Selling Lawsuits, Buying Trouble

Third-Party Litigation Funding in the United States

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I. Executive Summary

"Third-party litigation financing" is a term that describes the practice of providing money to a party to pursue a potential or filed lawsuit in return for a share of any damages award or settlement. Litigation-financing companies provide financing for myriad litigation costs, including attorneys' fees, court fees, and expert-witness fees. Funding arrangements also may involve financing the party's living expenses while the trial and any appeals are pending.

Third-party litigation financing is a growing phenomenon in the United States, and it has received much attention of late from both proponents and critics, including practicing lawyers, academics, jurists, and policy-makers. Although third-party funding is not widespread, it is playing an increasingly visible—and potentially harmful—role in U.S. litigation. If such funding becomes more prevalent, it will pose substantial risks of litigation abuse. This is particularly true in the context of class or mass actions, which are already very vulnerable to abuses.

The root problem with third-party litigation financing is that it introduces a stranger to the attorney-client relationship whose sole interest is a financial one. The stranger wants to protect its investment, and its interest lies in maximizing its return on that investment, not in vindicating a plaintiff's rights. Put simply: the stranger's motive is to pursue investments that will generate returns whether or not the claims underlying those returns lack merit. The stranger, like a law firm, is a repeat player in the lawsuit-financing game. But unlike a law firm, the stranger does not have a privileged, fiduciary relationship with the plaintiff. Eventually, then, the stranger's presence will require a relaxation of the rules governing attorney professional responsibility, compensation, and the attorney-client privilege to accommodate these new realities. This relaxation threatens to chip away at—and eventually eradicate—critical safeguards against lawsuit abuse.

This paper begins with an overview of third-party litigation financing. It next examines current third-party financing practices in the United States. It then sets forth a critique of the practice, particularly the incentives it creates to engage in frivolous and abusive litigation. In this section, the paper also presents a case study on the Commonwealth of Australia, the first jurisdiction to permit third-party litigation funding, where such funding has dramatically increased litigation and given investors pervasive—even total—control over a plaintiff's litigation. Finally, the paper proposes that third-party litigation financing be prohibited in the United States to prevent these abuses. At the very least, the paper concludes, such funding should be banned in class actions and other forms of aggregate litigation.

II. Third-Party Litigation Financing in the United States

Third-party litigation financing was forbidden at common law under the ancient doctrines of maintenance and champerty, which generally prohibited intermeddling in another's lawsuit, particularly in return for any part of the judgment. England and Wales abolished maintenance and champerty as crimes and torts in the Criminal Law Act of 1967.[1] In more recent years, a number of states in the United States also have abolished the doctrines altogether, or have limited their application.[2]

Third-party financing contracts generally resemble non-recourse loans: if the party recovers nothing, it does not have to repay the funding company. Thus, the practice avoids prohibitions against usury. If the party is successful, however, either by receiving a damages award at trial or by settling on favorable terms, the funding contract entitles the financing company to a share of the proceeds. The financier's share is calculated from several factors, including the amount of money advanced, the length of time until recovery, the potential value of the plaintiff's case, and whether the case settles or goes to trial.

Perry Walton, the founder of a litigation-finance company called Future Settlement, generally is recognized as the founder of the litigation-financing industry in the United States. In 1998, after having pleaded guilty to extortionate debt-collection practices in Nevada the previous year, Walton began popularizing the concept of litigation finance through training seminars.

Since then, a number of well-known financial institutions have begun offering third-party litigation financing for U.S. cases (many had previously funded cases in Europe). Some of the bigger names in the industry include Allianz ProzessFinanz (an affiliate of German insurer Allianz), Harbour Litigation Funding, IM Litigation Funding, and Juridica Capital Management. Swiss banking giant Credit Suisse also has a litigation-finance unit. Many hedge funds also are investing actively, but quietly, in litigation financing. John Jones, a technical director at Aon, has described the phenomenon this way:

> "…after having pleaded guilty to extortionate debt-collection practices in Nevada…Walton began popularizing the concept of litigation finance through training seminars."

