

Florida State University Law Review

Volume 43 | Issue 3

Article 6

Spring 2016

Embracing Third-Party Litigation Finance

David R. Glickman

Follow this and additional works at: <https://ir.law.fsu.edu/lr>

 Part of the [Contracts Commons](#), [Legal Ethics and Professional Responsibility Commons](#), and the [Litigation Commons](#)

Recommended Citation

David R. Glickman, *Embracing Third-Party Litigation Finance*, 43 Fla. St. U. L. Rev. 1043 (2017) .
<https://ir.law.fsu.edu/lr/vol43/iss3/6>

This Note is brought to you for free and open access by Scholarship Repository. It has been accepted for inclusion in Florida State University Law Review by an authorized editor of Scholarship Repository. For more information, please contact bkaplan@law.fsu.edu.

EMBRACING THIRD-PARTY LITIGATION FINANCE

DAVID R. GLICKMAN*

I. INTRODUCTION.....	1043
II. TRANSACTION STRUCTURE.....	1045
A. <i>Consumer Legal Funding</i>	1045
B. <i>Investment in Commercial Claims and Loans to Lawyers</i>	1047
III. LEGAL OBSTACLES TO THE SUCCESS OF TPLF.....	1051
A. <i>Champerty and Maintenance</i>	1052
B. <i>Usury</i>	1054
C. <i>Contract Principles</i>	1056
IV. CURRENT ATTITUDES.....	1057
A. <i>Frivolous Claims and Fiduciary Duties</i>	1058
B. <i>Consumer Vulnerability</i>	1060
C. <i>Lawyers' Ethical Obligations</i>	1061
V. EFFECT ON SETTLEMENT	1063
VI. REGULATORY SOLUTION	1066
VII. CONCLUSION	1069

I. INTRODUCTION

All litigation invariably requires financing. Let us be proactive and add Third-Party Litigation Finance (“TPLF”) providers to the list of major participants in the American legal system. TPLF is, generally speaking, the process through which the inherent value of a legal claim is used to secure financing. TPLF providers almost exclusively offer nonrecourse financing, i.e., consumers are only obligated to repay an investment to the extent their suit is successful. In its ideal form, providers recognize a litigation claim as a financial asset and offer its owners the flexibility to use it strategically in their business decisions. At this moment in time, however, contracts vary widely across this budding and unregulated industry. A characteristic split exists in the industry between consumer legal funding and investment in commercial claims, the latter including loans to lawyers and law firms. Investment in commercial claims is developing into a legitimate industry that provides historically unavailable solutions to businesses and lawyers involved in litigation. But intelligent regulation is necessary to achieve maximum protection for consumers and streamline the industry’s growth. Most important, the implementation of intelligent regulation will protect the integrity of the American legal system.

Part II first describes the initial split in the industry between consumer legal funding and investment in commercial claims. Understanding this dichotomy is crucial because this Note focuses largely

* J.D., *Cum Laude*, Florida State University College of Law, 2015; B.S. Finance, *Cum Laude*, Florida State University, 2011. Born, Juno Beach, Florida. The author is grateful to M. Utset for the positive opportunity to form these ideas.

on investment in commercial claims. Consumer legal funding is introduced and discussed because it persists as a feature of the TPLF landscape due to the lack of regulation of the industry as a whole. A picture of the market for investment in commercial claims is compared to the market for consumer legal funding. The various ways that parties structure transactions are described along with the purposes the parties intend to serve through the different structures. This Note also discusses the discrepancies involved in providing funding to defendant-consumers, as compared to plaintiff-consumers, and the challenges faced in expanding the TPLF industry to defense-side risk transfers. A subset of investment in commercial claims is explored: TPLF transactions directly with lawyers and law firms, including the distinct ethical challenges these arrangements pose.

Part III considers the different legal doctrines that have been applied to TPLF transactions in the past and whether they remain applicable in today's modern business context. There are two related legal doctrines that historically functioned to bar TPLF transactions—maintenance and champerty. These doctrines essentially barred a person or entity from providing support to a litigant in return for pecuniary consideration related to the suit. The state law doctrine of usury has also been applied to TPLF transactions. Usury laws historically prohibited people and entities from charging unfair and exorbitant interest rates in market transactions. Because many TPLF transactions in the consumer legal funding industry involve variable and often extraordinary interest rates, courts have attempted to apply usury laws to invalidate TPLF transactions they consider unfair to individual consumers. With a similar aim of protecting consumers, courts have also applied equitable principles of contract to TPLF transactions in their attempt to protect unwary consumers from falling victim to predatory consumer legal funding entities. The equitable common law contract principles of duress and undue influence are especially applicable to the unique transactions occurring throughout the TPLF industry.

Part IV addresses popular arguments and complaints against establishment of the TPLF industry. The focus here is protecting the consumer, and many of these problems arise only in connection with consumer legal funding. The remainder of the market is comprised of sophisticated entities that are familiar with the litigation process and able to negotiate at arm's length. Part IV largely addresses the ethical issues raised by TPLF transactions across the entire industry and current responses by authorities to those challenges.

A related major criticism is discussed in Part V: TPLF's effect on settlement incentives. TPLF's effect on settlement is largely driven by the accessibility of information. The role of bargaining power is discussed and the effect of TPLF transactions on both access to in-

formation and bargaining power is considered. Part V also considers how the introduction of TPLF will change parties' actions and incentives, whether these effects are desirable, and TPLF's overall cumulative effect on settlement in the American legal system.

Part VI proposes a regulatory solution aimed at protecting consumers and avoiding the negative externalities currently associated with the TPLF industry while promoting the value it creates and facilitating its overall growth.

II. TRANSACTION STRUCTURE

TPLF transactions occur in a broad spectrum, but the market is differentiated according to the sophistication of the consumer. Lawyers, law firms, and corporate parties to a lawsuit are sophisticated players akin to individuals and entities meeting the Securities and Exchange Commission's ("SEC") accredited investor standard.¹ Accredited investors are individuals with a net worth of over \$1 million (including spouse but excluding primary residence) or individuals whose income exceeded \$200,000 (or whose joint income with that of the spouse exceeded \$300,000) each of the prior two years and who reasonably expect the same in the current year.² These consumers have the knowledge and resources required to enter into negotiated, arms-length agreements with providers and are often repeat litigants familiar with the dynamics and incentives created by litigation. Individual personal injury tort plaintiffs, however, are rarely sophisticated investors. Because they lack the ability and leverage to effectively negotiate with TPLF providers, they often enter into boilerplate contracts that are to their detriment. Most of the legitimate issues raised regarding the TPLF industry stem from consequences in connection with consumer legal funding but are absent from commercial investment.

A. Consumer Legal Funding

In this transaction structure, a TPLF firm typically takes a financial interest in a plaintiff's personal injury or other relatively small claim.³ Although attorneys generally offer these plaintiffs contingent fee arrangements (itself a form of financing), plaintiffs' injuries often leave them out of work and with little money to cover simple living or

1. See Michael L. Monson, *The Evolution and Future of the Accredited Investor Standard for Individuals*, UTAH B.J., Nov./Dec. 2010, at 36, 37-38 (setting forth the history of the SEC accredited investor standard and its changes).

2. See 17 C.F.R. § 230.501(a) (2014).

3. See Douglas R. Richmond, *Other People's Money: The Ethics of Litigation Funding*, 56 MERCER L. REV. 649, 649-50 (2005) (discussing the prevalence of the litigation "loan" market in the United States).

medical expenses. It is often the case that these individuals find the most valuable asset they own is their contingent claim to a future award of damages. They use this claim arising from their injury as security in a transaction with consumer legal funders. The consumer contracts to repay the provider the principal amount forwarded plus interest out of any recovery.⁴ The only thing distinguishing these providers from settlement factoring companies is the fact that consumer legal funders take interests in claims that have yet to be resolved or reduced to judgment.⁵

Some serious concerns raised by critics of the TPLF industry are unique consequences resulting from consumer legal funding. Other issues relate more generally to the concept of litigation finance and apply to both consumer legal funding and investment in commercial claims. These latter issues are addressed in detail later.⁶ A legitimate concern in consumer legal funding transactions is the vulnerability of the consumer.⁷ There exists a valid concern that these consumers, typically victims of accidents, will be further victimized by sophisticated entities that induce them to enter into contracts of adhesion that they do not fully understand.⁸ A massive body of law, in the form of the Uniform Commercial Code (“UCC”), was created and adopted by the majority of states in recognition of the real threats consumers face on a daily basis in exercising their freedom of contract.⁹ An effort was therefore made to establish a functional framework of laws that reduce the vulnerability of the average American consumer, provide protections meant to prevent abuse in the first place, and offer substantive remedies to make victims whole after the fact.¹⁰ This Note proposes a regulatory solution to some of the issues resulting from investment in commercial claims and loans to law firms.¹¹ The

4. See Julia H. McLaughlin, *Litigation Funding: Charting a Legal and Ethical Course*, 31 VT. L. REV. 615, 620-21, 621 n.21 (2007) (describing the basic structure of consumer legal funding transactions).

