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ISLANDS OF LITIGATION FINANCE

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Islands of Litigation Finance

*Michael K. Velchik and Jeffery Y. Zhang**

April 25, 2017

Litigation finance has sparked heated debate at the bar, on the Hill, in the press, and among scholars over whether the country should embrace this new practice. We disagree with the premise of this debate: Litigation finance is not new at all. A study of legal history and the modern legal system reveals that third-party litigation finance is not only widespread, nor merely tolerable, but in fact central to our society and economy. The law already condones litigation finance in myriad contexts: public interest organizations, contingency fee arrangements, insurance subrogation, factoring, and bankruptcy claims trading. Yet because these practices are camouflaged under different names, they remain hidden in plain sight. We also note that a comparison between these examples and the proposed expansion of litigation finance demonstrates that third-party litigation financing is socially desirable under the appropriate set of regulations.

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I. Introduction

Litigation is costly.[1] Litigants with meritorious claims may therefore prefer or require outside financing in order to recover. Recently, countries like Australia and the United Kingdom have legalized third-party investment in legal claims.[2] This industry is generally known as litigation finance.[3] This development has provoked heated debate at the bar,[4] on the Hill,[5] in the press,[6] and among

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[1] *See* ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA 122 (trans. Gerald E. Bevan, http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf (noting that "[a]ll litigation, even *pro se* litigation, requires some degree of monetary funding").

[2] *See* George R. Barker, *Third-Party Litigation Funding in Australia and Europe*, 8 J.L. ECON. & POL'Y 451 (2012); Yue Qiao, *Legal-Expenses Insurance and Settlement*, 1 ASIAN J. L. & ECON. 1:4 (2010); Marco De Morpurgo, *A Comparative Legal and Economic Approach to Third-Party Litigation Funding*, 19 CARDOZO J. INT'L & COMP. L. 343 (2011). Alexander Bruns, *Third-Party Financing in the Perspective of German Law—Useful Instruments for Improvement of the Civil Justice System or Speculative Immoral Investment?*, 8 J.L. ECON. & POL'Y 525 (2012). Australia citations: *See generally* Thomas Markle, Comment, *A Call to Partner with Outside Capital: The Non-Lawyer Investment Approach Must Be Updated*, 45 ARIZ. ST. L.J. 1251, [1267-68] (2013); Michael Legg, Edmond Park, Nicholas Turner & Louisa Travers, *The Rise and Regulation of Litigation Funding in Australia*, 38 N. KY. L. REV. 625 (2011); Justin D. Petzold, Comment, *Firm Offers: Are Publicly Traded Law Firms Abroad Indicative of the Future of the United States Sector?*, 2009 WIS. L. REV. 67 (2009); 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); Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268 (2011).

[3] Specifically, the American Bar Association has defined litigation finance as "the funding of litigation activities by entities other than the parties themselves, their counsel, or other entities with a preexisting contractual relationship with one of the parties, such as an indemnitor or a liability insurer." American Bar Association, *supra* note 1. *See generally* MAX VOLSKY, INVESTING IN JUSTICE: AN INTRODUCTION TO LEGAL FINANCE, LAWSUIT ADVANCES AND LITIGATION FUNDING (2013); ANDREA PINNA, FINANCING CIVIL LITIGATION: THE CASE FOR THE ASSIGNMENT AND SECURITIZATION OF LIABILITY CLAIMS, IN NEW TRENDS IN FINANCING CIVIL LITIGATION IN EUROPE (Mark Tuil & Louis Visscher eds., 2010); JOHN BEISNER, JESSICA MILLER & GARY RUBIN, SELLING LAWSUITS, BUYING TROUBLE: THIRD-PARTY LITIGATION FUNDING IN THE UNITED STATES (2009); VICTORIA SHANNON & LISA BENCH NIEUWVELD, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION (2012).

[4] *See, e.g.*, American Bar Association, *supra* note 1.

[5] *See* Charles E. Grassley & John Cornyn, *Letter to Burford Capital*, US. Senate Committee on the Judiciary (Aug. 27, 2015), *available at* http://www.grassley.senate.gov/sites/default/files/judiciary/upload/2015-08-27%20CEG%2C%20Cornyn%20to%20Burford%20Capital%20%28Commerical%20Litigation%20Funding%29.pdf; *see also* Sara Randazzo, *Lawmakers Taking Closer Look at Litigation Funding*, The Wall Street Journal (Aug. 27, 2015), *available at* http://blogs.wsj.com/law/2015/08/27/senators-call-for-transparency-in-litigation-funding/.

[6] *See, e.g.*, Mattathias Schwartz, *Should You Be Allowed to Invest in a Lawsuit?*, N.Y. Times (Oct. 22, 2015), *available at* http://www.nytimes.com/2015/10/25/magazine/should-you-be-allowed-to-invest-in-a-lawsuit.html; Sara Randazzo, *Lawmakers Taking Closer Look at Litigation Funding*, The Wall Street Journal (Aug. 27, 2015), *available at* http://blogs.wsj.com/law/2015/08/27/senators-call-for-transparency-in-litigation-funding/; Lincoln Caplan, *Lawyers and the Ick Factor*, The New Yorker (Jul. 9, 2015), *available at*

scholars[7] over whether the United States should legalize these arrangements by abrogating the common law doctrines of maintenance and champerty. Maintenance is defined as the support of litigation by a stranger without just cause.[8] Champerty is defined as a species of maintenance whose distinguishing feature is the support of litigation in return for a share of the proceeds.[9]

Although they disagree on the desirability of litigation finance, many commentators from both sides often begin the discussion with the following premise: Litigation finance requires caution because it is novel. Indeed, the American Bar Association believes that litigation finance has "become increasingly prominent in recent years."[10] The Senate Judiciary Committee wants more information from practitioners in a "burgeoning industry" out of concern "about the nature of commercial financing agreements . . . on our civil justice

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http://www.newyorker.com/news/news-desk/lawyers-and-the-ick-factor; Paul Barrett, Hedge Fund Betting on Lawsuits Is Spreading, BloombergBusiness (March 18, 2016); Lee Drucker, *Don't Judge Lawsuit Funders by Peter Thiel*, Wall St. J. (June 17, 2016), *available at* http://www.wsj.com/articles/dont-judge-lawsuit-funders-by-peter-thiel-1466117124.