In a typical case[,] a hedge fund, acting on behalf of already wealthy investors, will seek to accumulate yet more money—not by investing in business enterprise or wealth creation—but by gambling on the outcome of a legal action for damages. They have no interest in the justice or otherwise of the case—only in the chances of success—as they will demand a share of the damages awarded in return for putting up the stake money.[3]

These financial institutions have enjoyed favorable results. Juridica, which invests only in commercial cases and mainly in the United States, raised £74 million in its December 2007 initial public offering on the London Stock Exchange's small companies market and another £33.2 million with a second offering in 2009. Juridica has seen its share price grow by 24% since it began trading in London and enjoys annual returns in excess of 20%.

The recent growth of third-party litigation financing in the United States results from a number of factors, including rising litigation costs, the lack of capital in the traditional lending market to fund litigation (which is inherently speculative), and professional-responsibility rules that prohibit attorneys from paying their client's living expenses while litigation is pending.[4]

Notably, despite strict rules governing the attorney-client relationship, state courts in the United States generally have had a hands-off approach to litigation-funding arrangements, leaving the regulation of third-party funding to the state legislatures.[5] Several state bar associations have determined that third-party funding is acceptable where the attorney explains the funding transaction to the client, and the risks and conflicts of interest created by the transaction are disclosed to the client.[6]

At least two states have addressed litigation financing and have enacted legislation setting forth specific requirements for contracts between litigation-financing companies and consumers. Maine enacted legislation in 2007 requiring litigation-financing companies to register with state authorities and mandating specific provisions that must be included in financing contracts, including a disclosure form setting forth the fees and interest rate charged, a representation that the company has no right to make, and will not make, any decisions respecting the course of the litigation, and a clause providing that the customer may cancel the contract within five business days.[7] Ohio's legislature passed a similar law in 2008.[8] Ohio's law is troubling, however, because, in passing it, the legislature directly overturned a prior decision of the Ohio Supreme Court striking down a third-party funding arrangement on the grounds that it constituted maintenance and that it provided the plaintiff with a disincentive to settle her case.[9] (That latter point—that third-party funding prolongs litigation by disincentivizing settlement—is a significant problem inherent in third-party funding, as discussed in Section III, below.)

Today, third-party funding is governed in the United States by a patchwork of relatively weak laws, cases, rules, and regulations—and they are only in force in a handful of states. There does not appear to be a nationwide consensus, or even a nationwide conversation, on whether the doctrines of maintenance and champerty should be abolished, whether litigation funding should be allowed, or, if it is, how it should be regulated. Below, we discuss some of the concerns that should be part of any such conversation.

III. The Problems Inherent in Third-Party Litigation Financing

Proponents of third-party litigation financing argue that the practice promotes access to justice. But this focus on access to justice ignores an obvious point—third-party litigation funding increases a plaintiff's access to the courts, not to justice. This is an important distinction because increasing plaintiff access to the courts also increases the likelihood that any potential defendant will be hauled into court on a meritless claim. Although the popular vision of U.S. litigation among proponents of third-party financing is of David-like plaintiffs pitted against Goliath-like defendants, this vision is not true to reality. In truth, potential defendants come in all guises: motorists, professional-services providers, small-business owners, and corporate stockholders. Practices like third-party funding increase the overall litigation volume, including the number of non-meritorious cases filed, and thus effectively reduce (not increase) the level of justice in the litigation system.[10]

"…third-party litigation funding increases a plaintiff's access to the courts, not to justice."

As discussed below, third-party funding is particularly troubling in the area of aggregate litigation. Class and mass actions in the United States are inherently more vulnerable to litigation abuse than other types of litigation procedures because they permit aggregation of the claims of many litigants in a single proceeding. As a result, a defendant in aggregate litigation frequently faces exposure exponentially greater than what it would face in a proceeding with just one individual plaintiff. Such large exposure often can compel defendants to settle aggregate lawsuits rather than seek adjudication on the merits, regardless of the validity of the claims at issue. Moreover, aggregate litigation already poses the risk of being driven by profit-seeking attorneys rather than legitimately injured and interested plaintiffs—a problem exacerbated by third-party funding. For these reasons, third-party litigation funding, which permits plaintiffs and their attorneys to offload risk and thus encourages them to test non-meritorious claims, would be particularly damaging to the orderly administration of justice in the aggregate-litigation context.

