Federal Regulation of Third-Party Litigation Finance

Third-party litigation finance has become a powerful and influential industry that will continue to play a significant role in shaping the legal landscape for years to come. The opportunities—and challenges—introduced by this burgeoning industry are legion, and with them has come a swath of disparate state regulations. These regimes have failed to balance important consumer- and commercial-lending protections with facilitation of the growth of an industry that is essential to increasing access to the courtroom.

In response, this Note contends that a federal agency, the Consumer Financial Protection Bureau, should be delegated the authority to promulgate regulations (1) capping interest rates at a percentage in line with fair commercial practices, (2) expressly prohibiting financier control over litigation decisions, and (3) limiting the information that financiers can request from their clients. Additionally, this Note proposes amending the Federal Rules of Civil Procedure to mandate disclosure of litigation-finance agreements in all cases.

INTRODUCTION

At the risk of stating the obvious, it is worth reminding ourselves that litigation is expensive and that litigants often struggle to meet the expenses of the moment while they await disposition of their cases. To bridge this gap, plaintiffs and defendants alike are increasingly turning to a relatively new source of liquidity: their legal claims. This practice is known as third-party litigation financing ("TPLF"), and it occurs when someone other than the party, the party's attorney, or a party with a preexisting contractual relationship (i.e., an indemnitor or insurer) agrees to provide financing for a dispute.[1] The financing is for profit and is generally nonrecourse, which means that a party is obligated to repay the "investment" only if its lawsuit is successful.[2] TPLF is based on the notion that a legal claim can be treated as an investment, wherein financiers stand to realize immense profits[3] through an investment unlike the stock market or any other asset class.[4]

1. Although there is no universally accepted definition of third-party litigation finance, such agreements share several common traits. *See* Bernardo M. Cremades Román, Jr., *Usury and Other Defenses in U.S. Litigation Finance*, 23 KAN. J.L. & PUB. POL'Y 151, 151–52 (2014) ("Third-party funding agreements typically share five common requirements: (i) a cash advance; (ii) made by a non-party; (iii) in exchange for a share of the litigation or arbitration proceeds; (iv) whether in settlement or judgment or award; and (v) payable at the time of recovery if, and only if, such recovery takes place.").

2. *Id.* at 151.

3. For example, Burford Capital, the world's largest litigation financier, reported in 2017 that "[i]n those eight years [since Burford was founded], Burford ha[d] gone from an £80 million start-up to one of the 250 largest public companies listed in London with a market capitalisation well in excess of $2 billion." BURFORD CAPITAL, 2017 INTERIM REPORT 3 (2017), http://www.burfordcapital.com/wp-content/uploads/2017/07/BUR-27947-Interim-Report-2017_web.pdf [https://perma.cc/Q23A-37HM].

4. *See* Anne Rodgers et al., *Emerging Issues in Third-Party Litigation Funding: What Antitrust Lawyers Need to Know*, ANTITRUST SOURCE, Dec. 2016, art. 2, at 1–2, https://www.americanbar.org/content/dam/aba/publishing/antitrust_source/dec16_full_source.authcheckdam.pdf [https://perma.cc/7NCP-A4F4] (examining the unique opportunities presented by lawsuit investment).

Individuals and corporate entities alike are drawn to this newfound source of liquidity in their claims for many reasons. TPLF plays a significant role in providing access to the courtroom for many types of parties—from the relatively unsophisticated personal-injury plaintiff needing to keep the bills paid until her claim is resolved, to the sophisticated large company seeking capital to offset the risk and hefty expense of litigation.[5] Litigants' interests in funding, paired with investors' potential for immense returns on investment, have spurred the expansion of the litigation-finance industry, with the bulk of investments lying in almost all areas of commercial litigation.[6]

Litigation finance is a rapidly evolving industry that infuses billions of dollars into the judicial system every year, and yet no comprehensive scheme of regulation has emerged in response.[7] At present, regulation of this industry consists of a patchwork of state statutes and judicial decisions under which access to funding varies dramatically. In states like Florida, New York, Ohio, and Texas, litigation funding is expressly permitted and widely available.[8] By embracing TPLF, these states have exposed themselves to a range of problems, including the potential for increases in both frivolous lawsuits and undue influence by financiers over litigation decisions.[9] In other states, like Alabama, Colorado, Kentucky, and Pennsylvania, litigation finance is either severely restricted or altogether unlawful.[10]

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5. *See* Michael Abramowicz, *Litigation Finance and the Problem of Frivolous Litigation*, 63 DEPAUL L. REV. 195, 195–96 (2014) ("Typically, a litigation finance company will give a plaintiff who otherwise might not be able to afford a lawsuit the funds needed to cover legal expenses.").

6. *See* Rodgers et al., *supra* note 4, at 2 (discussing the litigation-finance industry's ventures into a broad range of commercial cases).

7. *See* Paul Barrett, *The Business of Litigation Finance Is Booming*, BLOOMBERG BUSINESSWEEK (May 30, 2017, 4:00 AM), https://www.bloomberg.com/news/articles/2017-05-30/the-business-of-litigation-finance-is-booming [https://perma.cc/FZ3F-VQBA] (noting that Burford Capital had $378 million in new litigation investments in 2016 and that "Burford alone has more than $2 billion in capital invested or available to be invested"); Elizabeth Olson, *Lack of Capital to Lead Law Firms to Seek Help, Survey Finds*, N.Y. TIMES (May 3, 2016), https://www.nytimes.com/2016/05/04/business/dealbook/lack-of-capital-to-lead-law-firms-to-seek-help-survey-finds.html [https://perma.cc/97Y9-TZAR] (discussing the results of a litigation-finance survey indicating that more companies will begin utilizing litigation finance to "fuel growth").

8. Texas is one example of a state regime that is friendly to litigation finance. It does not regulate litigation finance and has case law permitting litigation-finance agreements. *See* Anglo-Dutch Petroleum Int'l, Inc. v. Haskell, 193 S.W.3d 87, 101, 104–05 (Tex. App. 2006) (holding that litigation-funding contracts that permit an investor to recover only if the client recovers are neither usurious nor contrary to Texas public policy). For further discussion of how these states regulate TPLF, see *infra* Section III.B.

9. For further discussion of concerns and criticisms related to permitting litigation finance, see *infra* Part II.

10. For an example of a state regime that restricts access to litigation funding, see Boling v. Prospect Funding Holdings, LLC, No. 1:14-CV-00081-GNS-HBB, 2017 U.S. Dist. LEXIS 48098, at *14 (W.D. Ky. Mar. 30, 2017) (holding that litigation-finance contracts violate a Kentucky statute

The lack of access to litigation funding in such states works to deprive plaintiffs of an effective means of bringing meritorious claims.[11]

In light of the important interests at play in this burgeoning industry, this Note advocates for the implementation of federal TPLF regulation. This Note contends that there are many desirable aspects of litigation finance and that a federal regulatory solution is the best means of promoting these beneficial aspects while mitigating potential downsides.[12]

Two chief principles guide this venture. First, regulation of TPLF must occur at the federal level. The current multitude of state regimes creates a demonstrable lack of uniformity in consumer protection and access to funding.[13] Uniformity is desirable both to protect equal access to the courtroom and to ensure that financiers across the United States are subject to the same consumer-protection standards. Further, TPLF is well suited to federal regulation because it functions in a manner very similar to, and therefore poses many of the same issues as, those sorts of loan, investment, and credit arrangements that the federal government has long had a hand in regulating.[14] Essential regulatory and procedural safeguards must be put in place at the federal level to uniformly protect the interests of both consumers and the TPLF industry. Second, there is an inherent tension between protecting consumer interests and promoting the business interests of the TPLF industry. The palatability of regulation for all parties involved, insofar as a regulatory proposal might be successfully implemented, depends on protecting properly defined consumer interests without unduly hampering the TPLF industry's ability to operate and grow.

Specifically, this Note proposes that the Consumer Financial Protection Bureau ("CFPB") be charged with administering the TPLF regulatory regime. To successfully effect the aforementioned guiding principles, three regulatory safeguards must be implemented: (1) interest rates must be brought in line with fair commercial practices,

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proscribing champerty). For further discussion of how these states regulate TPLF, see *infra* Section III.A.

11. For further discussion on concerns related to limiting access to litigation funding, see *infra* Part II.

12. This Note assumes that the litigation-finance industry has become so fixed in the U.S. judicial system that it will continue to play an important role in shaping the judicial landscape, even though the practice remains contentious. This Note thus primarily analyzes *how* TPLF should take place; for a discussion of *why* TPLF should be permitted, as well as common criticisms of TPLF, see *infra* Part II.

13. For further discussion of the varying state approaches to TPLF, including how these approaches impact consumer protection and access to funding, see *infra* Part III.

14. For an analysis of how TPLF is similar to other areas that are subject to federal regulation, see *infra* Part IV.

(2) financier control over litigation decisions must be expressly prohibited, and (3) the information that financiers can request from their clients must be limited so as to avoid conflict-of-interest issues related to attorney work product and the attorney-client privilege. Additionally, this Note proposes an amendment to the Federal Rules of Civil Procedure that would mandate disclosure of TPLF agreements in all litigation.