[7] S*ee, e.g.*, Geoffrey J. Lysaught & D. Scott Hazelgrove, *Economic Implications of Third-Party Litigation Financing on the U.S. Civil Justice System*, 8 J.L. ECON. & POL'Y 645 (2012); George R. Barker, *Third-Party Litigation Funding in Australia and Europe*, 8 J.L. ECON. & POL'Y 451 (2012); Jeremy Kidd, *To Fund or Not to Fund: The Need for Second-Best Solutions to the Litigation Finance Dilemma*, 8 J.L. ECON. & POL'Y 613 (2012); Jonathan T. Molot, *The Feasibility of Litigation Markets*, 89 IND. L.J. 171 (2014); *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L.J. 65 (2010); *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367 (2009); George S. Swan, *The Economics of Usury and the Litigation Funding Industry:* Rancman v. interim Settlement Funding Corp., 28 OKLA. CITY U. L. REV. 753 (2003); Marc J. Shukaitis, *A Market in Personal Injury Tort Claims*, 16 J. LEGAL. STUD. 329 (1987); Maya Steinitz, *Incorporating Legal Claims*, 90 NOTRE DAME L. REV. 1155 (2015); Michael Abramowicz, *On the Alienability of Legal Claims*, 114 YALE L.J. 697 (2005); Michael Faure & Jef P. De Mot, *Comparing Third-Party Financing of Litigation and Legal Expenses Insurance*, 8 J.L. ECON. & POL'Y 743 (2012); Peter C. Coharis, *A Comprehensive Market Strategy for Tort Reform*, 12 YALE J. ON REG. 435 (1995); Robert Cooter, *Towards a Market in Unmatured Tort Claims*, 75 VA. L. REV. 383 (1989); Keith N. Hylton, *The Economics of Third-Party Financed Litigation*, 8 J.L. ECON. & POL'Y 701(2012); Isaac M. Marcushamer, *Selling Your Torts: Creating a Market for Tort Claims and Liability*, 33 HOFSTRA L. REV. 1543 (2005); Sasha Nichols, Note, *Access to Cash, Access to Court: Unlocking the Courtroom Doors with Third-Party Litigation Finance*, 5 U.C. IRVINE L. REV. 197 (2015); Thurbert Baker, *Paying to Play: Inside the Ethics and Implications of Third-Party Litigation Funding*, 23 WIDENER L.J. 229 (2013); W. Bradley Wendel, *Alternative Litigation Finance and Anti-Commodification Norms*, 63 DEPAUL L. REV. 655 (2013).

[8] WILLISTON ON CONTRACTS § 15:1 ("Maintenance consists in maintaining, supporting or promoting the litigation of another, with most courts requiring that the maintaining party act as an officious intermeddler and be without any interest in the litigation.") (footnote omitted); 4 WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND *134 (1765) [hereinafter BLACKSTONE].

[9] WILLISTON ON CONTRACTS § 15:1 ("Champerty is a bargain to divide the proceeds of litigation between the owner of the litigated claim and the party supporting or enforcing the litigation. Champerty is said to be a species of aggravated maintenance.") (footnotes omitted); JOSEPH STORY, 2 COMMENTARIES ON EQUITY JURISPRUDENCE AS ADMINISTERED IN ENGLAND AND AMERICA 268, § 1048 (1877); 4 BLACKSTONE 134–35. *See generally* Note, *What Constitutes Champerty?*, 3 MINN. L. REV. 520.

[10] American Bar Association, *supra* note 1, at 1.

system."[11] The New York Times notes that "[i]n recent years, investors have started buying shares in other people's litigation proceedings."[12] In all these venues, commentators think of litigation finance as a novel instrument that has come into existence only recently and that it has the potential to change our legal system, for better or for worse.

We disagree. Litigation finance *already exists* in myriad places, hidden in plain sight. Investors trade in business debt, sovereign debt, and consumer debt. Individuals sell future claims to insurers. Lawyers offer clients contingency fee arrangements. Yet because these enclaves of third-party financing are camouflaged under different names, policymakers and scholars have unduly ignored this ubiquitous component of the modern economy. In point of fact, there are more arrangements that meet the literal definition of champerty without being held champertous, than arrangements actually considered champertous. The exceptions dwarf the rule.

This insight has three key implications. First, it should assuage concerns over the perceived novelty of litigation finance by dispelling the myth of two-party adjudication. Indeed, litigation creates third-party externalities that go well beyond the two people who engaged in it. Second, the identification of these already extant species of litigation finance provides data to test theoretical policy concerns scholars have raised about these third-party externalities. Our analysis finds that many of the traditional fears associated with litigation finance are not substantiated by existing practice, either because of existing regulations or market forces. Third, comparisons between "litigation finance proper" and these analogous areas reveal that litigation finance thrives in large part because third parties enjoy comparative advantages in litigation beyond mere financial liquidity. Any further expansion of litigation finance is likely to enjoy this attribute as well.

Part II briefly surveys historical case studies to show that third-party financing of litigation is not new. These practices have been in existence for millennia. Part III focuses on the present-day United States, and compares and contrasts the unacknowledged enclaves of litigation finance currently permitted by law. Using these analogous funding practices, Part IV tests several common theories about litigation finance. The analysis highlights implications that have thus far been underappreciated in the litigation finance scholarship. In particular, these examples illustrate that third parties often have comparative advantages in litigation beyond financial liquidity that renders them socially desirable. Part V concludes.

[11] Senate Judicial Committee, *supra* note 6, at 2.
[12] Schwartz, *supra* note 7.

II. Origins of Litigation Finance

History reveals that litigation finance has been occurring for millennia. Lenders have long funded suits for financial gain, but also for other reasons: friendship, animosity, altruism, and political gain. These practices have at times had adverse consequences on societies such as vexatious litigation, usury, and corruption of the judicial process through bribing jurors, perjuring evidence, and coercing judges. Societies have responded to these harms in different ways. Ancient Athens developed primarily social safeguards. Classical Rome had some social safeguards but began to craft laws to regulate litigation finance. Medieval England began to distinguish between various types of offenses and later carved out exceptions for supporting the claims of relatives, servants, and the poor. Today, countries differ widely in their regulation of litigation finance.