The dangers and perverse incentives presented by third-party funding are on full display in the Australian civil litigation regime. There, with High Court sanction, investors are allowed to stir up controversy for the purpose of making profits, including inducing plaintiffs to sue defendants and exercising total control over those plaintiffs' cases.

A. Third-Party Financing Encourages Frivolous and Abusive Litigation

Third-party litigation financing increases the volume of litigation in any jurisdiction where it is available. This has been shown empirically in Australia and is a matter of simple economics: by increasing the amount of money available to pay attorneys to litigate claims, third-party funding necessarily increases the volume of claims litigated. What is more, third-party financing particularly increases the volume of questionable claims. This is because, absent such financing, attorneys have two incentives not to permit their clients to bring such claims. First, they have a duty to advise clients when potential claims would be frivolous. And second, when lawyers are working on contingency, they obviously would rather spend their finite time on cases that are likely to be successful, as opposed to cases with a low probability of success. Accordingly, absent third-party funding, cases that plaintiffs and their attorneys actually decide to file ordinarily can be expected to be of higher merit than cases that plaintiffs and their attorneys decide not to file. When third-party litigation financing increases the overall volume of litigation, however, those weak cases that plaintiffs and their attorneys ordinarily would not have pursued are much more likely to be filed.

Proponents of third-party funding argue that the practice does not encourage frivolous lawsuits because a litigation-financing company has no incentive to make a non-recourse loan to fund a meritless case. They also argue that third-party funding does not promote frivolous lawsuits because litigation-financing companies often enter the picture after the plaintiff has chosen to file a lawsuit and has retained counsel.[12] These arguments lack merit for several reasons.

First, although providing non-recourse loans to fund litigation is inherently risky, it does not follow that litigation-finance companies will only finance claims that are likely to succeed. These companies—like all sophisticated investors—will base their funding decisions on the present value of their expected return, of which the likelihood of a lawsuit's success is only one component. The other component is the potential amount of recovery. If that potential recovery is sufficiently large, the lawsuit will be an attractive investment, even if the likelihood of actually achieving that recovery is small. Put simply, the present value (excluding inflation and opportunity cost) of a $500 million claim with only a 10% chance of success is still $50 million. Moreover, litigation-finance companies can further hedge their investments in risky lawsuits by demanding higher percentages of any award where recovery is less certain. Indeed, if investors were only attracted to low-risk investments, the high-yield junk-bond market never would have existed.

Already, the third-party funding market bears this out: some hedge funds specialize in financing "speculative" cases.[13] New Jersey-based hedge fund MKM Longboat's Susan Dunn explains that hedge funds "want to invest, and it is those [hedge funds] that were involved in the distress[ed-]debt market, so they are used to it. This is just a new class of risk to them."[14] As Mick Smith of third-party litigation funder Calunius Capital has observed, "the perception that you need strong merits is wrong—there's a price for everything."[15]

Moreover, third-party funding companies are able to mitigate their downside risk in two ways: they can spread the risk of any particular case over their entire portfolio of cases, and they can spread the risk among their investors. For this reason, litigation-finance companies have a high appetite for risk and are willing to fund speculative, high-yield cases. As one commentator has observed, litigation financing companies "staffed by a litigation savvy business person and a skilled litigation claims adjuster could reduce, even eliminate, the risk of loss by adroitly valuing the range of recovery in a personal injury action and by advancing only a fraction of the carefully calculated range of recovery dollars."[16]

Second, the statement that funding companies do not enter the picture until after a plaintiff has retained counsel and decided to file suit is groundless. Third-party funders make money when they invest in lawsuits, and they have every incentive to induce plaintiffs to file them. Without adequate safeguards, nothing prevents a funder from contacting a potential plaintiff and encouraging him or her to file an individual or class action lawsuit. This is precisely what occurred in the *Fostif* case in Australia, discussed in detail below.

And even if the funder does not affect the plaintiff's decision to commence litigation, the funder's presence prolongs the litigation beyond what is fair or necessary. This is because third-party litigation funding creates a disincentive for plaintiffs to settle at an amount below the value suggested by the financing arrangement, irrespective of whether that amount reflects a fair value for the claim as indicated by the strengths and weaknesses of the litigation.