5. See *id.* at 620 (stating that the “potential recovery, if any, secures the LFC’s interest”). See generally Adam F. Scales, *Against Settlement Factoring? The Market in Tort Claims Has Arrived*, 2002 WIS. L. REV. 859 (2002) (explaining the approach taken by settlement factoring companies and the increasing trend of asset securitization).

6. See *infra* pp. 1056-60.

7. See Adam Liptak, *Lenders to Those Who Sue Are Challenged on Rates*, N.Y. TIMES (May 19, 2003), <http://www.nytimes.com/2003/05/19/us/lenders-to-those-who-sue-are-challenged-on-rates.html> (discussing the exploitation of vulnerable consumers).

8. See *Fausone v. U.S. Claims, Inc.*, 915 So. 2d 626, 630 (Fla. 2d DCA 2005).

9. See generally U.C.C. (AM. LAW INST. & NAT’L CONFERENCE ON UNIF. STATE LAWS 2014).

10. See 15A AM. JUR. 2D *Commercial Code* § 2, Westlaw (database updated Nov. 2015) (describing the general purpose and effect of the UCC framework).

11. See *infra* pp. 1066-69.

solution tacitly assumes the outright prohibition of the consumer legal funding niche of TPLF or, at least, stringent regulation based on usury¹² and UCC principles.

B. Investment in Commercial Claims and Loans to Lawyers

The other half of the TPLF market is comprised of fewer, but larger and more sophisticated providers that invest in complex commercial claims including contract, antitrust, and intellectual property. These providers approach the investment in much the same way private equity firms and hedge funds approach investments: by establishing a structured and comprehensive review process used to evaluate potential investments. They conduct significant due diligence before making a decision to invest because they often invest substantial sums.¹³ These providers include both private and publicly traded companies that typically invest tens of millions of dollars in claims owned by corporate entities represented by top tier law firms.¹⁴ Juridica and Burford are excellent examples of TPLF providers having achieved successes validated by the public markets.¹⁵

The most straightforward example of investment in commercial claims is a situation in which the provider offers financing used to satisfy legal fees incurred in the litigation of a claim.¹⁶ Consumers contemplating this type of financing are usually repeat litigant corporate entities.¹⁷ Sometimes a party plaintiff approaches a provider at the outset of a suit because his or her opponent retained high quality, expensive legal counsel, and they are simply unable to afford hourly fees of comparable counsel.¹⁸ In this circumstance, the provider offers the consumer the flexibility to retain quality counsel, equal-

12. See *infra* pp. 1054-55.

13. See, e.g., *Funding Overview*, BENTHAM IMF, <http://www.benthamimf.com/docs/default-source/default-document-library/bentham-funding-overview.pdf?sfvrsn=10> (discussing the comprehensive due diligence process Bentham Capital LLC undertakes before making an investment) (last visited Feb. 24, 2016).

14. See generally Steven Garber, *Alternative Litigation Financing in the United States: Issues, Knowns, and Unknowns* 1, 16 (RAND, Occasional Paper, 2010), http://www.rand.org/content/dam/rand/pubs/occasional_papers/2010/RAND_OP306.pdf (discussing the extent to which sophisticated TPLF consumers borrow in comparison to the value of their litigation claims).

15. See, e.g., BURFORD CAPITAL LLC, <http://www.burfordcapital.com> (last visited Feb. 24, 2016); JURIDICIA INVESTMENTS LTD, <http://www.juridicainvestments.com> (last visited Feb. 24, 2016).

16. See Marco de Morpurgo, *A Comparative Legal and Economic Approach to Third-Party Litigation Funding*, 19 CARDOZO J. INT'L & COMP. L. 343, 352 (2011).

17. See Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268, 1304 (2011).

18. See JONATHAN T. MOLOT, BURFORD CAPITAL LLC, THEORY AND PRACTICE IN LITIGATION RISK 8 (2012), <http://www.burfordcapital.com/wp-content/uploads/2015/01/Booklet-Theory-and-Practice.pdf>.

izing the playing field and permitting the suit to proceed to a determination on the merits instead of settling based on dynamics unrelated to those merits.¹⁹ In another situation, a consumer may approach a provider in the middle of a case when fees have proved more expensive than anticipated and the consumer has accumulated unpaid legal bills.²⁰ Threatened with the withdrawal of its counsel and the agency costs associated with retaining substitute counsel, the provider covers the consumer's arrearages and finances the cost associated with completing the litigation.²¹ In this way, providers empower businesses to retain high quality legal counsel by offering the resources necessary for that counsel to function efficiently and effectively.

Regardless of whether a consumer is a repeat litigant, litigation can severely affect a business' operations.²² Management teams excel at running large-scale businesses and ongoing litigation has a debilitating effect on their ability to run them smoothly and profitably. Litigation is a major distraction to any business entity.²³ The opportunity costs involved in diverting capital to cover the cost of litigation can be overwhelming to the largest of these entities and fatal to the rest. Providers can relieve some of the pressure litigation places on businesses by providing cash for purposes other than payment of legal fees.²⁴ The managers of a small business might think they have a legitimate claim but might not be able to afford to litigate the claim while contemporaneously funding their operations. Providers enable these businesses to litigate their claim on the merits while financing the company's operations until recovery.²⁵ Larger businesses might be able to afford to litigate their claims but could benefit from additional capital to counter the effect litigation has on their financials. Under Generally Accepted Accounting Principles, legal fees are treated as ordinary expenses while recoveries are treated as extraordinary items.²⁶ The practical but illogical result for businesses is that the legal fees necessarily paid to litigate their claim reduce earnings, but any recovery amount cannot be included in earnings.²⁷ Business-

19. See discussion *infra* pp. 1063-66 (discussing TPLF's effect on settlement dynamics).

20. See MOLOT, *supra* note 18, at 7-8.

21. See *id.*

22. Cf. Alan J. Fink, *Litigation Management Model Developed by Corporate Counsel Section*, N.Y. ST. B.J., Jan. 1996, at 34, 34 (describing the ultimate management goal as avoiding litigation in the first place, whenever reasonably possible).

23. See *Business Law*, HAWKES LAW FIRM, P.S., hawkeslawcenter.com/practice-areas/business-law/ (last visited Feb. 24, 2016).

24. See MOLOT, *supra* note 18, at 8.

25. See *id.*

26. See *id.* at 11.

27. See Robert W. Wood, *Taxation of Litigation Recoveries*, 47 AM. JUR. TRIALS 591, § 8 Westlaw (database updated Nov. 2015).

es undergoing a recapitalization or reorganization use financing from providers to counter the effect of this perverse accounting treatment on their operations.²⁸ Providers understand the effects of litigation on large-scale businesses and are uniquely qualified to create and offer financing arrangements specifically aimed at solving the problems faced by these businesses.

Not all financing arrangements involve plaintiffs. Corporate defendants facing lawsuits encounter problems equal in scope to entities litigating claims as plaintiffs. But defendants do not have a potential judgment to use as security for financing. Corporate defendants are interested in a different type of risk transfer. These businesses want to mitigate the hazardous effects of a potential adverse judgment, or of a worse-than-expected adverse judgment. Because there is no potential judgment to use as security, these arrangements are similar in nature to insurance.²⁹ Corporate defendants are effectively interested in purchasing an insurance policy covering the risks associated with an adverse judgment. Traditional insurers have been reluctant to insure this risk because they are unable to accurately underwrite it.³⁰ Traditional insurers are able to accurately price risk by grouping together similar policyholders who bear similar risks.³¹ A corporate defendant is a unique entity facing a completely unique (and foreign, to the traditional insurer) risk in the form of a lawsuit.³² Traditional insurers do not possess the legal expertise to conduct the due diligence necessary to accurately underwrite the risk associated with an adverse judgment to a corporate defendant. Providers, on the other hand, possess both the legal expertise and the financial fluency to underwrite this type of risk.³³ What providers lack is the sheer magnitude of assets required to insure such massive risk. Still, there exist examples of providers and insurance companies successfully collaborating to offer insurance solutions to corporate defendants.³⁴

Partnering with a traditional insurer can enable a TPLF provider to insure the entire risk a corporate defendant faces.³⁵ Consider the

28. See MOLOT, *supra* note 18, at 11.

29. See *id.* at 14-15; see also Steinitz, *supra* note 17, at 1311. See generally Morpurgo, *supra* note 16, at 353 (describing traditional insurers' approach to before-the-event and after-the-event litigation insurance).