History also tells a compelling narrative: the gradual erosion of the myth that litigation concerns just the two parties to the suit. There has always been third-party involvement, third-party externalities, and attempted regulation. Athens perpetuated the venerable fiction that lawyers did not exist, despite the development of a robust industry of speechwriters and rhetoric teachers. Rome allowed lawyers but typically ignored the patronage of third parties necessary for litigation to proceed. England developed sophisticated common law doctrines and acknowledged that relatives and the poor can require third-party financing to bring meritorious suits. Later, the United States expanded this acknowledgement by legalizing contingency fee arrangements. In present day, some countries have confronted the problem with open candor by abolishing proscriptions on champerty and maintenance, going so far as to allow litigation finance companies to be publicly traded. So opened to public scrutiny, they can then be subject to regulation by securities administrations and other regulatory entities.

A. Ancient Athens

Prior to the United States, ancient Athens may have been the most litigious society the world had ever known.[13] But its legal system differed in

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[13] MATTHEW R. CHRIST, THE LITIGIOUS ATHENIAN 1 (1998); *cf.* Bayless Manning, *Hyperlexis: Our National Disease*, 71 NW. U. L. REV. 767 (1976); Marc Galanter, *Reading the Landscape of Disputes: What We Know and Don't Know (and Think We Know) About our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 4 (1983). *Compare* ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA 315 (trans. Gerald E. Bevan, 2003) (1840) ("There is hardly a political question in the United States which does not sooner or later turn into a judicial one."), *with* Aristophanes, *Pax* 505 ("You Athenians do nothing but judge lawsuits."); *Nubes* 207–08 (when shown a map for the first time, Strepsiades does not believe that it shows Athens because he cannot see any law courts in session on it).

For sources on ancient Athenian legal practice relied upon, *see generally* LENE RUINSTEIN, LITIGATION AND COOPERATION: SUPPORTING SPEAKERS IN THE COURTS OF CLASSICAL several important ways from the American. First, the democratic nature of Athenian society required every litigant to plead his own case.[14] A lawyer could not represent another in court; indeed, lawyers as a professional class did not exist. Yet there were professional "speech-writers" (*logographoi*) who would, for a fee, compose speeches for litigants to purchase, memorize, and recite. While Athenians were uncomfortable with the notion of professional lawyers, they nevertheless were content with the fiction of ghostwriters. They endured the charade of normal individuals speaking the words that all jurors knew were professionally written. The charade was so complete that Isocrates, perhaps the greatest of the "ten attic orators," who lived to the age of 98, never once delivered a speech in person. In addition to these speech-writers who prepared specific texts in preparation for specific cases, there were the "sophists" (*sophistai*), who charged clients fees in return for teaching them the art of eloquence, so that they could defend themselves in court and defeat any charge. These two industries provided one mechanism by which money could achieve greater legal success.[15]

Litigants were also allowed to bring forth witnesses to testify. There were no recognizable rules of evidence; and wealthy parties would try to pay individuals to testify on their behalf. The one judicial safeguard Athens had was large juries, generally ranging from 201 to 501 jurors. This made it difficult to bribe the jurors themselves, as the litigant would have to bribe hundreds of individuals. Yet the ability to purchase witnesses provided a second mechanism for money to influence outcomes.

Litigants could therefore benefit from money in at least three ways: bought eloquence, hired evidence, and bribed jurors. A litigant who could receive funds from a third party might therefore stand to benefit significantly from such

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ATHENS (2000); CHRIST, *supra* note ___; Roberts J. Bonner, Lawyesr and Litigants in Ancient Athens: The Genesis of the Legal Profession (ed. 1997) (1927); GEORGE MILLER CALHOUN, ATHENIAN CLUBS IN POLITICS AND LITIGATION (1913); THE CAMBRIDGE COMPANION TO ANCIENT GREEK LAW (eds. Michael Gagarin & David Cohen, 2005); ADRIAAN LANNI, LAW AND JUSTICE IN THE COURTS OF CLASSICAL ATHENS (2006); S.C. TODD, THE SHAPE OF ATHENIAN LAW (1993); GREEK LAW IN ITS POLITICAL SETTING: JUSTIFICATIONS NOT JUSTICE (eds. L. Foxhall & A.D.E. Lewis, 1996); STEVEN JOHNSTONE, DISPUTES AND DEMOCRACY: THE CONSEQUENCES OF LITIGATION IN ANCIENT ATHENS (1999); JOHN OSCAR LOFBERG, SYCOPHANCY IN ATHENS (1917); Max Radin, *Maintenance by Champerty*, 24 CAL. L. REV. 48, 51 (1935); Kellam Conover, Bribery in Classical Athens (Ph.D. dissertation, Princeton University 2010).

[14] The concept of *isonomia* was central to Athenian democracy. This is sometimes translated as "equality of political rights" or "equality of law."

[15] CALHOUN, *supra* note ___, at 43–46 (1913). "At Athens, as elsewhere, money could procure for the litigant every weapon of legal attack and defense." *Id.* at 43; *cf.* Demosthenes, 21.112 ("For, if I may add a word on this subject also, where the rich are concerned, Athenians, the rest of us have no share in our just and equal rights. Indeed we have not. The rich can choose their own time for facing a jury, and their crimes are stale and cold when they are dished up before you, but if any of the rest of us is in trouble, he is brought into court while all is fresh. The rich have witnesses and counsel in readiness, all primed against us; but, as you see, my witnesses are some of them unwilling even to bear testimony to the truth.") (trans. A.T. Murray).

contributions. Evidence of Athenian legal practice comes principally from the extant speeches of the ten Attic orators. Nevertheless, despite the limited evidence, there are several explicit references to litigation finance.