A plaintiff who must pay a finance company out of the proceeds of any recovery can be expected to reject what may otherwise be a fair settlement offer and hold out for a larger sum of money.[17] By the same token, the financing company can be expected to pressure plaintiffs only to accept settlement offers that are sufficient to cover the amount financed after subtracting the plaintiff's share of the recovery. Thus, the amount the company has financed likely would set the "floor" for acceptable settlement offers, and the company would pressure the plaintiff not to accept any settlement offer below the floor.[18] For example, if a funder provides a plaintiff $1 million to pursue litigation in return for 50% of any award, the funder naturally will attempt to set the settlement-recovery floor at $2 million. This amount, moreover, is entirely a function of the litigation funder's return on investment; it has nothing whatsoever to do with the merits of the claim. In this respect, litigation funding presents the same settlement disincentive as contingent attorney fees: attorneys working on contingency have a perverse incentive to convince their clients only to accept settlement amounts greater than the time-value the attorney has invested in pursuing the case.

> "…litigation-financing arrangements undercut the plaintiff's control over his or her own claim because investors inherently desire to protect their investment and will therefore seek to exert control over strategic decisions in the lawsuit."

In addition, from the defendant's perspective, by guaranteeing that plaintiffs will have sufficient funding to prosecute even questionable claims through trial, third-party funding creates pressure on defendants to settle all but the most frivolous claims, often on sub-optimal terms, and at an amount much higher than the merits-based value of the claim. This is because trial itself is expensive, independent of any award. Defendants must pay attorneys', experts', and other fees, and, under the "American" rule governing assessment of attorneys' fees in civil litigation, those costs generally cannot be shifted to the plaintiff even if the defendant prevails. By promoting coercive settlement in this way, third-party litigation financing increases the profitability—and therefore the likelihood—of abusive litigation.

B. Third-Party Litigation Financing Raises Ethical Concerns

The common-law obstacles to third-party litigation financing—maintenance and champerty—seem to have fallen by the wayside in a number of states, but serious ethical concerns about the litigation-financing industry remain. Most significantly, litigation-financing arrangements undercut the plaintiff's control over his or her own claim because investors inherently desire to protect their investment and will therefore seek to exert control over strategic decisions in the lawsuit. Gary Chodes, the founder of litigation-financing company Oasis Legal Finance, has said that "clients may have to relinquish some decision-making authority to the funder" and that "the client's interests may diverge from the funder in that other business reasons may suggest that they might settle a claim for less than the funder has targeted."[19] Arndt Eversberg, a managing director of Allianz ProzessFinanz, has touted plaintiffs' ability to draw on the company's "legal knowledge and experience" as an added benefit of obtaining litigation financing from it.[20] This is troubling because it reduces a justice system designed to adjudicate cases on their merits to a litigation system effectively controlled by third parties interested solely in profit. And, it places the power to make strategic decisions about the case in the hands of the funder, whose duties are to its investors, instead of in the hands of the attorney, whose duties are to the client. In addition, to the extent an attorney permits a third-party financier to "direct or regulate" the attorney's "professional judgment," the attorney may violate rules of professional conduct.[21]

In addition, obtaining funds from a third party to finance a case may also create conflicts of interest for the plaintiff's attorney, particularly the attorney's duty of loyalty owed to the client. This is especially true where the attorney has contracted directly with the funding company and thus has contractual duties to it that are independent of the attorney's professional duties to the plaintiff.[22] Moreover, because both third-party funders and attorneys are repeat players in the litigation market, it can be expected that relationships among them will develop over time. Attorneys can be expected to "steer" clients to favored financing firms, even if the client's particular circumstances suggest a different firm may be more appropriate, and *vice versa*.

Finally, litigation-financing arrangements also raise confidentiality concerns insofar as they require plaintiffs to disclose privileged information to the financier. In order to evaluate a plaintiff's claim and determine whether and on what terms to finance the case, a litigation financing company generally will ask to evaluate confidential, and possibly privileged, information belonging to the plaintiff. If the plaintiff elects to provide the information to the financing company, any privilege protecting it likely would be waived.[23] Attorneys advising a client at the outset of a case may be reluctant to provide the client full and candid advice in writing, knowing that any communications could be viewed by the funder as part of its diligence, and then would be available to the opposing party in discovery.

