

Recognizing Interest on Loans as a Litigation Expense

A COMMENTARY BY LAZAR EMANUEL

In the action brought in behalf of 10,000 claimants of 9/11 respiratory disease (*In Re: World Trade Center Disaster Site Litigation*, Docket No: 21 MC 100), Southern District Judge Alvin Hellerstein has dealt a bitter blow to Plaintiffs' lead lawyers, Worby Groner Edelman & Napoli Bern, L.L.P. (Worby/Napoli). The Judge has disallowed all interest (more than \$6 million) paid by the firm on borrowings which were used to pay for the expenses of the litigation.

The retainer agreements executed by the Worby/Napoli clients (most of the 10,000), provided for a contingent fee of 33 1/3% (voluntarily reduced to 25% by the Worby/Napoli firm) and for the recovery of costs and expenses incurred by the law firm. The retainer agreements provided that the clients would be responsible for all costs and expenses, contingent on recovery. To finance these costs and expenses, which were beyond the ability of the firm to advance, the firm borrowed the money to fund expenses from undisclosed sources. In all, the firm had disbursed \$27,653,228 in expenses attributable to the litigation between January 2004 and May 20, 2010. Most of its borrowings required the payment of 14-18% in interest. Both principal and interest were guaranteed by the firm's partners.

Problems arose when Worby/Napoli sought to charge the Plaintiffs with all the interest the firm had paid for its borrowings – a total of \$6.1 million. The firm treated the interest as one of the expenses of the litigation. It exempted from chargeable expenses all case-specific items and all overhead.

Curiously, in none of the documents submitted by Worby/Napoli to Judge Hellerstein in support of its claim of interest was I able to find any reference to either DR 5-103(B), which was in effect at the start of the litigation, or to Rule 1.8(e), which is identical to the DR. Instead, the firm in its memorandum, and in the Affidavits of Professors Anthony Sebok of Cardozo Law School and W. Bradley Wendel of Cornell Law School, built its arguments on Rule 1.5 and its prohibition against excessive or illegal fees, without discussing Rule 1.8(e) at all.

But a better argument can be made under Rule 1.8 than under Rule 1.5 for the recovery of interest on loans to a law firm which uses the funds to support a complex litigation like this one. It's impossible to ignore Rule 1.8(e), so I would argue that the interest should be brought under the umbrella of "expenses of litigation" as that term is used in the Rule, which provides:

(e) 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:

(i) a lawyer may advance court costs and the expenses of litigation, the repayment of which may be contingent on the outcome of the matter [Note: Rule 1.8(e) is consistent with Judiciary Law § 488(2)(c).]

Although interest on loans is not usually included in litigation expenses, there is no rational reason for its exclusion. Especially under the circumstances in which one law firm is representing more than 9,000 clients with varying degrees of injury in one action, it's only reasonable to expect that the firm will not be able to fund the action on its own, but will need to borrow from lenders who agree that there is merit in the plaintiffs' claims.

In a complex and many-faceted case like this one, why should a law firm be prevented from borrowing to support its expenditures in behalf of its clients? And why should it be prevented from charging and recovering a reasonable rate of interest on its borrowings?

We need to recognize that banks will not be the source of loans in cases like this. A law firm will have to reach out to secondary lenders who have confidence in the outcome of the litigation, at interest rates higher than the rates of traditional bank sources. Under the circumstances, perhaps it would be reasonable to limit the rate of interest chargeable to clients to 9 or 10%. The law firm, anticipating the benefits of recovery or settlement, would be expected to absorb the difference.

In that way, we can anticipate and codify the division of interest on borrowings between the law firm and its clients. The clients would know what they have to pay and the law firm would take an additional but measurable risk. In the instant case, our formula would reduce the interest claimed by Worby/Napoli by approximately 50%.

It's true that the expenses of litigation usually include only such items as court filing fees, and the cost of investigators, medical records, deposition transcripts, and experts. But why exclude a reasonable rate of interest on borrowings which are required by the nature and scope of the action?