Over time there developed political clubs (*hetaireiai*) whose chief activities were litigation and politics.[16] Some of these clubs seem to have operated for profit by pooling money together in order to file and win petty claims through hiring witnesses, accusers, and speech-writers.[17] Such associations were also used to defray the costs of adverse judgments through the assistance of other members. While poor or middle class members often contributed to these funds through their personal services as witnesses or voluntary prosecutors, many of the richer members preferred to make monetary contributions. This had the particular advantage of anonymity. This way, an affluent individual could simply convey funds whenever it was inexpedient for the connection between the litigant and his supporter to be generally known.

Athenian society developed a social device to protect against these practices: the "sycophant." Christ gives as an encompassing definition of *sycophant* one who engages in one or more the following:

> (1) [H]e seeks to make money by (a) blackmailing individuals with the threat of a legal prosecution; (b) bringing suits of the variety in which the prosecutor received a share of the fine; (c) prosecuting people for a fee. (2) He levels false charges. (3) He engages in sophistical quibbling. (4) He makes slanderous attacks. (5) He frequently takes people to court. (6) He acts after the event and rakes up old charges. (7) He is a fluent speaker.[18]

The sycophant was a *persona non grata* in Athenian society similar to the "busybody." As such, the epithet was commonly employed against opposing litigants. Likewise, it became a trope for litigants to begin speeches by demonstrating that they were not sycophants. So important did this concept become in Athenian culture that the sycophant regularly appears in ancient plays.

This is the picture of a small society without litigation finance regulation. The democratic nature of juries rendered lawsuits highly unpredictable and prone to manipulation. Widespread bribery only exacerbated the movement of money to fund litigation. Most notably, litigation finance seems to have been more commonly employed as a political weapon than an investment scheme. What regulatory response existed was partly legal, but principally social. There was a formal bar on professional representation in court. Yet much of the society's regulation occurred through stigmatizing sycophants. Importantly, the encompassing definition of *sycophant* indicates that it was a blunt instrument to regulate legal practice. It is not clear that Athenians could precisely articulate what exactly they found problematic about these practices. It was easier to

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[16] *See generally* CALHOUN. V.I. Anastasiadis, *Political "Parties" in Athenian Democracy: A Modernising Topos*, 32 ARETHUSA 313 (1999).

[17] CALHOUN 46.

[18] CHRIST, *supra* note ___, at 50. *See generally* LOFBERG, *supra* note ___.

express their aversion through the moral impulse that such practices were undemocratic.

B. Classical Rome

Roman civil litigation similarly advantaged the rich over the poor, but for different reasons.[19] First, Roman law lacked a reliable mechanism to compel parties to court. A more powerful adversary could therefore avoid judgment by refusing to show up to court. While American law affords plaintiffs a default judgment in the event that the defendant fails to appear, Roman law could not conceive of judgments without two cooperating parties present before a judge. Second, Roman culture conceived of rich individuals as inherently better than less powerful or less wealthy litigants; they therefore often received the benefit of the doubt in cases. Third, all judgments were for monetary damages; there were no "equitable" remedies. In an economy where most wealth was held in real estate, slaves, and other non-fungible matters, and where currency was tied to precious metals, it was often difficult for the poor to satisfy monetary judgments.[20]

A Roman could therefore seek to benefit from the patronage of a wealthy citizen. The patron could exert power to force his client's opposing party to appear. The patron could also increase the outcome on the merits through association with high moral standing. Finally, the patron in theory act as a financier by paying the judgment to an opposing party while requiring the client's allegiance or services in other respects, including his vote in political elections.

Evidence of Roman law comes principally from its compilation by the sixth-century emperor Justinian, rather than records of specific cases. There is thus very little evidence of Roman litigation practice. Nevertheless, the existence of legal proscriptions against litigation finance in the late empire implies that, at some point, litigants engaged in such schemes.

Under the law of *calumnia*, if a person received money in order to annoy another with vexatious litigation, the defendant was entitled to sue for four times the amount of the plaintiff's claim[21] or four times the settlement amount.[22] While this was one particular manifestation of *calumnia*, the term in general connoted much of what *sycophant* did in Athens. A calumniator might be translated as a

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[19] For sources on ancient Roman legal practice relied upon, *see generally* ERNEST METZGER, LITIGATION IN ROMAN LAW (2005); J.M. KELLY, ROMAN LITIGATION (1966); J.A. CROOK, LEGAL ADVOCACY IN THE ROMAN WORLD (1995); ANDREW M. RIGGSBY, ROMAN LAW AND THE LEGAL WORLD OF THE ROMANS (2010); Radin, *supra* note ___.

[20] *See generally* J.M. KELLY, ROMAN LITIGATION 31–84 (1966). Jhering viewed Roman litigation as engines of oppression of the economically weak would be litigant. *Id* at 81.

[21] Encyclopedic Dictionary of Roman Law, vol. 43, "calumnia."

[22] Radin, *supra* note ___, at 54; Dig. 3, 6, 5, 1.

malicious accuser.[23] The most expansive definition is given in the Theodosian Code:

> Calumniators are (1) those who without authorization bring actions (in the name of another) with which they have no concern; (2) those who after losing their suit by a just determination, attempt to bring the action again; (3) those who seek or file claims in court for property, that does not belong to them; (4) those who under the pretense of aiding the Treasury, plan to acquire the property of other persons and do not suffer law-abiding citizens to be at peace; (5) those who by bringing false charges against an innocent person undertake to arouse the wrath of the governmental authority against them."[24]

In general, Roman law forbade traffic in litigation. A claim once commenced (*lite pendent*) could not be sold; such a transaction was void.[25] Radin asserts that this general prohibition is not based on an attempt to discourage litigation, as much as it derives from the feeling always present in most communities that a controversy properly concerned "o[n]ly the persons actually involved in the original transaction."[26] The only reason the Romans themselves have given is that it was "*contra bonos mores*" ("against good customs"), which may more generally be translated as against public policy.[27]

For some time, a claim could be sold before litigation commenced (before it became a *res litigiosa*).[28] While this lasted for some time during the Empire, it was finally outlawed by a famous constitution of the emperor Anastasius in A.D. 506 because purchasers would coerce plaintiffs to sell their claims for amounts far less than their value.[29] That is, it seems the problem of predatory lending became so great that the only cure was to completely proscribe the sale of claims.