"By helping would-be plaintiffs shift their costs to others, third-party funding encourages plaintiffs' attorneys to test claims of questionable merit…"

C. Third-Party Financing in Class and Mass Actions: A Recipe for Abuse

Third-party financing is most troubling in the context of aggregate litigation—class and mass actions—which already poses substantial risks of abuse. This is so because, in aggregate litigation, the plaintiffs can threaten the defendant with staggering exposure on potentially thousands of claims. By helping would-be plaintiffs shift their costs to others, third-party funding encourages plaintiffs' attorneys to test claims of questionable merit, knowing that the enormity of the potential risk will often force defendants to settle class and mass actions on sub-optimal terms rather than roll the dice at trial. In this respect, contingent third-party funding arrangements are even *more* likely to invite frivolous litigation than contingent attorney fees, which bear a significant share of the blame for the United States's out-of-control tort system.

In addition, in an individual case, the plaintiff presumably hires the third-party funding company—or at least knows and understands the arrangement. In a suit involving thousands of class members who are effectively bound by a judgment or settlement if they do not opt out, there is no practical way to obtain permission from all the potential plaintiffs before entering the third-party funding agreement. Thus, the funding arrangement is essentially occurring without the consent of the plaintiffs.

Relatedly, third-party financing also exacerbates one of the fundamental problems with aggregate litigation—*i.e.*, that it is generally controlled by attorneys rather than plaintiffs. In a large consumer class action, the average plaintiff often has only a dollar or two at stake. The "representative" plaintiffs who are empowered to speak for the class in such cases tend to be friends, neighbors or even employees of the attorney bringing the suit. As a result, the lawyers fully control the cases—not the plaintiffs.

The concerns raised by such an arrangement are all the greater when the person driving the litigation is not even a lawyer with fiduciary obligations to the supposed clients or the court. In a case with a legitimately aggrieved plaintiff who is following the litigation and concerned about its outcome, there is, at least, someone watching the lawyer and the funding company—and that person can raise concerns if the funding company acts against his or her interests. In a class action, by contrast, there is often no interested plaintiff. Thus, the funding company can effectively run the litigation with no check on its actions.

In addition to increasing the risk of abusive aggregate litigation, third-party funding in class actions also eats into any damages that are justifiably awarded to plaintiffs. Already, the actual payout to class action plaintiffs is often negligible, because so much of the settlement pie goes to attorneys' fees. If a third-party funder is added to the mix, the slice that goes to class members would be even smaller, and the proceeds would essentially be divided between the lawyers and the funders.

D. Case Study: The Commonwealth of Australia and the Dangers Inherent in Third-Party Litigation Financing

Third-party financing originally developed in Australia in the 1990s for use in insolvency litigation. Australian courts, however, soon allowed the practice in group litigation. Today, plaintiffs use it primarily in commercial litigation and in group proceedings. One study has estimated that the volume of litigation in Australia has risen 16.5% as a result of the practice.[24]

The third-party funding industry has flourished in Australia in part because Australia prohibits attorneys from charging contingency fees, while allowing contingent returns on investment for funders. The practice thus provides a mechanism for plaintiffs to finance litigation on contingency.

1. The High Court's Fostif Decision and Pervasive Third-Party Control of Litigation

The evolution of third-party funding in Australia, from maintenance and champerty prohibitions to authorization in insolvency suits to its spread to other civil litigation, led in 2006 to the High Court decision in *Campbells Cash and Carry Pty Ltd v. Fostif Pty Ltd.*[25] In *Fostif*, a five-to-two majority of the High Court held that a third-party funder may exercise significant control over the litigation, and that this control is not an abuse of process and does not offend public policy in states that have abolished maintenance and champerty as crimes and torts.

