HARMONIZING THIRD-PARTY LITIGATION FUNDING REGULATION

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Third-party litigation funding is no longer a new phenomenon, but rather is a mainstay in global commerce and dispute resolution. Yet many observers still consider the third-party litigation funding industry as a "wild west" due to a lack of regulation in many countries. Some of the countries that have regulations suffer from a lack of uniformity and an array of conflicting laws at the sub-national level (i.e., the laws of states, provinces, territories, etc.). For example, the United States has a confusing patchwork of state laws on third-party litigation funding. This Article proposes

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harmonizing the regulatory framework for third-party litigation funding in the United States by identifying the three categories of interactions—transactional, procedural, and ethical—that make up third-party litigation funding, and suggesting avenues for regulation within those three categories. This approach will weave a regulatory "safety net" of minimum standards for the behaviors and interactions of the players in third-party litigation funding arrangements to ensure the integrity of the dispute resolution system in which they invest and participate.

TABLE OF CONTENTS

INTRODUCTION

This Article proposes a categorized regulatory framework for third-party litigation funding in the United States as an alternative to the existing piecemeal regulatory efforts that fail to answer certain transactional, procedural, and ethical questions raised by the third-party litigation funding industry. Third-party funding[1] is prevalent in litigation and arbitration both domestically and internationally.[2] Third-party funding, as discussed in this Article, involves a third party financing the legal representation of a party in a case as an alternative to the party self-funding the legal representation or receiving attorney financing through a contingent or conditional fee agreement.[3] If the funded party is the plaintiff, then the third-party entity contracts to receive a percentage or fraction of the proceeds from the case or a multiple of the funds invested, if the plaintiff wins.[4] If the funded party is the defendant, then the third-party entity contracts to receive a predetermined periodic payment from the defendant, similar to an insurance premium.[5] In addition, depending on the structure of the funding arrangement, the funder may legally control or influence

1 Some scholars use the term "third-party litigation funding" or "litigation funding" to refer to this same phenomenon. This Article intentionally uses the term "third-party funding"—without the word "litigation"—because this Article addresses funding of both litigation and arbitration, domestically and internationally.

2 *See* Cassandra Burke Robertson, *The Impact of Third-Party Financing on Transnational Litigation*, 44 CASE W. RES. J. INT'L L. 159, 162, 180–81 (2011).

3 There are other types of third-party funding, such as lawyer lending, assignment, or insurance covering legal expenses. This Article limits its discussion, however, to third-party funding arrangements with the following three characteristics: (1) the funder contracts directly with the original party to the case (i.e., not with the client's attorney); (2) the original party remains a party to the case; and (3) the funder does not become a party in the case (i.e., not an assignment of the underlying claim or liability). Thus, this Article intentionally does not address assignment of claims (in which the original client sells the entire claim and walks away leaving the funder to pursue the claim as a party) or insurance arrangements that fund legal expenses (in which the insurer may be a willing co-party or may be impleaded as a third-party defendant under Rule 14 of the Federal Rules of Civil Procedure). The funder becomes a party (or co-party) to the dispute through one of those types of arrangements, so concerns regarding the interests of the client may end with the conclusion of the transaction. Therefore, all three categories of regulation would not be proper. This Article also does not address lawyer lending (in which the funding transaction is between the law firm and the funder without directly involving the client). For an in-depth treatment of assignment and insurance policies in the third-party litigation funding context, see, e.g., Terrence Cain, *Third Party Funding of Personal Injury Tort Claims: Keep the Baby and Change the Bathwater*, 89 CHI.-KENT L. REV. 11 (2013); Anthony J. Sebok, *Betting on Tort Suits After the Event: From Champerty to Insurance*, 60 DEPAUL L. REV. 453 (2011); Marc J. Shukaitis, *A Market in Personal Injury Tort Claims*, 16 J. LEGAL STUD. 329 (1987); Paul Bond, Comment, *Making Champerty Work: An Invitation to State Action*, 150 U. PA. L. REV. 1297 (2002). For an in-depth discussion of insurance that specifically covers legal expenses, see generally LISA BENCH NIEUWVELD & VICTORIA SHANNON, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION (2012) (discussing after-the-event insurance, before-the-event insurance, and legal expenses insurance in various jurisdictions around the world). For an in-depth treatment of lawyer lending, see, e.g., Nora Freeman Engstrom, *Lawyer Lending: Costs and Consequences*, 63 DEPAUL L. REV. 377 (2014) [hereinafter Engstrom, *Lawyer Lending*]; Nora Freeman Engstrom, *Re-Re-Financing Civil Litigation: How Lawyer Lending Might Remake the American Litigation Landscape, Again*, 61 UCLA L. REV. DISCOURSE 110 (2013) [hereinafter Engstrom, *Re-Re-Financing*].

4 NIEUWVELD & SHANNON, *supra* note 3, at 4–11 (describing the players in third-party funding, the types of funding relationships, and the effect of the type of funder on the attorney-client relationship).

5 *Id.*

aspects of the legal representation or may completely take over the case and step into the shoes of the original party.[6] Third-party funding is no longer a new phenomenon, but rather is a mainstay in global commerce and dispute resolution. Yet, many observers still consider the third-party funding industry a "wild west" due to a lack of regulation in many countries and a lack of uniformity within some of the countries that do have regulations, particularly those countries that have sub-state political divisions (e.g., provinces, territories, etc.) with conflicting laws.[7]

In light of its increasing prevalence, there is a fascinating debate regarding the place of third-party funding both in the American legal system and in the context of international dispute resolution.[8] In the United States, there is a theoretical disconnect between the modern phenomenon of third-party funding in large commercial cases and the case law, statutes, and attorney ethics opinions that developed in the context of disputes involving individual consumers as plaintiffs, such as small civil claims and personal injury claims. In some states, those consumer laws apply to large commercial cases, while other states carve out exceptions for commercial disputes over a certain dollar value.[9] This

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6 *See supra* note 3, referencing articles on assignment.

7 *See generally* NIEUWVELD & SHANNON, *supra* note 3, at 187–96 (describing the Canadian case laws and statutes on third-party funding in the provinces of Ontario, Alberta, Nova Scotia, British Columbia, and New Brunswick); Susan Lorde Martin, *Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed*, 10 FORDHAM J. CORP. & FIN. L. 55 (2004); Richard A. Blunk, *Have the States Properly Addressed the Evils of Consumer Litigation Finance?*, MODEL LITIG. FIN. CONT. (Jan. 20, 2014), http://litigationfinancecontract.com/have-the-states-properly-addressed-the-evils-of-consumer-litigation-finance (describing the litigation funding statutes in Maine, Ohio, Nebraska, and Oklahoma—states that currently regulate litigation funding via statute); Heather Morton, *Litigation or Lawsuit Funding Transactions 2014 Legislation*, NAT'L CONF. ST. LEGISLATURES (June 4, 2014), http://www.ncsl.org/research/financial-services-and-commerce/litigation-funding-transactions-2014-legislation.aspx (adding Tennessee to the list of states that regulate litigation funding via statute).

8 *See, e.g.*, Susan Lorde Martin, *Litigation Financing: Another Subprime Industry That Has a Place in the United States Market,* 53 VILL. L. REV. 83, 83–95 (2008); Martin, *supra* note 7, at 56–57, 68–69, 72, 74, 77; Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367, 377–439 (2009) (proposing defense-side funding in the United States that would be similar to after-the-event insurance in Europe); Max Radin, *Maintenance by Champerty*, 24 CALIF. L. REV. 48, 74–75 (1935) (arguing for the regulation of contingency fees in a way similar to today's arguments for regulating third-party funding); Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61, 72 n.36, 139 (2011); Yifat Shaltiel & John Cofresi, *Litigation Lending for Personal Needs Act: A Regulatory Framework to Legitimatize Third Party Litigation Finance*, 58 CONSUMER FIN. L.Q. REP. 347, 350–61 (2004) (proposing a statute to regulate litigation funding for individual consumers called the Litigation Lending for Personal Needs Act); Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268, 1325–36 (2011); Courtney R. Barksdale, Note, *All That Glitters Isn't Gold: Analyzing the Costs and Benefits of Litigation Finance*, 26 REV. LITIGATION 707, 735 (2007); Jason Lyon, Comment, *Revolution in Progress: Third-Party Funding of American Litigation*, 58 UCLA L. REV. 571, 608–09 (2010); Mariel Rodak, Comment, *It's About Time: A Systems Thinking Analysis of the Litigation Finance Industry and Its Effect on Settlement*, 155 U. PA. L. REV. 503, 504, 508, 513–22, 523 & n.113, 526–27 (2006).

9 NIEUWVELD & SHANNON, *supra* note 3, at 144–59 (presenting a state-by-state survey of the laws regarding third-party funding, including all fifty states and the District of Columbia). *But see* Martin Merzer, *Cash-Now Promise of Lawsuit Loans Under Fire: 10 States Consider Laws to Hem*

ambiguity creates confusion regarding how to study and regulate the third-party funding industry as a whole. This Article takes a different approach. The categorized regulatory approach set forth herein would create a national baseline from which the state regulators can take guidance, similar to the Model Penal Code, the Model Uniform Commercial Code, the Model Rules of Professional Responsibility, and other national models.

Globally, the debate about third-party funding arises in the context of international arbitration and focuses on whether domestic laws on third-party funding at the place or seat of arbitration or at the place of enforcement may or should apply to third-party funding of international arbitration.[10] Some jurisdictions, such as Hong Kong, explicitly allow third-party funding in international arbitration while generally prohibiting the practice in domestic litigation.[11] In contrast, other jurisdictions, such as Singapore, currently prohibit third-party funding in all fora, including international arbitration.[12] Most countries fall somewhere in between. The current regulatory landscape in the United States is unclear at best, but it appears that the laws in roughly two-thirds of the states would allow third-party funding in international arbitration.[13] Given the limited grounds for vacating or setting aside an international arbitration award under the Federal Arbitration Act, addressing third-party funding in international arbitration through domestic arbitration laws would be unnecessary.[14]

When considering whom to regulate, there is a natural impetus to focus on regulating the funder and burdening the funder alone with

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in New High-Fee Loan Industry, CREDITCARDS.COM (Mar. 29, 2013), http://www.creditcards.com/credit-card-news/lawsuit-loans-under-fire-1282.php (describing proposed legislation in ten states in the United States addressing various rate caps and individual restrictions on third-party funders).

10 NIEUWVELD & SHANNON, *supra* note 3, at 4–11 (describing the players in third-party funding, the types of funding relationships, and the effect of the type of funder on the attorney-client relationship).

11 *Id.* at 227–31 (addressing the laws on third-party funding in Hong Kong).

12 *Id.* at 237–38 (addressing the laws on third-party funding in Singapore). *But see* MINISTRY OF LAW OF THE SING. GOV'T, REVIEW OF THE INTERNATIONAL ARBITRATION ACT: PROPOSALS FOR PUBLIC CONSULTATION (2011), *available at* http://www.mlaw.gov.sg/content/dam/minlaw/corp/assets/documents/linkclickf651.pdf (soliciting public comment on a proposed amendment to allow third-party funding in international arbitration cases over one million Singapore dollars, subject to certain restrictions and requirements).

13 NIEUWVELD & SHANNON, *supra* note 3, at 144–59 (presenting a state-by-state survey of the laws regarding third-party funding, including all fifty states and the District of Columbia).

14 *See generally* 9 U.S.C. §§ 1–16, 201–208 (2014). For international arbitration, promulgating guidance and guidelines at the international level through arbitral institutions and international bar associations would be most effective. For an example of a global effort to create such guidelines for international arbitration, see *ICCA Projects: Third-Party Funding*, INT'L COUNCIL FOR COMMERCIAL ARBITRATION, http://www.arbitration-icca.org/projects/Third_Party_Funding.html (last visited Jan. 12, 2015).

obligations and ethical restrictions.[15] After all, the funder is an intermediary and gatekeeper with a significant amount of information, expertise, and (at least de facto) control.[16] In addition, the funder has the ability to cause a catastrophe for the client—and our dispute resolution system—by withdrawing from the case after it has progressed past a certain stage.[17] For this same reason, we require attorneys to seek permission from the court to withdraw from cases after the case has passed a certain stage.[18]

Yet funders do not conduct funding in isolation. Several actors are required in order for funding to take place, including attorneys, clients, opposing parties, decisionmakers, and funders. Thus, regulating funders alone or trying to regulate funders by regulating lawyers are both ineffective strategies. Furthermore, clients are not regulated at all, and winning clients sometimes refuse to pay the funder's share, which forces funders to charge higher rates of return in order to offset the higher risk created by unscrupulous clients.[19] In sum, regulating only individual actors, rather than the interactions between the actors, may lead to imbalances of power and perverse incentives for collusion and deception among certain actors (e.g., funder-attorney collusion against the client's interests, funder-client collusion against the attorney's ethical obligations, a winning client reneging on its agreement with the funder, etc.). Such imbalances, if they occur, would disadvantage other actors and threaten the integrity of our worldwide system of dispute resolution.[20] This is the primary reason for a categorized approach to

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15 The author thanks Phil Nichols of the Wharton School at the University of Pennsylvania for helping flesh out this idea.

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18 AM. BAR ASS'N COMM'N ON ETHICS 20/20, INFORMATIONAL REPORT TO THE HOUSE OF DELEGATES (2012), *available at* http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf [hereinafter ABA WHITE PAPER] (describing how a lawyer would handle a third-party funding arrangement within the existing Rules of Professional Responsibility).

19 This observation was made by a participant at the Washington and Lee Roundtable on Third-Party Funding of Litigation and Arbitration on November 7–8, 2013. This is the most common way for a funding agreement to become the subject of litigation or become public. There is currently no regulation of clients, but funders say this is a big problem. A client may try to renegotiate or rescind the funding agreement if it looks like it will win in order to avoid paying the funder the contractual amount.

20 *See, e.g.*, Anthony J. Sebok & W. Bradley Wendel, *Duty in the Litigation-Investment Agreement: The Choice Between Tort and Contract Norms when the Deal Breaks Down*, 66 VAND. L. REV. 1831, 1832 (2013) ("Is this new form of economic activity best understood as an ordinary commercial-lending contract, a form of insurance, a commercial joint venture, venture capital financing, or an alternative lawyer-client fee arrangement?"). The author is a member of a Third-Party Funding Task Force, *see ICCA Projects: Third-Party Funding*, *supra* note 14, that is currently grappling with the issue of how to define third-party funding in a meaningful way that is neither

regulating third-party funding: to set standards for common funding relationships that ensure fairness for all involved in the system.

One could argue that harmonized standards are unnecessary, since each funding transaction is unique and tailored to the needs of the client, funder, and attorney involved. Not enough data on existing funding arrangements is available yet to prove or disprove this claim. There are at least two reasons for this lack of data. First, although there are three public funders worldwide that share their case data, most funders are private companies and will not voluntarily share data on cases that they are considering or have considered funding.[21] Second, there currently are no rules requiring disclosure of the use of funding in any particular litigation or arbitration proceeding in the United States. For these reasons, the examples of funding that have entered the public consciousness through the media are cases involving celebrities, sovereigns, or salacious situations.[22] An ordinary, uneventful litigation funding transaction may never come to light, especially if it goes smoothly. Thus, regulators have no representative transactions to exemplify, only outliers and obvious violators. Recalling the old adage that "hard cases make bad law," basing regulations for third-party funding on such cases would likely render those regulations either inapplicable to regular funding arrangements or ineffective for dealing with ordinary funding issues.[23] This Article takes the view that, by

overinclusive nor underinclusive of various types of third-party funding arrangements. This task has proven to be quite a challenge for the Task Force.

21 *See infra* note 286.

22 *See, e.g.*, Weaver v. Speedy Bucks, Inc., 162 F. Supp. 2d 448, 450–52 (W.D.N.C. 2001); Abu–Ghazaleh v. Chaul, 36 So. 3d 691, 692–94 (Fla. Dist. Ct. App. 2009); Martin, *supra* note 7, at 71–72; Julia H. McLaughlin, *Litigation Funding: Charting a Legal and Ethical Course*, 31 VT. L. REV. 615, 640–41 (2007); Jan Wolfe, *Burford Signs Deal with Chevron, Says Patton Boggs Hid Truth About Ecuadorian Plaintiffs*, N.Y.L.J., Apr. 19, 2013, at 2; Daniel Gilbert, *Chevron Flips Some Legal Adversaries as It Battles Ecuadorian Judgment*, RIGZONE (Apr. 21, 2013), http://ww.oilcareerfair.com/news/oil_gas/a/125951/Chevron_Flips_Some_Legal_Adversaries_as_It_Battles_Ecuadorian_Judgment; Roger Parloff, *Have You Got a Piece of This Lawsuit?*, FORTUNE (June 28, 2011, 6:06 PM), http://features.blogs.fortune.cnn.com/2011/06/28/have-you-got-a-piece-of-this-lawsuit-2; Roger Parloff, *Investment Fund: We Were Defrauded in Suit Against Chevron*, FORTUNE (Jan. 10, 2013, 2:05 PM), http://finance.fortune.cnn.com/2013/01/10/burford-capital-chevron-ecuador; Christie Smythe & Patricia Hurtado, *Chevron Wins U.S. Ruling Calling Ecuador Judgment Fraud*, BLOOMBERG (Mar. 4, 2014, 4:13 PM), http://www.bloomberg.com/news/2014-03-04/ecuador-judgment-against-chevron-ruled-a-fraud-by-u-s-.html.