Finally, there was also the problem of litigants involving a third party to increase the strength of their claims.[30] Because social standing was so important to the substantive outcome of cases, litigants would try to sell or give a claim to a more powerful individual who might have a better chance of winning the case by virtue of his higher social standing. Simultaneously, persons of high social rank were amassing more and more legal privileges, while the role of judges were increasingly being performed by low-level bureaucrats who would be easily intimidated by influential litigants.[31]

Overall, Roman law developed more formal regulations of third parties than Athenian law did. Litigants were allowed to have lawyers represent them in

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[23] *See generally* J.M. KELLY, ROMAN LITIGATION (1966); ERNEST METZGER, LITIGATION IN ROMAN LAW (2005); J.A. CROOK, LEGAL ADVOCACY IN THE ROMAN WORLD (1995).
[24] COD. THEOD. 9, 39, 3; *cf.* Dig. 44, 6; Code Just. 8, 36, 2 (litigiosi).
[25] Radin, *supra* note ___, at 54; *see also* Dig. 3, 6, 5, 1.
[26] Radin, *supra* note ___, at 54.
[27] Radin, *supra* note ___, at 54; Cod. Just. 2, 12, 15; 4, 35, 20–22.
[28] Radin, *supra* note ___, at 55.
[29] *See* Cod. Just. 4, 35, 22 & 23.
[30] *Cf.* Cod. Just. 2, 13, 1. Radin, *supra* note ___, at 55.
[31] Radin, *supra* note ___, at 55.

court. Roman law formally proscribed vexatious litigation and, later, third party investment in claims. Roman culture also developed the character of the *calumniator* as Athens did the *sycophant*, but this character was not nearly so dominant in Roman culture. It is worth noting that while both Athens and Rome responded to the problems of vexatious litigation, it was not until late in the Roman empire that the law sought to protect litigants from the usurious sale of claims.

C. Medieval England

In contrast to the expansive terms *sycophant* and *calumniator*, the common law in medieval England distinguished between three separate offenses: barratry, maintenance, and champerty.[32] Barratry is the offense of stirring up vexatious litigation. It included those who were overly officious in encouraging groundless litigation and those who actually brought such suits, whether for profit or harassment.[33] Maintenance is the support of litigation by a third party who has no legitimate interest in the lawsuit.[34] The common law grew to allow exceptions for funding suits by kinsmen, servants, and poor neighbors. A species of maintenance is champerty, whereby the financier has some share in the profits of the suit.[35] Its etymology is revealing. It ultimately derives from the Latin *campus*

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[32] For sources on the development of maintenance and champerty at common law relied upon, *see generally* Percy H. Winfield, *The History of Maintenance and Champerty*, 35 L.Q. REV. 50 (1919); Percy H. Winfield, *Assignment of Choses in Action in Relation to Maintenance and Champerty*, 35 L.Q. REV. 143 (1919); W.W. Thornton, *Champertous Agreements*, 19 CENT. L.J. 402 (1884); Radin, *supra* note ___; A.H. Denis, *The Law of Maintenance and Champerty*, 169 L.Q. REV. 169 (1890).

[33] 4 BLACKSTONE, *supra* note ___, at 133–34 (1765) ("Common barretry [sic] is the offence of frequently exciting and stirring up suits and quarrels between his majesty's subjects, either at law or otherwise. . . . Hereunto maybe referred an offense of equal malignity and audaciousness; that of suing another in the name of a fictitious plaintiff.").

Barratory seems also to have been known in medieval Italy. Dante placed barrators in the eighth circle, fifth bolgia of Hell. DANTE ALIGHIERI, DIVINA COMMEDIA (1320) (describing barrators immersed in a lake of boiling pitch, representing the stick fingers and dark secrets of their corrupt deals; Dante viewed them as the political analogue to the simoniacs).

[34] WILLISTON ON CONTRACTS § 15:1 ("Maintenance consists in maintaining, supporting or promoting the litigation of another, with most courts requiring that the maintaining party act as an officious intermeddler and be without any interest in the litigation.") (footnote omitted); 4 BLACKSTONE, *supra* note ___, at 134 ("Maintenance is . . . an officious intermeddling in a suit that no way belongs to one, by maintaining or assisting either party with money or otherwise, to prosecute or defend it: a practice, that was greatly encourage by the first introduction of uses. This is an offense against public justice, as it keeps alive strife and contention, and perverts the remedial process of the law into an engine of oppression. And therefore, by the Roman law, it was a species of the *crimen falsi* to enter into any confederacy, or do any act to support another's lawsuit, by money, witnesses, or patronage. A man may, however, maintain the suit of his near kinsman, servant, or poor neighbor out of charity and compassion, with impunity.").

[35] WILLISTON ON CONTRACTS § 15:1 ("Champerty is a bargain to divide the proceeds of litigation between the owner of the litigated claim and the party supporting or enforcing the litigation. Champerty is said to be a species of aggravated maintenance.") (footnotes omitted);

(field) and *partire* (to apportion). Champerty grew out of the practice of wealthy lords funding suits by villeins challenging titles to real property. The power of a local lord could easily transform a frivolous suit into a winning claim. The two would therefore hope to intimidate the judge into granting them title to the land. The two would then divide the spoils: *campum partire*.

Financiers seemed to have maintained actions for a variety of nefarious purposes. One reason for the doctrine of champerty "was to prevent the rich and powerful barons from purchasing claims against those who were in debt, and overwhelming the debtor by a prosecution for payment at one time of all his indebtedness."[36] Another was that "rich and powerful barons, unless restrained, would buy up claims, and, by means of their exalted and influential positions, would overawe the courts, and thus secure unjust and unmerited judgments, and oppressing those against whom their anger was directed."[37] Nobles evidently formed armed retinues for such activities, first intimidating the judge, then seizing the land, and finally frightening away any potential claimant. The hazards and expense of such a legal system induced the poor to associate with a local patron in the hope of sharing in these profits as well as securing immunity from other nobles.[38] These patronage structures became so elaborate that feudal lords would initiate and underwrite suits against their personal enemies as a form of "private war." The hope was that through such litigation schemes, they could financially