Fostif involved a third-party litigation financier called Firmstones & Feil, Consultants, which financed a collective action brought on behalf of tobacco retailers to recover licensing fees they had paid to tobacco wholesalers. Firmstones actually had sought out the retailers and convinced them to grant it authority to bring an action on their behalf. Ultimately, Firmstones financed the litigation on a contingent, non-recourse basis.[26]

Under the financing agreement, Firmstones exercised considerable control over the litigation. The High Court's majority opinion reveals that Firmstones itself, and *not* the retailer-plaintiffs who were owed the reimbursements, conceived of and planned the litigation, set it in motion, and exercised pervasive control over the retailers' claims. Indeed, it is questionable that the retailers ever would have sued the wholesaler-defendants at all, had Firmstones not seen it as a way to line its own pockets. The majority highlighted these troubling facts:

- Firmstones contacted the plaintiff-retailers and encouraged them to pursue refunds from the defendant-wholesalers, offering to finance this effort in return for a share of any recovery;
- Firmstones selected and retained the retailers' trial counsel;
- Firmstones prohibited counsel from contacting the retailers directly;
- Firmstones instructed counsel throughout the proceeding; and
- Firmstones retained the power to settle the proceeding with the wholesalers on behalf of the retailers.[27]

On appeal, the wholesalers argued that the retailers' funding agreement was impermissible and that the trial court's approval of the arrangement was an abuse of process and contrary to public policy. The High Court disagreed. The majority held that Firmstones's efforts to seek out plaintiffs and retain control over the litigation did not abuse any process or violate any public policy because seeking to profit from another's litigation—as lawyers do and have always done—is not against public policy.[28] Three of the Justices in the majority held that in states that had abolished the crimes and torts of maintenance and champerty, those concepts could not be used to challenge the funding agreement; the only policy question in such circumstances is whether the agreement is enforceable among its parties.

The minority opinion savagely criticized third-party litigation financing and the majority's holding, stating that the "purpose of court proceedings is not to provide a means for third parties to make money by creating, multiplying and stirring up disputes in which those third parties are not involved and which would not otherwise have flared into active controversy." The minority also stated that "public confidence in, and public perceptions of, the integrity of the legal system are damaged by litigation in which causes of action are treated merely as items to be dealt with commercially."[29]

At its core, the minority opinion in *Fostif* was a forceful reminder that the third-party financier is a stranger, an "alien" to the traditional adversarial relationship between plaintiff and defendant.[30] But in this respect, the minority ultimately was talking past the majority. The minority complained that third-party financing presents the evils that the doctrines of maintenance and champerty were designed to prevent. But the majority held that once those doctrines are abolished, whatever practices grow up are no longer considered evil. To frame it in the majority's terms: once maintenance and champerty are abolished as crimes and torts, they no longer should affect a nation's policy of what litigation *should* be. *Fostif* thus demonstrates the slippery slope of embracing third-party funding.

"…critics have expressed concern about the lack of regulation over third-party funders, the substantial fees they earn, and the unfair manner in which they negotiate funding contracts with plaintiffs"

2. Fostif's Aftermath

In the wake of *Fostif*, critics have expressed concern about the lack of regulation over third-party funders, the substantial fees they earn, and the unfair manner in which they negotiate funding contracts with plaintiffs.[31] Others have observed that third-party litigation funding has increased the number of class actions in Australia, which, outside of North America, is the jurisdiction where corporations are most likely to have to defend class actions.[32]

Especially since *Fostif*, third-party litigation financiers in Australia generally reserve the right to withdraw funding unilaterally at any time. They also generally require that they be apprised of and consulted regarding proposed settlements, with some companies going so far as to require the plaintiff to obtain the funder's consent before settling the case. Funders also often advise the plaintiff on selecting counsel. And, at least one Australian litigation funding company goes so far as to determine case strategies, evaluate and approve key witnesses, and conduct settlement discussions.[33]

As a result of these practices, Australian courts are belatedly considering rules to govern funding agreements. In addition, in 2006, the Standing Committee of Attorneys-General published a discussion paper on regulating litigation funding in Australia and invited public comment.[34] The Committee's efforts toward recommending a regulatory structure for third-party litigation funding companies are moving slowly. In its March 2008 Communiqué, the Committee reported that a working group is drafting a litigation-funding regulation impact statement that will outline strategies for regulating the industry.[35]

IV. Conclusion

By increasing the funds available to pursue litigation, third-party litigation financing inevitably increases the volume of litigation. Moreover, because third-party financing vitiates traditional safeguards against frivolous claims, much of this increased litigation volume consists of claims of questionable merit. For this reason, lawmakers and regulators should consider prohibiting third-party funding in the United States. At the very least, third-party funding should be banned in the context of aggregate litigation. As discussed above, aggregate litigation is already prone to abuse because there is a tremendous amount of money at stake and very little accountability to the supposed plaintiffs. Combining third-party funding with class and mass actions would exacerbate the risks of such abuse by adding yet another interested party to the mix and further reducing the already minimal role of the claimants themselves in such cases.