30. See MOLOT, *supra* note 18, at 6.

31. See *id.*

32. Jonathan T. Molot, *The Feasibility of Litigation Markets*, 89 IND. L.J. 171, 188 (2014).

33. See, e.g., MOLOT, *supra* note 18, at 15 (noting that Burford Capital LLC recently invested \$10 million to essentially insure a commercial plaintiff that had already won a jury verdict worth more than \$50 million but was being appealed).

34. See *id.*

35. See *id.* at 15 (stating that Burford Capital LLC was able to offer a litigant nearly \$40 million to protect a \$50 million jury verdict that was being appealed by partnering

effect that litigation risk has on the corporate defendant who is a party to a pending merger or acquisition. An entire deal may be scuttled because the target is subject to an unacceptable and uncertain amount of pending or ongoing litigation risk.³⁶ By enabling a target to transfer some or all of this risk, TPLF providers offer a crucial solution to a complex problem for corporate defendants.

A specialized subset of these providers also makes loans directly to lawyers and law firms.³⁷ These loans are secured by firm assets and are distinct in that way from financing arrangements made directly with party plaintiffs or defendants.³⁸ Collateral ranges from furniture and fixtures to accounts receivable or a percentage of the firm's contingent fee in a current case. Entire law firms dedicate their legal practice to matters lending themselves to contingent fee arrangements. While such firms routinely outlay funds necessary to litigate a suit, occasionally they must turn down business they are incapable of financing.³⁹ Only the largest law firms are able to finance cases requiring millions of dollars in disbursements. Many firms specializing in contingent fee matters are financially unable to assume that level of risk despite seeing a strong claim on the merits due to cash-flow problems or otherwise.⁴⁰ Historically, such a firm would turn to traditional lenders including banks and insurance companies in an effort to finance these cases, but few law firms have the type of relationship with a bank necessary to facilitate such large scale financing.⁴¹ Moreover, many of these traditional sources of credit simply dried up following the financial crisis.⁴² TPLF providers, relying on their crucial legal and financial expertise, are willing to provide sufficient capital to reduce a law firm's exposure to a suitable amount, allowing the law firm to proceed on a contingent fee basis.

TPLF providers also offer financing to lawyers to ameliorate circumstances created by the economics of law practice. As more law firms approach the practice of law as a business rather than a profession, it has become commonplace for practice groups within large firms to have disagreements with firm management about fee ar-

with an insurance company and that this transaction structure allowed the plaintiff to use \$10 million dollars to secure protection "far beyond what a \$300 million fund could do for a single case").

36. *See id.* at 6.

37. *See* Jasminka Kalajdzic et al., *Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding*, 61 AM. J. COMP. L. 93, 128-30 (2013).

38. *See id.*

39. *See* Elizabeth Chamblee Burch, *Financiers as Monitors in Aggregate Litigation*, 87 N.Y.U. L. REV. 1273, 1306 (2012).

40. *See id.*

41. *See id.*

42. *See id.*

rangements and other financial matters.⁴³ Firm management may be unhappy with a practice group's preference for contingent fee arrangements and may pressure them to accept more hourly fee business.⁴⁴ Management teams of TPLF providers include successful lawyers with experience at top-flight firms who are intimately familiar with the economic issues involved in the practice of law.⁴⁵ These providers are in a unique position to offer solutions for the problems created by these issues. The provider may agree to finance the group's entire portfolio of contingent fee matters, significantly reducing the law firm's risk exposure and appeasing management.⁴⁶ The practice group may simply borrow from the provider (using its contingent share of suit proceeds as security) and give the borrowed cash directly to firm management in lieu of accepting more hourly fee business.⁴⁷ Where the personalities and risk profiles are too volatile to continue under a single roof, the provider can finance the practice group's split from the law firm and costs associated with the establishment of a new firm.⁴⁸

III. LEGAL OBSTACLES TO THE SUCCESS OF TPLF

Today's TPLF industry operates in an uncertain legal gray area. The undeniable trend, however, embraces the proliferation of TPLF.⁴⁹ The industry does not yet enjoy much notoriety in this country despite growing at an exponential rate across the world⁵⁰ since a 2006 landmark decision of the Australian High Court.⁵¹ TPLF has been embraced in Australia, Germany, and the United Kingdom for some time, as traditional prohibitions on maintenance and champerty were abolished by statute in those jurisdictions years ago.⁵² The industry's legal status remains undefined in the United States largely because the industry is so new that the most relevant existing legal frameworks are woefully inapplicable to this cross-discipline business context. The common law principles of champerty and maintenance once

43. See MOLOT, *supra* note 18, at 11-12.

44. See *id.* at 12.

45. See, e.g., *Our Team*, BENTHAM CAPITAL LLC, <http://www.benthamimf.com/about-us/our-team> (last visited Feb. 24, 2016).

46. See MOLOT, *supra* note 18, at 11-12.

47. See *id.* (stating that practice groups being pressured by firm management to accept more hourly fee work have "sought financing in an effort to . . . bring in enough cash to satisfy firm management").

48. See *id.*

49. See Victoria A. Shannon, *Harmonizing Third-Party Litigation Funding Regulation*, 36 CARDOZO L. REV. 861, 864 (2015) (mentioning TPLF's "increasing prevalence").

50. *Id.* at 869.

51. See *Campbells Cash & Carry Pty Ltd v. Fostif Pty Ltd* [2006] HCA 41 (Austl.).

52. See Shannon, *supra* note 50, at 869, 871.

barred third parties from offering financing to litigants.⁵³ However, many courts around the country nowadays are unwilling to bar modern TPLF agreements under these ancient doctrines.⁵⁴ Moreover, the nonrecourse nature of TPLF agreements governing investment in commercial claims prohibits courts from using usury principles to invalidate them.⁵⁵ Equitable contract principles of duress and undue influence may function to bar unconscionable consumer legal funding agreements, however.⁵⁶

A. *Champerty and Maintenance*

“Champerty and maintenance are common-law doctrines, often referred to as ‘antique laws,’ which have long prohibited the outside financing of litigation.”⁵⁷ Maintenance refers broadly to any assistance to another person in their prosecution of a lawsuit.⁵⁸ Champerty is a specific type of maintenance and refers to the support of a lawsuit with the expectation of pecuniary gain.⁵⁹ The term is used to describe:

[T]he purpose of stirring up litigation and strife, encouraging others either to bring actions or to make defenses which they have no right to make, and the term seems to be confined to the intermeddling in a suit of a stranger or of one not having any privity or concern in the subject matter, or standing in no relation of duty to the suitor.⁶⁰

Today, courts use the terms nearly synonymously.⁶¹ The historical justification for the prohibition was to prevent what is recognized today as abuse of process.⁶² The policy goals driving prohibitions on

53. See *id.* at 873-74.

54. See Mariel Rodak, *It's About Time: A Systems Thinking Analysis of the Litigation Finance Industry and its Effect on Settlement*, 155 U. PA. L. REV. 503, 511 (2006).

55. See Shannon, *supra* note 50, at 892.

56. Rodak, *supra* note 54, at 513.

57. Jacqueline Sheridan, *Champerty and Maintenance in the Modern Era: How Litigation Funding Groups are Changing the Landscape*, DINSMORE (Jan. 22, 2016), http://www.dinsmore.com/champerty_and_maintenance_modern_era/ (“The doctrines of champerty and maintenance date back to the middle ages, and some argue as early as the ancient Greece and ancient Roman eras.” (citing Jason Lyon, *Revolution in Process: Third-Party Funding of American Litigation*, 58 UCLA L. REV. 571 (2010))).

58. Paul H. Rubin, *Third-Party Financing of Litigation*, 38 N. KY. L. REV. 673, 674 (2011) (“Maintenance is assistance in a lawsuit by someone who has no interest in the case.”).

59. See *id.* (“[C]hamperty is an agreement between a litigant and a stranger by which the stranger pursues the claim in return for a share of the proceeds . . .”).