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JOSEPH STORY, 2 COMMENTARIES ON EQUITY JURISPRUDENCE AS ADMINISTERED IN ENGLAND AND AMERICA 268, § 1048 (1877); 4 BLACKSTONE, *supra* note ___, at 134–35 ("Champerty, *campi-partitio*, is a species of maintenance, and punished in the same manner: being a bargain with a plaintiff of defendant *campun partire*, to divide the land or other matter feud for between them, if they prevail at law; whereupon the champertor is to carry on the party's suit at his own expense. . . . In our sense of the word it signifies the purchasing of a suit, or right of suing: a practice so much abhorred by our law, that it is one main reason why a *chose* in action, or thing of which one hath the right but not the possession, is not assignable at common law; because no man should purchase any pretence to sue in another's right. These pests of civil society, that are perpetually endeavoring to disturb the repose of their neighbours, and officiously interfering in other men's quarrels, even at the hazard of their own fortunes, were severely animadverted on by the Roman law, '*qui improbe coeunt in alienam litem, ut quic quid ex condemnation in rem ipsius redactum fuerit inter eos communicaretur, lege Julia de vi prvata tenentur*;' and they were punished by the forfeiture of a third part of their goods, and perpetual infamy."); JOSEPH STORY, 2 COMMENTARIES ON EQUITY JURISPRUDENCE AS ADMINISTERED IN ENGLAND AND AMERICA 268, § 1048 (1877) ("Champerty (*campi partitio*) is properly a bargain between a plaintiff or a defendant in a cause, *campum partire*, to divide the land or other matter sued for between them, if they prevail at law; whereupon the champertor is to carry on the party's suit at his own expense. Maintenance (of which champerty is a species) is properly an officious intermeddling in a suit, which no way belongs to one, by maintaining or assisting either party with money or otherwise, to prosecute or defend it. Each of these is deemed an offence against public justice, and punishable accordingly, both at the common law and by statute, as tending to keep alive strife and contention, and to pervert the remedial process of the law into an engine of oppression.").

[36] Thornton, *supra* note ___, at 401.

[37] *Id.*

[38] Dennis, *supra* note ___.

weaken them. At the close of the middle ages, nobles unable to raise sufficient taxes from their vassals turned to such methods of corruption.

Two centuries ago, Jeremy Bentham concluded that such proscriptions were outdated given the rise of judicial independence:

> Whether, in the barbarous age which gave birth to these barbarous precautions, whether, even under the zenith of feudal anarchy, such fettering regulations could have had reason on their side, is a question of curiosity rather than use. My notion is, that there never was a time, that there never could have been, or can be a time, when the pushing of suitors away from court with one hand, while they are beckoned into it with another, would not be a policy equally faithless, inconsistent, and absurd. But, what every body must acknowledge, is, that, to the times which called forth these laws, and in which alone they could have started up, the present are as opposite as light to darkness. A mischief, in those times, it seems, but too common, though a mischief not to be cured by such laws, was, that a man would buy a weak claim, in hopes that power might convert it into a strong one, and that the sword of a baron, stalking into court with a rabble of retainers at his heels, might strike terror into the eyes of a judge upon the bench. At present, what cares an English judge for the swords of an hundred barons?—Neither fearing nor hoping, hating nor loving, the judge of our days is ready with equal phlegm to administer, upon all occasions, that system, whatever it be, of justice, or injustice, which the law has put into his hands.[39]

Nevertheless, until very recently, champerty and maintenance were offenses at common law.

In sum, medieval England also developed protections against third-party involvement. As in Athens and Rome, this emanated from a fear of individuals disrupting civil society. English law was more nuanced: it differentiated between three separate categories of offenses. It also began to make exceptions for kinsmen, servants, and the local poor. English society also illustrates quite spectacularly how the patronage of a wealthy financier could impact the substantive outcome of the cases. Without robust judicial safeguards, the wealthy could commandeer the judiciary to accumulate wealth, harass enemies, or amass dependents.

III. Modern Alcoves of Litigation Finance

Litigation finance is not new and is widespread in the United States. We simply fail to notice because it is camouflaged under different names. This section advances the argument by sketching several examples of third-party litigation financing sanctioned by current law. It then analyzes their characteristics and shows that they violate the literal definitions of maintenance and champerty. Table 1 *infra* provides the basic framework of the analysis. It lists the following examples of third-party funding along the leftmost column: (A) public interest;

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[39] Jeremy Bentham, Letter XII.7, Maintenance and Champerty (1787).

(B) contingency fee; (C) insurance; (D) factoring; (E) bankruptcy claims; and (F) "litigation finance proper." In this article, litigation finance proper refers to the financing of lawsuits; elsewhere, scholars and practitioners use the term loosely to refer to a variety of private investment funds, which earn profits through a combination of contingency fees, factoring, bankruptcy claims, and investments in lawsuits.[40] Each of these third-party funding arrangements are defined and described in this section.

In order to analyze the claimed structural similarities between these arrangements, we consider their similarities along a number of shared characteristics, including: (1) Is the entity a repeat player? (2) Is the entity a third party to the initial controversy? (3) Is the entity profit driven? (4) Does the entity have control over litigation strategy? (5) Does the entity own the claim? (6) Is the entity free from external regulations? (7) Does the entity deal mostly with corporate clients? (8) Is there moral unease with the entity? This list is not meant to be exhaustive.

These characteristics—either individually or pairwise—are sufficient to generate the main externalities focused on by the literature. Specifically, asking whether the entity is a repeat player is meant to capture comparative advantages in litigation brought to bear by third parties. Asking whether the entity is a third party implies the existence of outside funding, which necessarily loosens liquidity constraints on litigants. This theoretically improves access to justice for some parties but may also lead to a higher frequency of frivolous lawsuits. Column (3)—"Is the entity profit driven?"—is important to the extent that it plays a role in shaping the ways in which society views the third-party funding mechanism. Columns (4) and (5), when viewed together, can potentially result in agency problems (misaligned incentives). If the control over litigation strategy and the ownership of the claim were in the hands of one party, then there would be no agency problems. Column (6) simply checks whether existing regulations are already in place to solve some of the policy concerns like frivolous lawsuits or misaligned incentives between the lawyer and his client. Column (7) notes that increased access to justice is not uniformly distributed; some types of clients might benefit more than others. Finally, the last column documents general emotions felt toward the outside funding entity.