So far, third-party litigation funding is not widespread in the United States. If it gains in popularity, however, especially in the area of aggregate litigation, policy-makers should heed Australia's cautionary tale about the dangers presented by third-party funding and consider safeguards against the abusive litigation that will otherwise result if this practice becomes more prevalent.

"…because third-party financing vitiates traditional safeguards against frivolous claims, much of this increased litigation volume consists of claims of questionable merit."

[1] 1967 c. 58.

[2] *See, e.g., Anglo-Dutch Petroleum Int'l, Inc. v. Haskell,* 193 S.W.3d 87 (Tex. App. 2006) (holding third-party financing arrangement not usury or champerty, and not against public policy); *Kraft v. Mason*, 668 So. 2d 679 (Fla. Dist. Ct. App. 1996) (same); *Sneed v. Ford Motor Co.*, 735 So. 2d 306, 315 (Miss. 1990) (holding agreement to provide litigation financing was not champertous because funder did not induce plaintiff to sue).

[3] Joshua Hamerman, *Hedge Funds: A Litigious Bunch*, Investment Dealers' Digest, Dec. 17, 2007, Gale Group Document Number: A172510098.

[4] Model Rules of Prof'l Conduct, R. 1.8(e) (2009) (a "lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation").

[5] *See, e.g., Fausone v. U.S. Claims, Inc.*, 915 So. 2d 626, 629-30 (Fla. 2d Dist. Ct. App. 2005) (affirming arbitration award in favor of litigation-financing company).

[6] Julia H. McLaughlin, *Litigation Funding: Charting a Legal and Ethical Course*, 31 Vt. L. Rev. 615, 648 (2007) (citing state bar opinions from Connecticut, New York and Pennsylvania approving third-party litigation-financing agreements under limited conditions); Florida State Bar Opinion 00-3 (Mar. 15, 2002) (discouraging third-party funding, but holding attorneys may provide clients with information about it); *see also* Oregon State Bar Association Board of Governors Opinion Number 1993-133 (Jan. 1993).

[7] 9-A ME. REV. STAT. ANN. tit. 9-A, §§ 12-104, 12-106.

[8] OHIO REV. CODE ANN. § 1349.55 (2009).

[9] *Rancman v. Interim Settlement Funding Corp.*, 789 N.E.2d 217 (Ohio 2003).

[10] Examples abound of small businesses pushed to the brink of bankruptcy by lawsuit abuse. *See, e.g.*, U.S. Chamber of Commerce, *Family business facing more than 100 lawsuits teeters on the brink*, The Faces of Lawsuit Abuse, http://facesoflawsuitabuse.org/2009/04/family-business-facing-more-than-100-lawsuits-teeters-on-the-brink/ (last visited June 29, 2009) (describing the story of Monroe Rubber & Gasket of Monroe, Louisiana, a family business that may have to close its doors as a result of defending over 100 lawsuits filed by 2,000 plaintiffs related to the company's use of material containing asbestos); U.S. Chamber of Commerce, *Lawsuit over bathroom mirror 2 inches too high*, The Faces of Lawsuit Abuse, http://facesoflawsuitabuse.org/2009/03/lawsuit-over-bathroom-mirror-2-inches-too-high/ (last visited June 29, 2009) (telling the story of a restaurant owner who has spent more than the restaurant made in a year defending suit for multiple violations of disabilities regulations when employees replaced bathroom mirror, hanging it two inches too high per applicable disability regulations).