60. L. S. Tellier, Annotation, *Assertion of Defense of Champerty in Action by Champertous Assignee*, 22 A.L.R. 2d 1000, § 1[a] (1952) (citing 10 AM. JUR. 548, *Champerty and Maintenance* § 1).

61. See *id.*

62. See *Wolford v. Tankersley*, 695 P.2d 1201, 1222 (Idaho 1984).

champerty are now largely accomplished in other ways, such as through court rules and model rules of professional conduct.⁶³ These concerns do not outweigh the benefits the TPLF industry has to offer.

As the business landscape in this country has developed in complexity over the last decade, courts have increasingly been unwilling to apply the doctrine of champerty to invalidate agreements between litigants and third parties. Courts as early as 1824 observed that state laws sufficiently addressed problems caused by maintenance and champerty.⁶⁴ Around the turn of the nineteenth century, courts began embracing champertous agreements not involving a party's attorney.⁶⁵ This trend continued into the early twentieth century, as champertous agreements involving a party's own lawyer remained circumspect in the eyes of courts.⁶⁶ By the middle of the twentieth century, contingency fee agreements had been carved out as a de facto exception to the traditional doctrine of champerty.⁶⁷ These agreements would without question be permitted in today's modern legal practice as contingency fee agreements.⁶⁸

More recently, many state supreme courts have explicitly ruled that their common law permits agreements previously considered champertous.⁶⁹ Some states were not even willing to concede that the prohibition on champerty traveled to this country with the early English common law.⁷⁰ Other states abandoned the champerty restrictions adopted from the early common law.⁷¹ The Massachusetts Supreme Court dissolved its prohibition on champerty in 1997, citing a systematic change in the way society viewed litigation.⁷² Florida courts refused to agree that TPLF agreements "officious[ly] intermeddle[d]" in suits, gutting the claim that the specific arrangement

63. See *Saladini v. Righellis*, 687 N.E.2d 1224, 1227 (Mass. 1997) (holding that the champerty doctrine is no longer needed because there are now other mechanisms in place that can prevent the same evils the champerty doctrine was designed to protect against); *Osprey, Inc. v. Cabana Ltd. P'ship*, 523 S.E.2d 269, 277 (S.C. 2000) (eliminating champerty as a defense because other well-developed principles of law can more effectively accomplish the goals champerty aims to achieve).

64. See *Thalhimer v. Brinckerhoff*, 3 Cow. 623, 624 (N.Y. 1824) (finding that an agreement was void based on the state's "more explicit" statute, rather than the common-law doctrine of champerty).

65. See, e.g., *Brown v. Bigne*, 28 P. 11, 13 (Or. 1891).

66. See *In re Gilman's Adm'x*, 167 N.E. 437, 439 (N.Y. 1929).

67. See Max Radin, *Maintenance by Champerty*, 24 CAL. L. REV. 48, 70-71 (1936).

68. See Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61, 99 (2011).

69. See Rodak, *supra* note 54, at 511.

70. See, e.g., *Rice v. Farrell*, 28 A.2d 7, 8 (Conn. 1942) ("[T]he common law doctrines of champerty and maintenance as applied to civil actions have never been adopted in this state . . .").

71. See, e.g., *Fastenau v. Engel*, 240 P.2d 1173, 1175 (Colo. 1952); *Polo ex rel. Shipley v. Gotchel*, 542 A.2d 947 (N.J. Super. Ct. Law Div. 1987).

72. See *Saladini v. Righellis*, 687 N.E.2d 1224, 1226-27 (Mass. 1997).

in that case was champertous.⁷³ In New York, a partial assignment of proceeds from a lawsuit in exchange for services was upheld in 1993.⁷⁴

Over half of jurisdictions in the United States now permit some form of champerty, subject to certain limitations.⁷⁵ The limitations typically disallow champertous agreements promoting frivolous lawsuits or based on improper motives.⁷⁶ An important limitation prohibits champertous agreements that intermeddle with the administration of litigation. Examples of intermeddling include reserving the authority to choose counsel, directing trial strategy, and controlling settlement decisions.⁷⁷ Given the apparent trend and the fact that more than half of the states now permit champerty in one form or another, dated prohibitions on champerty seem to pose little threat to the expansion of the TPLF industry in this country. There remain, however, a handful of states that still enforce prohibitions on champerty.⁷⁸

B. Usury

Usury laws prohibit lenders from charging exorbitant interest rates in debt transactions.⁷⁹ Typically these laws provide a maximum rate at which interest may be charged. Those rates depend on a number of factors including the category of lender involved. There is no federal legal framework for usury law. Instead, state laws vary widely regarding permissible maximum rates and the extent to which they apply to different lenders, whether commercial or consumer. Sometimes even nonrecourse financing is described as a loan.⁸⁰ This

73. See *Kraft v. Mason*, 668 So. 2d 679, 682-83 (Fla. 4th DCA 1996).

74. See *Leon v. Martinez*, 638 N.E. 2d 511, 513 (N.Y. 1994).

75. See *Sebok*, *supra* note 68, at 98-99.

76. See *id.* at 102-05 (referring to these limitations as “malice maintenance” and arguing against the prohibition of malice maintenance due to the existence of other legal doctrines and rules).

77. See *id.* at 109.

78. See, e.g., *Lott v. Kees*, 165 So. 2d 106, 110-11 (Ala. 1964); *Johnson v. Wright*, 682 N.W. 2d 671, 679-80 (Minn. Ct. App. 2004) (upholding the validity of the champerty doctrine in Minnesota and citing to other states that have refused to abolish the champerty doctrine, including Arizona, *Lingel v. Olbin*, 8 P.3d 1163, 1167-68 (Ariz. Ct. App. 2000), Ohio, *Ranman v. Interim Settlement Funding Corp.*, 789 N.E.2d 217 (Ohio 2003), and Pennsylvania, *Fleetwood Area Sch. Dist. v. Berks Cty. Bd. of Assessment Appeals*, 821 A.2d 1268, 1273 (Pa. Cmmw. Ct. 2003)).

79. See George Steven Swan, *The Economics of Usury and the Litigation Funding Industry*; *Ranman v. Interim Settlement Funding Corp.*, 28 OKLA. CITY U. L. REV. 753, 765 n.102 (2003) (“Regulations that specify a maximum rate of interest that an institution can charge for lending money are known as usury laws.” (quoting W. KIP VISCUSI ET AL., *ECONOMICS OF REGULATION AND ANTITRUST* 518 (3d ed. 2001))).

80. See, e.g., The Ass’n of the Bar of the City of N.Y. Comm. on Prof’l Ethics, Formal Op. 2011-2 (2011) (“This opinion addresses non-recourse litigation loans, *i.e.* financing re-

oxymoronic rhetoric used by legal authorities contributes to the confusion presently surrounding the industry in this country. TPLF providers indicate that the nonrecourse nature of the financing they provide prevents the financing from being characterized as a debt transaction.⁸¹ Providers insist they are making an investment or simply purchasing partial assignment of a claim, not making loans.⁸² It follows that whether usury laws may function to invalidate TPLF agreements will depend on whether courts characterize TPLF financing as loans or investments.

In the context of consumer usury laws, courts generally agree one of the hallmarks of a loan or debt transaction is the absolute obligation to repay the funds advanced.⁸³ Some courts, however, simply see nonrecourse TPLF agreements as a type of loan.⁸⁴ Such a characterization may permit the application of state usury laws to certain TPLF agreements. These laws were enacted to protect vulnerable consumers against deceitful lenders. They function well for this purpose in the consumer legal funding context. Petitioned by large consumer legal funders in 2010, the Colorado Attorney General issued a declaratory order holding nonrecourse debt agreements subject to usury regulations under Colorado's Uniform Consumer Credit Code.⁸⁵

paid by a litigant only in the event he or she settles the case or is awarded a judgment upon completion of the litigation.”).

81. See ABA Comm'n on Ethics 20/20, White Paper on Alternative Litigation Finance 13 (draft), http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111019_draft_alf_white_paper_posting.authcheckdam.pdf (“This product does not fall into a traditional ‘loan product’ category as it is non-recourse.” (quoting Comments of Oasis Legal Fin., LLC to the ABA Working Grp. on Alt. Litig. Fin. (Jan. 18, 2011))).

82. These claims only ring true with respect to providers investing in large-scale, commercial lawsuits. As part of a bespoke agreement, these providers typically negotiate a set percentage return. Consumer legal funders, however, often set a rate of interest that compounds monthly. While the “loan” is technically nonrecourse, this arrangement expands the vulnerability of consumers that enter these agreements. Further, financing offered directly to lawyers and law firms is usually a secured transaction, where the law firm will provide as collateral firm assets or part of its contingent fee.