23 *See* N. Sec. Co. v. United States, 193 U.S. 197, 400–01 (1904) (Holmes, J., dissenting) ("Great cases, like hard cases, make bad law. For great cases are called great, not by reason of their real importance in shaping the law of the future, but because of some accident of immediate overwhelming interest which appeals to the feelings and distorts the judgment. These immediate interests exercise a kind of hydraulic pressure which makes what previously was clear seem doubtful, and before which even well settled principles of law will bend."); Winterbottom v. Wright, (1842) 152 Eng. Rep. 402 (Exch.) 405–06 ("This is one of those unfortunate cases in which . . . it is, no doubt, a hardship upon the plaintiff to be without a remedy, but by that consideration we ought not to be influenced. Hard cases, it has been frequently observed, are apt to introduce bad law.").

creating some limited, baseline standards based on currently available knowledge about ordinary litigation funding arrangements, society can glean valuable information about existing successful funding arrangements and encourage the industry to grow in a constructive way.

This Article begins to formulate a framework for baseline regulatory standards for third-party funding in three ways. First, this Article identifies the three categories of interactions within third-party funding: transactional, procedural, and ethical. Second, this Article argues that the solution to regulating third-party funding is to implement regulatory solutions for the universal aspects of third-party funding within each of the three categories described in this Article. Third, this Article advocates linking those regulations together through cross-references to harmonize regulatory standards across all three categories. This network of regulations will essentially weave a regulatory "safety net" that will provide a floor for the behaviors and interactions of the players in third-party funding. The hope is that by providing a baseline for third-party funding, regulators can "nudge"[24] the players toward more optimal behaviors to ensure the integrity of the dispute resolution system. This Article calls for a high level of regulatory coordination that may seem idealistic. Yet there are high levels of regulatory coordination across multiple legal regimes and regulatory bodies for several other sectors, including legal services, bankruptcy, law enforcement, insurance, and accounting services. Thus, with concerted effort, effective regulatory coordination for third-party funding is achievable as well.

Part I gives an overview and background of third-party funding, including the basic mechanics of funding agreements. Part II describes existing attempts to regulate third-party funding and explains why those approaches are insufficient. Part III explains why we need a categorized regulatory framework; defines the transactional, procedural, and ethical categories; identifies the relationships and conduct to regulate within those categories; and suggests cross-references between those regulations that harmonize the regulatory standards used. Finally, the Conclusion proposes areas for future inquiry and research, including empirical work.[25]

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24 *See generally* RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS (Penguin Books rev. ed. 2009) (2008).

25 Two scholars have conducted a study on public data on third-party funding available in Australia. *See* David S. Abrams & Daniel L. Chen, *A Market for Justice: A First Empirical Look at Third Party Litigation Funding*, 15 U. PA. J. BUS. L. 1075 (2013). One could conduct a similar study on court cases funded in the United States using data collected directly from litigants and their attorneys, if funders will not share their data. *See infra* note 286.

A. *The Impetus for the Third-Party Litigation Funding Industry*

The leading jurisdictions worldwide—in terms of volume, sophistication, and regulation of third-party funding arrangements—are Australia, the United Kingdom, the United States, and Germany.[26] In the past, third-party funding was a smaller niche market, but in recent years, the demand for third-party funding services in these and other jurisdictions has grown exponentially.

There are three overarching global forces driving the sharp increase in the demand for dispute financing. The first force is the public policy ideal of increasing access to justice for plaintiffs who otherwise could not afford to pursue a meritorious claim individually or through class actions or mass claims.[27] Another force is the slew of companies seeking a means to pursue a claim or defend against a claim while also maintaining enough cash flow to continue conducting business as usual.[28] A third force is the worldwide market turmoil and uncertainty in recent years, which has inspired hedge funds, banks, and other financial investors to seek investments that are not directly tied to or affected by the volatile and unpredictable financial markets.[29] The global economic slowdown has also inspired companies facing bankruptcy or insolvency to seek funding to pursue claims that may generate cash flow for their businesses or mitigate the risk of losing a "bet-the-company" dispute.[30]

Practical reasons for the explosion of third-party funding include technological advancements that have helped dissolve barriers to entry in the third-party funding market, the increasing costs of litigation and arbitration, the prohibition on attorneys advancing living expenses to clients in nearly all states in the United States,[31] the wariness of

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26 NIEUWVELD & SHANNON, *supra* note 3, at 11, 71–174 (this section is entitled "Part II: Key Third-Party Funding Markets," including separate chapters on third-party funding in Australia, the United Kingdom, the United States, and Germany); Robertson, *supra* note 2; Rodak, *supra* note 8, at 504–05, 513–14.

27 *See, e.g.*, Abrams & Chen, *supra* note 25, at 1076 n.3, 1077 n.6, 1077 n.7.

28 James D. Dana, Jr. & Kathryn E. Spier, *Expertise and Contingent Fees: The Role of Asymmetric Information in Attorney Compensation*, 9 J.L. ECON. & ORG. 349, 365–66 (1993); Martin, *supra* note 8, at 85; Martin, *supra* note 7, at 67 n.93; Steinitz, *supra* note 8, at 1275–76; Neil Rose, *Something for Nothing?*, RACONTEUR ON LEGAL EFFICIENCY, Mar. 25, 2010, at 8–9, *available at* http://np.netpublicator.com/netpublication/n89269938.

29 Steinitz, *supra* note 8, at 1283–84.

30 *Id.*; Rose, *supra* note 28; Doug Jones, Third-Party Funding of Arbitration, Paper Presentation at Hot Topics in International Arbitration at SJ Berwin, London, United Kingdom 7 (Sept. 22, 2008) (on file with author); Ralph Lindeman, *Third-Party Investors Offer New Funding Source for Major Commercial Lawsuits*, FULBROOK CAP. MGMT., LLC (Mar. 5, 2010), http://www.fulbrookmanagement.com/third-party-investors-offer-new-funding-source-for-major-commercial-lawsuits.

31 Texas and the District of Columbia are exceptions, allowing attorneys to finance their clients' non-litigation expenses to some extent. *Compare* TEX. DISCIPLINARY R. PROF. CONDUCT

traditional lenders to count the potential proceeds from pending litigation as an asset for the purpose of determining the creditworthiness of a corporation, and the widespread roll back of maintenance and champerty laws (discussed below) in many jurisdictions in recent years.[32]

For funders, international arbitration is a particularly attractive area of investment because of the high values of the claims, the speed of the proceedings, the potential for greatly reduced evidentiary costs, the industry expertise of the decisionmakers, and the high enforceability of arbitration awards. With respect to enforceability, there are currently 150 jurisdictions in which a party can enforce a contract-based arbitral award through the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention"), which is the main vehicle for enforcing arbitral awards worldwide.[33] These and other forces will likely lead to further increases in the supply of willing third-party funders and the demand from clients who are either unwilling or unable to finance their own disputes.

B. *The Players and Relationships in Third-Party Litigation Funding*

The major players in third-party funding arrangements are the funder, the client (i.e., the party in the case), and the attorney. The opposing side and the decisionmaker also have a role to play, even if they are completely unaware of the existence of the funding arrangement.

1.08(d)(1) (1989) (stating that a Texas lawyer may advance or guarantee "reasonably necessary medical and living expenses, the repayment of which may be contingent on the outcome of the matter"), *and* D.C. RULES OF PROF'L CONDUCT R. 1.8(d)(2) (2007) (stating that a D.C. lawyer may give a client "financial assistance which is reasonably necessary to permit the client to institute or maintain the litigation or administrative proceedings"), *with* MODEL RULES OF PROF'L CONDUCT R. 1.8(e)(1) (stating that "a lawyer may advance court costs and expenses of litigation" but intentionally omits medical and living expenses).

32 Stephen C. Yeazell, *Re-Financing Civil Litigation*, 51 DEPAUL L. REV. 183, 193–94 (2001); Rodak, *supra* note 8, at 504–05.

33 Jones, *supra* note 30, at 9–10; Clifford J. Hendel, *Third Party Funding*, LATIN ARBITRATION LAW, http://latinarbitrationlaw.com/third-party-funding (last visited Jan. 14, 2015). At the time of this writing, 150 countries have signed the New York Convention. For a current list of signatories to the New York Convention, see *Status: Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958)*, UNCITRAL, http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html (last visited Jan. 14, 2015). Third-party funding is also prevalent in investor-state arbitration, which is typically authorized by a treaty and most often takes place under the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, also known as the "ICSID Convention" or the "Washington Convention," which presently has 159 signatories. For a current list of signatories to the ICSID Convention, see *Member States*, ICSID, https://icsid.worldbank.org/apps/ICSIDWEB/about/Pages/Database-of-Member-States.bak.aspx (last visited Jan. 18, 2015).

The entity supplying the financial backing (commonly referred to as the "funder") most often is an insurance company or a financial institution, such as a bank or hedge fund.[34] Some institutional funders specialize in third-party funding, while others invest in litigation or arbitration claims as part of a wider portfolio of traditional financial investments.[35] The majority of specialized litigation funding institutions are based in countries where the third-party funding industry is well developed, such as Australia, Germany, the United Kingdom, the United States, the Netherlands, Canada, South Africa, and New Zealand, with much smaller pockets of funders—if any at all—in Continental Europe, Asia, Latin America, the Middle East, and Africa.[36] Many other funders prefer to invest on a case-by-case basis rather than devote an entire business unit to this investment type.

The funder usually provides the client with either a traditional loan or non-recourse funding where repayment is contingent upon the client winning its case.[37] If the client has an insurance policy that covers the situation at hand, then the insurance policy might be a form of third-party funding if its terms provide that the insurance company will cover litigation or arbitration expenses.[38] Assignment of all or part of the claim or the proceeds of the claim is another possibility, depending on the applicable laws on assignment.[39] Funders also engage in lawyer lending, where the client is the lawyer (or law firm) and the funder finances one or a few of the lawyer's cases or the lawyer's entire portfolio of cases.[40] Lawyer lending is most common among attorneys involved in

34 *See generally* Steinitz, *supra* note 8.

35 Examples of third-party funders include Allianz Profess Finanz, ARCA Capital Partners, BridgePoint Financial Services, Burford Capital Group, Calunius Capital, Fulbrook Management LLC, Global Arbitration & Litigation Services, Harbour Litigation Funding Ltd., IMF (Australia) Ltd., IM Litigation Funding, The Judge Limited, Juridica Capital Management, Juridica Investments, Juris Capital, and the Litigation Risk Strategies Group of Credit Suisse Group AG, Therium, and Gerchen Keller Capital.

36 *See generally* NIEUWVELD & SHANNON, *supra* note 3 (the entire book discusses third-party funding worldwide); Selvyn Seidel, *The Third Man*, EUR. LAW., May 2011, at 5, *available at* http://www.fulbrookmanagement.com/wp-content/uploads/2014/06/EL-May2011.pdf (discussing third-party funding worldwide).

37 Andrew Hananel & David Staubitz, *The Ethics of Law Loans in the Post-*Rancman *Era*, 17 GEO. J. LEGAL ETHICS 795, 800 (2004).

38 NIEUWVELD & SHANNON, *supra* note 3, at 5–6, 77, 96–97, 123–24, 162–63, 186, 197–98 (discussing third-party funding through various insurance-based options in Australia, the United Kingdom, the United States, Germany, Canada, and South Africa).

39 *Id.* at 8, 77–78, 110–11, 124–25, 186–87 (discussing claim assignment in Australia, the United Kingdom, the United States, and Canada); Sebok, *supra* note 8.

40 For a detailed analysis of the pros and cons of lawyer lending, see, e.g., Engstrom, *Lawyer Lending*, *supra* note 3; Engstrom, *Re-Re-Financing*, *supra* note 3; Thomas Markle, Comment, *A Call to Partner with Outside Capital: The Non-Lawyer Investment Approach Must Be Updated*, 45 ARIZ. ST. L.J. 1251 (2013).

contingency fee arrangements with their clients and law firms involved in representing a class or group of plaintiffs.[41]

Direct clients of third-party litigation funding may be corporations, law firms, individuals, and sovereign states, but in virtually all disputes, the client will either initiate a claim or defend against a claim.[42] The funder will ask the client to provide information about the case so that it may assess the claim or defense.[43] The information that the client provides may be privileged under applicable law, and disclosure to the funder may endanger that privilege.[44] The funder will analyze the strengths and weaknesses of the claim or defense, the likelihood of success on the merits, and the ability to recover from the assets of the losing party.[45] If the funder agrees to fund the client's case, the funder will grant the client funding to pay its own attorney fees and evidentiary costs.[46] The client and the funder will negotiate a detailed funding agreement.[47] In some jurisdictions, the funding agreement may include provisions addressing whether the funder would pay an adverse costs award if the funded party loses.[48] An adverse costs award requires the losing party to pay some or all of the winning party's costs of representation, which may include attorney's fees, evidentiary costs (including costs for documents and witnesses), and administrative fees (including court fees or the fees of the arbitral institution).[49] The law applicable to the substantive dispute and the laws of the procedural seat govern the use of adverse costs awards and what expenses an adverse costs award covers.[50]

The lawyer's role varies widely depending on the jurisdiction, venue, and applicable law in the case. According to attorney ethical rules in most states within the United States, the funder must not exercise any control over the legal representation or the attorney.[51] The lawyer representing the underlying client in the case must adhere to any rules

41 *See supra* note 40.

42 Robertson, *supra* note 2, at 180–81; Steinitz, *supra* note 8, at 1277, 1302.

43 *See, e.g.*, NIEUWVELD & SHANNON, *supra* note 3, at 20–21, 34–37 (explaining case due diligence procedures that commercial funders require). Similarly, consumer funders will ask potential funding clients for information about their individual claims.

44 *See infra* note 99.

45 *See infra* note 99.

46 *See infra* note 99.

47 *See infra* note 99.

48 *See* NIEUWVELD & SHANNON, *supra* note 3, at 22–24, 27 & n.8, 28, 30, 33 n.16 (explaining situations in which a third-party funder would pay an adverse costs award).

49 *See infra* note 99.

50 *See infra* note 99.

51 NIEUWVELD & SHANNON, *supra* note 3, at 9–11 (discussing the effect of the type of funder on the attorney-client relationship), 39–67 (discussing how various attorney ethical rules in common law and civil law countries, such as the United Kingdom, Germany, the United States, Australia, the Netherlands, and South Africa, put varying levels of restraint on the role of the attorney in a third-party funding arrangement).

of professional responsibility or ethics of the jurisdiction(s) in which she is licensed to practice and may be subject to specific ethical rules of the dispute resolution venue as well.[52] Controversial ethical issues worldwide relating to the attorney's role in a third-party funding arrangement include the maintenance and champerty doctrines,[53] how much influence the funder may have over the legal representation, whether attorneys may refer their clients to funders, conflicts of interest involving the attorney-funder and attorney-client relationships, the possible disclosure of third-party funding arrangements to the court or to the opposing side, the reasonableness of the attorney's fees, the funder's influence over settlement negotiations, and the possible waiver of the attorney-client privilege or the work product doctrine for documents and information disclosed to the funder.[54]

This Article focuses on funding arrangements between the funder and a party to the dispute (i.e., not lawyer lending) in which the funder does not become a party to the case (i.e., not an assignment of the underlying claim or liability).[55] The quintessential example of this arrangement is when an institution provides financial backing to a claimant in a dispute in exchange for the promise of a share of the proceeds if, and only if, the claimant recovers any money, whether through a settlement agreement, court judgment, or arbitral award. On the defense side, the funding arrangement typically involves the defendant making payments to the funder in exchange for the funder paying the defendant's legal expenses in the case and a success fee for the funder if the defendant wins.[56]

I. THE EXISTING REGULATORY LANDSCAPE

A. *Legal Doctrines in Jurisdictions Prohibiting Third-Party Litigation Funding*

The legal doctrines regarding the continued existence and viability of the third-party funding industry center on whether a third-party funding agreement would be valid and enforceable in a particular jurisdiction. Maintenance and champerty are the most widespread and long-standing doctrines that may serve to constrain the behavior of

52 *See supra* note 51.
53 *See infra* Part II.A.
54 *See supra* note 51.
55 See *supra* note 3 for the scope of the types of third-party funding addressed in this Article.
56 *See generally* NIEUWVELD & SHANNON, *supra* note 3, at 5–6 (discussing insurance as a type of third-party funding), 95–97 (discussing before-the-event and after-the-event insurance in the United Kingdom); Molot, *supra* note 8 (proposing defense-side funding in the United States that would be similar to after-the-event insurance in Europe).

attorneys, funders, or both in most jurisdictions around the world.[57] The doctrines of maintenance and champerty originated in the ancient Greek and Roman legal systems, evolved in the common law system of England during feudal times, and spread to other jurisdictions largely through the far-reaching British Empire.[58] Some nations deem these doctrines obsolete and prefer newer ones aimed at preventing frivolous and fraudulent claims. Others have revived the doctrines of maintenance and champerty in recent years and used them as a lens through which they evaluate the desirability and the legality of third-party funding agreements.[59]

Various jurisdictions around the globe define maintenance differently. A broad-based definition would be that maintenance is the act of providing financial assistance to a party to a dispute *without* taking an interest in the outcome and *without* an expectation of receiving a share of that party's recovery.[60] Champerty is providing the same assistance *with* the expectation of receiving a share of any money recovered if the party wins.[61] Maintenance is an umbrella term encompassing champerty as a type of maintenance in which the funder seeks to profit from the client's successful claim.[62]

Many jurisdictions in the nineteenth and twentieth centuries outlawed acts of maintenance or champerty as criminal violations of the widespread public policy against stirring up excessive litigation and frivolous claims and as a safeguard against the extortion and oppression of indigent clients by wealthy funders.[63] In the twenty-first century, however, many jurisdictions are reexamining these doctrines to consider whether they are still useful and relevant given the myriad of other safeguards against fraud and abuse that legal systems employ

57 Douglas R. Richmond, *Other People's Money: The Ethics of Litigation Funding*, 56 MERCER L. REV. 649, 652–55 (2005).

58 Jern-Fei Ng, *The Role of the Doctrines of Champerty and Maintenance in Arbitration*, 76 ARBITRATION 208 (2010); Radin, *supra* note 8, at 49, 52–54 (1935); Steinitz, *supra* note 8, at 1275–76; Ari Dobner, Comment, *Litigation for Sale*, 144 U. PA. L. REV. 1529, 1543–46 (1996).