Part I examines the historical foundation and modern practice of litigation finance. Part II then identifies the most important issues in the TPLF debate and concludes that litigation financing is a desirable practice. Part III illustrates the multitude of ways in which states have implemented TPLF regulation. Finally, Part IV considers the constitutional authority of the federal government to regulate litigation finance under the Commerce Clause; details why federal regulation is preferable to state; and proposes the aforementioned federal regulatory scheme, which would protect the interests of consumers and litigation financiers as well as the integrity of the judicial system as a whole.

I. TPLF PAST AND PRESENT: CHAMPERTY, USURY, AND THE MODERN FORM

To understand how and why litigation finance is used today, it is helpful to first understand how TPLF developed historically. This review begins with the often-forgotten common law doctrines of champerty and maintenance and the evolution of usury law.

A. Historical Bars to TPLF: The Prohibition on Champertous Agreements

At common law, the doctrines of champerty and maintenance have long prohibited the practice of TPLF.[15] Maintenance is defined as "[i]mproper assistance in prosecuting or defending a lawsuit given to a litigant by someone who has no bona fide interest in the case" or, in other words, the act of "meddling in someone else's litigation."[16] Champerty is a form of maintenance and refers to "[a]n agreement between an officious intermeddler in a lawsuit and a litigant by which the intermeddler helps pursue the litigant's claim as consideration for

15. *See* Jacqueline Sheridan, *Champerty and Maintenance in the Modern Era*, DINSMORE (Jan. 22, 2016), http://www.dinsmore.com/publications/champerty-and-maintenance-in-the-modern-era [https://perma.cc/L7CX-CEG2].

16. *Maintenance*, BLACK'S LAW DICTIONARY (10th ed. 2014).

receiving part of any judgment proceeds."[17] In total, "maintenance is helping another prosecute a suit," and "champerty is maintaining a suit in return for a financial interest in the outcome."[18]

These doctrines originated in ancient Greek and Roman societies and were later incorporated into English medieval law.[19] It was long believed that "a controversy properly concerned only the persons actually involved in the original transaction," and thus a general prohibition was observed that the intermeddling of a third party in a lawsuit voided the suit.[20]

These doctrines were incorporated into U.S. common law, but over time, they have weakened such that courts today are far less willing than their historical antecedents were to invalidate an agreement as champertous. Near the end of the nineteenth century, some courts began upholding agreements that were traditionally viewed as champertous. For example, in 1891, the Oregon Supreme Court in *Brown v. Bigne* held that an agreement by a third party to fund a suit was not champertous where a third party was induced by the plaintiff to fund the suit because the plaintiff could not fund the litigation himself.[21] Judge Bean neatly summarized the shifting view in the United States, noting that in England, "[s]o great was the evil of rich and powerful barons buying up claims, . . . that it became necessary . . . to prevent such practices, and to invoke in all its rigor the doctrine against champerty and maintenance."[22] But with regard to the United States, Judge Bean stated:

> In this country, where no aristocracy or privileged class elevated above the mass of the people has ever existed, and the administration of justice has been alike impartial to all without regard to rank or station, the reason for the ancient doctrine of champerty and maintenance does not exist, and hence has not found favor in the United States.[23]

The *Brown v. Bigne* court found that while a majority of the states continued to observe the doctrine of champerty, others had disregarded it entirely.[24] The court concluded that agreements that would traditionally be viewed as champertous are "not unlawful, unless . . . made for the mere purpose or desire of perpetuating strife and litigation."[25]

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17. *Champerty*, BLACK'S LAW DICTIONARY (10th ed. 2014).
18. *In re* Primus, 436 U.S. 412, 424 n.15 (1978).
19. Max Radin, *Maintenance by Champerty*, 24 CALIF. L. REV. 48, 48 (1935).
20. *Id.* at 54.
21. 28 P. 11, 13 (Or. 1891).
22. *Id.* at 12.
23. *Id.* at 12–13.
24. *Id.* at 13.
25. *Id.*

This trend continued gaining steam, and during the latter decades of the twentieth century, contingency fees became widely recognized and accepted as an exception to champerty.[26] Today, as the U.S. Court of Appeals for the Ninth Circuit recently noted, "The consistent trend across the country is toward limiting, not expanding, champerty's reach."[27] TPLF has proven to be no exception to this trend, as nearly half of all states now allow some form of litigation finance.[28] Through this doctrinal relaxation, TPLF agreements have risen to prominence as a form of "permissible champerty," though allowance of such agreements varies immensely among the states.[29]

For example, a Delaware superior court recently held that a plaintiff's agreement with a litigation funder, wherein the plaintiff received funding in exchange for a percentage of any future proceeds of the litigation, was not barred as champertous because the plaintiff retained ownership of the claim and the funder was given no authority to maintain the claim.[30] But in a Kentucky case involving a very similar funding arrangement, a federal district court held that a state statute proscribing champerty barred litigation-funding agreements.[31]

B. Historical Bars to TPLF: The Prohibition on Usury

Usury is defined as "the charging of an illegal rate of interest as a condition to lending money."[32] Under English law, the charging of any interest rate was illegal until the sixteenth century, at which time

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26. *See* Schnabel v. Taft Broad. Co., 525 S.W.2d 819, 825 (Mo. Ct. App. 1975) (dismissing claim in a case involving a contingency fee agreement because "there [was] no allegation that [the attorney] undertook to pay or protect the client from payment of the costs and expenses of litigation, an essential element of champerty properly pleaded").

27. Del Webb Cmtys., Inc. v. Partington, 652 F.3d 1145, 1156 (9th Cir. 2011).

28. *See* Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61, 122 (2011) (noting that "almost half of the jurisdictions in the United States allow some form of profit maintenance, and a few arguably have lifted all restrictions on maintenance under their common law").

29. For further discussion of the various statutory and judicial actions that states have taken with regard to TPLF agreements, see *infra* Part III.

30. *See* Charge Injection Techs., Inc. v. E.I. DuPont de Nemours & Co., No. N07C-12-134-JRJ, 2016 Del. Super. LEXIS 118, at *8–12 (Del. Super. Ct. Mar. 9, 2016) (holding that plaintiff was the "the bona fide owner of the claims in this litigation, and [litigation funder] Burford has no right to maintain this action").

31. Boling v. Prospect Funding Holdings, LLC, No. 1:14-CV-00081-GNS-HBB, 2017 U.S. Dist. LEXIS 48098, at *14 (W.D. Ky. Mar. 30, 2017).

32. *Usury*, BLACK'S LAW DICTIONARY (10th ed. 2014). In *Wilkie v. Roosevelt*, 3 Johns. Cas. 206, 206–07 (N.Y. Sup. Ct. 1802), Judge Thompson helpfully stated:

> Usury consists in extorting or taking a rate of interest for money, beyond what is allowed by law. It is not necessary that money should be actually advanced, in order to constitute the offence of usury, but any pretence or contrivance whatever, to gain more than legal interest, where it is the intent of the parties to contract for a loan, will make that contract usurious.

courts began to enforce loans with interest rates below the usury ceiling—ten percent at the time.[33] The usury ceiling continued declining over the next several centuries, reaching a low point of five percent in the nineteenth century.[34] As Professor Eric Posner has noted, "[P]arties at all times attempted to contract around the usury ceiling, but the courts of equity generally resisted the most obvious attempts at evasion, and the evidence indicates that the usury laws did restrict the small loan market."[35] In the United States, most states today have passed statutes establishing maximum interest rates (ranging from six to twenty percent)—which typically vary depending on the type of agreement—and penalties for usury.[36]

As early as 1830, the U.S. Supreme Court set forth the elements of a usurious transaction.[37] Establishing usury generally requires a showing of (1) a loan or forbearance of money, (2) an absolute obligation to repay the principal (not contingent on any event), and (3) greater compensation for the loan (e.g., interest) than is allowed under statute.[38] Litigation-funding agreements are typically structured as nonrecourse so as to avoid the second requirement, but such a structure has not always been entirely successful in protecting TPLF agreements from usury law.[39]

Because TPLF agreements are generally nonrecourse, courts have largely construed them as financing agreements rather than as loans.[40] Bernardo Cremades has argued that the underlying rationale rests on "the inherent contingent nature of such contracts or, more precisely, the risk born [sic] by the lender."[41] Cremades notes that "[s]uch risk, however, must be substantial and thus a mere colorable hazard will not preclude excessive interest charges from being usurious."[42] To avoid usury, a lender must be "subject to some greater

33. Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract*, 24 J. LEGAL STUD. 283, 312 (1995).

34. *Id.*

35. *Id.*

36. *See* Cremades, *supra* note 1, at 160.

