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RE: Opinion 08-01
Hypothecation Agreements

The Committee has received several requests from lawyers who are being asked to sign irrevocable letters of agreement recognizing that their clients have assigned any future recovery that a client may have to a third party lender as a way of guarantying present payment to the client. The lawyers question whether such agreements are “ethical”.

These agreements are commonly known as hypothecation agreements. Clients hypothecate their future recovery for a present fixed sum. Lawyers are often asked to acknowledge the hypothecation so as to ensure that disbursal will be made to the lender in accordance with the agreement.

At the outset we caution that hypothecation agreements are different from statutory or contractual insurance subrogation agreements. They are in essence a financial instrument whereby one pledges the future recovery on an existing claim for a present cash loan. They are complex agreements and are fraught

with issues regarding assignment and ownership. We start from the position that the claim belongs to the client and the client is free to do with it as they wish. If they wish to take a loan against the claim they remain free to do so. Likewise if they wish to sell or assign the claim they may do so. While it is a matter between the client and the lender or assignee, it does introduce a third party into the relationship.

The lawyers duty in this situation is to advise the client of the risks involved in hypothecating one's claim. Such risks could include loss of standing to pursue the claim as a real party in interest, loss of control and authority regarding the prosecution or defense of the claim and settlement, as well as issues including the attorney client privilege. Further counsel should ensure that the hypothecation agreement does not cede control of the case to the lender.

Lawyers should pay particular attention to Rule 32:1.8 comment 11 cautioning:

> Because third-party payers frequently have interests that differ from those of the client, including interests in minimizing the amount spent on the representation and in learning how the representation is progressing, lawyers are prohibited from accepting or continuing such representations unless the lawyer determines that there will be no interference with the lawyer's independent professional judgment and there is informed consent from the client. See also rule 32:5.4(c) (prohibiting interference with a lawyer's professional judgment by one who recommends, employs, or pays the lawyer to render legal services for another).

Furthermore, if the attorney has a pre-existing contingent fee agreement with the client the client and lender should be advised that the amount hypothecated would only be such sums as the client would received after sums due under the attorney-client contingent fee agreement has been discharged.

Once fully advised of the risks attendant to such action the decision as to whether to hypothecate the claim remains with the client.

For the Committee

Nick Critelli