59 Ng, *supra* note 58; Richmond, *supra* note 57; Richard Lloyd, *The New, New Thing*, AM. LAW., May 17, 2010; Nate Raymond, *Attorneys Explore Third-Party Funding in Commercial Disputes*, N.Y.L.J., June 3, 2010, at 1.

60 JOHN BEISNER, JESSICA MILLER & GARY RUBIN, SELLING LAWSUITS, BUYING TROUBLE: THIRD-PARTY LITIGATION FUNDING IN THE UNITED STATES (2009), *available at* http://ilr.iwssites.com/uploads/sites/1/thirdpartylitigationfinancing.pdf; STEVEN GARBER, ALTERNATIVE LITIGATION FINANCING IN THE UNITED STATES: ISSUES, KNOWNS, AND UNKNOWNS (2010), *available at* http://www.rand.org/content/dam/rand/pubs/occasional_papers/2010/RAND_OP306.pdf; Ng, *supra* note 58; Richmond, *supra* note 57; Sebok, *supra* note 8, at 73 n.43, 98 n.159; Jones, *supra* note 30, at 10–12; Doug Jones, Third-Party Funding of Arbitration, PowerPoint Presentation at Hot Topics in International Arbitration at SJ Berwin, London, United Kingdom (Sept. 22, 2008).

61 *See supra* note 60.

62 *See supra* note 60.

63 Richmond, *supra* note 57, at 651–52; Steinitz, *supra* note 8, at 1288.

today.[64] Some jurisdictions have reaffirmed these doctrines, while others have abolished or redefined them to carve out an exception with respect to third-party funding.[65]

Many scholars now espouse the view that the framework of maintenance and champerty laws should no longer bar third-party funding arrangements.[66] Champerty prohibitions "materially predate contemporary business and legal practices, and are, therefore, less than ideal frameworks with which to analyze litigation finance."[67] Third-party funding was not antithetical to the laws of those ancient cultures from whence the champerty and maintenance doctrines came.[68] Those ancient cultures reviled the maintenance of frivolous lawsuits, not authentic ones.[69] To them, as long as the underlying cause of action was authentic, then the mere involvement of a third-party funder did not change that original authenticity.[70] It is not in the funder's interest to fund frivolous cases, because the funder would incur only costs without benefits when the case fails, and a court may sanction the funded party for bringing a frivolous case.[71]

In addition, the champerty doctrine is inconsistently applied.[72] Champerty originally applied to attorneys.[73] The modern utility of champerty laws has become unclear given the widespread legalization of contingency, conditional, success, and uplift fees in the United States and many other countries.[74] There are also overlapping and

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64 Hananel & Staubitz, *supra* note 37, at 801; Ng, *supra* note 58; Steinitz, *supra* note 8, at 1278–82.

65 Hananel & Staubitz, *supra* note 37, at 801; Ng, *supra* note 58; Richmond, *supra* note 57, at 655–60; Steinitz, *supra* note 8, at 1289.

66 *See, e.g.*, McLaughlin, *supra* note 22, at 627; Richmond, *supra* note 57, at 652; Sebok, *supra* note 8, at 107 n.191; George Steven Swan, *The Economics of Usury and the Litigation Funding Industry:* Rancman v. Interim Settlement Funding Corp., 28 OKLA. CITY U. L. REV. 753, 757 (2003); Lyon, *supra* note 8, at 576 & n.28, 579–81.

67 Rodak, *supra* note 8, at 510; *see also* Susan Lorde Martin, *Financing Plaintiffs' Lawsuits: An Increasingly Popular (and Legal) Business*, 33 U. MICH. J.L. REFORM 57, 83–84 (1999); Radin, *supra* note 8, at 54–56, 58, 68–70; Sebok, *supra* note 8, at 122, 133–34; Lyon, *supra* note 8, at 587, 589–90.

68 Radin, *supra* note 8, at 54–56, 58, 68–70; Sebok, *supra* note 8, at 123, 125–27; Lyon, *supra* note 8, at 580.

69 Radin, *supra* note 8, at 54–56, 58; Sebok, *supra* note 8, at 123, 125–27.

70 Sebok, *supra* note 8, at 123, 125–27.

71 Martin, *supra* note 8, at 86–87; Jonathan T. Molot, *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L.J. 65, 106–07 (2010); Richmond, *supra* note 57, at 660–61, 666; Lyon, *supra* note 8, at 594–95.

72 Sebok, *supra* note 8, at 121 n.240; Rodak, *supra* note 8, at 511–12.

73 Hananel & Staubitz, *supra* note 37, at 798; Susan Lorde Martin, *Financing Litigation On-Line: Usury and Other Obstacles*, 1 DEPAUL BUS. & COM. L.J. 85, 87 (2002); Martin, *supra* note 67, at 89; Radin, *supra* note 8, at 65–86; Sebok, *supra* note 8, at 121–22; Yeazell, *supra* note 32, at 184 n.4; Lyon, *supra* note 8, at 583, 593; Rodak, *supra* note 8, at 511 n.40.

74 *See supra* note 73; *see also,* NIEUWVELD & SHANNON, *supra* note 3 (discussing the use of contingency, conditional, success, and uplift fees in attorney-client relationships around the world).

contradictory legal regimes that have been applied to third-party funding by various state courts in the United States, including champerty, attorney ethics rules, and predatory lending restrictions.[75]

The champerty doctrine has been steadily eroding for nearly a century in most states in the United States, and all states have carved out exceptions for contingency fees, which essentially serve the same purpose—from the perspective of a funded party—as third-party funding.[76] Other laws and attorney ethical rules now address the intended purpose of the champerty laws, so champerty should no longer bar third-party funding.[77] In addition, it would be logically improbable for a lawyer to agree to a defense-side contingency fee, whereas defense-side third-party funding does exist and, if structured properly, is profitable for the funder.[78] Thus, third-party funding addresses a need in the defense-side legal market that contingency fees will never be able to meet.

Furthermore, since third-party funders can fund the defense side of the dispute, they are a completely different animal from traditional "champertors." Third-party funders can also fund counterclaims and cross-claims in multiparty disputes or investment treaty arbitrations against or on behalf of sovereign governments, which contingency fees and traditional loans may be unable to accommodate. Thus, third-party funders can help level the playing field by providing funding for defendants to compete with plaintiffs' access to both contingency fees and third-party funding.[79]

Finally, the champerty doctrine creates a slippery slope between providing funding in an appropriate way and "officious intermeddling," and states are conflicted regarding where to draw the line.[80] Specialized, cash-infused segments of the plaintiff's bar—involving products liability, asbestos, tobacco, and securities litigation—were already legally treating litigation as investments a decade ago.[81] They employed sophisticated financial tools such as specialization, diversification, insurance, and hedging.[82] Third-party funders are doing the same thing; they just are not lawyers. This is one more reason why the champerty doctrine is not the ideal framework for regulating third-party funding.

75 Martin, *supra* note 7, at 55 & n.3, 56.

76 Hananel & Staubitz, *supra* note 37, at 803; Martin, *supra* note 73; McLaughlin, *supra* note 22, at 625–26.

77 Martin, *supra* note 67, at 57; Sebok, *supra* note 8, at 106 n.187.

78 *See supra* note 77.

79 Martin, *supra* note 73, at 101–02; Yeazell, *supra* note 32, at 216.

80 For an example of a court drawing the line, see *infra* note 100.

81 Yeazell, *supra* note 32, at 212–15.

82 *Id.*

The industry needs clearer rules and guidance in order to be able to grow and develop in a way that advances the goals of our legal system.[83]

B. *Piecemeal Regulations in Jurisdictions Allowing Third-Party Litigation Funding*

In light of maintenance, champerty, and other doctrines, some scholars have argued in favor of prohibiting third-party funding, and a few countries have prohibited the practice by law.[84] Most countries, however, either have no laws on third-party funding or have proposed or enacted legislation allowing and regulating the industry.[85] Most attempts around the world to regulate third-party funding have adopted a piecemeal approach, focusing on one type of conduct or problem that has arisen in courts or in the media, rather than addressing the phenomenon as a whole.[86] In the countries that do regulate third-party funding, there are a mix of regulations, ethical guidelines, and funder self-regulation leading to confusion about what the rules mean and mixed reactions from the public.[87] The reason that regulatory attempts so far have been unsuccessful or stymied is that the regulations often address only one aspect of third-party funding at a time, such as attorney ethical conduct, limits on the funder's rate of return, or font size in disclosure agreements presented to clients.

There are three main reasons why existing third-party funding regulations generally adopt a piecemeal approach. First, there is no worldwide consensus regarding what constitutes third-party funding, and third-party funding takes so many forms that it is difficult to determine a proper regulatory definition.[88] Existing literature addressing third-party funding draws a bright dividing line between

83 Sebok, *supra* note 8, at 109–12.

84 *See, e.g.*, BEISNER, MILLER & RUBIN, *supra* note 60; Alexander Bruns, *Third-Party Financing in the Perspective of German Law—Useful Instrument for Improvement of the Civil Justice System or Speculative Immoral Investment?*, 8 J.L. ECON. & POL'Y 525 (2012). Singapore is an example of a country that expressly prohibits third-party funding in all dispute resolution within its borders, including international arbitration, but it is possible that Singapore will soon change its position for commercial cases. *See* NIEUWVELD & SHANNON *supra* note 3, at 237–38 (describing the laws on third-party funding in Singapore).

85 *See generally* NIEUWVELD & SHANNON, *supra* note 3 (the entire book details the existing laws in Australia, the United Kingdom, the United States, Germany, Canada, the Netherlands, South Africa, Hong Kong, Singapore, Malaysia, and New Zealand, and countries in Continental Europe, as well as the lack of laws on third-party funding in most jurisdictions in Africa, the Middle East, Latin America, and the remainder of Asia).

86 *See, e.g.*, ABA WHITE PAPER, *supra* note 18; Merzer, *supra* note 9.

87 *See, e.g.*, Mary H. Terzino, *Litigation Funding Is Not Going Away—But Neither are the Problems*, OUR LEGAL FUTURE (Jan. 3, 2014), http://ourlegalfuture.co.uk/litigation-funding-is-not-going-away-but-neither-are-the-problems.

88 *See supra* note 20.

consumer and commercial third-party funding or between domestic and international disputes, because there are important differences in the transactional, procedural, and ethical concerns for each of these types of funding.[89] For example, individual funded parties have different goals, concerns, and vulnerabilities than corporate funded parties.[90]

Despite the bright lines drawn in legal literature, however, it is not always clear where to draw the line between an individual and a corporate concern. For example, a high-net worth individual or a class of plaintiffs might be seeking funding for a case worth millions of dollars while an insolvent small business organized as a corporation or a cash-strapped community not-for-profit organization (such as a church or local charity) might be seeking funding for a case worth a few thousands of dollars. In addition, consumer cases are sometimes (but not always) cheaper to fund than commercial cases, so one could categorize the cases based on how much financial support the funder provides.[91] However, there would inevitably be cases incorrectly categorized at either end of the spectrum. Furthermore, the relative bargaining power of the party seeking funding is very fact-dependent. A consumer client may have more bargaining power than a corporate client may have, depending on the particular situation. Thus, it may not be fair to place all natural persons seeking funding into the "consumer" box or to lump all legal persons seeking funding into the "commercial" box automatically.[92] Another possibility may be to draw a conceptual line based on what type of funder is interested in the case. Funders who fund "consumer" claims typically do not fund "commercial" claims and vice versa. Still, how would one classify a funded class action claim, a funded class action defendant, or an arbitration under such a regime?[93] How would one characterize an individual small business owner, without a corporate structure, making a tort claim under this regime?

89 *See, e.g.*, Tatyana Taubman, Access to Justice with Protection: Improving Alternative Litigation Financing with Consumer Protections (2013) (unpublished note), *available at* http://www.law.gwu.edu/News/20112012events/Documents/ALF_ConferenceNote.pdf.

90 *See id.*

91 The author thanks Charlie Gollow of Bentham IMF, a U.S. funder affiliated with IMF Australia, for this insight.

92 *See* Taubman, *supra* note 89.

93 Third-party funding of class actions is not yet prevalent in the United States, but the practice is widespread in other leading third-party funding jurisdictions such as Australia, Canada, and the Netherlands. *See, e.g.*, Deborah R. Hensler, *The Future of Mass Litigation: Global Class Actions and Third-Party Litigation Funding*, 79 GEO. WASH. L. REV. 306 (2011); Jasminka Kalajdzic, Peter Cashman & Alana Longmoore, *Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding*, 61 AM. J. COMP. L. 93 (2013); Michael Legg & Louisa Travers, *Necessity Is the Mother of Invention: The Adoption of Third-Party Litigation Funding and the Closed Class in Australian Class Actions*, 38 COMMON L. WORLD REV. 245 (2009); Michael J. Legg, *Shareholder Class Actions in Australia—The Perfect Storm?*, 31 U. NEW S. WALES L.J. 669 (2008); Ianika N. Tzankova, *Funding of Mass Disputes: Lessons from the Netherlands*, 8 J.L. ECON. & POL'Y 549 (2012).

This is one reason why a definition of third-party funding is so difficult to articulate and why many consumer and commercial third-party funding instances straddle the bright line in legal literature. If we cannot reliably categorize *all* funding instances as consumer or commercial, or agree upon a clear definition of what constitutes funding, then our dichotomous regulatory framework will hinder us in achieving truly effective regulatory standards. Categorized regulatory standards narrowly tailored to address the readily identifiable overarching themes that affect a wide cross-section of third-party funding arrangements[94] are the best way to supplement the already growing body of literature and legislation addressing the unique nuances of each type of funding.[95]

Many similar, significant issues arise during debates about both consumer and commercial third-party funding that share the following three characteristics: (1) the funder contracts directly with the original party to the case (i.e., not with the client's attorney); (2) the original party remains a party to the case; and (3) the funder does not become a party in the case (i.e., not an assignment of the underlying claim or liability).[96] Such issues are universal to the various types of third-party funding, regardless of the parties, forum, amount in dispute, subject matter of the case, or the international or domestic nature of the disputes.[97] Examples of those universal issues include: disclosure of the existence of the funding arrangement to the arbitrator or judge for the purpose of assessing potential conflicts of interest,[98] the waiver or non-waiver of evidentiary privileges for information disclosed to the funder,[99] whether an arbitrator or judge can exercise jurisdiction over a non-party funder,[100] whether the funder should be required to cover

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94 *See supra* note 3 for the scope of the types of third-party funding addressed in this Article.

95 *See, e.g.*, Cain, *supra* note 3; Shaltiel & Cofresi, *supra* note 8; Martin J. Estevao, Casenote & Comment, *The Litigation Financing Industry: Regulation to Protect and Inform Consumers*, 84 U. COLO. L. REV. 467 (2013); Taubman, *supra* note 89.

96 *See supra* note 3 for the scope of the types of third-party funding addressed in this Article.

97 *See supra* note 3 for the scope of the types of third-party funding addressed in this Article.

98 *See generally* AUSTL. SEC. & INVS. COMM'N (ASIC), REGULATORY GUIDE 248, LITIGATION SCHEMES AND PROOF OF DEBT SCHEMES: MANAGING CONFLICTS OF INTEREST (2013) [hereinafter ASIC RG 248], *available at* https://dv8nx270cl59a.cloudfront.net/media/1247153/rg248.pdf (guidelines on how litigation funders in Australia should manage their conflicts of interest); Vicki Waye, *Conflicts of Interests Between Claimholders, Lawyers and Litigation Entrepreneurs*, 19 BOND L. REV. 225 (2007).