37. *See* Lloyd v. Scott, 29 U.S. (4 Pet.) 205, 224 (1830) (identifying the requisite elements necessary to establish a usurious transaction as (1) "[a] loan either express or implied"; (2) "[a]n understanding that the money lent shall or may be returned"; and (3) "[t]hat a greater rate of interest than is allowed by the statute, shall be paid").

38. *See* Cremades, *supra* note 1, at 160.

39. *See* Bernardo M. Cremades Román, *Implications of Usury in Third-Party Litigation Funding*, MODEL LITIG. FIN. CONT. (Apr. 15, 2013), http://litigationfinancecontract.com/implications-of-usury-in-third-party-litigation-funding [https://perma.cc/47TJ-82V3].

40. Cremades, *supra* note 1, at 162.

41. Cremades, *supra* note 39.

42. *Id.*

hazard than the mere risk that the borrower might fail to repay the loan or that the security might depreciate in value," and to that end, some courts have found that litigation poses a substantial risk.[43]

Other courts have relied on usury laws to void TPLF agreements with excessive interest rates. For example, a New York trial court in a strict liability labor case found "low, if any risk" of the litigation funder not recovering and thought it "ludicrous to consider this transaction anything else but a loan."[44] In North Carolina, a state court of appeals found that a TPLF agreement was an investment but concluded that the investment constituted a "cash advance" subject to the state's usury law.[45] In total, the application of usury law to TPLF agreements, much like the doctrines of champerty and maintenance, varies significantly from state to state.

C. Defining the Modern Forms of TPLF

Today, TPLF comprises two chief funding subindustries—consumer and commercial—each with its own unique funding arrangements for different types of clients.[46] TPLF is typically provided to plaintiffs but is also available to defendants. The latter form is far less common, as it is considerably more difficult to value the likelihood of "success" for a defendant.[47]

Plaintiff funding is typically nonrecourse, which means that a plaintiff has no obligation to repay an advance if he loses his suit. Only if there is a recovery may the financier take the agreed-upon percentage along with interest accrued on the loan amount.[48] Defendant funding is generally structured as a reverse contingency fee, "whereby the capital provider receives an interest in the differential between a defendant's exposure and the amount of the claim that is ultimately paid."[49] For

43. *Id.*

44. Echeverria v. Estate of Lindner, No. 018666/2002, 2005 N.Y. Misc. LEXIS 894, at *22–23 (N.Y. Sup. Ct. Mar. 2, 2005).

45. Odell v. Legal Bucks, LLC, 665 S.E.2d 767, 780–81 (N.C. Ct. App. 2008).

46. Cremades, *supra* note 1, at 155.

47. *See Guide to Litigation Financing*, WESTFLEET ADVISORS 3–4, http://westfleetadvisors.com/wp-content/uploads/2018/11/WA-Guide-to-Litigation-Financing.pdf (last visited Jan. 20, 2019) [https://perma.cc/SJ5Z-MPYX] (discussing the types of parties and claims that typically receive TPLF).

48. *See FAQ*, BURFORD, http://www.burfordcapital.com/faqs/ (last visited Jan. 20, 2019) [https://perma.cc/3UKH-BH3Z] ("Our capital is almost always non-recourse—meaning that we do not earn an investment return if the underlying litigation is unsuccessful."); *Our Value Proposition*, JURIDICA INV. LTD, http://www.juridicainvestments.com/about-juridica/our-value-proposition (last visited Jan. 20, 2019) [https://perma.cc/9TTY-2R9L] (stating that Juridica provides nonrecourse capital to businesses and law firms).

49. *See Guide to Litigation Financing*, *supra* note 47, at 3 (detailing how defendant TPLF is used); *see also* Michael McDonald, *Litigation Finance for Defendants*, ABOVE L. (Mar. 28, 2017,

both plaintiff and defendant financing, the TPLF model allows parties to shift the risk of an unsuccessful suit to the litigation financier.[50]

TPLF is appealing primarily because it allows litigants to eliminate some of the risk of an unsuccessful suit. For TPLF to work as a business model, then, financiers must be able to evaluate the risk they are assuming; this includes the likelihood of both recovering litigation costs and profiting from their investments.[51] To determine whether a risk is justified, TPLF providers engage in a process of due diligence, the depth of which varies depending on the type of funding sought and the complexity of the claim.

1. Consumer-Litigation Financing

Consumer-litigation finance deals primarily with personal-injury, divorce, and small claims in which the plaintiff is typically not well funded.[52] During the course of litigation, and occasionally after resolution,[53] a plaintiff can receive nonrecourse funding at the cost of principal plus interest and fees out of the proceeds of the lawsuit.[54] The funding advanced usually ranges from $500 to $100,000, and interest

5:31 PM), https://abovethelaw.com/2017/03/litigation-finance-for-defendants/ [https://perma.cc/D6V7-KRUW] ("If the litigation finance firm wants to [fund a defendant], they assign an expected loss or damages amount to the case. Then any amount below the expected damages is the value generated by the litigation finance firm, which gets a portion of that value.").

50. COMM'N ON ETHICS 20/20, AM. BAR ASS'N, INFORMATIONAL REPORT TO THE HOUSE OF DELEGATES 6 (2012), https://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf [https://perma.cc/AJH8-EL97] [hereinafter ABA WHITE PAPER].

51. *See* STEVEN GARBER, RAND CORP., ALTERNATIVE LITIGATION FINANCING IN THE UNITED STATES: ISSUES, KNOWNS, AND UNKNOWNS 1, 24 (2010), https://www.rand.org/content/dam/rand/pubs/occasional_papers/2010/RAND_OP306.pdf [https://perma.cc/XCL5-PEKU] ("The main costs of ALF [alternative-litigation-financing] suppliers associated with a particular deal are costs associated with evaluating prospects for repayment (i.e., due diligence costs) and opportunity costs of capital (i.e., costs associated with having money tied up)." (emphasis omitted) (footnote omitted)).

52. *See* Maya Steinitz, *The Litigation Finance Contract*, 54 WM. & MARY L. REV. 455, 460 (2012) (noting that consumer-TPLF clients are typically less sophisticated than commercial-TPLF clients).

53. In some cases, it can take from several weeks to several years for a settlement to be paid, which prompts consumers in need of financial support to seek funding after the disposition of their cases. *See Post-Settlement Lawsuit Funding for Plaintiffs*, BALANCED BRIDGE FUNDING, https://www.balancedbridge.com/post-settlement-plaintiff-funding (last visited Jan. 21, 2019) [https://perma.cc/5P6R-2AFQ] (detailing the process of obtaining post-settlement funding).

54. *See* Paige Marta Skiba & Jean Xiao, *Consumer Litigation Funding: Just Another Form of Payday Lending?*, 80 LAW & CONTEMP. PROBS., no. 3, 2017, at 117, 117.

rates vary from two to fifteen percent per month (resulting in annual percentage rates[55] of over two hundred percent).[56]

Financing can be obtained in person or online, where a financier gauges the strength of a consumer's case by looking to factors such as the amount of potential damages, the likelihood of gaining a profitable settlement or winning at trial, and whether the consumer owes other debts or attorney's fees that would need to be satisfied first.[57] Upon recovery and after all other debts and obligations are paid, the attorney disburses repayment to the financier.

Consumer-TPLF plaintiffs are generally referred to as "unsophisticated," meaning they do not possess the same level of negotiating power as do larger commercial entities or law firms.[58] Scholars have expressed concern that this asymmetry exposes consumers to a greater risk of abusive practices than their commercial counterparts.[59] Such practices generally consist of either influence over litigation strategy or the charging of exorbitant interest rates, which would typically be illegal were this type of finance governed by most states' usury laws.[60]

Due diligence in consumer-litigation financing is fairly straightforward. It involves an assessment of the likelihood of a claim's success and any relevant debts that will need to be paid from the proceeds of the suit.[61] Because the average financing involved in consumer litigation is low, the amount of money a financier would be willing to spend on due diligence is also relatively low.[62] Predictably, reduced diligence results in a less complete picture of a plaintiff's

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55. Annual percentage rate ("APR") is "[t]he actual cost of borrowing money, expressed in the form of an annualized interest rate." *Annual Percentage Rate*, BLACK'S LAW DICTIONARY (10th ed. 2014).

56. Skiba & Xiao, *supra* note 54, at 122.

57. *See id.* at 122–23.

58. *See* Jennifer Anglim Kreder & Benjamin A. Bauer, *Litigation Finance Ethics: Paying Interest*, 2013 J. PROF. LAW. 1, 17–18 (suggesting that allowing private lenders to exercise a certain degree of control over litigation strategy may violate the Model Rules of Professional Conduct); *see also* Julia H. McLaughlin, *Litigation Funding: Charting a Legal and Ethical Course*, 31 VT. L. REV. 615, 648–49 (2007) (stating that numerous state bar associations and jurisdictions have issued opinions offering guidance on the ethical limits of third-party financiers' ability to control litigation strategy).

