigation and the federal rules (Fed. R. Civ. P. 23) provide adequate assurance that the clients and not the lawyers will control the litigation. The federal statute, for example, encourages the designation of a lead plaintiff who has the greatest financial interest in the litigation. Rule 23 helps to assure client control by requiring judicial scrutiny of the adequacy of class representatives.

Furthermore, "[A] federal court is not bound to enforce New York's view of what constitutes ethical professional conduct." Most states no longer follow the New York rule, relying instead on ABA Model Rule 1.8(e)(1), which enables a lawyer to advance the costs and expenses of litigation though repayment is contingent on the outcome of the litigation.