83. See BURFORD CAPITAL LLC, SUMMARY OF FINDINGS: SECOND ANNUAL LITIGATION FINANCING SURVEY (2013), at 12, n.47 (2014) (“The second element of a traditional usury case is the debtor’s absolute obligation to repay the principal amount of the money transferred to him or her.” (quoting 1-6 CONSUMER CREDIT LAW MANUAL § 6.08 (2011))); *Odell v. Legal Bucks, LLC*, 665 S.E. 2d 767, 777 (N.C. Ct. App. 2008) (stating that a contract where the “borrower’s repayment of the principal is subject to a contingency is not considered a ‘loan,’ because the terms of the transaction do not necessarily require that the borrower ‘repay the sum lent’” (quoting *State ex rel. Cooper v. NCSS Loans, Inc.*, 624 S.E.2d 371, 374 (2005))).

84. See *Lawsuit Financial, L.L.C. v. Curry*, 683 N.W.2d 233, 239 (Mich. Ct. App. 2004).

85. See ABA COMM’N ON ETHICS 20/20, INFORMATIONAL REPORT TO THE HOUSE OF DELEGATES 13 (2012), http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf.

C. Contract Principles

The traditional equitable doctrines of undue influence and duress aim to achieve similar policy goals as the doctrines of maintenance and champerty.⁸⁶ The applicable form of duress functions to invalidate contracts where one party makes an improper threat that induces the other party to accept the contract terms and the accepting party has no reasonable alternative to manifesting their assent.⁸⁷ The essence of this equitable doctrine is to protect consumers from inducement by improper threat. Such an improper threat, however, does not amount to duress if the victim has a reasonable alternative and fails to take advantage of it.⁸⁸ The threat must arouse such fear as would preclude a party from exercising its free will and judgment, but it is enough if the threat actually induces assent on the part of one who has no reasonable alternative.⁸⁹ This type of duress could potentially be applicable in the consumer legal funding context where a consumer has filed a lawsuit and cannot afford typical living or medical expenses. The consumer will be faced with a decision either to drop the suit or enter into a contract with a consumer legal funding entity. If the entity uses that leverage to impermissibly induce the consumer into entering the contract, a reviewing court may very well consider such action within the definition of duress and void the contract. If a reviewing court believes the consumer has any reasonable alternative to entering the consumer legal funding contract, however, even an improper threat would not function to void the contract for duress.

Undue influence involves unfair persuasion instead of an improper threat and contemplates a milder form of pressure than duress. Undue influence is the unfair persuasion of a party who is under the domination of the person or entity exercising their influence.⁹⁰ A consumer in the scenario just described could be considered under the domination of the provider if they had no other ability to cover living expenses while prosecuting their suit. The extent to which persuasion is unfair depends on a variety of circumstances, including the unfairness of the resulting bargain, the unavailability of independent advice, and the susceptibility of the person persuaded.⁹¹ These factors are not by themselves controlling, however.⁹² A reviewing court may

86. See Paul Bond, *Making Champerty Work: An Invitation to State Action*, 150 U. PA. L. REV. 1297, 1307 (2002).

87. RESTATEMENT (SECOND) OF CONTRACTS § 175(1) (AM. LAW INST. 1981).

88. *Id.* at cmt. b.

89. *Id.*

90. *Id.* § 177(1).

91. *Id.* at cmt. b.

92. See *id.*

be more likely to find the unfair persuasion contemplated by undue influence than the improper threat involved in duress. Regardless, the strict requirements of satisfying these doctrines likely render them inapplicable to the negotiated agreements reached between sophisticated parties that govern investment in commercial claims.⁹³ Courts could, however, potentially use these doctrines to nullify contracts between consumer legal funding entities and individual parties.

IV. CURRENT ATTITUDES

Trade associations and legal authorities have begun to give more attention to the TPLF industry in recent years. In 2012, the United States Chamber of Commerce's Institute for Legal Reform ("ILR") published a report highlighting the purported threats the TPLF industry creates and describing it as a "clear and present danger to the impartial and efficient administration of civil justice in the United States."⁹⁴ Despite its negative outlook on the industry, the report includes some regulatory measures even proponents of the industry would agree are necessary to ensure its continued viability.⁹⁵ Lawmakers have yet to respond to the regulatory proposals. In August of 2014, the ILR issued another report proposing a regulatory scheme for the Australian TPLF industry.⁹⁶ The American Bar Association Commission on Ethics 20/20 ("Commission") issued a draft white paper addressing the ethical and professional responsibility issues raised by the emerging TPLF industry.⁹⁷ The Commission concluded that the TPLF industry does not run afoul of ethical and professional responsibility rules governing lawyers but suggested lawyers involved in TPLF be especially careful to maintain their independent professional judgment and make decisions in their clients' best interest, all things considered.⁹⁸ Most recently, in April 2014, representatives of the ILR, American Insurance Association, American Tort Reform Association, Lawyers for Civil Justice, and National Association of Manufacturers penned a letter to the Secretary of the Committee

93. See *id.* § 208 cmt. d ("A bargain is not unconscionable merely because the parties to it are unequal in bargaining position . . .").

94. JOHN H. BEISNER & GARY A. RUBIN, U.S. CHAMBER INST. FOR LEGAL REFORM, STOPPING THE SALE ON LAWSUITS: A PROPOSAL TO REGULATE THIRD-PARTY INVESTMENTS IN LITIGATION 1 (2012), http://www.instituteforlegalreform.com/uploads/sites/1/TPLF_Solutions.pdf.

95. Some of these suggestions include measures addressing consumer protection, ownership of providers, and confidentiality.

96. NICK MAVRAKIS ET AL., U.S. CHAMBER INST. FOR LEGAL REFORM, AN OVERSIGHT REGIME FOR LITIGATION FUNDING IN AUSTRALIA 1 (2014), <http://www.instituteforlegalreform.com/uploads/sites/1/LitinAUS.pdf>.

97. ABA Comm'n on Ethics 20/20, *supra* note 81.

98. See *id.* at 4-5.

on Rules of Practice and Procedure for the Administrative Office of the United States Courts proposing a TPLF disclosure requirement be added to the Federal Rules of Civil Procedure.⁹⁹ The Committee will consider the proposal.

Certain arguments against the TPLF industry recur in the reports mentioned above and throughout the academic literature addressing TPLF. This Part identifies and addresses these arguments concerning the TPLF industry and attempts to show how the industry's negative externalities can be managed while preserving the value the industry creates for consumers. The most popular argument against TPLF is that it increases the amount of frivolous claims filed in the court system.¹⁰⁰ There exists a similar argument that while TPLF may or may not increase the amount of frivolous claims filed, it will generally increase the overall volume of litigation.¹⁰¹ Another complaint against the industry is its perceived exploitation of consumers.¹⁰² The vulnerability of consumers is certainly an issue in consumer legal funding where individuals do not possess the leverage required to sufficiently negotiate protections into their contracts. The final area of concern involves lawyers' ethical obligations and potential conflicts of interest that may be raised by TPLF arrangements. There is a legitimate concern that information exchanges between TPLF providers and litigants will waive attorney-client and work-product privileges.¹⁰³ Additionally, nothing currently prohibits TPLF providers from negotiating for control over decisional aspects of litigation traditionally reserved for parties. Retention of this type of control by providers can interfere with an attorney's exercise of independent professional judgment and must be avoided.

A. *Frivolous Claims and Fiduciary Duties*

Critics of the industry are quick to point to a host of negative externalities associated with TPLF. Many argue the industry is an engine for frivolous litigation.¹⁰⁴ Critics argue that because TPLF providers fund many cases and thus are able to distribute risk across

99. See Letter from Lisa A. Rickard, President, U.S. Chamber Inst. for Legal Reform, to Jonathan C. Rose, Sec'y of the Comm. on Rules of Practice and Procedure of the Admin. Office of the U.S. Courts (Apr. 9, 2014) [hereinafter Letter from Lisa A. Rickard], http://www.instituteforlegalreform.com/uploads/sites/1/4_-_FINAL_VERSION_-_TPLF_Disclosure_letter_4_9.pdf.