99 *See generally* Michele DeStefano Beardslee, *The Corporate Attorney-Client Privilege: Third-Rate Doctrine for Third-Party Consultants*, 62 SMU L. REV. 727 (2009) [hereinafter Beardslee, *Corporate*]; Michele DeStefano Beardslee, *Taking the Business Out of Work Product*, 79 FORDHAM L. REV. 1869 (2011) [hereinafter Beardslee, *Work Product*]; Michele DeStefano, *Claim Funders and Commercial Claim Holders: A Common Interest or a Common Problem?*, 63 DEPAUL L. REV. 305 (2014); Maya Steinitz & Abigail C. Field, *A Model Litigation Finance Contract*, 99 IOWA L. REV. 711 (2014).

100 *See* Abu-Ghazaleh v. Chaul, 36 So. 3d 691, 692–94 (Fla. Dist. Ct. App. 2009) (holding that two funders were de facto "parties" to the litigation proceedings under Florida state law for the

possible costs if the funded client loses (either by posting a bond in court or by paying security for costs in arbitration),[101] possible collusion between the funder and the attorney to the detriment of the client,[102] the conflicts of interest that may arise when the attorney negotiates the funding arrangement for a case in which that attorney is also representing the client,[103] uneven bargaining power between the client and funder during the negotiation of the funding transaction,[104] whether the involvement of a sovereign or government as the funded or non-funded party should warrant special funding rules,[105] how much de jure or de facto control (depending on the jurisdiction) the funder is allowed to exercise over the underlying legal representation,[106] the viability of defense-side funding,[107] and the public policy barriers to enforcement of a funded court judgment or arbitral award in a jurisdiction that prohibits or restricts funding.[108] These universal issues affect all types of third-party funding in which (1) the funder contracts directly with the original party to the case (i.e., not with the client's attorney); (2) the original party remains a party to the case; and (3) the funder does not become a party in the case (i.e., not an assignment of the underlying claim or liability).[109] These crosscutting aspects of third-party funding would benefit most from harmonized, rather than piecemeal, regulatory standards.

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purposes of a state fee-shifting statute because the funders had financed and controlled major aspects of the case, including filing the lawsuit, selecting the attorneys, recruiting the witnesses, reviewing the attorney's bills, and approving settlement agreements).

101 *See generally* William Kirtley & Koralie Wietrzykowski, *Should an Arbitral Tribunal Order Security for Costs When an Impecunious Claimant is Relying upon Third-Party Funding?*, 30 J. INT'L ARB. 17 (2013); Jonathan T. Molot, *Fee Shifting and the Free Market*, 66 VAND. L. REV. 1807 (2013).

102 *See generally* ABA WHITE PAPER, *supra* note 18 (section on lawyer-funder collusion, fee-sharing, referral fees, etc.).

103 *See generally id.* (section on lawyers negotiating funding arrangements and the requirement that they advise their clients to seek separate legal counsel to negotiate the funding arrangement).

104 *See supra* note 103.

105 *See generally* ORG. FOR ECON. CO-OPERATION & DEV. (OECD), INV. DIV., INVESTOR-STATE DISPUTE SETTLEMENT, PUBLIC CONSULTATION: 16 MAY–23 JULY 2012, at 37–43 (2012), *available at* http://www.oecd.org/dataoecd/61/29/50291642.pdf (section II.E on third-party financing of investor-state dispute settlement); Gustavo Laborde, *The Case for Host State Claims in Investment Arbitration*, 1 J. INT'L DISP. SETTLEMENT 97 (2010); Eric de Brabandere & Julia Veronika Lepeltak, *Third Party Funding in International Investment Arbitration* (Grotius Ctr., Working Paper No. 2012/1, 2012), *available at* http://ssrn.com/abstract=2078358; Willem H. van Boom, Third-Party Financing in International Investment Arbitration (Dec. 31, 2011) (unpublished manuscript), *available at* http://ssrn.com/abstract=2027114.

106 *See generally* ABA WHITE PAPER, *supra* note 18 (section on who can direct the legal representation).

107 *See* Molot, *supra* note 8.

108 *See, e.g.*, United Paperworkers Int'l Union, AFL-CIO v. Misco, Inc., 484 U.S. 29, 42 (1987) ("A court's refusal to enforce an arbitrator's award under [an arbitration] agreement because it is contrary to public policy is a specific application of the more general doctrine, rooted in the common law, that a court may refuse to enforce contracts that violate law or public policy.").

109 *See supra* note 3 for the scope of the types of third-party funding addressed in this Article.

The second reason why existing third-party funding regulations generally adopt a piecemeal approach is that there is no consensus regarding whom to regulate—attorneys, clients, or funders—or how to regulate them—whether via statutes, case law, procedural rules, ethical rules, or no regulation at all.[110] By contrast, regulating interactions between the actors solves the problem of determining which actors to regulate or what behavior to regulate. Each of the three categories set forth in this Article (transactional, procedural, and ethical) involve the actions of all three of the actors (funder, attorney, and client) in the types of third-party funding arrangements addressed in this Article.[111] The transactional category relates to the actors' behaviors when negotiating the funding arrangement. The procedural category relates to the actors' behaviors while resolving the underlying dispute and enforcing the result. The ethical category relates to how the actors perceive and exploit each other's interests, incentives, vulnerabilities, weaknesses, and levels of bargaining power. This covers all actors and virtually all types of behaviors possible in the types of third-party funding addressed in this Article.[112]

The third reason why existing third-party funding regulations generally adopt a piecemeal approach is that the majority of the current methods of regulation address only one or two aspects of the funding issue at a time.[113] Furthermore, the existing regulations of actors or conduct do not interconnect or "talk to" one another, thereby inviting loopholes through which unwanted behavior can slip. Regulating only one single aspect at a time—transactional, procedural, or ethical—can lead to unintended consequences and may further skew the regulatory results.

If we regulate only the transaction, then the funder may simply restructure the transaction so that its involvement in the dispute will not

110 *See generally* NIEUWVELD & SHANNON, *supra* note 3, at 144–59 (fifty-one-jurisdiction survey of U.S. jurisdictions revealing that statutes, case law, and attorney ethics opinions are among the devices used by various jurisdictions that regulate, or do not regulate, third-party funding).

111 *See supra* note 3 for the scope of the types of third-party funding addressed in this Article.

112 *See supra* note 3 for the scope of the types of third-party funding addressed in this Article.

113 *See, e.g.*, NIEUWVELD & SHANNON, *supra* note 3, at 144–59 (presenting a state-by-state survey of the laws regarding third-party funding, including all fifty states and the District of Columbia, most of which addresses only whether a funding arrangement is legal or illegal in that state, which relates to the transaction only); Blunk, *supra* note 7 (describing the statutes in Maine, Ohio, Nebraska, and Oklahoma that address the transaction and a little of the ethics, but not the procedure); Morton, *supra* note 7 (describing Tennessee's statute addressing only the transaction, as well as proposed legislation in other states); Merzer, *supra* note 9 (describing proposed legislation in ten states in the United States addressing various rate caps and individual restrictions on third-party funders relating to the transaction only).

appear to fall within the regulated area.[114] For example, funders currently structure funding arrangements in ways that avoid transactional regulations on traditional loans, such as prohibitions on usurious interest rates.[115] Funders could come up with new, creative arrangements to keep their deals from falling within whatever transactional definition legislators designate. If we regulate only the procedure, then in many states within the United States that expressly prohibit funder control over the legal representation, funders will simply remain in the shadows where they will be invisible or will appear to remain at arm's length. Nevertheless, the transaction documents may contain, for instance, a valid clause that directly affects procedural issues, such as the funder reserving the right to approve settlement agreements or to remove and replace the legal counsel.[116] In many states within the United States, it is legal for a funder to make an agreement with the client restricting the attorney's legal representation that attorney ethics rules would prohibit the attorney from making directly with the client.[117] If we regulate only the ethics, then we can regulate only the attorneys through their professional ethics rules under the threat of sanctions or disbarment, because the few ethical duties currently placed on clients and the fewer placed on funders are not weighty enough to shape their behavior.[118] For example, in a few jurisdictions, individual funders or groups of funders have placed ethical duties on themselves through a voluntary code of conduct, or

114 *See generally* NIEUWVELD & SHANNON, *supra* note 3, at 43–44 (discussing whether usury restrictions apply to third-party funding in the United States); Martin, *supra* note 73; Steinitz & Field, *supra* note 99.

115 *See generally* Steinitz & Field, *supra* note 99.

116 ABA WHITE PAPER, *supra* note 18, at 21 ("[T]he balance of policy considerations may be different and the recipient of funding may be permitted to validly agree to limitations on rights he or she would otherwise possess. For example, while a *lawyer* is not permitted to restrict the client's right to discharge counsel, the client's contract with the supplier may restrict this right. The validity of such a provision is a matter of state law and public policy and is beyond the scope of this Informational Report.").

117 *Id.*

118 *See generally* ABA WHITE PAPER, *supra* note 18 (an example of regulating attorneys through the threat of sanctions or disbarment without regulating the conduct of funders or parties); THE OFFICE OF THE LEGAL SERVS. COMM'R (AUSTL.), THE REGULATION OF THIRD PARTY LITIGATION FUNDING IN AUSTRALIA—DISCUSSION PAPER (2012), *available at* http://www.olsc.nsw.gov.au/agdbasev7wr/olsc/documents/pdf/regulation_of_third_party_ litigation_funding_march2012_part1.pdf [hereinafter AUSTRALIA OLSC PAPER]. A pending proposed revision to Rule 1 of the Federal Rules of Civil Procedure would add a duty on the parties to "construe[], administer[], and employ[]" the rules "to secure the just, speedy, and inexpensive determination of every action and proceeding." *See* COMM. ON RULES OF PRACTICE & PROCEDURE OF THE JUDICIAL CONFERENCE OF THE U.S., PRELIMINARY DRAFT OF PROPOSED AMENDMENTS TO THE FEDERAL RULES OF APPELLATE, BANKRUPTCY, CIVIL, AND CRIMINAL PROCEDURE: REQUEST FOR COMMENT (2014), *available at* http://www.uscourts.gov/uscourts/ rules/preliminary-draft-proposed-amendments.pdf.

best practices.[119] The author is unaware of any jurisdictions that place ethical restrictions on third-party funding clients. Yet funders lament that their own clients may try to renegotiate or rescind their funding agreements if a win is within reach, because the winning clients may not want to pay the funder as much as they had originally agreed.[120]

II. A HARMONIZED REGULATORY APPROACH

Many observers fear that third-party funding will destroy the integrity of our dispute resolution system.[121] Professor Bradley Wendel discusses the "ick factor" as a means of explaining why people view the idea of third-party funding as distasteful and third-party funders as unsavory characters.[122] Similar criticisms have been leveled against the legal profession.[123] However, lawyers are fully regulated in all three categories. With respect to the transactional category, law firms are regulated, and attorney retainer agreements have legal and ethical requirements and restrictions in the Model Rules of Professional Responsibility.[124] With respect to the procedural category, lawyers' participation in litigation and arbitration is heavily regulated through various rules of procedure and evidence.[125] With respect to the ethical category, lawyer ethics are also heavily regulated through the state versions of the Model Rules of Professional Responsibility and state bar

119 In the United States, there is the AM. LEGAL FIN. ASS'N (ALFA), http://www.americanlegalfin.com/IndustryBestPractices.asp, and in the United Kingdom there is the ASS'N OF LITIG. FUNDERS (ALF), http://associationoflitigationfunders.com/code-of-conduct. Both organizations have issued codes of conduct for their members. Individual funders also have best practices and codes of conduct. For example, Bentham IMF, a subsidiary of IMF (Australia) Ltd., recently publicly released a code of best practices for itself. *See* BENTHAM IMF, CODE OF BEST PRACTICES (2014), *available at* http://www.benthamimf.com/docs/default-source/default-document-library/code-of-best-practices-final-10-01-14.pdf?sfvrsn=2.

120 *See supra* note 19.

121 *See supra* note 84.

122 *See* CATHERINE A. ROGERS, *Gamblers, Loan Sharks, and Third-Party Funders*, *in* ETHICS IN INTERNATIONAL ARBITRATION (2014). *See generally* W. Bradley Wendel, *Alternative Litigation Finance and Anti-Commodification Norms*, 63 DEPAUL L. REV. 655, 657 (2014).

123 *See, e.g.*, Marc Galanter, *The Faces of Mistrust: The Image of Lawyers in Public Opinion, Jokes, and Political Discourse*, 66 U. CIN. L. REV. 805 (1998); Michael Rappaport, *COMMENTARY: Nobody Likes a Lawyer Until They Need One*, LAW. WKLY. (Toronto) (Feb. 22, 2008), http://www.lawyersweekly.ca/index.php?section=article&articleid=625; Kellie Schmitt, *Are TV Shows to Blame for Distrust of Lawyers?*, RECORDER (Feb. 19, 2008), http://www.therecorder.com/id=900005560221/Are-TV-Shows-to-Blame-for-Distrust-of-Lawyers?slreturn=20140122173142; Rachel M. Zahorsky, *It's Not Just Money Fears Blocking Access to Legal Help; Lawyer Distrust Is Growing*, A.B.A. J. (Dec. 1, 2012, 9:20 AM), http://www.abajournal.com/magazine/article/its_not_just_money_fears_blocking_access_to_legal_help_lawyer_distrust_is_g.

124 *See generally* MODEL RULES OF PROF'L CONDUCT.

125 *See* FED. R. CIV. P. 11 & 37 (sanctioning attorney misconduct with respect to court filings and discovery).

licensing entities.[126] Thus, while society may still view lawyers negatively, overall, the network of regulations surrounding lawyers will help protect society and dispute resolution from bad lawyering and will punish offenders appropriately. Similarly, the categorized regulatory approach described in this Article will help protect society and dispute resolution from bad funding arrangements and bad funders.

The United States faces the challenge of having a patchwork of sub-national states that have varying degrees of regulation of third-party funding.[127] Some observers in the United States have posited that national-level regulations would be most beneficial in the United States, because much of funding crosses state boundaries, and it is currently unclear which state's laws would apply to such a situation.[128] Yet, individual states have a constitutional right to choose disparate state legislation and state court practices, as long as the states' exercise of that right does not conflict with the U.S. Constitution.[129]

The categorized regulatory standards presented in this Article would work for either approach. Model legislation and model court rules could illustrate the regulatory standards that states could voluntarily adopt or reject. Alternatively, federal legislation and federal court rules could set the baseline upon which states could build and tailor their laws. A third option would be to employ regulatory standards at both the state and federal levels. For example, in arbitration, the Federal Arbitration Act and individual state arbitration laws are both applicable to arbitration proceedings taking place in the United States.[130]

Regulations within each of the three categories described in this Article—transactional, procedural, and ethical—should employ common, harmonized regulatory standards, instead of piecemeal ones. In particular, categorized regulatory standards are the best approach to cultivating transparency and certainty in the third-party funding industry while dispelling mistrust and fear of the involvement of funders in dispute resolution. Categorized regulatory standards would be appropriate for every jurisdiction that allows funding, even though each jurisdiction has different policies and regulations for attorneys,

126 *See generally* MODEL RULES OF PROF'L CONDUCT, *supra* note 124.

127 NIEUWVELD & SHANNON, *supra* note 3, at 144–59 (presenting a state-by-state survey of the laws regarding third-party funding, including all fifty states and the District of Columbia). Currently four states have statutes that regulate third-party funders directly through registration requirements and mandatory disclosure to potential customers, but those regulations are not comprehensive. *See* Blunk, *supra* note 7.

128 *See, e.g.*, Shaltiel & Cofresi, *supra* note 8; Estevao, *supra* note 95.

129 *See* U.S. CONST. art. VI, cl. 2.

130 *See generally* Victoria Shannon, *Comparing the Federal Arbitration Act and the UNCITRAL Model Law on International Commercial Arbitration*, *in* INTERNATIONAL ARBITRATION IN THE UNITED STATES (Laurence Shore et al. eds., 2015) (forthcoming) (on file with author until book is published).

transactions, and litigation. Each jurisdiction and legal system can tailor each of the categories to its needs. In the realm of arbitration, arbitral rules, institutions, and guidelines can be the regulatory vehicles for implementing supervisory standards addressing the procedural and ethical categories of third-party funding.[131] In all arbitration cases, the national legal rules chosen as the law(s) applicable to the contract(s) that make up the funding arrangement would govern the structure, contours, and validity of funding transactions.[132] Cross-border collaboration on developing general principles for regulating third-party funding will ensure that various jurisdictions will become familiar with the rules of other jurisdictions.[133] In addition, local courts will learn what rules to apply in a proceeding to recognize, enforce, vacate, annul, or set aside a funded foreign arbitral award.

In addition to fostering cross-border collaboration on regulatory goals and ideals, categorized regulatory standards would dramatically simplify the regulatory landscape for third-party funding. As explained in Part II.B below, the transactional, procedural, and ethical categories apply to both consumer and commercial third-party funding because of significant overlapping issues present in both types of funding.[134] In addition, regulators can address distinctions between consumer and commercial funding with nuanced regulation within each of the three categories.