59. *See* McLaughlin, *supra* note 58, at 627 (discussing how legal scholarship has supported the use of litigation-finance agreements, despite "the unequal bargaining position of the customer and the LFC [litigation financier], the financial duress prompting the customer to sign an LLA [litigation-funding agreement], the usurious profit reaped by the LFCs, and the ethical pressures placed on the attorney-client relationship").

60. *See id.*

61. *See* Skiba & Xiao, *supra* note 54, at 123.

62. *See* GARBER, *supra* note 51, at 24–25 (noting that in consumer TPLF, "individual transactions in this segment are fairly small, perhaps in the range of $1,750 to $4,500").

likelihood of success, which increases the risk to consumer financiers through variations in returns on their portfolios.[63] For those consumer-TPLF providers with sufficient capital to fund many suits at once, however, "portfolio risk—that is, variation in the returns on the portfolio—can be fairly small because of risk pooling across deals."[64]

2. Commercial-Litigation Financing

Commercial-litigation finance is typically arranged for disputes involving antitrust, intellectual property, and business-contract issues.[65] Commercial-TPLF financiers normally provide funding directly to corporate plaintiffs in exchange for a share of the recovery, though funding may be extended to defendants as well.[66]

Commercial-TPLF clients employ TPLF services for several reasons. One is that TPLF can be used as a financing technique for budgetary or accounting-management purposes (where the party could afford the litigation costs otherwise).[67] Another reason commercial plaintiffs use TPLF is to overcome financial constraints in pursuing litigation.[68] This rationale typically applies to smaller businesses or individuals with commercial interests who could not ordinarily afford litigation.[69] TPLF can also be used "to obtain assessments of the legal merits and likely economic values of their claims to supplement those provided by their outside counsel."[70] Further, because obtaining financing may indicate to opposing parties that a claim has been judged to have considerable merit, "some companies might accept [TPLF] (and reveal this to the other side) in hopes of strengthening their bargaining positions in settlement negotiations."[71]

Investments in commercial-litigation finance tend to be much larger than in the consumer context, and financiers stand to obtain immense returns on their investments. While it is difficult to obtain information about the dealings of most commercial-litigation financiers, there is substantial information available about Burford Capital (the

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63. *Id.*

64. *Id.*

65. Steinitz, *supra* note 52, at 460.

66. *See* GARBER, *supra* note 51, at 13.

67. *See* Maya Steinitz & Abigail C. Field, *A Model Litigation Finance Contract*, 99 IOWA L. REV. 711, 716–17 (2014). Because wealthier individuals possess more capital and are generally more aware of their negotiating power, they are more "sophisticated" in the sense that they can even out their bargaining position relative to litigation financiers.

68. *Id.*

69. *Id.*

70. GARBER, *supra* note 51, at 15.

71. *Id.*

world's largest provider of commercial TPLF) and Juridica Investments, because both of these companies are subject to disclosure requirements as publicly traded corporations. Burford and Juridica both generally deal with large, wealthy companies that are seeking at least $2 million in funding. Burford's website indicates that "[c]lients, firms and Burford get the best value when the amount requested is at least $2 million. Most of our investments are between $4 and $10 million, and some are significantly larger."[72] Juridica's website states that "[i]nvestment size typically ranges from US $2,000,000 to US $10,000,000, although larger investments in exceptional opportunities or a portfolio of opportunities are made."[73]

Litigation-funding arrangements by Bentham IMF, another of the world's largest litigation financiers, provide one example of what commercial-TPLF agreements can look like. In a typical funding agreement for a single case, "Bentham will pay 50 percent of the client's legal fees in exchange for 20 percent of any recovery. The law firm agrees to defer the other 50 percent of its fees in exchange for also receiving a 20 percent interest in the recovery."[74]

Commercial-TPLF clients are generally more "sophisticated" than those in consumer financing. These clients include both companies and wealthy individuals who possess more resources than do consumer-TPLF clients and are more likely to recognize the negotiating power in their claims.[75] Because the parties in commercial TPLF have essentially equal negotiating power, it is far less likely that financiers will be able to take advantage of clients through excessive interest rates. Nevertheless, commercial TPLF still raises concerns of increased frivolous litigation and undue influence over litigation strategy.[76]

In the commercial context, the due diligence process is much more involved. Not only is there far more money on the line, but the litigation at issue in commercial TPLF tends to be more complex than in its consumer counterpart.[77] Thus, the cost of due diligence tends to be much higher. For example, Burford builds a comprehensive "risk

72. Emily O. Slater, *Demystifying the Litigation Finance Diligence Process*, BURFORD (Sept. 18, 2017), http://www.burfordcapital.com/blog/demystifying-litigation-finance-diligence [https://perma.cc/BR83-DWFH].

73. *Investment Policy*, JURIDICA INV. LTD, http://www.juridicainvestments.com/about-juridica/investment-policy.aspx (last visited Jan. 22, 2019) [https://perma.cc/32GE-R3PF].

74. Joan C. Rogers, *Litigation Funding on Rise in Big Cases, Panel Says*, BLOOMBERG (Mar. 23, 2017), https://www.bna.com/litigation-funding-rise-n57982085617 [https://perma.cc/J23B-4VB7].

75. *See* Steinitz & Field, *supra* note 67, at 716.

76. For further discussion of the criticisms of commercial-litigation funding, see *infra* Section II.B.

77. GARBER, *supra* note 51, at 26.

profile" for each client that assesses six separate criteria: (1) type of matter, (2) strength of the merits, (3) experience of counsel, (4) jurisdiction, (5) amount of capital required, and (6) expected recovery.[78]

Juridica engages in a similar process, where "[u]ltimately, Juridica seeks to invest in claims that are likely to be resolved through settlement in a reasonable time frame."[79] In 2010, Juridica's chairman and CEO stated that the due diligence process is "a very detailed and expensive process, averaging about 60 to 90 days" and that "Juridica spends an average of $75,000–$100,000 for each screening."[80] This expense can include the enlistment of outside legal resources for specific practice areas and economic and financial consultants to evaluate damages.[81]

II. COMMON OBJECTIONS TO TPLF

In February 2012, the ABA's Commission on Ethics 20/20 filed a white paper with the ABA House of Delegates that detailed the impact of TPLF on legal ethics.[82] The Commission found that "[t]he market for alternative litigation finance involves suppliers and customers who demand this form of financing" and that the use of TPLF "will undoubtedly continue to evolve."[83] Though ambivalent about the use of TPLF generally, the Commission reached essentially the same conclusion as this Note: that the TPLF industry is likely to continue growing and that special steps must be taken to protect clients using TPLF services.

The Commission limited its recommendations to legal ethics alone, but many of the ethical concerns they identified are helpful to both understanding what motivated the current patchwork of state

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78. According to Burford Capital's website, their risk profile includes an evaluation of whether

> [t]he case does not turn on a "he-said-she-said" credibility determination[, t]here is more than one viable legal theory that could lead to a recovery[, t]he legal theory is tested and has good support in statutory or case-law[, t]he case theory makes sense in the commercial context of the transaction or course of dealing[, t]he damages theory can be reasonably extrapolated from past performance of the damaged company or there is an established contract, statutory or royalty rate[, and t]he economics of the investment do not depend on the case settling early or on obtaining treble damages[.]

Slater, *supra* note 72.

79. *See Investment Policy*, *supra* note 73.

80. Ralph Lindeman, *Third-Party Investors Offer New Funding Source for Major Commercial Lawsuits*, FULBROOK CAP. MGMT., LLC (Mar. 10, 2010), https://fulbrookmanagement.com/third-party-investors-offer-new-funding-source-for-major-commercial-lawsuits [https://perma.cc/39WX-8PQX].

81. *Id.*

82. ABA WHITE PAPER, *supra* note 50.

83. *Id.* at 39.

regulations[84] and formulating an overarching federal regulatory solution.[85] To meaningfully approach these matters, it is useful, then, to first address the arguments supporting and opposing the practice of TPLF. This Part examines the most common arguments on both sides of the TPLF debate and explains why the criticisms are not insurmountable barriers to the use of litigation financing.

A. Increased Filing of Frivolous Claims

The oldest and most common objection to litigation finance is that the practice may increase the filing of frivolous claims. The Institute for Legal Reform ("ILR") has argued that "TPLF companies are mere investors—and they base their funding decisions on the present value of their expected return, of which the likelihood of success at trial is only one component."[86] The ILR argues that because litigation financiers can spread risk over a large number of cases in their portfolios, TPLF providers "can be expected to have higher risk appetites than most contingency-fee attorneys and to be more willing to back claims of questionable merit."[87]

In terms of commercial-litigation finance, concerns over frivolous litigation are entirely unfounded. Commercial-TPLF financiers engage in an expensive and time-consuming process of due diligence to ensure that claims are precisely the opposite of frivolous.[88] The objective of these financiers is to see a return on their investments, and investing in suits that already have a high likelihood of being dismissed during the pleadings or disposed of on summary judgment would make for a poor business practice.[89] To the contrary, then, the due diligence process yields the positive effect of promoting meritorious claims and facilitates the bringing of these claims.[90]

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84. *See infra* Part III.