Throughout the subsequent analysis, it should become clear that each of these arrangements satisfies the literal definitions of maintenance and champerty. Recall that maintenance is defined as the support of litigation by a stranger

[40] *See* Christopher P. Bogart, *The State of the Litigation Finance Industry in 2017* (Jan. 28, 2017), Law360, *available at* https://www.law360.com/aerospace/articles/885864/the-state-of-the-litigation-finance-industry-in-2017 ("[I]n 2017 it's time to update terms: 'litigation finance' has really evolved into 'legal finance,' and leading 'funders' are more like investment banks for law.").

without just cause; champerty is defined as a species of maintenance whose distinguishing feature is the support of litigation in return for a share of the proceeds. Maintenance is satisfied by a “Yes” in column 2 of Table 1 *infra*; champerty requires a “Yes” in both columns 2 and 3.

Table 1: Various Forms of Third-Party Litigation Finance

	Characteristics							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Entity	Is the entity a **repeat player**?	Is the entity a **third party** to the initial controversy?	Is the entity **profit driven**?	Does the entity have **control over litigation** strategy?	Does the entity **own the claim**?	Is the entity free from **external regulations**?	Does the entity deal mostly with **corporate clients**?	Is there **moral unease** with the entity?
Public Interest	Yes	Yes	No	Yes	No	No	No	No
Contingency Fee	Yes	Yes	Yes	Yes	No	No	No	No
Insurance Subrogation	Yes	Yes	Yes	Yes	Yes	No	No	No
Factoring	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No
Bankruptcy Claims	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No
Litigation Finance Proper	Yes	Yes	Yes	No	No	Yes	Yes	Yes

A. Public Interest

Table 2: Characteristics of Public Interest Organizations

Is the entity a **repeat player**?	Is the entity a **third party** to the initial controversy?	Is the entity **profit driven**?	Does the entity have **control over litigation** strategy?	Does the entity **own the claim**?	Is the entity free from **external regulations**?	Does the entity deal mostly with **corporate clients**?	Is there **moral unease** with the entity?
Yes	Yes	No	Yes	No	No	No	No

Definition

Not only is financing Supreme Court litigation well outside the means of the average citizen,[41] but no average citizen can afford to maintain individually the levels of litigation necessary to effect social change.[42] On this front, public interest organizations like the American Civil Liberties Union have provided invaluable financing as well as legal expertise. With a budget in the hundreds of millions,[43] they have played a central role in advancing social progress by "represent[ing] parties that decisionmakers may not have fully heard, and to vindicate rights that decisionmakers have overlooked or illegitimately compromised."[44]

Maintenance

However, one cannot overlook the clear fact that their actions constitute a literal violation of common law maintenance: the support of litigation by a third party.[45] They receive financial resources from donors in order to litigate cases consistent with their founding missions—cases to which they are the third party. This concern has historical precedent. In the 1950s and 1960s, for example, certain states attempted to enforce maintenance claims against civil rights groups for providing "selfless maintenance"—merely offering advice and support for

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[41] Bowers & Cornter, *supra* note ___.

[42] John Roberts end of year report on judiciary (___).

[43] *See* ACLU Annual Report 2015 (showing that the institution received $137,493,060 in total support and revenue in fiscal year 2015), *available at* https://www.aclu.org/other/aclu-annual-report-2015.

[44] Robert Hermann & R. Thomas Hoffman, *Financing Public Interest Litigation in State Court: A Proposal for Legislative Action*, 63 CORNELL L. REV. 173 (1978).

[45] Ari Dobner, *Litigation for Sale*, Comment, 144 U. PA. L. REV. 1529 n.21 (1996) (noting that public interest litigation are existing examples of lawsuit syndication) (citing Roy D. Simon, Jr., *Lawsuit Syndication: Buying Stock in justice*, 69 BUS. & SOC'Y R. 10, 13 (1989)).

litigation.[46] That attempt was thwarted when the Supreme Court held in *NAACP v. Button*[47] that the state could not prohibit the NAACP activities based on barratry, maintenance, and champerty.

In the 1980s, Canadian public interest lawyers were so concerned that their efforts would be held invalid under maintenance and champerty rules, these doctrines filled entire chapters of how-to-litigate guidebooks. Consider this excerpt from one such manual:

> Organizers of a "defense fund," lawyers and expert witnesses who donate their services, and individuals and groups who donate money to defray legal costs should be aware of the torts of maintenance and champerty. . . .
>
> Of greater concern, however, is the possibility that wealthy defendants in public interest suits may use maintenance to sue storefront legal clinics, public interest groups, lawyers or other who support public interest plaintiffs. Maintenance could be used to harass and intimidate such groups.[48]

Even today, the British—the originators of maintenance and champerty—proscribe public interest law firms under these doctrines.[49] In the United States, however, the thought of eliminating this foundational legal pillar in the name of maintenance would be unconscionable because of its contributions to social progress—particularly through its expansion of access to justice for poor litigants—even though it ostensibly falls within scope of such laws.

Concerns

To understand the policy concerns, or lack thereof, with public interest litigation, one can simply glance at Table 2. Public attitude toward public interest litigation is overwhelmingly positive, even though such litigation is theoretically susceptible to frivolous lawsuits because many organizations are litigating to promote a particular ideology. There are also potential issues with misaligned incentives between the organization and the client because the organization does not own the case, as it is not an original party, yet its lawyers manage the litigation. These potential costs, however, is implicitly outweighed by the fact that such organizations are non-profits and benefit society by providing access to

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[46] Sebok, *supra* note___.

[47] 371 U.S. 415 (U.S. 1963).

[48] JOHN SWAIGEN, HOW TO FIGHT FOR WHAT'S RIGHT: THE CITIZEN'S GUIDE TO PUBLIC INTEREST LAW (1981).