[11] Susan Lorde Martin, *The Litigation Financing Industry: The Wild West of Finance Should be Tamed Not Outlawed*, 10 Fordham J. Corp. & Fin. L. 55, 77 (2004); Douglas R. Richmond, *Other Peoples' Money: The Ethics of Litigation Financing*, 56 Mercer L. Rev. 649, 661 (2005); Mariel Rodak, *It's About Time: A Systems Thinking Analysis of the Litigation Finance Industry and Its Effects on Settlement*, 155 U. Pa. L. Rev. 503, 518–519 (2006) (summarizing proponents' argument and collecting sources); Michael Herman, *Fear of third party litigation funding is groundless*, Times Online, Oct. 25, 2007 (arguing that the claim that litigation funding will encourage frivolous suits is unfair because litigation funding companies seek to invest in commercial, rather than personal, disputes).

[12] *See, e.g.*, Rodak, *It's About Time*, 155 U. Pa. L. Rev. at 519.

[13] Hamerman, *Hedge Funds.*

[14] *Legal Report—A get out of jail for a fee card?*, Europe Intelligence Wire, at 3 (Mar. 8, 2007).

[15] Edward Smerdon, *Third Party Litigation Funding*, Reynolds Porter Chamberlain LLP D&O Update, Mar. 2008, http://www.rpc.co.uk/FileServer.aspx?oID=649&lID=0.

[16] McLaughlin, *Litigation Funding*, 31 Vt. L. Rev. at 621.

[17] *See Rancman v. Interim Settlement Funding Corp.*, 789 N.E.2d 217, 220-21 (Ohio 2003) (noting that the amount the plaintiff-appellant owed to litigation financiers was an "absolute disincentive" to settle at a lesser amount).

[18] Australia provides a case study of where these incentives ultimately will lead: there, some funding companies' financing contracts specifically provide that the companies have the power to accept or reject settlement offers.

[19] Anne Urda, *Legal Funding Gains Steam But Doubts Linger*, Law360 (Aug. 27, 2008).

[20] Allianz Deutschland AG, *Risk-free Litigation Financing*, Aug. 17, 2007, http://www.allianz.com/en/press/news/business_news/insurance/news_2007-08-17.html.

[21] Model Rules of Prof'l Conduct, R. 5.4(c) (providing that "a lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services").

[22] *See, e.g., id.*, R. 1.7(a) (providing that a "concurrent conflict of interest exists where" "there is a significant risk that the representation…will be materially limited by the lawyer's responsibilities to…a third person").

[23] It is unlikely that a third-party financier enjoys a joint-defense or common-interest privilege with the client. Those privileges require a common legal interest, not a mere common business interest.

[24] A recent study of the effects of third-party funding on litigation in Australian states that permit such funding found that for every AUD 10 million of funding provided by one funder, the number of lawsuits filed for every 100,000 people increased by 16.5%. *See* David Abrams and Daniel L. Chen, *A Market for Justice: The Effect of Litigation Funding on Legal Outcomes* (unpublished article), http://home.uchicago.edu/~dlc/papers/MktJustice.pdf) (last visited September 29, 2009).

[25] [2006] 229 CLR 386.

[26] *Id.* at 389-90.

[27] *Id.* at 390, 413, 424.

[28] *Id.* at 433-34.

[29] *Id.* at 488.

[30] *Id.*

[31] Stuart Clark and Christina Harris, *The Push to Reform Class Action Procedure in Australia: Evolution or Revolution?*, 32 Melb. U.L. Rev. 775, 810 (2008).

[32] S. Stuart Clark, *Thinking Locally, Suing Globally: The International Frontiers of Mass Tort Litigation in Australia*, 74 Def. Counsel J. 139, 139-40 (2007); Greg Williams, *Litigation Funding in Australia*, July 28, 2009.

[33] Vicki Waye, *Conflicts of Interest between Claimholders, Lawyers and Litigation Entrepreneurs*, 19 Bond L. Rev. 223 (2007) (includes an appendix detailing responses of six Australian third-party litigation funding companies to several questions about industry practices).

[34] Standing Committee of Attorneys-General, *Litigation Funding In Australia*, May 2006, http://www.lawlink.nsw.gov.au/lawlink/legislation_policy/ll_lpd.nsf/vwFiles/Litigation_Funding_Discussion_paper_May_06.doc/$file/Litigation_Funding_Discussion_paper_May_06.doc.

[35] Standing Committee of Attorneys-General, *Summary of Decisions* March 2008, Mar. 28, 2008, http://www.scag.gov.au/lawlink/SCAG/ll_scag.nsf/pages/scag_meetingoutcomes.

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