100. See BEISNER & RUBIN, *supra* note 94, at 4.

101. Rodak, *supra* note 54, at 519.

102. See *id.* at 517-18.

103. See MOLOT, *supra* note 18, at 13.

104. See Rubin, *supra* note 58, at 682 (discussing the potential increase in meritless and opportunistic claims as a result of an increase in the pool of resources available to fund litigation).

their portfolio of investments, the risks associated with funding a single claim are negligible.¹⁰⁵ They claim this higher risk appetite combined with providers' single-minded pursuit of a return on capital contributes to increased frivolous litigation.¹⁰⁶ This argument does not stand on firm ground, however.¹⁰⁷ TPLF providers are indeed interested in earning a handsome return on capital, but this incentivizes TPLF providers only to advance money to plaintiffs with meritorious claims. In the words of one of the largest providers in today's industry, "[f]unding meritless suits is a sure way to lose money."¹⁰⁸ TPLF providers in the commercial context conduct significant due diligence before moving forward with an investment because they offer substantial nonrecourse investments.¹⁰⁹ TPLF providers assess a number of factors including the type and strength of a case, jurisdiction, evidence, potential damages, settlement prospects, and expertise of counsel.¹¹⁰

Ethical standards also function to negate the argument that TPLF increases the volume of frivolous claims filed in court. Professional responsibility guidelines prohibit attorneys from using their services to support frivolous claims.¹¹¹ While these guidelines certainly do not ensure eradication of frivolous litigation in our justice system, they are an example of an already established procedural protection applicable to the TPLF industry. Furthermore, the largest TPLF providers are publicly traded entities.¹¹² The officers and directors of these publicly traded entities are subject to fiduciary duties and are required by law to make business decisions in the best interests of their shareholders.¹¹³ It remains a question of first impression whether or the extent to which corporate law and the business judgment rule may exculpate TPLF providers from negligent investments in litigation. As previously mentioned, only the largest TPLF providers are publicly traded and subject to fiduciary duties. The regulatory solution proposed in this Note suggests TPLF providers should be required to register with the SEC as investment advisers, which are

105. See BEISNER & RUBIN, *supra* note 94, at 12.

106. See *id.* at 677.

107. See Shannon, *supra* note 50, at 875 ("It is not in the funder's interest to fund frivolous cases, because the funder would incur only costs without benefits when the case fails, and a court may sanction the funded party for bringing a frivolous case.")

108. See MOLOT, *supra* note 18, at 16.

109. See, e.g., *Funding Overview*, *supra* note 13.

110. *Id.*

111. MODEL RULES OF PROF'L CONDUCT r. 3.1 (AM. BAR ASS'N 1983).

112. See, e.g., Burch, *supra* note 39, at 1303.

113. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (1993) ("Directors are charged with an unyielding fiduciary duty to protect the interests of the corporation and to act in the best interests of its shareholders.")

also fiduciaries.¹¹⁴ This will effectively ensure all entities providing TPLF are subject to fiduciary duties and make investment decisions in their clients' best interests.

A related argument is that TPLF increases the volume of litigation generally.¹¹⁵ TPLF does propose to give some plaintiffs access to the civil justice system that they otherwise would not have. Empirical evidence suggests, however, that the majority of TPLF agreements are entered into after a case has been filed.¹¹⁶ While plaintiffs may file a case they otherwise would not file in hopes of retaining financing, the amount of parties willing to take this risk is unlikely to contribute to a significant overall increase in litigation. Furthermore, most TPLF agreements are the result of attorney referrals.¹¹⁷ To this day, many successful attorneys with large portfolios of contingent fee cases are not even aware the TPLF industry exists. Its relative obscurity weakens the idea that it is currently abused to increase the general volume of litigation.¹¹⁸

B. Consumer Vulnerability

There is a concern that the consumer legal funding market wrongfully takes advantage of consumers.¹¹⁹ As previously mentioned, the consumers in this area are usually victims of accidents.¹²⁰ These are individuals without the financial and business acumen to effectively negotiate agreements with sophisticated providers in this area. Providers argue that the exorbitant rates charged are appropriate for the risks taken, but some question the actual extent of risk involved.¹²¹ Proponents of the consumer legal funding industry argue that they provide credit to high-risk consumers who would not be able to obtain credit otherwise.¹²² Such a subprime consumer credit market exists in the form of payday loans and other services which have been heavily regulated or outright prohibited by many states. As the consumer legal funding industry lacks many substantive regulations found in

114. STAFF OF THE INVESTMENT ADVISER REGULATION OFFICE, U.S. SEC. & EXCHANGE COMM'N, REGULATION OF INVESTMENT ADVISERS BY THE U.S. SECURITIES & EXCHANGE COMMISSION 22 (2013), http://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf.

115. See Rodak, *supra* note 54, at 519.

116. *Id.*

117. See *id.*

118. See *id.*

119. See Garber, *supra* note 14, at 12.

120. See *supra* text accompanying note 8.

121. See Cristina Merrill, *Judgment Call: Firms That Lend to Personal-Injury Plaintiffs Take Steps to Improve Their Bad-Guy Image*, CRAIN'S N.Y. BUS., Jan. 27, 2003 (questioning whether the risk is great enough to justify high rates).

122. See Rodak, *supra* note 54, at 514.

the prime lending market, this Note proposes a regulatory solution: the outright prohibition of the consumer legal funding market.

C. *Lawyers' Ethical Obligations*

The most concerning issues raised regarding the TPLF industry are the perceived conflicts of interest it creates between attorneys, litigants and funders as well as its effect on lawyers' ability to conform to rules of professional responsibility. These issues were treated extensively in the ABA Commission's White Paper on Alternative Litigation Finance.¹²³ Two scenarios and associated concerns are repeated in the literature discussing the TPLF industry's potential effects on ethical obligations. First, exchanges of information between the provider and the litigant before an agreement is consummated have the potential to waive the crucial attorney-client and work-product privileges.¹²⁴ In order to conduct the due diligence necessary to make successful investments, TPLF providers seek information about a case before agreeing to fund it.¹²⁵ The provision of privileged information to a third party functions to waive the specific privilege associated with the information.¹²⁶ Avoiding waiver of these privileges is absolutely crucial, and attorneys must take special care to ensure they remain intact. TPLF providers argue that much of the information they seek is factual in nature and therefore discoverable by the party's opponent in any case.¹²⁷ They argue that while many TPLF providers in the UK seek counsels' legal opinions and analysis of the underlying case, a successful TPLF provider does not rely solely on counsels' legal analysis but independently analyzes the merits on their own.¹²⁸ The ability to accurately and independently analyze the merits of a case is crucial to the success of TPLF providers because litigants and their attorneys have an incentive to couch their case in as favorable terms as possible in order to secure funding. Additionally, TPLF providers argue that information exchanges can be carefully structured so as to avoid the waiver of any privilege.¹²⁹ In fact, other industries have confronted and successfully avoided this

123. ABA COMM'N ON ETHICS 20/20, *supra* note 85.

124. See MOLOT, *supra* note 18, at 13; see also Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367, 381, 390-92 ("[T]here are work product and privilege issues that must be addressed if information is to be shared with a third party seeking to price and assume litigation risk from a defendant.").

125. See Lazar Emanuel, *Overall View of Litigation Funding Industry*, N.Y. LEGAL ETHICS REP. (Feb. 1, 2011), <http://www.newyorklegalethics.com/an-overall-view-of-the-litigation-funding-industry/>.

126. See MODEL RULES OF PROF'L CONDUCT r. 1.6 cmt. 18 (AM. BAR ASS'N 1983).

127. MOLOT, *supra* note 18, at 13.

128. *Id.*

129. *Id.*

very problem.¹³⁰ Collaborations with TPLF providers should not be treated any differently than discussions about a defendant's case with its insurer. Moreover, exchanges of information are almost exclusively carried out according to confidentiality agreements. Disclosure of information to a potential source of funding under a confidentiality agreement should not meaningfully risk exposure of that information to an adversary and therefore does not waive the crucial privileges protecting that information.¹³¹ The public policy considerations behind protecting privileges in this type of information exchange are strong. Statutes enacted in Alaska and California to solve this problem in the context of insurance are exemplary.¹³²

The second major area of concern results from TPLF providers reserving control over litigation decisions. Some providers attempt to exercise control over the litigation they are invested in, ostensibly to protect their investment.¹³³ Typical reservations of control extend as far as choice of counsel and direction of litigation strategy including settlement negotiations. Some TPLF providers, however, recognize the dangers associated with retaining this type of control and advertise themselves as purely passive providers of financing.¹³⁴ The retention of control over decision-making by TPLF providers interferes substantially with a lawyer's independent professional judgment. According to rules of professional responsibility, lawyers must at all times maintain their "independent professional judgment."¹³⁵ Ceding control over decisions informed by such judgment almost certainly runs afoul of model rules of professional conduct. The regulatory solution proposed in this Note attempts to ensure that lawyers are able to freely exercise their independent professional judgment once a provider gets involved. The absolute prohibition of any type of control over litigation and decision-making by attorneys and litigants is a necessary component of any successful regulatory scheme applicable to the TPLF industry.¹³⁶ While some ethical issues exist outside of this context,¹³⁷ they are eminently more manageable.