First, with respect to the transactional category, virtually all funding arrangements are comprised of one written contract or a network of written contracts.[135] Contract law derives from national or state laws, regardless of the forum for dispute resolution, the type of

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131 The international arbitration community is currently addressing this issue through the Third-Party Funding Task Force, *see ICCA Projects: Third-Party Funding*, *supra* note 14, in hopes of devising a set of guidelines or rules for the practice. In addition, the International Bar Association (IBA) revised its Guidelines on Conflicts of Interest in International Arbitration in October 2014 to address potential arbitrator conflicts of interest due to the participation of a third-party funder, taking into account the advice and input of the Third-Party Funding Task Force. INT'L BAR ASS'N, IBA GUIDELINES ON CONFLICTS OF INTEREST IN INTERNATIONAL ARBITRATION (2014), *available at* http://www.ibanet.org/Publications/publications_IBA_guides_and_free_materials.aspx.

132 *See generally* Stephen K. Huber, *Arbitration and Contracts: What are Law Schools Teaching?*, BEPRESS LEGAL SERIES (2003), http://law.bepress.com/cgi/viewcontent.cgi?article=1059&context=expresso (reviewing the major case law, statues, and restatements relating to contract law and arbitration law in the United States).

133 The Task Force on Third-Party Funding in International Arbitration is an example of cross-border collaboration on developing general principles for regulating third-party funding. *See ICCA Projects: Third-Party Funding*, *supra* note 14. Task Force members include attorneys, clients, funders, academics, arbitral institutions, and government representatives from around the world. *Id.*

134 *See supra* note 3 for the scope of the types of third-party funding addressed in this Article, and *infra* Part II.B regarding the overarching concerns common to both consumer and commercial types of funding.

135 *See infra* Part III.A.1, describing the network of agreements in the transactional category.

client, or the amount in dispute. The parties choose the substantive law applicable to the funding contract(s), or if they fail to do so, the judge or arbitrator will determine the substantive law if there is a dispute about the funding arrangement.[136] Since all funding arrangements are borrowing from national law regarding contract law and the law of transactions, resolving any dispute about the third-party funding contract or transaction would require the application of national law principles.

Second, with respect to the procedural category, all third-party funding of dispute resolution is funding either litigation or arbitration, and many funders fund cases involving both types of dispute resolution simultaneously.[137] The funder's participation affects the procedure of the litigation or the arbitration, even though the funder is not specifically "on record" with the court or arbitral tribunal.[138] The litigation or arbitration procedural rules govern the participation of all non-party actors, such as attorneys, experts, witnesses, and amici curiae.[139]

For litigation, national legal rules govern court procedures in all jurisdictions.[140] While arbitration, on its face, may seem to be wholly separate from litigation and beyond the reach of national laws, this is a misconception. There are several essential and existential links between litigation and arbitration. Resolving a contractual dispute through either arbitration or litigation requires the arbitrator or judge to apply the substantive law chosen by the parties to govern the legal relationship memorialized in the contract.[141] Although arbitration has its own separate procedural rules, certain rules and laws of the procedural seat

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136 *See, e.g.*, Vitek Danilowicz, *Choice of Applicable Law in International Arbitration*, 9 HASTINGS INT'L & COMP. L. REV. 235 (1986).

137 Third-party funders only fund litigation and arbitration because funders need a result that is enforceable in court in order to ensure that they will be able to collect the award or legal costs—in jurisdictions with a rule that the loser pays the legal costs—from the losing party. While a judge or arbitrator could convert a mediated settlement agreement into a judgment or award, there is no guarantee that a judge or arbitrator would be willing to do so or that the parties would want an enforceable result from mediation. Furthermore, a failure of the mediation process is essentially a financial stalemate, and the parties must still incur the cost of litigating or arbitrating their unresolved dispute. Funders are not attracted to pure mediation cases due to this uncertainty, even though mediation is often far cheaper than litigation or arbitration. However, funders may fund a case involving a multi-staged dispute resolution clause calling for mediation followed by litigation or arbitration if the mediation is unsuccessful.

138 *See supra* note 100.

139 Examples include the Federal Rules of Civil Procedure, the Federal Rules of Evidence, and the various rules of arbitration procedure promulgated by arbitration institutions.

140 *See supra* note 139.

141 *See, e.g.*, ALAN REDFERN, J. MARTIN HUNTER, NIGEL BLACKABY & CONSTANTINE PARTASIDES, REDFERN AND HUNTER ON INTERNATIONAL ARBITRATION § 3.94 (5th ed. 2009) ("It is generally recognised that parties to an international commercial agreement are free to choose for themselves the law (or the legal rules) applicable to that agreement.").

of the arbitration also govern various aspects of arbitral procedure.[142] For example, any party who seeks to compel arbitration or who seeks an anti-arbitration junction may apply to a national court located at the procedural seat of the arbitration.[143] A national court at the seat of arbitration may also assist an arbitral tribunal with injunctions, restraining orders, or subpoenas directed to parties to the arbitration or to non-parties over whom an arbitrator has no power.[144] A national court at the seat of arbitration is the only place where a party may annul, vacate, or set aside an arbitral award. A court may decide to annul, vacate, or set aside an arbitral award for a public policy reason based on the laws of its jurisdiction, which may include a prohibition on third-party funding in the jurisdiction of the seat of arbitration.[145] Furthermore, if the parties do not voluntarily comply with the award, then enforcing an arbitral award in any jurisdiction around the world requires an application to a national court.[146] Thus, arbitration cannot exist without litigation.

Furthermore, arbitration cannot exist without procedural and evidentiary concepts and rules that national legal systems promulgate. Arbitration often borrows evidentiary and privilege rules from national laws, such as the applicable rules on waiver of evidentiary privileges, which are of particular importance to third-party funding arrangements.[147] The parties can choose any rules of evidence that they prefer to govern their arbitration proceedings.[148] Even if the parties fashion their own evidentiary processes, the terms that they will use to describe their processes—briefs, witnesses, memorials, submissions, experts, motions, hearings, and so on—are all terms borrowed from litigation and generally have the same meaning in arbitration. Arbitral institutions use those exact same litigation terms in their rules of arbitral procedure, so that attorneys from litigation backgrounds around the world will understand their meanings. Litigation and arbitration are inextricably intertwined. Regulating the funding of each procedure using disparate regulatory standards, at best, would be duplicative and,

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142 *See generally* William W. Parka, *National Law and Commercial Justice: Safeguarding Procedural Integrity in International Arbitration*, 63 TUL. L. REV. 647 (1989).

143 *Id.*

144 *Id.*

145 *See supra* note 108.

146 *See, e.g.*, 9 U.S.C. §§ 9, 207 (Federal Arbitration Act sections on enforcing arbitration awards).

147 *See generally* Klaus Peter Berger, *Evidentiary Privileges: Best Practice Standards versus/and Arbitral Discretion*, 22 ARB. INT'L 501 (2006); Richard M. Mosk & Tom Ginsburg, *Evidentiary Privileges in International Arbitration*, 50 INT'L & COMP. L.Q. 345 (2001); Jack M. Sabatino, *ADR as "Litigation Lite": Procedural and Evidentiary Norms Embedded Within Alternative Dispute Resolution*, 47 EMORY L.J. 1289 (1998).

148 *See supra* note 147.

at worst, may lead to serious conflicts and confusion due to arbitration borrowing so many rules and concepts from litigation already.

Third, with respect to the ethical category, conflicts of interest may arise during the negotiation of third-party funding arrangements[149] or because of the participation of repeat-player funders, decisionmakers, and attorneys.[150] Attorneys must follow the ethical rules of the bar(s) in which they are licensed to practice, regardless of whether their client's case is a litigation or arbitration matter.[151] National licensing entities and courts are the bodies that carry out attorney sanctions even if the attorney's ethical violation took place in an arbitration.[152] National laws and ethics rules also govern conflicts of interest of judges.[153] Arbitral rules of procedure and international guidelines for arbitrator conflicts of interest borrow heavily from the national legal principles regarding conflicts of interest of judges.[154] Thus, the overall goals of the ethics rules are nearly the same in both litigation and arbitration, and very similar ethical problems arise in third-party funding in both fora.

Categorized regulatory standards would be especially helpful since there is a "revolving door" whereby arbitrators serve as attorneys and then serve again as arbitrators, or may serve in both roles simultaneously in different cases.[155] Similarly, judges carry conflicts of interest with them from when they once served as legal counsel, and a judge's conflicts of interest from serving as counsel and on the bench will be pertinent when serving as an arbitrator after retiring from the bench.[156] Academics who serve as arbitrators or legal counsel also have the same duty to disclose connections that may give rise to conflicts of interest.[157] All members of the legal profession should be required to actively record and disclose any interactions with a third-party funder that they have at any point during their legal career. To do otherwise could lead to devastating results, such as the challenge or removal of an

149 *See supra* note 3 for the scope of the types of third-party funding addressed in this Article.

150 *See, e.g.*, Jennifer A. Trusz, Note, *Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration*, 101 GEO. L.J. 1649 (2013).

151 *See, e.g.*, ABA WHITE PAPER, *supra* note 18; *Growing Trend of Third-Party Litigation Funding Creates Mixed Opinions*, JAMS DISP. RESOL. ALERT (JAMS, Irvine, Cal.), Spring 2012, at 1–2 [hereinafter *Growing Trend*] (discussing the New York City Bar Association ethics opinion on third-party financing issued in June 2011).

152 *See, e.g.*, Catherine A. Rogers, *Context and Institutional Structure in Attorney Regulation: Constructing an Enforcement Regime for International Arbitration*, 39 STAN. J. INT'L L. 1 (2003); Steven C. Bennett, *Who is Responsible for Ethical Behavior by Counsel in Arbitration*, DISP. RESOL. J., May–July 2008, at 38.

153 *See, e.g.*, MODEL CODE OF JUDICIAL CONDUCT (2011).

154 *See, e.g.*, INT'L BAR ASS'N, *supra* note 131.

155 *See, e.g.*, Joseph R. Brubaker & Michael W. Kulikowsky, *A Sporting Chance? The Court of Arbitration for Sport Regulates Arbitrator-Counsel Role Switching*, 10 VA. SPORTS & ENT. L.J. 1, 7–11 (2010).

156 *See supra* note 153.

157 *See, e.g.*, INT'L BAR ASS'N, *supra* note 131.

arbitrator—which causes delay in resolving the dispute and increases the cost of resolving the dispute—or annulment of an award on the grounds of lack of arbitrator independence.[158] If a conflict of interest arises involving a judge, the judge will have to recuse herself, and the parties may have to start litigating again from the beginning.[159] An affirmative duty to manage ethics and conflicts of interest throughout the life cycle of a member of the legal profession is necessary to prevent those costly consequences.[160]

For the foregoing reasons, categorized regulatory standards will provide a universal baseline for the behavior of the actors—i.e., funders, attorneys, and parties—within the three categories that describe their third-party funding relationships—i.e., the transactional, procedural, and ethical categories.[161] The following Sections in this Part describe the most useful regulatory standards for third-party funding in each of those categories. The Article calls for a high level of regulatory coordination that may seem idealistic, but we have been able to achieve high levels of regulatory coordination for several other sectors, including legal services, bankruptcy, law enforcement, insurance, and accounting services. Thus, with a concerted effort, effective regulatory coordination is achievable for third-party funding as well.

A. *The Transactional Category*

The transactional category of regulatory standards centers around three main observations: that the funder, client, and attorney enter into a network of agreements that make up the funding transaction; that the funder sees its financial outlay as an investment; and that the funder and client view the claim as an asset that can be valued and, potentially, transferred.[162] The United States already heavily regulates traditional investments, such as stocks and bonds, as well as the assignment and transfer of legal rights to property and the liquidation of assets during bankruptcy. Regulating the litigation funding transaction as an investment or asset class would be within the realm of existing transactional regulatory goals.

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158 *See id.* and *infra* note 280, regarding grounds for annulling an arbitration award.

159 *See supra* note 153.

160 *See* ABA WHITE PAPER, *supra* note 18.

161 *See supra* note 3 for the scope of the types of third-party funding addressed in this Article, and *infra* Part II.A regarding the overarching concerns common to both consumer and commercial types of funding.

162 *See* Mick Smith, *Mechanics of Third-Party Funding Agreements: A Funder's Perspective*, *in* NIEUWVELD & SHANNON, *supra* note 3, at 19–37 (discussing the processes for negotiating a commercial litigation funding agreement and case due diligence). Note that this citation refers to Chapter 2 of the book, which was written by Mick Smith, Co-Founder and Partner of Calunius Capital, a third-party funder based in the United Kingdom.

1. The Network of Agreements

While a consumer funding agreement may be contained within a single contract, a commercial funding arrangement is typically a network of interconnected contracts with various purposes.[163] Each contract within the network represents a different type of relationship and obligation between the parties to that agreement.[164] This is one reason why it is more effective to regulate the interactions in litigation funding rather than the actors.

A commercial funding arrangement is typically comprised of a litigation finance agreement and several ancillary agreements.[165] A litigation finance agreement typically contains several provisions, particularly if the client is a corporate entity. The financial terms of the funding arrangement outline the maximum investment by the funder, the expected return, how the return changes depending on the time to resolution, the budget for the legal expenses, and other related financial issues.[166] The due diligence provisions govern the period of time during which the funder will review the client's evidentiary support of its case as well as the client's internal financial documents.[167] The funder often retains its own separate legal counsel to conduct this investigation, and this process may take several weeks or several months.[168] The funder will also likely research the opposing party in the case, particularly if funding the claimant, in order to determine the likelihood of being able to compel the opposing party to pay if the funded party wins.[169] If the opposing party is essentially judgment-proof—either "can't pay" (insolvent) or "won't pay" (recalcitrant)—the funder is unlikely to fund the case.[170] The exclusivity provisions prevent the client from approaching several different funders simultaneously to shop around for the best terms. For non-recourse funding to a claimant, the funder may have a contractual right to (but not a security interest in) the proceeds of the case.[171] The definition of "proceeds" from the case will likely contemplate both settlement and winning the claimant's case.[172] The priority agreement governs the order in which the various stakeholders are paid, typically starting with returning the funder's initial investment and paying the funder's return, then paying the

163 *See id.*
164 *See id.*
165 *See id.*
166 *See id.*
167 *See id.*
168 *See id.*
169 *See id.*
170 *See id.*
171 *See id.*
172 *See id.*

insurer (if an insurer is involved) any contingent premiums, then paying the attorneys any contingent or conditional fees (because the funder has already been paying the base attorney fees and evidentiary expenses throughout the case), and ending with the client receiving the remainder of the proceeds.[173] The priority agreement may also link to a standstill agreement, which ensures that the funded client's shareholders or other creditors do not take priority over the funder in receiving the proceeds, especially if the underlying client is seeking funding due to its own insolvency.[174] The termination provisions give both the funder and the client terms and procedures to exit if either of them no longer wishes to continue the arrangement.[175] The agreement will normally contain confidentiality and privilege agreements in an effort to preserve any evidentiary privileges that may exist over information disclosed to the funder.[176] These provisions may or may not be effective, depending on how the jurisdiction in which the litigation or arbitration is pending views disclosures to third-party funders. The attorney retainer is typically an agreement between the funded client and the attorney, unless the funder has taken an assignment of the claim, in which case the funder would be the attorney's direct client.[177] The attorney retainer may cap the dollar amount of attorney fees that the funder is willing to pay.[178] The funder may require an adverse costs or litigation expenses insurance policy to cover paying costs to the winning party if the funded client loses in a jurisdiction with a "loser pays" rule.[179] In some jurisdictions, a court or arbitrator may directly require the funder to pay security for costs, regardless of the terms of the funding arrangement.[180]

This is just an overview of the various agreements involved in a funding transaction, as there are many other detailed provisions involved. There are also many crucial aspects of the case that are unknown at the time the funding agreement is negotiated, because presumably the client has not yet received any key evidence or information from the opposing side. The funding arrangement will try to build in some contingencies regarding potential unknowns, but, of course, it is impossible to predict all of the possibilities. This uncertainty is likely one of the factors that leads to unscrupulous behavior by clients who refuse to follow the agreed terms, or by funders who try to withdraw or cut off funding prematurely when they feel the investment is no longer profitable.

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173 *See id.*
174 *See id.*
175 *See id.*
176 *See id.*
177 *See id.*
178 *See id.*
179 *See id.*
180 *See supra* note 101 and accompanying text.

Regulating the negotiation of the transactional elements is crucial because the transaction is the script that defines the roles for the actors in the ensuing drama as the case progresses on the litigation or arbitration stage. If the roles are ill defined, or if one party (usually the client) feels that it was not adequately able to bargain, then the temptation to rescind or renegotiate the agreement may arise as the case progresses, destroying trust and making the entire dispute resolution system more expensive and unstable. Regulators must uphold the parties' freedom of contract while also ensuring that the contract terms are not so onerous or precarious that unhappy litigants or funders jeopardize the dispute resolution system. Providing basic rules for funding agreements, while leaving wide latitude for negotiation and customization, will also increase public trust in third-party funding, particularly in cases involving individuals as parties.

2. Funding as an Investment, Not a Loan

Financial investments are necessarily transactional in nature, as they involve an outlay of money at the outset by the investor and an expectation of a return of that money plus some additional amount of money at some point in the future. This same description, however, also applies to a loan, and usury statutes protect borrowers from excessive interest rates. Why is third-party funding an investment rather than a loan, and why should usury statutes not apply?