85. *See infra* Part IV.

86. U.S. CHAMBER INST. FOR LEGAL REFORM, STOPPING THE SALE ON LAWSUITS: A PROPOSAL TO REGULATE THIRD-PARTY INVESTMENTS IN LITIGATION 4 (2012), https://www.instituteforlegalreform.com/uploads/sites/1/TPLF_Solutions.pdf [https://perma.cc/W4FS-X4A2].

87. *Id.*

88. *See supra* Section I.C.2 (examining the due diligence process in commercial-litigation funding).

89. *See* Douglas R. Richmond, *Litigation Funding: Investing, Lending, or Loan Sharking?*, 2005 SYMP. ISSUE PROF. LAW. 17, 27 (noting that "funding companies have no incentive to advance money to plaintiffs whose lawsuits might reasonably be described as frivolous because their chance of recovery is low").

90. *See id.* ("[B]ecause the merits of a case exist independent of a plaintiff's ability to afford litigation, prohibiting litigation funding will in some instances discourage meritorious lawsuits.").

Concerns about an increase in frivolous litigation are more salient in the consumer-TPLF context because of the model on which consumer financiers operate, but this is largely inconsequential. Although consumer financiers could conceivably be more likely to invest in frivolous suits because of both their ability to spread risk across many claims and their lesser ability to engage in due diligence, it is not at all obvious that relatively simpler consumer claims require the heightened diligence of commercial TPLF to serve this gatekeeping function. Moreover, other mechanisms prevent the filing and maintenance of frivolous litigation.

One such mechanism is Federal Rule of Civil Procedure 11. At the federal level, lawyers are required to certify that submissions to the court are not presented for an improper purpose, that arguments are nonfrivolous or supported by existing law, and that factual assertions have or are likely to have evidentiary support.[91] Failing to observe the rule can result in a range of sanctions, which include "nonmonetary directives; an order to pay a penalty into court; or, if imposed on motion and warranted for effective deterrence, an order directing payment to the movant of part or all of the reasonable attorney's fees and other expenses directly resulting from the violation."[92] Many states have adopted a similar rule and provide for similar sanctions.[93]

Another mechanism to prevent frivolous lawsuits is the ABA Model Rules of Professional Conduct, which most states have adopted in some form.[94] Rule 3.1 requires that "[a] lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis in law and fact for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law."[95] In the TPLF context, this rule and Federal Rule of Civil Procedure 11 both serve to prevent frivolous litigation by

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91. FED. R. CIV. P. 11(b).

92. FED. R. CIV. P. 11(c)(4).

93. *See, e.g.*, MASS. R. CIV. P. 11(a) ("The signature of an attorney to a pleading constitutes a certificate by him that he has read the pleading; that to the best of his knowledge, information, and belief there is a good ground to support it; and that it is not interposed for delay."); TEX. R. CIV. P. 13 (requiring that the signature of attorneys or parties certify "to the best of their knowledge, information, and belief formed after reasonable inquiry the instrument is not groundless and brought in bad faith or groundless and brought for the purpose of harassment" and that violators be held guilty of contempt).

94. For a list of states that have adopted the ABA Model Rules of Professional Conduct, see *Alphabetical List of Jurisdictions Adopting Model Rules*, A.B.A. (Aug. 17, 2018), https://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/alpha_list_state_adopting_model_rules.html [https://perma.cc/W4GD-P463]. Most states, however, amended the rules upon or after adoption. *See Jurisdictional Rules Comparison Charts*, A.B.A. (Oct. 30, 2018), https://www.americanbar.org/groups/professional_responsibility/policy/rule_charts.html [https://perma.cc/2SZY-2PP4].

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

disincentivizing lawyers from bringing such suits, thus limiting the ability of TPLF financiers to back them.

B. Improper Influence over Litigation Strategy

Another common objection to litigation finance involves TPLF's possible influence on litigation decisions and settlement incentives. This influence could be effected through two means. First, as the ILR has noted, "[T]he TPLF company [as an investor in a plaintiff's lawsuit] presumably will seek to protect its investment, and can be expected to try to exert control over the plaintiff's strategic decisions."[96] Second, because a TPLF consumer must pay the financier with the proceeds of the lawsuit, the consumer might feel pressured to resist settlement in hopes of receiving a larger sum of money.[97]

With regard to the first concern, most financiers are aware of the ethical issues this practice would raise and accordingly disclaim control over strategy or settlement decisions.[98] The ABA Model Rules of Professional Conduct also address this issue by restricting limitations on an attorney's independent judgment. According to commentary accompanying Rule 1.7, "Loyalty and independent judgment are essential elements in the lawyer's relationship to a client."[99] Additionally, Rule 1.8(f) states that a lawyer shall not accept compensation from a third party unless "there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship."[100] But given that these rules govern only attorney conduct, these measures alone are likely insufficient to mitigate concerns over financier control.

With regard to the second concern, litigation financing serves to lessen any resource disparity between the parties that might otherwise impact settlement decisions. Because financiers have a strong incentive not to fund frivolous litigation,[101] TPLF actually promotes the settlement of meritorious claims. This is because TPLF "forc[es] a recalcitrant defendant to approach a case reasonably and pragmatically in light of the fact that its adversary has the resources to meaningfully

96. *See* U.S. CHAMBER INST. FOR LEGAL REFORM, *supra* note 86, at 4–5.

97. *Id.* at 5.

98. *See FAQ*, *supra* note 48 ("We don't get any rights to manage the litigation in which we invest, unless a client sells us a judgment or engages us specifically to manage as well as finance litigation. . . . Nor do we get any rights to control the settlement of the litigation . . . .").

99. MODEL RULES OF PROF'L CONDUCT r. 1.7 cmt. 1.

100. MODEL RULES OF PROF'L CONDUCT r. 1.8(f).

101. *See* Richmond, *supra* note 89, at 27.

prosecute the matter."[102] Thus, while TPLF agreements may lead some plaintiffs to resist settlement based solely on their TPLF contracts, the benefits of TPLF in promoting the settlement of meritorious claims outweigh this burden.

Accordingly, this Note proposes a regulatory solution that details an absolute prohibition of any decisionmaking authority by the financier over strategic litigation decisions.[103] And to better alleviate concerns over settlement incentives, this Note also proposes several limitations on TPLF agreements to soften their influence on case disposition.[104]

C. Attorney-Client Privilege and Attorney Work Product Protection Waivers

Another significant concern is that communications between attorneys and TPLF financiers may constitute a waiver of attorney-client privilege or attorney work product protection.[105] By satisfying a financier's demands during the due diligence process, an attorney may be required to disclose information within the scope of the privilege or the work product doctrine, thus rendering the information discoverable by opposing counsel.[106]

This concern poses a real obstacle to the use of TPLF, but it can be managed, as financiers typically only request information that is ordinarily discoverable by the opposing party anyway.[107] To ensure this remains the case, this Note proposes express limitations on the types of information financiers may request, thus preserving these protections while still facilitating the ability of financiers to engage in due diligence.[108]

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102. *Id.*

103. *See infra* Section IV.C.

104. *See infra* Section IV.C.

105. *See* Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367, 381 (2009) ("[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."); *see also* U.S. CHAMBER INST. FOR LEGAL REFORM, *supra* note 86, at 6 ("TPLF investments compromise the attorney-client relationship and diminish the professional independence of attorneys by inserting a new party into the litigation equation whose sole interest is making a profit on its investment.").

106. *See* MODEL RULES OF PROF'L CONDUCT r. 1.6 (AM. BAR ASS'N 1983).

107. *See* Jonathan T. Molot, *The Feasibility of Litigation Markets*, 89 IND. L.J. 171, 186 (2014) ("[M]ost of the information that a third-party funder will need to evaluate a lawsuit is factual information of the sort that is discoverable by the adversary in any event.").

108. *See infra* Section IV.C.

III. THE "RULES" OF LITIGATION FINANCE: DIVERGENT STATE APPROACHES

Today, the "rules" of litigation finance are an amalgam of state-level legislative enactments and court decisions.[109] TPLF is not currently regulated at the federal level, and state regulation varies immensely. In 2007, Maine became the first state to pass legislation regulating litigation-finance agreements.[110] A number of states have since followed, including Oklahoma,[111] Nebraska,[112] and Ohio.[113] Several more states are presently considering legislation that would regulate TPLF agreements, and it is likely that the complex state-based framework of regulation will continue to grow.[114]

The broad range of state approaches to TPLF regulation has resulted in a number of substantive differences in how consumers and financiers across the country engage in TPLF. These differences arise from whether agreement-disclosure requirements are imposed, how underwriting is performed, and how private citizens obtain funding compared to corporations, among other differences.[115] Further, because states disagree over whether TPLF should be permitted in the first

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109. *See* Mikey Abts, *The Current State of Litigation Finance Legislation: Part 1*, LITIG. FIN. J. (June 2, 2017), https://litigationfinancejournal.com/current-state-litigation-finance-legislation [https://perma.cc/WS2S-9YHY] (examining the different attempts by state legislatures to regulate litigation finance).