130. See John P. Ludington, Annotation, *Insured-Insurer Communications as Privileged*, 55 A.L.R. 4th 336, § 2 (1987) (discussing the attorney-client privilege in the insurance context).

131. See *id.*

132. See ALASKA STAT. § 21.96.100(e) (2015); CAL. CIV. CODE § 2860(d) (West 2015).

133. See Burch, *supra* note 39, at 1320-21.

134. See *Anglo-Dutch Petroleum Int'l, Inc. v. Haskell*, 193 S.W.3d 87, 104 (Tex. Ct. App. 2006) (discussing the lack of evidence that the provider exercised any control over the lawsuit); ABA COMM'N ON ETHICS 20/20, *supra* note 85, at 26.

135. MODEL RULES OF PROF'L CONDUCT r. 1.2 (AM. BAR ASS'N 1983).

136. See BEISNER & RUBIN, *supra* note 94, at 12; MAVRAKIS, *supra* note 96, at 6, 8.

137. Other issues include potential waiver of privileges, confidentiality, and conflicts of interest.

Further, retention of control over decision-making has the potential to create confusion surrounding which party is truly driving the litigation.¹³⁸ Courts acknowledge that “hidden funding can introduce a dynamic into a plaintiff’s case—an agenda unrelated to its merits, a resistance to compromise—that otherwise might not be present and, unless known, cannot be managed or evaluated.”¹³⁹ This dynamic is incredibly concerning in a landscape where TPLF providers are free to retain whatever control they are able to negotiate away from litigants and their counsel. A sufficient prohibition on retention of this type of control should be enough to ameliorate the issues in that context. Severe restriction or outright prohibition of the consumer legal funding industry will address the concerns regarding vulnerability of consumers. Imposing fiduciary duties on TPLF providers will address concerns regarding facilitation of frivolous claims. Conflicts of interest and other ethical challenges are raised throughout the industry, but TPLF transactions can be carefully structured to avoid these issues. Even where these precautions are taken, however, there exists a troubling dynamic in relation to the effect of financing on settlement incentives.

V. EFFECT ON SETTLEMENT

Settlement is a crucial part of the American system of justice. The vast majority of cases do not reach trial and are instead resolved by alternative dispute methods. Less than ten percent of cases in the United States are decided at trial.¹⁴⁰ The extent to which our justice system embraces the settlement of cases, like the TPLF industry, has its critics and proponents. Settlement is encouraged by a number of factors present in our judicial system, including court rules of procedure and judges’ ability and willingness to participate in and facilitate settlements. Settlement is viewed as a way to resolve legal disputes with increased efficiency while preserving scarce judicial resources.¹⁴¹ Trials are considered wasteful since both sides expend arguably unnecessary funds and resources going to trial.¹⁴² Settlement also avoids the emotional cost involved in seeing a trial through to verdict, including all opportunity costs associated with doing so. Critics of settlement argue that trials educate the public and that the increasingly private nature of settlement reduces the transparency of and public access to the justice system.¹⁴³ Bargaining imbalances of-

138. See Letter from Lisa A. Rickard, *supra* note 99, at 2-3.

139. See *Conlon v. Rosa*, 12 LCR 292, 293 (Mass. Land Ct. 2004).

140. Rodak, *supra* note 54, at 519.

141. See *id.* at 521.

142. *Cf. id.* (noting that settlements “optimiz[e] . . . economic efficiency”).

143. *Id.*

ten present in settlement negotiations have been criticized as preventing the equal application of justice.¹⁴⁴ Despite these contentions, the modern American justice system continues to embrace and promote settlement. For this reason, it is important to understand how TPLF will affect parties' incentives to settle cases.

Inherent bargaining imbalances exist between parties in legal proceedings. One party often enjoys far more resources than the other,¹⁴⁵ facilitating informational asymmetries.¹⁴⁶ Other than strict pecuniary differentiation, risk preferences also vary widely among litigants. A one-time litigant will approach the litigation process in a wildly different manner than a repeat litigant, even if they enjoy similar resources. Sometimes the weaker party is the plaintiff, who cannot credibly threaten to go to trial against a well-heeled corporate defendant. Other times the weaker party is the defendant, who cannot risk a larger-than-anticipated adverse judgment or is distracted by other business dealings.¹⁴⁷ These dynamics are often the driving force behind settlement despite being unrelated to the merits of the underlying proceeding. A judicial system that values justice above all should be concerned with the extent to which cases are resolved based on bargaining imbalances completely unrelated to the merits of the case. Plaintiffs who have meritorious claims but few resources are often induced to settle at an amount that under-compensates for their true injury.¹⁴⁸ Defendants who are unable to bear the risk of an adverse settlement in a class action suit will often overpay in their settlement.¹⁴⁹ If either party can credibly threaten to go to trial, they gain leverage at the negotiating table. TPLF providers level the playing field by enabling companies with valid claims or defenses but few resources to obtain fair settlements.

By removing the competitive advantage that one party has over another in litigation, the TPLF industry will affect parties' settlement incentives. Both critics and supporters of TPLF see support for their perspective in how TPLF affects settlement incentives.¹⁵⁰ Supporters claim that because TPLF levels the playing field as far as resources and risk preferences, more claims will be resolved according to the merits of the suit, regardless of whether the suit is settled or taken to trial.¹⁵¹ This would mean previously under-compensated

144. See Owen M. Fiss, Comment, *Against Settlement*, 93 YALE L.J. 1073, 1075-76 (1984).

145. *Id.* at 1076.

146. See MOLOT, *supra* note 18, at 4-5.

147. See *id.* at 5.

148. See *id.*

149. See *id.*

150. See Rodak, *supra* note 54, at 520.

151. See MOLOT, *supra* note 18, at 2-3.

plaintiffs would receive their proper due, while overpaying defendants would only be liable for the actual amount of damage they are responsible for.¹⁵² Detractors, however, raise two troubling effects TPLF may have on settlement incentives. Terms of financing will without a doubt affect a litigant's decision to settle. A rational litigant may be reluctant to accept what might otherwise be a reasonable settlement offer in consideration of its obligation to repay a TPLF provider.¹⁵³ Further, the nonrecourse nature of financing compounds this issue as litigants will be ambivalent between settling for less than the amount owed to the provider and losing at trial.¹⁵⁴ In each case where financing has been provided, the litigant will be able to calculate a break-even number that essentially sets a floor on the amount the litigant is willing to settle for.¹⁵⁵ For these reasons, critics claim the TPLF industry deters settlement, frustrating the beneficial effects discussed above.

Interestingly, the presence of TPLF may also over-incentivize settlement. Depending on the terms of TPLF agreements, a plaintiff may have an incentive to settle early and for a low amount.¹⁵⁶ While some TPLF agreements tie repayment to the amount advanced or to the amount of any award, others include terms that link repayment to the amount of time elapsed between investment and resolution of the case. Still other TPLF repayment schedules provide for excessive interest rates.¹⁵⁷ If the transaction is structured so providers take a larger percentage of any award the longer a suit continues or charge exorbitant (and even increasing) interest rates as payments are made, a rational consumer will be incentivized to accept an early but low settlement offer even if it does not adequately compensate them according to the merits of the case. The issue lurking behind the consequences of TPLF on parties' settlement incentives is the extent to which these incentives prohibit attorneys from exercising their independent professional judgment. Settlement decisions are the prerogative of the client, but attorneys are expected to provide competent

152. *See id.* at 5.

153. *See, e.g.,* Rancman v. Interim Settlement Funding Corp., 789 N.E.2d 217, 218-20 (Ohio 2003) (discussing the potential effect on settlement incentives of provider's right to receive the first \$16,800 of suit proceeds).

154. Both scenarios result in the consumer receiving nothing.

155. *See* Weaver, Bennett & Bland, P.A. v. Speedy Bucks, Inc., 162 F. Supp. 2d 448, 451 (W.D.N.C. 2001) (stating that the plaintiff rejected a settlement offer because it was below the number necessary to break even when considering repayment obligations to the TPLF provider).

156. *See* ABA COMM'N ON ETHICS 20/20, *supra* note 85, at 27-28.