There are several reasons why litigation funding is an investment rather than a loan. First, there is no absolute obligation for the funded client to repay the litigation funder.[181] If the client is the claimant, the client must only repay the funder if the client wins the case.[182] If the client is the defendant, the premium payments end as soon as the case settles, and if the defendant loses, the funder will not receive a success fee or bonus.[183] Second, litigation funding is non-recourse, meaning that if the client loses the case, the funder cannot pursue the client's other assets unrelated to the litigation to gain satisfaction.[184] Third, the funder

181 *See supra* Part I.B.

182 *See supra* Part I.B.

183 *See, e.g.*, Bernardo M. Cremades, Jr., *Third Party Litigation Funding: Investing in Arbitration*, TRANSNAT'L DISP. MGMT., Oct. 2011, at 16–25 (discussing several arrangements for defense-side funding in which the funder is only paid if the defendant/respondent wins the case).

184 *See, e.g.*, N.Y.C. Bar Comm. on Prof'l Ethics, Formal Op. 2011-2 (2011), *available at* http://www.nycbar.org/ethics/ethics-opinions-local/2011-opinions/1159-formal-opinion-2011-02 ("This opinion addresses non-recourse litigation loans, *i.e.*, financing repaid by a litigant only in the event he or she settles the case or is awarded a judgment upon completion of the litigation. Under these arrangements, financing companies advance funds that will be reimbursed, if at all, *solely* from any proceeds of the lawsuit." (emphasis added)); Stuart L. Pardau, *Alternative Litigation Financing: Perils and Opportunities*, 12 U.C. DAVIS BUS. L.J. 65, 66 (2011) ("The

is taking on more risk than a traditional collateral-based lender; therefore, the funder is seeking a much higher rate of return than a traditional lender. This is not a unique concept. For example, an unsecured credit card typically carries more risk than a secured loan, so regulations tolerate much higher interest rates on unsecured credit cards than allowed even on subprime mortgages, which are backed by collateral. Similarly, as mentioned above, funders structure their agreements to avoid classification as loans in order to avoid the caps that usury laws place on interest rates for mortgages and credit cards.[185]

Fourth, distancing funding even further from a loan, funders are taking on even more risk than unsecured credit cards because the credit card agreement is a bilateral transaction, while funding is a multilateral transaction. The credit card issuer and the debtor are making an agreement based on a promise by the debtor that she will repay the credit card charges at regular intervals.[186] There is no third-party involved, and whether the debtor pays or not is based entirely upon the debtor's own choices. By contrast, the funder and the client are making an agreement based on what a judge or arbitrator will do at some future unknown date or on whether the client and the other side will settle at some future unknown date. Thus, in a funding arrangement, there is a reliance upon at least one additional actor (the judge or arbitrator) and possibly two (the judge or arbitrator and the opposing party), which greatly increases the amount of risk in the transaction.[187] Fifth, there is an asymmetry of information, because at the commencement of the funding arrangement, the funder and client typically do not yet have access to documents or evidence from the other side, so they cannot be completely sure of the likelihood of winning on the merits or settling the

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arrangement typically is characterized as a 'non-recourse' loan; the ALF provider, or the 'lender,' has *no claim for repayment* if the lawsuit results in an award less than the money lent." (emphasis added)).

185 *See supra* note 114 and accompanying text; *infra* Part III.A.2.

186 *See, e.g.,* Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1 (2008); Angela Littwin, *Beyond Usury: A Study of Credit-Card Use and Preference Among Low-Income Consumers*, 86 TEX. L. REV. 451 (2008); Eric A. Zacks, *Unstacking the Deck? Contract Manipulation and Credit Card Accountability*, 78 U. CIN. L. REV. 1471 (2010).

187 This also makes the transaction resemble a trilateral credit default swap, where the funder is the swap seller and the client is the swap buyer, but the funder's payments go to the attorney instead of the client. The contingent "default" is whether the client will win or lose the case, which depends on the actions of the decisionmaker and the other side with respect to settlement or adjudication of the dispute. For a general overview of the credit default swap phenomenon, see generally Kristin N. Johnson, *Things Fall Apart: Regulating the Credit Default Swap Commons*, 82 U. COLO. L. REV. 167 (2011); Douglas B. Levene, *Credit Default Swaps and Insider Trading*, 7 VA. L. & BUS. REV. 231 (2012); Frank Partnoy & David A. Skeel, Jr., *The Promise and Perils of Credit Derivatives*, 75 U. CIN. L. REV. 1019 (2007); Robert F. Schwartz, *Risk Distribution in the Capital Markets: Credit Default Swaps, Insurance and a Theory of Demarcation*, 12 FORDHAM J. CORP. & FIN. L. 167 (2007); Daniel Hemel, Comment, *Empty Creditors and Debt Exchanges*, 27 YALE J. ON REG. 159 (2010).

case. Under these circumstances, one can see why it is not reasonable to subject funders to the exact same restrictions as traditional lenders.[188]

Instead, the funder and client view the funder's money as an investment, and a variety of factors determine the rate of return on that investment. As such, unlike a credit card agreement or a mortgage in which the debtor knows at any given time the amount of principal owed, the value of a funding arrangement changes over time based on the actions taken and information gleaned during the course of the litigation or arbitration. The funder buys the right to receive a portion of the eventual value of the litigation and continues to put money into that investment in hopes that, in the future, it will be worth far more than the initial investment. Funders are not seeking to break even, so they will only invest if they calculate that they have a good chance of receiving a multiple of their investment in addition to a return of their initial capital contribution.[189] In fact, the funder often calculates its rate of return as a multiple of the amount invested rather than a percentage of the amount recovered.[190] This also distinguishes the funder's investment from a contingent attorney's fee, which is usually a percentage of the amount recovered by the client, subject to the regulatory caps set forth in the ethical or procedural rules in nearly all jurisdictions that allow contingency, conditional, or success fees.[191]

Finally, there are no defense-side attorneys paid on contingency, whereas funders are able to offer contingent defense-side funding to their clients. The funder pays the defendant's legal expenses, and the funding arrangement involves periodic payments from the defendant to the funder, sometimes with a success payment if the defendant wins the case.[192] Defense-side funding is most prevalent in Europe, where it is termed before-the-event insurance (if purchased before the dispute arises), after-the-event insurance (if purchased after the dispute arises), or litigation expenses insurance.[193] Defense-side funding has not yet developed as an industry in the United States for reasons that are

188 *See generally* Steinitz & Field, *supra* note 99; Merzer, *supra* note 9.

189 *See supra* Part II.A.1.

190 *See supra* Part II.A.1.

191 There is an extensive body of literature on attorney contingency fees, the discussion of which is beyond the scope of this Article. *See, e.g.*, Lester Brickman, *The Market for Contingent Fee-Financed Tort Litigation: Is It Price Competitive?*, 25 CARDOZO L. REV. 65 (2003); Herbert M. Kritzer, *Seven Dogged Myths Concerning Contingency Fees*, 80 WASH. U. L.Q. 739 (2002); Richard W. Painter, *Litigating on a Contingency: A Monopoly of Champions or a Market for Champerty?*, 71 CHI.-KENT L. REV. 625 (1995); Ted Schneyer, *Legal-Process Constraints on the Regulation of Lawyers' Contingent Fee Contracts*, 47 DEPAUL L. REV. 371 (1998); Jeffrey D. Swett, Comment, *Determining a Reasonable Percentage in Establishing A Contingency Fee: A New Tool to Remedy an Old Problem*, 77 TENN. L. REV. 653 (2010); Angela Wennihan, Comment, *Let's Put the Contingency Back in the Contingency Fee*, 49 SMU L. REV. 1639 (1996).

192 *See supra* note 56.

193 *See supra* note 56.

beyond the scope of this Article.[194] All of the aforementioned transactions involve a funder's investment, rather than a loan.

Nevertheless, in situations in which third-party funding is classified as a loan—which, arguably, is an incorrect classification—courts often choose to apply statutory protections against usury when evaluating the funding arrangement. Usury is the act of charging or receiving a greater interest rate or rate of return on a loan of money than the law allows.[195] Historically, usury laws were intended to protect consumer borrowers from predatory lending or otherwise excessive interest payments.[196] The presence of a loan is the key element of the definition of usury that raises potential issues with respect to third-party funding; yet, courts in various jurisdictions disagree as to whether third-party funding constitutes a loan.[197]

On the one hand, most third-party funders would only agree to pay for a client's representation after they have calculated with reasonable certainty that they will likely recover the amount of their investment plus some extra funds. The funder's expectation of a return of its capital, plus some extra funds as profit, resembles a lender's expectation of the return of the initial loan amount plus interest. On the other hand, the third-party funding client's obligation to repay the funds is conditioned on recovering money in the case. Thus, unlike a loan, the client does not have an absolute obligation to repay the funder or provide the funder with a profit if the client does not recover any funds. In addition, there are no installment payments in plaintiff-side third-party funding arrangements.[198] Whether a third-party funding agreement is classified as a loan in a particular jurisdiction is the key to determining whether the doctrine of usury applies to third-party funding.[199] If the doctrine of usury applies to third-party funding in a particular jurisdiction, then it would likely make dispute funding a much less attractive investment option in that jurisdiction.

Usury laws "materially predate contemporary business and legal practices, and are, therefore, less than ideal frameworks with which to analyze litigation finance."[200] They are too haphazard and arbitrary to constitute a solid means of regulating the third-party funding

194 *See* Molot, *supra* note 8.

195 Richmond, *supra* note 57, at 665.

196 Richmond, *supra* note 57, at 665–67; Swan, *supra* note 66, at 766 n.107.

197 McLaughlin, *supra* note 22, at 636; Richmond, *supra* note 57, at 665–67.

198 Defense-side funding may involve installment payments. *See supra* note 56 and accompanying text.

199 NIEUWVELD & SHANNON, *supra* note 3, at 16, 130–32 (discussing how usury laws might apply to third-party funding in the United States).

200 Rodak, *supra* note 8, at 510.

industry.[201] In addition, many states consider third-party funding contracts as investments rather than loans, so usury laws would not apply.[202] Many states require that the borrower have an absolute obligation to repay the funds in order for usury laws to apply.[203] It is clear in third-party funding that the borrower does not have an absolute obligation to repay the money advanced. Yet, the states disagree with respect to the question of whether third-party funding constitutes a loan for the purposes of usury statutes.[204] This ambiguity and confusion is just one example of why the usury doctrine is not solid ground upon which to regulate the third-party funding industry.

Furthermore, third-party funding is often mistakenly categorized as predatory lending.[205] Predatory lending normally involves an unconditional requirement to repay the principal amount loaned plus the agreed interest rate, whereas traditional third-party litigation funding is not lending at all, as discussed above. In addition, insolvent companies often enter into transactions with funders that more resemble a sale of a chose-in-action than a loan.[206] The sale of a chose-in-action during bankruptcy proceedings is widely legal, even in jurisdictions that prohibit traditional third-party funding of litigation.[207] Finally, funders are willing to take on more risk with respect to pending litigation than traditional lenders, and thus, serve the needs of defendants and parties that have difficulty obtaining traditional loans.[208]

For the foregoing reasons, third-party litigation funding transactions should be regulated as investments, not loans.

B. *The Procedural Category*

The funder's participation in litigation and arbitration not only changes the outcome, but also changes the course of the proceedings themselves. The participation of a third-party litigation funder may determine whether a case is filed or whether an impecunious litigant can

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201 Martin, *supra* note 73, at 90; Martin, *supra* note 7, at 77; Richmond, *supra* note 57, at 666–67; Swan, *supra* note 66, at 783.

202 NIEUWVELD & SHANNON, *supra* note 4, at 28 ("In other words, dispute resolution funding is an equity investment in the claim, not a full recourse loan provided to the claimant."); Swan, *supra* note 66, at 784; Barksdale, *supra* note 8, at 723; Rodak, *supra* note 8, at 512–13.

203 McLaughlin, *supra* note 22, at 637–38; Rodak, *supra* note 8, at 512 n.54.

204 Martin, *supra* note 7, at 58 & n.21, 59, 69 n.100.

205 Martin, *supra* note 7, at 63, 64 & n.73, 65, 67, 70; Lyon, *supra* note 8, at 577.

206 *See, e.g.*, NIEUWVELD & SHANNON, *supra* note 3, at 73 (explaining that a third-party funder may obtain control over an insolvent company's "company property," including legal claims, under statutory powers of sale in Australia); *id.* at 227–31 (addressing the case law allowing the sale of a chose-in-action during bankruptcy or liquidation proceedings in Hong Kong, where third-party funding in domestic litigation is otherwise prohibited).

207 *See supra* note 206.

208 *See* Martin, *supra* note 73, at 94, 98–99.

continue a pending case. The funder's cash infusion may affect tactical decisions regarding how the client's side of the case is presented, including which evidence and how much evidence is presented, settlement negotiations and offers, what arbitrator the client chooses (if arbitrator selection is allowed), and the choice (or replacement) of legal counsel.[209] In addition, some arbitrators have noted that they may view the fact that a funder is funding a party as a signal regarding the strength of that party's case, because the funder already thoroughly assessed that party's case when making its funding decision.[210] The arbitrator may thus be more inclined to rule in favor of a funded party.[211] This is one example of the potential negative consequences of unregulated inequities in procedure when a funder is involved.

1. Rules of Litigation and Arbitration Procedure

The role of funders in dispute resolution proceedings ranges widely along a spectrum from jurisdictions that require funders to remain at arm's length from the underlying disputes to jurisdictions that allow funders to control some aspect of the party's legal representation.[212] Regardless of the stance taken in a particular jurisdiction, it is undisputed that the funder plays a role in the dispute resolution as a matter of procedure by influencing the actors that have a direct role in the litigation—the attorneys, the client, the decisionmaker, and the opposing party. Funders in many jurisdictions have operated in the background, outside of the rules normally applied to the various roles in litigation and arbitration. From a regulatory perspective, however, it is better to find a way to acknowledge the funder's influence and memorialize it in our litigation and arbitration procedures. This will provide checks and balances regarding the funder's influence and will put funders on notice regarding allowable and prohibited behaviors.

Courts and arbitrators may pull funders into the proceedings directly or indirectly, even though funders do not have a defined role. Some jurisdictions allow courts and arbitral tribunals to issue orders for costs against funders or join funders as parties in cost proceedings, even

209 *See, e.g.*, ROGERS, *supra* note 122.

210 *See, e.g.*, Michael Abramowicz & Omer Alper, *Screening Legal Claims Based on Third-Party Litigation Finance Agreements and Other Signals of Quality*, 66 VAND. L. REV. 1641 (2013). Also, an attendee at the British Institute for International Comparative Law (BIICL) Investment Treaty Forum event on October 24, 2013 stated that arbitrators may potentially be swayed by knowledge that one side of the arbitration case has the support of a third-party funder. BRITISH INST. OF INT'L & COMPARATIVE LAW, 21ST INVESTMENT TREATY FORUM PUBLIC MEETING: THE ECONOMIC AND FINANCIAL ASPECTS OF INVESTOR-STATE ARBITRATION (2013), *available at* http://www.biicl.org/files/6603_21st_itf_programme_-_final-_24_october_2013.pdf.

211 *See supra* note 210.

212 *See supra* Part I.

if the funder has not agreed to jurisdiction or signed onto the underlying arbitration agreement.[213] Under the doctrine of "personal jurisdiction" in the United States, the act of funding court litigation may create the "minimum contacts" that could subject the funder to the personal jurisdiction of a court hearing a funded case or ruling on the enforcement or annulment of a funded arbitral award.[214] Furthermore, courts and arbitral tribunals may decide to exert jurisdiction over third-party funders under doctrines that allow jurisdiction over a non-signatory to the arbitration agreement or the underlying contract who has a financial interest in the outcome of the dispute.[215]

Funders do not fit neatly into any of the typical roles outlined in litigation or arbitration rules. Funders are intentionally not parties or co-parties (in order to avoid liability), not legal counsel (although they are often lawyers), not witnesses (although their participation may lead to disclosures of privileged information to the opposing side in jurisdictions that do not extend evidentiary privileges to disclosures made to funders), not amicus curiae (since they do not make submissions, although they certainly support the position of the funded party in the case), and certainly not judges, arbitrators, courts, or arbitral institutions (although they do make prima facie determinations about the merits of the case that may determine whether the case actually will proceed). A funder is also not a third-party beneficiary of the parties' original contract, because the funder cannot enforce the funded party's claim on its own, unless the funder purchases the claim outright and becomes a party through assignment.[216] Unlike insurance companies, litigation funders on the defense side intentionally avoid becoming co-parties, so the insurance analogy does not quite fit either. Most funders consider themselves investors, and an investor in litigation or arbitration is a new animal indeed. Recognizing and memorializing the funder's role and influence in litigation and arbitration rules is a step toward ensuring that funders are constructive forces in dispute resolution processes.

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213 *See, e.g.*, *supra* note 101.

214 *See, e.g.*, *supra* note 100.