110. *See* Maine Consumer Credit Code Legal Funding Practices, ch. 394, 2007 Me. Laws 965 (codified at ME. REV. STAT. ANN. tit. 9-A, §§ 12-101 to -107 (2008)); Steinitz & Field, *supra* note 67, at 714 (discussing early state efforts to regulate litigation financing).

111. OKLA. STAT. tit. 14A, §§ 3-801 to -817 (2018) (setting forth licensing and bond requirements for TPLF financiers, contract specifications, and a range of prohibited activities and conduct).

112. NEB. REV. STAT. § 25-3306 (2018) (establishing that communication between an attorney and TPLF provider as it pertains to nonrecourse litigation funding shall not "limit, waive, or abrogate the scope or nature of any statutory or common-law privilege, including the work-product doctrine and the attorney-client privilege").

113. OHIO REV. CODE ANN. § 1349.55 (West 2018) (establishing that TPLF agreements are valid and enforceable, provided they satisfy a number of contractual requirements).

114. South Carolina is one of the states currently considering regulating litigation finance. On February 8, 2017, legislation was introduced in the South Carolina Senate contemplating the imposition of certain requirements on consumer-litigation-funding companies. The legislation's stated goal is to

> require a consumer litigation funding company to make certain disclosures on a litigation financing contract, to prohibit a consumer litigation funding company from taking certain actions, to require a consumer litigation funding company to provide notice and documents to a consumer's attorney if the consumer is represented by counsel, and to require a consumer litigation funding company to submit an annual report containing certain information related to the company's business and operations.

S. 390, 122d Gen. Assemb., Reg. Sess. (S.C. 2017).

115. *See supra* notes 89–90 and accompanying text.

place, the ability of consumers to even obtain TPLF services is geographically dependent.

Sections III.A and III.B provide a broad outline of the various ways in which states have attempted to address and regulate TPLF. This list is not intended to be exhaustive; rather, its purposes are to highlight the more common state solutions to TPLF, to demonstrate the inherent tension among states' approaches, and to examine how the lack of uniformity impacts consumer and commercial interests across the country.

A. Prohibiting or Strongly Regulating TPLF

In terms of the regulation and enforceability of TPLF agreements, a number of states are widely regarded as being hostile to litigation finance. Through either judicial pronouncement or legislation, these states have prohibited or strongly regulated TPLF.

For those states that have dealt with litigation finance through judicial pronouncement, Alabama is perhaps the harshest. In *Wilson v. Harris*, the Alabama Court of Civil Appeals held that a litigation-finance agreement was void under an Alabama statute prohibiting gambling contracts and further held that TPLF is generally contrary to the public policy against champertous agreements.[116]

Colorado has also addressed litigation financing through judicial pronouncement. In *Oasis Legal Finance Group, LLC v. Coffman*, the Colorado Supreme Court held that TPLF agreements are loans (regardless of whether the duty to repay is on a contingency) and are thus subject to state usury laws.[117] In doing so, the court "effectively disregarded express contract provisions," and so "there is reason to think that Colorado courts will interpret litigation finance contracts very loosely and will not respect the strict terms of the agreement."[118]

Other states appear to have outlawed litigation-finance agreements through legislation. In Kentucky, the relevant statute provides:

> Any contract, agreement or conveyance made in consideration of services to be rendered in the prosecution or defense, or aiding in the prosecution or defense, in or out of court, of any suit, by any person not a party on record in the suit, whereby the thing sued for or in

116. 688 So. 2d 265, 270 (Ala. Civ. App. 1996).

117. 361 P.3d 400, 407–09 (Colo. 2015) (holding that the litigation-finance agreement "creates 'debt' because it creates an obligation to repay" and that an unconditional obligation to repay is not required to subject the agreement to state usury laws as a loan).

118. Michael McDonald, *The Best and Worst States for Litigation Finance (Part II)*, ABOVE L. (July 11, 2017, 5:33 PM), https://abovethelaw.com/2017/07/the-best-and-worst-states-for-litigation-finance-part-ii [https://perma.cc/R75T-3HQ2].

> controversy or any part thereof, is to be taken, paid or received for such services or assistance, is void.[119]

On its face, this statute would appear to render litigation-finance agreements void, though there is no Kentucky case law explicitly addressing this point. In a recent federal case, however, the U.S. District Court for the Western District of Kentucky surmised that the Kentucky Supreme Court would hold that litigation-finance agreements violate the Kentucky statute proscribing champerty and the public policy of the commonwealth.[120]

Finally, in some states that have begun to allow TPLF, strict requirements have been imposed on the amount of interest that litigation funders can charge.[121] For example, a Tennessee statute prohibits litigation financiers from charging an interest rate above ten percent.[122] In imposing such a limit on TPLF agreements, Tennessee has brought the practice more in line with the mainstream understanding of nonusurious interest rates.[123]

B. Allowing or Lightly Regulating TPLF

On the other end of the spectrum, many states are more welcoming (or at least less hostile) to the practice of TPLF. These states have largely addressed the practice through either judicial pronouncement or legislation as well, and at least one state has employed its attorney general's office to lightly regulate TPLF financiers.

Among the states that have addressed litigation funding through judicial pronouncement, the broadest endorsement comes from a Texas court of appeals, in *Anglo-Dutch Petroleum International, Inc.*

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119. KY. REV. STAT. ANN. § 372.060 (West 2018).

120. *See* Boling v. Prospect Funding Holdings, LLC, No. 1:14-CV-00081-GNS-HBB, 2017 U.S. Dist. LEXIS 48098, at *14 (W.D. Ky. Mar. 30, 2017) ("In light of the undecided question of Kentucky law at issue, the Court concludes that the Kentucky Supreme Court would hold that the Agreements violate Kentucky public policy and the statute proscribing champerty for the reasons articulated in *Stice*.").

121. *See* TENN. CODE ANN. §§ 47-16-101 to -110 (2018) ("All consumers entering into litigation financing transactions shall pay the litigation financier an annual fee of not more than ten percent (10%) of the original amount of money provided to the consumer for the litigation financing transaction."); VT. STAT. ANN. tit. 8, §§ 2251–2260 (2018); H.R. 1340, 119th Gen. Assemb., 1st Reg. Sess. (Ind. 2015) (stating that the bill "[s]ets forth certain requirements and prohibitions with respect to CPAP transactions, including limits on the funded amount and specifications for the CPAP contract amount").

122. TENN. CODE ANN. § 47-16-110(a).

123. See *supra* Section I.B for a discussion of modern usury laws.

v. Haskell.[124] There, the court held that TPLF agreements are generally enforceable and that usury laws do not apply to them.[125]

Like Texas courts, Florida courts have held that litigation-finance agreements are enforceable.[126] In *Kraft v. Mason*, a district court of appeal rejected the argument that the doctrine of champerty posed an absolute bar to litigation finance, but it did not explicitly recognize that usury laws do not apply to litigation-finance agreements.[127] It is unlikely, however, that usury law would be applied specifically to nonrecourse TPLF, as other Florida courts have held that nonrecourse lending is not subject to usury laws.[128]

New York courts have also expressly recognized the enforceability of litigation-finance agreements.[129] Additionally, the New York Bureau of Consumer Frauds and Protection, a division of the New York Attorney General's Office, has undertaken a light form of regulation by entering into an agreement with a number of litigation funders, which is aimed at protecting consumers from entering finance contracts without a full understanding of the terms and their effect.[130] The agreement requires that "the consumer may cancel the contract within five business days following the consumer's receipt of funds, without penalty or further obligation."[131]

As an example of statutory regulation, Ohio has passed legislation directly regulating litigation finance.[132] Unlike the strict limits imposed by Tennessee and other states,[133] Ohio's limits are fairly minimal. Contracts must include various disclosures,[134] attorneys cannot be required to have any duties contrary to the state's rules of

124. *See* 193 S.W.3d 87, 104–05 (Tex. App. 2006) ("[W]e hold that the agreements do not violate Texas public policy.").

125. *Id.* (holding that "agreements that are 'champertous in nature' " are not automatically void).

126. *See* Kraft v. Mason, 668 So. 2d 679, 683, 686 (Fla. Dist. Ct. App. 1996) ("[T]his court holds that the trial court correctly found the contract in issue was neither champertous nor usurious . . . .").

127. *Id.*

128. *See* McDonald, *supra* note 118 (noting that litigation financiers place "particular emphasis [on Florida], in part due to the size of the state, but also because of settled case law").

129. Echeverria v. Estate of Lindner, No. 018666/2002, 2005 N.Y. Misc. LEXIS 894, at *18 (N.Y. Sup. Ct. Mar. 2, 2005) ("Under New York law these assignments are allowed as long as the primary purpose and intent of the assignment was for some reason other then [sic] bringing suit on that assignment.").

130. *New York AG Agreement with Legal Funding Companies*, MIGHTY (Aug. 2, 2015), https://www.mighty.com/blog/nyattorneygeneralplaintifffundingagreement [https://perma.cc/FFP9-UWJB].