157. *See* Fausone v. U.S. Claims, Inc., 915 So. 2d 626, 627-28 (Fla. 2d DCA 2005) (discussing the need for regulation in the area of TPLF agreements after a plaintiff's repayment plan included a 200% interest rate).

advice to the client in their consideration of settlement offers.¹⁵⁸ In each of the above scenarios, a client could have acted reasonably either in rejecting a reasonable settlement offer or accepting an early, low offer. There are many aspects that inform a client's decision to settle, and the terms of a TPLF agreement should be added to the list. Attorneys are obliged to provide advice based on their client's best interests, all things considered. As the ABA acknowledged, "All fee arrangements create conflicts of interest to some extent."¹⁵⁹ TPLF does not create novel ethical issues. The issues it does create can be mitigated if only attorneys would act with care.

VI. REGULATORY SOLUTION

The TPLF industry boldly marries cutting edge financial analysis with the steeped-in-history traditional professionalism of the bar. This cross-discipline dynamic uniquely defines the industry and demands a tailored regulatory framework. Part of the confusion surrounding TPLF stems from the piecemeal approach to regulation taken by courts in interpreting the archaic legal doctrines discussed above.¹⁶⁰ Lawmakers in this country have yet to address regulation of the industry in a meaningful way despite numerous calls to do so. Intelligent regulation of this industry will achieve maximum protection for consumers and serve to streamline the industry's growth. Most important, it will protect the integrity of the American justice system.

The ILR proposed a federal regulatory scheme for the TPLF industry in 2012.¹⁶¹ That proposal suggested appointing the Federal Trade Commission ("FTC") as the federal agency responsible for regulating the TPLF industry and proposed a number of interesting substantive regulations,¹⁶² some of which are foundational and therefore also adopted in this proposal. The most logical approach to regulation of the TPLF industry is, for all of the reasons discussed in the ILR proposal, to establish a new statutory scheme authorizing a federal administrative agency to regulate the industry. This is preferable to a state-by-state regulatory framework, exemplified by the insurance industry or by state blue-sky securities laws.¹⁶³ Instead of the FTC, however, the Securities and Exchange Commission ("SEC") is

158. See MODEL RULES OF PROF'L CONDUCT r. 1.2(a) (AM. BAR ASS'N 1983).

159. See ABA COMM'N ON ETHICS 20/20, *supra* note 85, at 28.

160. See discussion *supra* Section III.A.

161. See MAVRAKIS, *supra* note 96.

162. See *id.*

163. Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 FLA. ST. U. L. REV. 625, 629 (1999).

in a much better position to regulate the TPLF industry because TPLF providers are very similar to entities the SEC already regulates: hedge funds and investment advisers. As previously mentioned, TPLF providers approach the provision of financing as an investment, conducting significant due diligence before advancing funds,¹⁶⁴ just like hedge fund and investment advisers do. Moreover, the SEC has already promulgated many regulations for broker-dealers and investment advisers that are applicable to the TPLF industry such as custody and net capital requirements as well as books and records requirements.¹⁶⁵ This Note accordingly proposes that TPLF providers be required to register with the SEC as investment advisers.

First, investment advisers are fiduciaries. They are obligated to make investment decisions in their clients' best interests.¹⁶⁶ If all TPLF providers are required to be fiduciaries, many of the ethical problems discussed in this Note will be mitigated. Second, the SEC's already established regulatory framework for broker-dealers and investment advisers aims to achieve many of the same goals as potential regulation of the TPLF industry. These aims include the collection of necessary data on regulated entities, deterrence of and protection from fraud, prevention of unfit persons from managing regulated entities, and adoption of compliance procedures necessary to protect consumers.¹⁶⁷ Because these frameworks are already established, there will be significantly less work involved in tailoring these laws and regulations to the TPLF industry as compared with the wholesale creation of a regulatory framework under the FTC. SEC regulations may be incorporated by reference, achieving the same effect as if an entire framework were created from scratch under the FTC. These rules will require TPLF providers to maintain specific policies and procedures regarding privacy, codes of ethics, management processes, funding procedures, the accuracy of disclosures, and compliance programs.¹⁶⁸ These policies and procedures will ensure TPLF providers comply with the federal statutory framework to be created contemporaneously. There still remain certain issues unique to the TPLF industry that such a comprehensive regulatory regime must address.

164. See *Funding Overview*, *supra* note 13; see also *supra* text accompanying notes 13, 109-12.

165. See generally Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 to 80b-20 (2012).

166. 3 HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW § 23:119.55 (2d ed.), Westlaw (database updated Mar. 2016).

167. James J. Frolik & Douglas L. Hammer, *SEC Requires Hedge Fund Managers to Register as Investment Advisers*, SCHWAB INSTITUTIONAL, May 2005, at 1, 3, <http://www.sflaw.com/wp-content/uploads/2016/02/JFrolik-Compliance-Review-May-2005.pdf>.

168. *Id.* at 4-5.

TPLF agreements should be discoverable. As previously mentioned, the ILR has recently proposed an amendment to the Federal Rules of Civil Procedure that would accomplish this.¹⁶⁹ The Committee agreed to consider the proposal. If TPLF is to become a permanent fixture in American civil litigation, its use should be transparent. Transparency will enable courts to ensure compliance with ethical obligations, protecting the integrity of the judicial system. It will also inform parties as to who is really on the other side of an action.¹⁷⁰ Further, the disclosure of agreements will inform courts' decisions regarding whether to impose cost-shifting measures in cases with onerous discovery.¹⁷¹ Finally, the ILR argues disclosure of TPLF agreements will also inform courts' decisions about whether and to what extent to impose sanctions.¹⁷²

TPLF providers should be prohibited from exercising control over any aspect of the litigation process.¹⁷³ They should not be able to control the filing of the lawsuit, selection of counsel, recruiting of witnesses, or settlement decisions. A disclosure in an Oasis Legal Funding agreement is instructive:

PURCHASER OASIS LEGAL FINANCE, LLC, AS THE COMPANY AGREES THAT IT SHALL HAVE NO RIGHT TO AND WILL NOT MAKE ANY DECISIONS WITH RESPECT TO THE CONDUCT OF THE UNDERLYING LEGAL CLAIM OR ANY SETTLEMENT OR RESOLUTION THEREOF AND THAT THE RIGHT TO MAKE THOSE DECISIONS REMAINS SOLELY WITH YOU AND YOUR ATTORNEY IN THE CIVIL ACTION OR CLAIM.¹⁷⁴

This single prohibition will have a positive and far-reaching effect on the TPLF industry. It will ensure consumers' rights are protected during the course of litigation and that TPLF providers act ethically and do not increase the cost of proceedings. By ensuring that litigants make independent strategic decisions with the advice of counsel, all parties involved in the transaction benefit.

Law firms and lawyers should be prohibited from referring clients to TPLF providers in which they have any type of financial interest.¹⁷⁵ Lawyers should also be prohibited from benefitting financially from the referral of clients to TPLF providers.¹⁷⁶ TPLF companies are

169. Letter from Lisa A. Rickard, *supra* note 99, at 1, app. A.

170. *Id.* at 2-3.

171. *Id.* at 4.

172. *Id.* at 6.

173. BEISNER & RUBIN, *supra* note 94, at 12.

174. ABA COMM'N ON ETHICS 20/20, *supra* note 85, at 26 n.96.

175. *See* BEISNER & RUBIN, *supra* note 94, at 11.

176. *See id.*

often publicly traded or supported by popular investment funds in which judges, jurors, and attorneys may have financial interests. This requirement will function as a corollary to the above disclosure requirement and will assist in the identification of potential ethical issues.

VII. CONCLUSION

There is evidence of a shift in the overarching perception of the practice of law from a profession above the ethics of the marketplace to a business with a focus on the bottom line. Some attorneys embrace the shift, joining large law firms that seek to resemble hedge funds and other profit-making ventures by focusing on advertising, cutting costs, and collecting revenue. Many lawyers, however, continue to view themselves as professionals rather than businessmen. Business is inherent in the practice of law. Some lawyers just choose to ignore it. When lawyers offer alternative fee arrangements to their clients, they are offering services entirely separate and apart from their legal expertise. By assuming the entire responsibility of risk management and financing, the TPLF industry will allow lawyers to focus entirely on providing high quality legal services. TPLF is an emerging industry that has much to offer the evolving legal profession and the business clients it serves. The embrace of an intelligent regulatory scheme will serve to cultivate the positive aspects of the industry while maintaining the integrity of the legal profession and our justice system.