215 *See, e.g.*, *supra* note 100; *see also* J. Douglas Uloth & J. Hamilton Rial, III, *Equitable Estoppel as a Basis for Compelling Nonsignatories to Arbitrate—A Bridge Too Far?*, 21 REV. LITIG. 593 (2002); Dwayne E. Williams, *Binding Nonsignatories to Arbitration Agreements*, 25 FRANCHISE L.J. 175 (2006); Alexandra Anne Hui, Note, *Equitable Estoppel and the Compulsion of Arbitration*, 60 VAND. L. REV. 711 (2007); Aubrey L. Thomas, Comment, *Nonsignatories in Arbitration: A Good-Faith Analysis*, 14 LEWIS & CLARK L. REV. 953 (2010).

216 *See generally supra* note 3, including the articles addressing assignment of claims.

2. Rules of Evidence

The funder has a direct effect on the evidence presented in a case based on the amount of funding it allows the attorney to spend for the purpose of collecting, culling, and presenting evidence.[217] The funder also conducts its own due diligence when determining whether to fund a case and may hire separate legal counsel to conduct that due diligence.[218] The funder asks the potential client for immense amounts of information about the case, which for corporate clients may include financial statements and background information about the client itself.[219]

The funder may also conduct research on the characteristics and financial position of the client's opponent in the case.[220] Public corporations, governments, and government-owned corporations, are relatively easy for funders to profile, because there is usually a wealth of public information available about them.[221] In addition, governments carry reputations for complying or not complying with court judgments and arbitration awards, and those reputations are widely known around the world.[222] Furthermore, case records involving governments, in both litigation and arbitration, are relatively transparent and public, so funders can easily assess the case history of a particular government and, with a little extra digging, the government's payment history as a losing defendant in the past.[223] This is one reason why funding has increased in the investment arbitration area, where funders are often funding corporate claims against government respondents and—in some cases—are funding government respondents as well.[224] The funder can also typically find out a lot of information about large corporate defendants

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217 See *supra* Part II.A.1, addressing the terms of the attorney retainer agreement in the network of funding agreements.

218 See *supra* Part II.A.1, addressing the due diligence agreement in the network of funding agreements.

219 *See supra* Part I.B (describing the information the funder seeks from the potential funding client).

220 NIEUWVELD & SHANNON, *supra* note 3, at 4 ("The funder will analyze the strengths and weaknesses of the claim or defense, the likelihood of success on the merits, and the ability to recover from the assets of the losing party."); *id.* at 29 ("Recovery—what is the credit standing of the respondent? Do they have a presence in the OECD world which can be attached? Are they a sovereign state adopting a 'won't pay' policy? What is the size of the claim relative to the size of the respondent?"); *id.* at 30 ("Third-party funders tend to divide respondents into two camps: respondents worth pursuing (either because they have a history of paying or because they can be compelled to pay through enforcement), and the rest."); *id.* at 37 ("As discussed above, this analysis may boil down to answering the question: 'Based on current information, is there any reasonable basis to believe that the respondent cannot be compelled to pay?'").

221 *See supra* note 220.

222 *See supra* note 220.

223 *See supra* note 220.

224 *See supra* notes 33 and 105.

that are normally subject to strict tax and financial reporting requirements to their home government and to the company's shareholders.[225] Many of those records are public.[226] This is one reason why funders will easily fund litigation or arbitration against solvent insurance companies and multinational corporations, including mass torts or class action cases in jurisdictions where funding is allowed in those types of cases.

This information gathering phase is such an important part of the funder's decision regarding whether to invest in the case that there is typically a due diligence agreement governing this process signed by the funder and the client, as discussed above.[227] In addition, funders and clients are increasingly signing confidentiality agreements in hopes of preserving evidentiary privileges for information that the potential client discloses to the funder.[228] In addition, the confidentiality agreement may prohibit the client from disclosing the funder's proprietary formulas or algorithms for calculating its rate of return as well as other terms of the agreement.[229] The information disclosed to the funder during the due diligence process or during the course of the case may be privileged or otherwise exempt from disclosure to the other side through the attorney-client privilege, work product doctrine, trade

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225 *See generally* Cara Griffith, *Trending: More Public Disclosure of Corporate Taxpayer Information*, FORBES (Jan. 9, 2014, 10:35 AM), http://www.forbes.com/sites/taxanalysts/2014/01/09/trending-more-public-disclosure-of-corporate-taxpayer-information (discussing the trend toward requiring private companies to disclose more information); *Public Disclosure Requirements for Private Companies: U.S. vs. Europe*, JONES DAY (Oct. 2012), http://www.jonesday.com/public_disclosure_requirements (explaining disclosure requirements for privately held companies); *SEC Disclosure Laws and Regulations*, INC.COM, http://www.inc.com/encyclopedia/sec-disclosure-laws-and-regulations.html (last visited Jan. 13, 2015) (explaining disclosure requirements for privately held companies).

226 *See generally Federal Regulation of Publicly Traded Companies*, REP. COMMITTEE FOR FREEDOM PRESS, http://www.rcfp.org/sunshine-inc/federal-regulation-publicly-traded-companies (last visited Jan. 13, 2015) (listing federal legislation and required disclosures); *The Laws that Govern the Securities Industry*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/about/laws.shtml (last visited Jan. 13, 2015) (listing federal legislation and required disclosures); *Public Companies*, INVESTOR.GOV, https://www.investor.gov/introduction-markets/how-markets-work/public-companies (last visited Jan. 13, 2015) (defining public companies and listing disclosure requirements).

227 *See supra* note 218.

228 *See generally* Meriam N. Alrashid, Jane Wessel & John Laird, *Impact of Third Party Funding on Privilege in Litigation and International Arbitration*, 6 DISP. RESOL. INT'L 101 (2012); Beardslee, *Corporate*, *supra* note 99; Beardslee, *Work Product*, *supra* note 99; Edward J. Imwinkelried, *The Applicability of the Attorney-Client Privilege to Non-Testifying Experts: Reestablishing the Boundaries between the Attorney-Client Privilege and the Work Product Protection*, 68 WASH. U. L.Q. 19 (1990); Edward J. Imwinkelried & Andrew Amoroso, *The Application of the Attorney-Client Privilege to Interactions among Clients, Attorneys, and Experts in the Age of Consultants: The Need for a More Precise, Fundamental Analysis*, 48 HOUS. L. REV. 265 (2011); Douglas R. Richmond, *The Attorney-Client Privilege and Associated Confidentiality Concerns in the Post-Enron Era*, 110 PENN ST. L. REV. 381 (2005).

229 The author thanks Ralph Sutton of Bentham Capital LLC, a subsidiary of Bentham IMF Limited, for this insight.

secret doctrine (particularly in patent cases, which are a particularly lucrative type of case for funders), or some other privilege.[230] In some jurisdictions around the world, regulators preserve the attorney-client privilege or the work product doctrine by including disclosures to the funder within the "common interest" rule against waiver, which provides that a co-party or other entity with a common interest in the case may have access to privileged information without causing the disclosing party to waive the privilege.[231] In other jurisdictions, the funder is lumped together with all other third parties to whom disclosure waives the privilege.[232] Regardless of the jurisdiction, as a precaution, commercial funders typically include privilege and confidentiality clauses in the network of agreements that make up the funding transaction.[233] It is unclear whether these provisions are effective in all jurisdictions. Thus, regulators should clarify the rules regarding whether evidentiary privileges are preserved or waived when the client or attorney shares privileged material with the funder.

3. Enforcing Judgments and Awards

The Full Faith and Credit Clause of the U.S. Constitution requires all states to honor the judgments of other states.[234] Thus, enforcing a funded state court judgment—even in another state that disallows litigation funding—should not be difficult. There may be difficulties, however, when a winning party tries to enforce a funded arbitral award in a jurisdiction that has express laws or a public policy against funding. Many people find distasteful the idea that some money from the award or judgment will go to a private entity that became involved in the case solely for profit.[235] With respect to arbitral awards in particular, the New York Convention, described above, has a public policy exception by which an enforcing court can decline to enforce an otherwise valid arbitral award if the award somehow violates public policy.[236] For

230 *See supra* note 228.

231 *See, e.g.*, Miller UK Ltd. v. Caterpillar, Inc., 17 F. Supp. 3d 711 (N.D. Ill. 2014) (upholding protection under work product doctrine for documents disclosed to funder, but not upholding protection under attorney-client privilege, because the court did not view the funder as falling within the "common interest" exception to waiver); Robert Moskowitz, *Judge Rules that Clients' Discussions with Litigation Funders are Privileged*, LEGAL FIN. J. (Dec. 5, 2012), http://legalfinancejournal.com/judge-rules-that-clients-discussions-with-litigation-funders-are-privileged.

232 *See, e.g.*, Leader Techs., Inc. v. Facebook, Inc., 719 F. Supp. 2d 373 (D. Del. 2010) (holding that common interest privilege did not exist between patentee and litigation financing companies, and thus patentee was required to produce documents withheld under that privilege).

233 NIEUWVELD & SHANNON, *supra* note 3, at 23.

234 *See* U.S. CONST. art. IV, § 1.

235 *See supra* note 122.

236 *See supra* note 108.

example, the United States has implemented the New York Convention domestically through Chapter 2 of the Federal Arbitration Act (FAA). Notably, the FAA incorporates by reference key provisions of the New York Convention, such as in 9 U.S.C. § 207, which states that, "the court shall confirm the award unless it finds one of the grounds for refusal or deferral of recognition or enforcement of the award specified in the said Convention."[237] This language refers to the "public policy" exception found in Article V.2.b of the Convention, which states that the court may sua sponte deny enforcement if "the recognition or enforcement of the award would be contrary to the public policy of that country [where enforcement is sought]."[238]

Given the privacy of arbitration, the author has yet to hear of an example of a court declining to enforce an arbitral award due to the involvement of a third-party funder on the winning side, but there is a possibility that it may have happened in private already or that it will happen in the future. If we have clear rules for the involvement of litigation funders throughout the conduct of the dispute resolution procedures to allay concerns regarding due process and undue interference, then a court will be less likely to decline to enforce a judgment or award in the future simply on the basis of a funder's involvement.

C. *The Ethical Category*

The ethical category has traditionally been addressed either through regulating the professional conduct of attorneys or through funders self-regulating through a voluntary code of conduct or best practices.[239] Clients of funding are not regulated at all. These methods may be successful on an individual basis, but not all funders participate. Thus, society is essentially relying on funders to act ethically on their own, which may be second nature for many funders while other funders may struggle with ethical behavior. Given the importance of ethics as a unifying feature of both the transactional and procedural categories, harmonized regulatory standards for appropriate conduct and best practices are highly desirable.

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237 *See supra* note 33.

238 *See supra* note 33.

239 Funder self-regulatory organizations include the American Legal Finance Association (ALFA) in the United States and the Association of Litigation Funders (ALF) in the United Kingdom. *See supra* note 119. For an example of regulating third-party funding through attorneys, see, e.g., Jonathan T. Molot, *The Feasibility of Litigation Markets*, 89 IND. L.J. 171 (2014); *Growing Trend*, *supra* note 151.

1. Disclosures and Conflicts of Interest

While the client may have an advantage when secretly deploying funding, checking the potential conflicts of interest of judges and arbitrators is a compelling reason to require that the client at least disclose the identity of the funder to the decisionmaker in the case.[240] Many leading funding jurisdictions already have a requirement that judges and arbitrators must disclose any conflicts of interest they have with parties or lawyers involved in the case.[241] An arbitrator may be required to resign or a judge to recuse herself if there is a conflict of interest with respect to a party; if there is a conflict with respect to the legal counsel, the attorney may be required to resign from the case instead.[242]

Currently, litigation funding takes place largely in secret, and there is no general rule that the parties or their legal counsel must disclose identities of funders.[243] In addition, many funders are banks, hedge funds, or other financial institutions in which a judge or arbitrator may have funds invested or may own shares. To make matters more complex, in the United Kingdom, for example, law firms now allow outside investment,[244] so a hedge fund that invests in litigation may also directly invest in a law firm involved in a case or in a law firm of which an arbitrator is a member. Furthermore, attorneys tend to move from law firm to law firm or change their personal investment strategies on a regular basis, so while there may not be a conflict at the start of the representation, additional conflicts may arise later. Given the potential for ongoing conflicts of interest due to crisscrossing investment

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240 *See supra* note 98.

241 *See infra* Part III and accompanying notes.

242 *See infra* Part III and accompanying notes.

243 *See supra* note 98.

244 *See, e.g.*, Caroline Binham, *The New Rules of Law*, FIN. TIMES, Oct. 6, 2011, http://www.ft.com/cms/s/0/241d9d24-ed5a-11e0-be97-00144feab49a.html ("For the first time, law firms will be able to offer shares on the stock market or take capital from external investors, and will be able to extend partnership to professionals other than solicitors in what are known as alternative business structures (ABSs). Companies that are not law firms, meanwhile, will be able to offer legal services."); E. Leigh Dance, *The U.K. Legal Services Act: What Impacts Loom for Global Law Firm Competition?*, L. PRAC. MAG., July–Aug. 2008, at 35, *available at* http://www.americanbar.org/publications/law_practice_home/law_practice_archive/lpm_magazine_articles_v34_is5_pg35.html ("The eye-opener for American law firms is the LSA's [Legal Services Act's] green light for U.K. firms to take outside investment and combine with other professional services. . . . The bill . . . was passed into law in October 2007 as the Legal Services Act. The act aims to liberalize and regulate the market for legal services in England and Wales, to encourage competition and provide a new consumer complaint mechanism. Most of the new legislation goes into effect in 2011 or 2012. The LSA also allows alternative business structures (ABSs) with nonlawyers in professional, management or ownership roles. These legal disciplinary practices (LDPs), which can have up to 25 percent nonlawyer managers, are expected to bring big advantages to U.K. consumers.").

relationships, the parties should disclose the identity of the funder, at least to the decisionmaker, in order to prevent a future challenge to the award or judgment on the grounds of bias.

A secondary issue is whether the parties should disclose the terms of the funding agreement to the decisionmaker or to the opposing side, completely or in part. Given that the funding arrangement is a private agreement that is unrelated to determining the merits of the underlying dispute, the obvious answer seems to be "no." When delving a bit deeper into the issue, however, there is a possibility that requiring a party to disclose at least an outline of its funding arrangement may ensure that funders are negotiating fair funding arrangements out of fear that that those arrangements may be invalidated by a court. This may be necessary in the particular case of class funding, because, depending on how class proceedings work in a particular jurisdiction and whether open or closed classes are allowed, the funder may be allowed to negotiate solely with the representative plaintiff(s) and may not be required to have all class members view or sign the funding agreement.[245] A court may need to step in to ensure that an agreement regarding the funder's share of the proceeds is fair to all potential class members.[246] In many jurisdictions, courts must approve any potential settlements in class cases as well as the percentage of the class's recovery that will go toward attorney's fees.[247] Similar court oversight is likely useful in the context of funded class actions as well, particularly since the funder and the attorney are essentially sharing a percentage of the judicially approved class recovery.[248] Outside of the context of class actions, however, requiring a private party in a dispute to disclose the terms of its funding arrangement is probably unnecessary.

Thus, overall, requiring parties to disclose the terms of their funding arrangement is likely unnecessary, except perhaps in the context of class actions. Disclosing the name of the funder to the judge or arbitrator, however, is essential to maintaining the integrity and independence of decisionmakers.

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245 *See generally* DEBORAH R. HENSLER, NOTES ON (SOME OF) THE EFFECTS OF ALTERNATIVE LITIGATION FINANCING ON LARGE-SCALE LITIGATION (2012), *available at* http://www.law.gwu.edu/News/20112012events/Documents/ALF%20Event%20Submissions/Hensler%20ALF%20Submission.pdf; Samuel Issacharoff, *Litigation Funding and the Problem of Agency Cost in Representative Actions*, (N.Y. Univ. Law & Econ. Working Papers, Paper 344, 2013), *available at* http://lsr.nellco.org/nyu_lewp/344.

246 In the United States, courts already approve the amount of the attorney's fees that can be deducted from the class's recovery. *See supra* notes 93 and 191. Courts are unlikely to approve a larger fee simply because a funder is involved, so most likely the funder would be splitting the court-approved fee with the attorney.

247 *See supra* note 246.

248 *See supra* note 246.

2. Ethically Negotiating Funding Arrangements

In the few U.S. states that regulate third-party funding by statute,[249] there are particular requirements that the funder must follow with respect to the disclosure of the terms of the funding arrangement to the client, particularly if the client is an individual.[250] Some jurisdictions require funders to register with state licensing agencies.[251] Others require that the funders make disclosures to the client in plain language, in a certain font size, or with the requirement that the client assent to each independent term of the agreement.[252] With respect to disclosures, there is a divide in the market with respect to what level of disclosure is required for an individual consumer client rather than a corporate client. Many jurisdictions are already looking into legislation to protect individual consumer clients.[253] There is a consensus that corporate clients do not need the same level of protection, since they are sophisticated and often retain their own legal counsel to assist them in negotiating their funding arrangements.