131. *Id.*

132. OHIO REV. CODE ANN. § 1349.55 (West 2018).

133. *See* TENN. CODE ANN. §§ 47-16-101 to -110 (2018).

134. OHIO REV. CODE ANN. § 1349.55(B)(1).

professional conduct,[135] and consumers must be permitted to cancel the contract without penalty within five business days of receipt of funds.[136] The level of interest that financiers may charge is not limited.

IV. THE FEDERAL REGULATORY SOLUTION

TPLF is a burgeoning industry that will continue to have a significant and lasting impact on the U.S. legal system. Through usury law and the common law doctrines of maintenance and champerty, states have addressed the rise of TPLF in a multitude of ways. This has ultimately led to a web of piecemeal regulations that have failed to uniformly protect important consumer interests or facilitate access to litigation funding. Because neither the beneficial nor the detrimental effects of TPLF are being adequately managed by state regimes, federal oversight is needed to ensure consumer and financier interests are balanced.

Federal regulation is preferable to state regulation for several reasons. First, federal regulation creates uniformity by establishing a single regime to oversee TPLF in all fifty states. Aside from promoting a general interest in fairness by ensuring access to litigation finance nationwide, a uniform system of regulation would eliminate forum-shopping issues. Because some states are far more hostile to litigation finance than others, TPLF financiers are most likely to do business in those states with the most relaxed rules and thus the weakest oversight.[137] Federal regulation would eliminate the need for litigants to enter choice-of-law and choice-of-forum clauses, thus allowing all TPLF consumers to be accorded the same degree of protection. Further, uniform regulation ensures that consumers will not be unduly coerced into these contracts by financiers that target jurisdictions with the least restrictive litigation-finance lending requirements and thus the least protection of consumer interests.[138]

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135. *Id.* § 1349.55(C).

136. *Id.* § 1349.55(B)(2).

137. *See* U.S. CHAMBER INST. FOR LEGAL REFORM, *supra* note 86, at 9 (noting concerns with "a checkerboard of disparate state laws, rules, and regulations that apply only within any given state, and which, owing to the differences among the state oversight regimes, likely would funnel TPLF-financed cases to the state courts in the jurisdictions with the weakest oversight regimes").

138. *See* Michael McDonald, *The Best and Worst States for Litigation Finance (Part I)*, ABOVE L. (June 28, 2017, 5:17 PM), https://abovethelaw.com/2017/06/the-best-and-worst-states-for-litigation-finance-part-i [https://perma.cc/4STD-HBJ5] (noting that choice-of-law and choice-of-forum clauses are used to control TPLF agreements under the jurisdiction of states who have shown acceptance of these agreements).

Litigation financing is also frequently used to fund the most expensive and complex suits, which often end up in federal court.[139] It is therefore logical, as will be discussed in further detail below, to amend the Federal Rules of Civil Procedure to effect an important procedural reform.

In total, the inherent dangers of TPLF are not adequately addressed under the current patchwork of state regulations. A federal regulatory regime is thus necessary to protect consumers' financial interests without compromising the growth of the litigation-finance industry.

This Note contends that the best manner of regulating litigation finance is by delegating authority to the CFPB to promulgate and administer regulatory safeguards. To fairly and effectively balance the consumer and financier interests discussed in Part II, these safeguards must necessarily include creating negotiating parity between consumers and financiers, eliminating financier control over litigation strategy, and protecting against disclosure of privileged information. In order for the CFPB to effectively administer these safeguards, the Federal Rules of Civil Procedure should be amended to require disclosure of TPLF agreements at the outset of all litigation.

A. Constitutional Authority to Regulate TPLF

In order to authorize the CFPB to regulate TPLF, Congress must have the authority to regulate TPLF. As the ILR has noted, "TPLF investors operate nationally (and internationally), and use the means and instrumentalities of interstate commerce (e.g., the mails, telecommunications, and money transfers) to carry out their business."[140] As a result, Congress can regulate TPLF under the commerce power as interstate commerce[141] or, alternatively, as economic activity that "substantially affects" interstate commerce under *United States v. Lopez*.[142]

Under the substantial effects test, even those litigation funders that engage in purely intrastate financing would be subject to regulation because, in the "aggregate," their activities would have a substantial effect on interstate commerce.[143] After *Lopez*, however, the

139. *See* U.S. CHAMBER INST. FOR LEGAL REFORM, *supra* note 86, at 8 (arguing that most TPLF activity is likely to occur in federal court).

140. *Id.*

141. U.S. CONST. art. I, § 8, cl. 3.

142. 514 U.S. 549, 559 (1995).

143. *See, e.g.*, Gonzales v. Raich, 545 U.S. 1, 22 (2005); Wickard v. Filburn, 317 U.S. 111, 125 (1942) (holding that intrastate activity may be regulated under the commerce power where the

Supreme Court held in *United States v. Morrison* that "*Lopez*'s review of Commerce Clause case law demonstrates that in those cases where we have sustained federal regulation of intrastate activity based upon the activity's substantial effects on interstate commerce, the activity in question has been some sort of *economic endeavor*."[144] After *Morrison*, application of the substantial effects test to TPLF likely depends on courts' recognition of litigation finance as an economic activity. Given the similarities between TPLF and the other sorts of loan and credit activities that the federal government already regulates under the commerce power, it is likely that TPLF would be found to be economic activity within the scope of the substantial effects test.

B. Delegating Authority to the CFPB

The CFPB is not only constitutionally authorized to regulate TPLF but well situated to do so. The CFPB operates as an independent agency within the Board of Governors of the Federal Reserve, as established by the Dodd-Frank Wall Street Reform and Consumer Protection Act.[145] The Dodd-Frank Act states that the purpose of the agency is to "enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive."[146] The Federal Register website describes the purpose of the CFPB as "promot[ing] fairness and transparency for mortgages, credit cards, and other consumer financial products and services."[147]

The purpose of the agency aligns neatly with regulation of the litigation-finance industry. Atmospherically, both TPLF and the sorts of loan and credit agreements the CFPB regulates raise the same sorts of concerns. These include liquidity and financial risk and the potential

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failure to do so would significantly limit the effectiveness of comprehensive congressional regulation over an interstate economic activity).

144. 529 U.S. 598, 611 (2000) (emphasis added).

145. 12 U.S.C. §§ 5481–5603 (2012). It should be noted that there have been a number of challenges in recent years to the constitutionality of the CFPB. One court has recently upheld the agency's structure against constitutional challenge. *See* PHH Corp. v. Consumer Fin. Prot. Bureau, 881 F.3d 75 (D.C. Cir. 2018) (en banc) (upholding constitutionality of statute providing that the CFPB's sole director could be removed by the president only for cause). At least one other court, however, subsequently held that the CFPB's structure is unconstitutional. *See* Consumer Fin. Prot. Bureau v. RD Legal Funding, LLC, 332 F. Supp. 3d 729 (S.D.N.Y. 2018) (holding that the CFPB's composition violates separation of powers requirements). The ultimate resolution of these complex constitutional questions is uncertain and accordingly beyond the scope of this Note.

146. 12 U.S.C. § 5511(a).

147. *Consumer Financial Protection Bureau*, FED. REG., https://www.federalregister.gov/agencies/consumer-financial-protection-bureau (last visited Jan. 24, 2019) [https://perma.cc/A4BX-EBLQ].

for consumer abuse. Because TPLF agreements are similar to activities the CFPB already regulates, the promulgation of new TPLF regulations would come from an agency familiar with the issues TPLF presents.

The CFPB has also previously indicated a willingness to assert regulatory authority over the litigation-finance industry. In February 2017, the CFPB, together with the New York Attorney General's Office, filed a lawsuit in federal court against RD Legal Funding, two related entities, and the company's founder for allegedly luring 9/11 victims and National Football League concussion victims into illegal funding agreements.[148] The defendants were in the business of advancing funds to consumers entitled to compensation under settlement agreements.[149] The CFPB alleged, in part, that these transactions were falsely marketed as assignments rather than as loans and that the lending violated New York usury laws.[150]

Although the CFPB has not yet asserted regulatory authority over presettlement litigation funding, which the bulk of this Note's proposals target, the agency's willingness to subject settlement-funding agreements to state usury laws bolsters the notion that the litigation-finance industry fits naturally within the scope of the agency's duty to "protect[ ] consumers in the financial marketplace" from "unfair, deceptive, or abusive acts or practices."[151] This does not necessarily suggest that the regulation of presettlement litigation funding is already within the authority of the CFPB but rather that it would be well suited to the task if given congressional authorization.

Therefore, Congress should statutorily authorize the CFPB to administer federal TPLF regulation.[152] Through this authorization, the CFPB should then promulgate rules instituting, at the bare minimum, the following proposed safeguards.

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148. *See RD Legal Funding*, 332 F. Supp. 3d at 746, 749.

149. *Id.* at 746.