A second concern regarding ethically negotiating funding arrangements is the role of the lawyer in the case.[254] Often the lawyer introduces the client to the funder and then proceeds to negotiate the funding arrangement.[255] However, if the lawyer and the funder have an arrangement whereby they often refer business to each other, then the interests of the two of them may trump the interest of the underlying client as they are negotiating the funding arrangement.[256] A further difficulty is that both the lawyer and the funder are involved in the case for profit, so their interests may not completely align with the client's interests.[257] As a possible solution to this issue, the American Bar Association recommends that attorneys notify their clients that they have the option of retaining separate legal counsel for negotiating the funding arrangement.[258] This is likely to be a wise decision, particularly if the client is a corporate client and millions, or even billions, of dollars are at stake in the underlying dispute. A consumer client, on the other hand, may not be able to afford to retain a second independent attorney who will not be paid by the funder, so the client's original attorney will

249 The U.S. states that regulate third-party funding by statute are Maine, Nebraska, Ohio, and Oklahoma. *See also* Merzer, *supra* note 9 (discussing proposed legislation in ten other states).

250 *See generally* Blunk, *supra* note 7; Cain, *supra* note 3.

251 *See supra* notes 7 and 249.

252 *See supra* notes 7 and 249.

253 *See supra* notes 7 and 249.

254 *See supra* note 103.

255 ABA WHITE PAPER, *supra* note 18.

256 *Id.*

257 *Id.*

258 *Id.*

have to navigate the ethical issues while negotiating the funding arrangement. The funder may retain independent counsel to conduct due diligence in a large corporate case, and the funder has extensive experience negotiating funding agreements, so it is likely to be able to protect its own interests quite well.[259]

A third concern is that the funding agreement between the funder and client may contain terms that directly conflict with an attorney's ethical obligations under the ethical rules of the jurisdiction(s) in which the attorney is licensed.[260] For example, the funding agreement may state that the funder must approve any settlement agreement, but the attorney's primary ethical responsibility is to negotiate the best deal for the client, even if it is not the best deal for the funder.[261] The best deal for the client may include non-monetary terms that do not carry any financial benefit for the funder, so the attorney may feel pressure to focus on the monetary aspects of the settlement rather than taking a holistic approach. Another example of a potential conflict of interest is that the funding agreement may state that the funder can unilaterally remove and replace the legal counsel if the funder is unhappy with the legal representation.[262] Thus, the attorney is on notice to keep the funder happy in order to keep his or her job, even if keeping the funder happy is at odds with the client's best interests. Yet, the attorney ethics rules state that the attorney must put the client's interests above all others, including the attorney's own interests.[263] This can lead to a very difficult ethical situation for an attorney for whom the only solution might be to withdraw from the representation.

In order to tackle these and other difficult ethical issues, the ethical rules for third-party funding must address the triumvirate of interests, rather than focusing on the actions of only one of the players at time. The ethical rules for third-party funding should also complement and coordinate with the existing ethical rules for attorneys in order to avoid conflicting ethical requirements that might put attorneys and funders at odds.

3. The Funder's Influence on the Attorney

Assuming that there is an ethically negotiated funding agreement, the next issue is whether the funder may influence the attorney in a

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259 *See supra* note 43.
260 ABA WHITE PAPER, *supra* note 18.
261 *Id.*
262 *See supra* note 116.
263 ABA WHITE PAPER, *supra* note 18.

particular jurisdiction.[264] The role of lawyers in third-party funding depends on the professional ethics rules of the relevant jurisdiction(s).[265] For example, in most states within the United States, lawyers must keep their distance somewhat from the funder.[266] The rules of professional ethics govern attorneys in the jurisdiction(s) in which they are licensed, but even with those ethical rules, lawyers cannot really influence the behavior of funders very much except by withdrawing from the case or not referring clients to the funder in the future.[267] Thus, ethical regulations should clarify how much influence the funder may exercise in relation to the underlying client's control over the attorney and how the funder can and cannot exert that influence.[268] This also would put funders on notice regarding the allowable and prohibited behaviors, which would bring regulatory stability to an industry that has a high potential for conflicts of interest.

III. SUGGESTED AVENUES FOR REGULATION

There are endless possibilities for implementing these categorized regulatory standards at the federal or state levels, or both. This Article cannot attempt to describe all the potential regulations. Instead, here are a few avenues for regulation that would be highly relevant to all three categories. First, a working definition of a "third-party *funder*" and "third-party *funding*" would be very helpful. Funders and funding take so many different forms, however, that proposed uniform definitions may be overinclusive or underinclusive.[269] Still, defining these two terms is crucial to any successful regulatory effort. In addition, regulations within all three categories should incorporate the same definitions of these two terms to clarify the type of arrangement to which all the regulations are referring. This will create cohesion and uniformity within the proposed regulatory scheme.

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264 *See, e.g.*, Michele DeStefano, *Nonlawyers Influencing Lawyers: Too Many Cooks in the Kitchen or Stone Soup?*, 80 FORDHAM L. REV. 2791 (2012).

265 NIEUWVELD & SHANNON, *supra* note 3, at 39–67 (chapter summarizing ethical rules applicable to third-party funding in various jurisdictions around the world).

266 NIEUWVELD & SHANNON, *supra* note 3, at 133–43 (summarizing the ABA's description of the attorney ethics requirements when dealing with a third-party funding arrangement).

267 ABA WHITE PAPER, *supra* note 18 (section discussing how the attorney can withdraw from the case if there is an unresolvable conflict between the funding arrangement and the attorney's ethical obligations).

268 Recall the types of funding arrangements addressed in this Article. *See supra* note 3. In such arrangements, the funder is not a co-client of the funded party's attorney. Thus, the funder's influence must be quite limited in order to comply with the attorney's professional responsibility rules.

269 *See supra* note 20. This comment was actually made during the first Task Force meeting on February 12, 2014.

Second, the transactional regulations should specify the minimum corporate standards required for a third-party litigation funder to operate legally. For example, one of the fears about third-party litigation funding is that funders will have insufficient cash on hand to fully fund their portfolio of investments in disputes and will either withdraw from cases or run out of money in the middle of cases, leaving the parties without financing.[270] Placing capital requirements on funders or requiring them to obtain insurance policies covering the amount of their promised contributions to litigation expenses, for example, would help allay those fears.[271] There are additional corporate standards that might be useful based on existing best practices of corporations and fiduciary duties of corporate officers and directors.

Third, the transactional regulations should specify any baseline disclosures that funders must make to the underlying client and the format for such disclosures. For example, the regulations should require funders to give the client a document detailing the amount of the recovery that the funder would receive based on the parameters that the funder is using to calculate its return, such as the time to recovery, a multiple of the amount invested, a percentage of amount recovered, or whether the case results in a settlement or judgment. Another example would be requiring funders to clearly disclose whether there is a cap on the amount of money they will spend on the legal representation and, if so, how much. An example of a regulation with respect to the format for the disclosure would be creating a standardized disclosure box similar to the Schumer box for disclosing terms of credit card agreements.[272]

270 *See, e.g.*, Aren Goldsmith, *Third-Party Funding in International Dispute Resolution*, 25 INT'L L. PRACTICUM 147, 149 (2012) ("One additional area of potential concern associated with the structuring of funding relationships is the question of termination. In recognition of this concern, the England and Wales [Third-Party Funding (TPF)] Code regulates both capital adequacy (requiring immediate access to funds) and the terms on which funding may be withdrawn (enumerating the conditions and excluding unrestricted discretionary termination). While capital adequacy could be seen primarily as a problem for the party seeking funding, opposing parties in an international arbitration may also have reason to be concerned when the funder behind a claim lacks sufficient capital or may enjoy liberal termination rights. For example, the England and Wales TPF Code allows for the termination of funding when the funder 'reasonably ceases to be satisfied about the merits of the dispute' or 'reasonably believes that the dispute is no longer commercially viable.' Where the funded party relies upon the funder for the financing of his claim, such provisions may expose the opposing party to costs risks (i.e., the risk of being unable to collect costs from a defaulting entity no longer supported by TPF) in the event the funder should decide to withdraw funding because the claim appears to have weakened over time." (footnotes omitted)); *see also* Maya Steinitz, *The Litigation Finance Contract*, 54 WM. & MARY L. REV. 455 (2012).

271 *See supra* note 270; *see also* Maya Steinitz, *Incorporating Legal Claims*, 90 NOTRE DAME L. REV. (forthcoming 2015), *available at* http://papers.ssrn.com/sol3/papers.cfm? abstract_id=2423541.

272 *See generally Schumer Box*, WIKIPEDIA, http://en.wikipedia.org/wiki/Schumer_box (last visited Jan. 14, 2015) ("The Schumer box is a summary of the costs of a credit card in the United States. . . . All credit card companies use the same format, making comparison shopping for credit

There are additional disclosures and formats that regulations could require.

The aforementioned examples of transactional regulations are relatively uncontroversial. In fact, the most reputable funders are already maintaining similar best practices, so some have argued that regulation is unnecessary. As the market grows, however, the new funding players that enter the market may not have the same penchant for maintaining reputable business practices. Baseline regulations such as those described in this Article would put new entrants on notice regarding what type of conduct is acceptable and would give regulators the tools to deter poor conduct and prosecute offenders.

This Article does not advocate for transactional regulations for every single aspect of the third-party funding transaction. For example, this Article has not suggested regulating the structure of the transactions, because the structure that may be suitable for a particular client is a very fact-dependent determination. Furthermore, the regulations proposed in this Article aim to provide a baseline but not to stifle creativity in designing innovative, useful, reliable financing arrangements to add to the current menu of options available to litigants.[273]

Currently, there are only two types of dispute resolutions procedures funded worldwide: litigation and arbitration.[274] Thus, regulating the procedural category would consist of modifying the rules for both procedures. As discussed above, however, funders do not fit neatly into any of the typical roles outlined in litigation or arbitration rules.[275] For litigation, the Federal Rules of Civil Procedure and Federal Rules of Evidence should be either reinterpreted or amended to address the aspects of litigation affected by the participation of funders, including judges' conflicts of interest and the waiver of evidentiary privileges.[276] Similarly, the attorney-client privilege already covers the situation of clients sharing information with potential legal counsel

cards easy. . . . The Schumer box is also known as the summary box, transparency box, clarity box, consumer box and honesty box."). The author would like to thank the participants of the George Washington C-LEAF Junior Faculty Workshop for this idea.

273 Other types of funding currently available to litigants include attorney financing through pro bono representation, contingent fees, or conditional fees, such as insurance, traditional loans, and assignment of a claim. *See* NIEUWVELD & SHANNON, *supra* note 3, at 5–9.

274 *See supra* note 137.

275 *See supra* Part II.B.1.

276 *See generally* Victoria Shannon, Revealing Third-Party Litigation Funding (2015) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2478245.

before the retainer is signed.[277] The same protection should be extended to clients' conversations with potential litigation funders. This privilege would protect clients seeking funding who may be vulnerable and may not fully appreciate what rights they may waive by disclosing confidential information to funders. In addition, such a privilege would also protect the client from the funder's unauthorized use of the client's confidential information in another proceeding or against the client in another matter.

For arbitration, the relevant rules of procedure and evidence are typically public or private sets of rules chosen or drafted by the parties.[278] International arbitration providers that promulgate rules and international arbitration professional organizations that promulgate guidelines are already beginning to address the issue of funder participation in international arbitration.[279] To date, this author is unaware of any organization examining third-party funding in domestic arbitration in the United States. This is likely because the U.S. Supreme Court's strong pro-arbitration stance and its narrow interpretations of Sections 10, 11, and 207 of the Federal Arbitration Act are unlikely to support a state or federal court invalidating an arbitration award simply because one party engaged a third-party funder.[280] An exception might be if the third-party funder's involvement in the case raised due process concerns or otherwise jeopardized the fairness of the process.[281] Another exception might be if the arbitration clause specifically prohibited the use of third-party funding within the arbitration.[282] However, it is unlikely that private parties will decide to contract for such a prohibition in advance, because they will likely be unable to determine whether they will need third-party funding until a dispute arises. Thus, independent regulation of third-party funding in domestic arbitration is likely unnecessary at this time.

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277 *See* MODEL RULES OF PROF'L CONDUCT R. 1.18(a)–(b). Specifically,

> (a) A person who consults with a lawyer about the possibility of forming a client-lawyer relationship with respect to a matter is a prospective client. (b) Even when no client-lawyer relationship ensues, a lawyer who has learned information from a prospective client shall not use or reveal that information, except as Rule 1.9 would permit with respect to information of a former client.

Id.

278 *See supra* Part II.

279 *See supra* note 131.

280 *See* 9 U.S.C. §§ 10, 11, 207. These are the only grounds available for vacating or annulling an arbitration award under the Federal Arbitration Act, and parties may not contract for expanded grounds for annulment. *See* Hall St. Assocs. v. Mattel, Inc., 552 U.S. 576, 586 (2008).

281 *See supra* note 280.

282 However, such a prohibition may arise in the public context. For example, one might see such a prohibition in a bilateral or multilateral investment treaty in the future in light of the current debate about whether third-party funding should be allowed at all in the investment arbitration context. *See, e.g.*, van Boom, *supra* note 105, at 50 n.248.

As mentioned above, the ethical category is a unifying principle that runs throughout the transactional and procedural categories. The best approach to addressing the ethical concerns described in this Article would likely be to create Model Rules of Professional Responsibility for Third-Party Funders. Developing Model Rules specifically for funders is a logical next step for the industry because, to some extent, funders are already self-regulating the ethics of their profession through codes of conduct and best practices.[283] A universal code of conduct or best practices, like the one in the United Kingdom, may be implemented successfully in the United States. However, it may not be as effective in the United States unless funder participation was somehow mandated or unless funders who chose not to participate were marginalized in the market. For example, the American Legal Finance Association (ALFA) is a voluntary membership group for American funders that has promulgated a list of best practices.[284] According to its website, ALFA currently has over 30 member funders.[285] ALFA has no direct means of enforcing its best practices, however, and many funders are not part of ALFA. Thus, ALFA, at best, offers only a partial solution.

The true utility to having categorized regulatory standards is cross-referencing the transactional, procedural, and ethical regulations to achieve clarity and predictability within the regulatory framework. Cross-references would be useful in at least two main areas. First, as mentioned above, the three categories of regulations should share their definitions of "third-party funding" and "third-party funder" to ensure a uniform interpretation of those terms, even though the definitions of those terms will likely evolve over time. Second, the three categories of regulations should cross-reference their provisions on sanctions for funder misconduct. A unified approach to enforcement and sanctions in all three categories would ensure that a funder deficient under one category of regulations would not pass detection simply by complying with regulations in another category. Altogether, this network of cross-references combined with concurrent enforcement authority among the courts and other enforcement bodies (if any others are involved) would help bolster these baseline regulatory standards and ensure the

283 *See supra* note 119.

284 The American Litigation Finance Association is a voluntary association for litigation funders in the United States that has issued a voluntary code of conduct for its members. *See supra* note 119; *see also* Press Release, Am. Legal Fin. Ass'n, American Legal Finance Association Is Established; Will Set Up the Highest Standards for the Non Recourse Funding Industry (Mar. 10, 2005), *available at* http://www.americanlegalfin.com/press/ALFA_formation.jpg; *Industry Best Practices—ALFA's Code of Conduct*, AM. LEGAL FIN. ASS'N, http://www.americanlegalfin.com/IndustryBestPractices.asp (last visited Jan. 14, 2015).

285 *See Officers and Members*, AM. LEGAL FIN. ASS'N, http://www.americanlegalfin.com/OfficersAndMembers.asp (last visited Jan. 14, 2015) (note that there are several prominent U.S.-based funders that are not members of ALFA).

continued growth of the third-party funding industry and the integrity of the dispute resolution system.

CONCLUSION

This Article sets forth a framework for categorized regulatory standards for third-party litigation funding. However, this Article only begins to delve into the nuances of the proposed regulatory approach. Feedback from the larger community of scholars, regulators, courts, funders, attorneys, and clients is needed to develop further these ideas. Empirical research would be ideal, although robust data is difficult to obtain.[286] The overarching theme of this Article is that the existing regime of piecemeal regulation is inadequate to ensure that new entrants to the third-party funding market know what behavior is appropriate and to ensure that existing players in this market do not exploit one another's vulnerabilities. In addition, reliance upon existing market participants to monitor themselves and police each other may prove ineffective as the market grows larger. This Article aims to incite conversation about regulatory standards that address the transactional, procedural, and ethical aspects of third-party funding in order to provide a robust, predictable regulatory "floor" upon which innovative solutions to litigation finance can be built with integrity.

286 A representative of a prominent global funder mentioned to the author that the likelihood of convincing private funders to share their proprietary data is low, but that there are at least three public funders—Burford, IMF, and Juridica—for which significant case data is available and from whom more data may be obtained. If such data is robust, then perhaps a proper empirical analysis could be conducted. Alternatively, one could conduct an exit survey of court litigants after their civil case has ended in order to gauge how they financed their legal representation and whether the use of third-party funding is common. Furthermore, one could survey jurors regarding their decisionmaking processes in funded cases. For example, a litigation funder recently conducted a survey of 732 surrogate jurors regarding whether knowing that litigation funding is involved in a case affects their decisionmaking. *See generally* VINSON RESOLUTION MGMT., LITIGATION FINANCING: LAWYERS NEED NOT WORRY: A STUDY ON HOW LITIGATION FINANCING AFFECTS JUROR DECISION-MAKING (2014), *available at* http://www.vinres.com/wp-content/uploads/2014/11/VRM_Research-Paper_Lawyers-Need-Not-Worry.pdf.