150. *Id.* at 748–49; *see also CFPB and New York Attorney General Sue RD Legal for Scamming 9/11 Heroes out of Millions of Dollars in Compensation Funds*, CONSUMER FIN. PROTECTION BUREAU (Feb. 7, 2017), https://www.consumerfinance.gov/about-us/newsroom/cfpb-and-new-york-attorney-general-sue-rd-legal-scamming-911-heroes-out-millions-dollars-compensation-funds [https://perma.cc/BV98-4WHM] (listing allegations against RD Legal).

151. *The Bureau*, CONSUMER FIN. PROTECTION BUREAU, https://www.consumerfinance.gov/about-us/the-bureau (last visited Jan. 24, 2019) [https://perma.cc/AW6D-TCZD].

152. Given the uncertainty of today's political climate, it is difficult to predict when and with whose support this legislation would pass. Such predictions are accordingly beyond the scope of this Note.

C. Essential Components of the Regulatory Solution

First, interest rates should be brought in line with fair commercial practices.[153] This requires setting a maximum interest rate that TPLF financiers may charge. Specifically, a twenty-percent limit on commercial TPLF and a ten-percent limit on consumer TPLF should suffice. These rates would be sufficient to protect less sophisticated consumers and discourage frivolous litigation while still facilitating consumer- and commercial-TPLF lending. A twenty-percent commercial-TPLF cap does not exceed the average maximum interest rate set by states—six to twenty percent—and would thus bring commercial-TPLF agreements more in line with what states deem to be nonusurious lending.[154] A ten-percent limit on consumer TPLF would also be more in line with average interest rates and provide additional protection for less sophisticated consumers—protection that is not necessarily needed in the commercial-TPLF context (where the average sophisticated TPLF client can more readily understand and absorb the impact of the finance agreement).[155]

Limiting interest rates will likely shift the risk calculus for financiers such that they will be less inclined to advance funds to those suits in which their reduced recovery will not justify the risk of advancing those funds. These limits will provide important benefits without unreasonably limiting financier incentives. Interest caps are a potent means of protecting against unfair lending, and in the consumer-TPLF context specifically, limiting maximum interest rates will lessen the impact of lender recovery on unsophisticated plaintiffs. Moreover, because interest caps will lessen financiers' potential recovery, capping interest rates may also reduce the incentive to back suits with lower chances of success. This would further discourage commercial and consumer financiers from funding those suits that might be described as frivolous.

The second necessary regulatory component involves implementing a strict policy that limits litigation financiers' control over litigation strategy.[156] Because TPLF financiers' focus is to obtain a

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153. *See* Susan Lorde Martin, *The Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed*, 10 FORDHAM J. CORP. & FIN. L. 55, 73–74 (2004) (discussing examples of how litigation financiers "are making attempts to institutionalize their industry, to improve their image by being more forthcoming on the rates they are charging, to keep those rates closer to credit card rates, and to become more involved in their communities").

154. *See supra* Section I.B; *see also* Cremades, *supra* note 1, at 160 (discussing the history of state restrictions on interest rates).

155. *See supra* Section I.B.

156. *See* Richmond, *supra* note 89, at 29 (examining how litigation-funding agreements can be structured to avoid any undue influence of financiers over litigation strategy); Steinitz & Field,

maximum return on their investment, they have strong incentives to exert control over decisions made by lawyers during the course of litigation.[157] Although the ABA Model Rules guide attorneys' conduct in protecting the objectivity of their judgment,[158] the rules do not apply to TPLF financiers, and so an explicit regulatory prohibition on financiers' control over any aspect of a lawyer's independent judgment is needed. Through the promulgation of a rule expressly prohibiting financier control, lawyers will not be asked to compromise their independent judgment, and client interests will not take a back seat to the financiers' interests.

The third necessary regulatory component entails expressly limiting the types of disclosures TPLF financiers can request during due diligence, so as to avoid conflict-of-interest issues related to attorney work product and the attorney-client privilege.[159] While assessing whether to finance a particular suit or in monitoring a suit's progress, a financier could request that an attorney divulge protected information under the terms of a finance agreement. This, in turn, could result in a waiver of the attorney-client privilege or work product protection.[160] To protect against privilege and work product issues related to such disclosures, financiers' requests should be limited to information that would ordinarily be discoverable under Federal Rule of Civil Procedure 26.[161]

Naturally, this disclosure limitation cannot be so onerous as to deprive financiers of information necessary to value a suit, so the CFPB should promulgate rules to permit certain additional disclosures as are deemed necessary to facilitate access to funding. The decision of what additional disclosures are necessary should rely heavily on whether

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supra note 67, at 728 (advocating for a model litigation-funding contract in which financiers gain "influence over the litigation, but not control").

157. *See* ABA WHITE PAPER, *supra* note 50, at 22 ("ALF suppliers are businesses, operated with the goal of maximizing return on investments. The investments are in legal claims, acquired in whole or in part. The interests of a supplier in any given transaction, therefore, will be to maximize the expected value of a legal claim.").

158. *See* MODEL RULES OF PROF'L CONDUCT r. 1.7 cmt. 1 (AM. BAR ASS'N 1983) (stating that "independent judgment" is one of the "essential elements in the lawyer's relationship with a client"); MODEL RULES OF PROF'L CONDUCT r. 1.8(f) (prohibiting a lawyer from accepting compensation from a third party unless "there is no interference with the lawyer's independence of professional judgment").

159. *See* Molot, *supra* note 105, at 391, 420 (discussing conflict-of-interest issues related to TPLF agreement disclosures and noting that "the same common interest privilege that is often invoked when litigants need to share information with conventional liability insurers and potential acquirers" should extend to disclosures to litigation financiers).

160. J. Randolph Evans & Shari L. Klevens, *The Growing Acceptance of Litigation Finance*, LAW.COM (Oct. 9, 2017, 10:10 AM), https://www.law.com/sites/dailyreportonline/2017/10/09/the-growing-acceptance-of-litigation-finance [https://perma.cc/36DT-C67B].

161. *See* FED. R. CIV. P. 26 (listing the general provisions governing discovery).

disclosure of the requested type of information is ordinarily protected by the work product doctrine or if disclosure would fall within the common-interest exception of the attorney-client privilege.[162] Under these guidelines, the implementation of disclosure limits would protect attorney and client interests without significantly burdening TPLF financiers' ability to conduct due diligence.

Lastly, the Federal Rules of Civil Procedure should be amended to mandate disclosure of TPLF agreements in all litigation.[163] Although federal courts may already have discretion to order the production of TPLF agreements during discovery—at least one court has adopted a local rule requiring disclosure of TPLF agreements in class-action suits[164]—mandating disclosure in all suits will promote transparency and aid the CFPB in ensuring compliance with the aforementioned safeguards. And as the ILR has noted, "[B]ecause many states have modeled their rules of civil procedure on the federal rules and periodically adopt changes in the federal rules for use in their own courts," amending the federal rules would likely lead to changes in state rules as well, which further promotes CFPB administration of the safeguards.[165]

Mandating disclosure up front will also promote speedy determinations related to cost shifting—which ultimately leads to more efficient use of judicial resources—and will allow courts to police the ethical obligations of attorneys more readily. Moreover, because courts may already require disclosure of TPLF agreements, it is unlikely this amendment would have any significant impact on financiers' interests.

CONCLUSION

TPLF is now a powerful and influential industry that will play a significant role in reshaping the legal landscape. At present, the important interests of parties engaging TPLF services, along with the sheer amount of funding being infused into the legal system overall,

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162. For further discussion of the common-interest exception and work product doctrine in relation to TPLF, see ABA WHITE PAPER, *supra* note 50, at 34–36.

163. *See* U.S. CHAMBER INST. FOR LEGAL REFORM, *supra* note 86, at 14 (arguing that Federal Rules of Civil Procedure 7.1 and 28 should be amended to require disclosure of third-party-funder identities and relevant investment details).

164. N.D. CAL. R. 3-15; Ben Hancock, *Northern District, First in Nation, Mandates Disclosure of Third-Party Funding in Class Actions*, LAW.COM (Jan. 23, 2017, 10:07 PM), https://www.law.com/therecorder/almID/1202777487488 [https://perma.cc/K8XP-5CNQ] ("The U.S. District Court for the Northern District of California on Monday announced a new rule requiring the automatic disclosure of third-party funding agreements in proposed class-action lawsuits, walking back from an earlier proposal for broader transparency requirements.").

165. *See* U.S. CHAMBER INST. FOR LEGAL REFORM, *supra* note 86, at 8 (arguing that most TPLF activity is likely to occur in federal court).

warrant careful oversight to ensure that litigation finance is fair and equitable. On the other hand, litigation finance has greatly improved the ability of plaintiffs to bring meritorious claims and has provided commercial entities with a new and useful budgeting and risk-spreading tool. To best promote the interests of consumers and financiers alike, a federal regulatory regime administered by the CFPB along with a mandatory-disclosure requirement under the Federal Rules of Civil Procedure should be implemented.

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