[49] *See* Paul H. Rubin, *Third-Party Financing of Litigation*, 38 N. Ky. L. R. 674 (2011) ("Britain particularly discourages group litigation. In a class action, the representative plaintiff is personally responsible for all legal fees. If the case fails, this plaintiff is responsible for the losing party's legal costs as well. In the United States, public interest law firms are not subject to rules of champerty, but in Britain they are.").

justice for non-corporate clients, many of whom do not have resources to get their day in court.

B. Contingency Fee

Table 3: Characteristics of Contingency Fee Arrangements

Is the entity a **repeat player**?	Is the entity a **third party** to the initial controversy?	Is the entity **profit driven**?	Does the entity have **control over litigation** strategy?	Does the entity **own the claim**?	Is the entity free from **external regulations**?	Does the entity deal mostly with **corporate clients**?	Is there **moral unease** with the entity?
Yes	Yes	Yes	Yes	No	No	No	No

Definition

Contingency fee arrangements have existed in the United States for decades, despite champerty laws in many states.[50] In such an arrangement, the lawyer represents the client in exchange for a share of the financial award, should the suit be successful. If the suit is unsuccessful, the lawyer typically receives nothing. Thus, the lawyer bears the risk in exchange for the monetary upside. Contingency fee arrangements are used frequently in personal injury cases and have recently become prominent in corporate and securities litigation.[51]

Champerty

Contingency fee arrangements satisfy the literal definition of champerty: supporting litigation for profit. By construction, the lawyers are only financing these cases in the hope of partaking some profit.[52] In the early 19th century, the elite members of the American bar viewed the contingency fee contract as champertous and therefore void.[53] State courts were receptive of third parties

[50] Sebok, *supra* note ___ (“Technically, of course, all fifty-one jurisdictions permit at least one form of maintenance: the contingency fee. At the turn of the twentieth century lawyers began to offer to take cases without payment unless they obtained a settlement or a judgment for their clients, a practice that was flatly illegal under the doctrines of maintenance and champerty.”).

[51] Molot, *supra* note ___, at n. 77.

[52] *See, e.g.*, Matthew Scully, Contingency Fees: Another Name for Champerty, Wall St. J. (Nov. 10, 1997).

[53] Peter Karsten, *Enabling the Poor to Have Their Day in Court: The Sanctioning of Contingency Fee Contracts, A History to 1940*, 47 DEPAUL L. REV. 231 (1997).

providing litigation funds for altruistic motives, like helping poor neighbors, but balked at the idea of providing funds in exchange for a monetary reward.[54]

Contingency fee arrangements remained controversial even a century later, when Chief Judge Benjamin Cardozo of the New York Court of Appeals voided the contingency payment by an administratrix to her attorney for legal services rendered. Cardozo reiterated in the opinion: "maintenance inspired by charity or benevolence has been sharply set apart from maintenance for spite or envy or the promise or hope of gain. . . . What is feared and forbidden is the oppressive intermeddling of wealth or officialdom for publicity or profit."[55] Recall that maintenance is the provision of support for a lawsuit to which one is not a party, and champerty—a form of maintenance—is the acquisition of an interest in the lawsuit. As seen in Cardozo's opinion, contingency fee arrangements were a direct violation of champerty. It could not have been any clearer.

If one needs further evidence of a connection between contingency fee arrangements and litigation finance, consider the fact that plaintiffs' lawyers often require external funding in order to litigate lengthy cases.[56] In mass tort cases, for example, expenditures for plaintiffs' lawyers can enter the neighborhood of millions of dollars.[57] Not every plaintiffs' lawyer has that much cash on hand, which means the lawyer oftentimes cannot afford to wait years before receiving any monetary inflow. Plaintiffs' lawyers have thus found various ways of funding themselves. The simplest is self-financing through a diversified portfolio of lawsuits. But self-financing is oftentimes insufficient. In the 1980s, as expenses increased, they borrowed from fellow plaintiff's lawyers and bankers. By the mid-1990s, they started accepting recourse loans from specialized lenders. Today, they borrow from specialized lenders that provide nonrecourse loans.[58] With the exception of self-financing, these forms of litigation funding all involve third

[54] *See id.* ("[A Good Samaritan who was to] lay out money in . . . a suit to recover a [tract of land] of which his poor neighbor had been deprived, and without which he must lose it . . . [since] . . . right, humanity and justice would approve it; but, if he were to do it upon a stipulation, that he shall receive one half of the filed, if it be recovered, he is . . . a champertor.") (citing *Findon v. Parker*, 152 Eng. Rep. 976, 979 (Ex. 1843)).

[55] *In re Gilman's Administratrix*, 167 N.E. 437, 439-40 (N.Y. 1929). By the mid-1930s, however, most jurisdictions had accepted contingency fee arrangements as "industrialization brought more claims in need of legal representation." American Bar Association, *supra* note ___.

[56] *See* Stephen C. Yeazell, *Re-Financing Civil Litigation*, 51 DEPAUL L. REV. 183 (2001) ("One can see the modern plaintiffs' bar, better capitalized and diversified, as a response to the demands of a procedural regime requiring greater investment. Without better financial resources, the plaintiffs' bar simply could not have survived, much less prospered.").

[57] Nora F. Engstrom, *Re-Re-Financing Civil Litigation: How Lawyer Lending Might Remake the American Litigation Landscape, Again*, 61 UCLA L. REV. DISC. 110 (2013).

[58] *Id.*; *see also* Martin, *supra* note ___ ("Although traditional banks are not extending funds to litigants making repayment contingent on the litigants' success in their cases, some have started opening lines of credit for lawyers supported by cases they have taken on a contingency fee basis.").

parties. In short, third parties have been directly financing the litigators—and hence, the litigation—for decades. Even the contingency fee lawyers need third-party financing.[59]

Concerns

One can glean the main externalities of contingency fee litigation by looking across Table 3. It is very similar to public interest litigation. There are the potential costs of frivolous lawsuits and misaligned incentives between the client and his lawyer, and there is the potential benefit of access to justice for a client without independent financial resources. But there is one key distinction—contingency fee arrangements are profit driven.

Despite this difference, many in modern America believe that contingency fee arrangements are socially desirable. The American Bar Association notes that this type of contractual arrangement alleviates the financial pressures faced by plaintiffs who are physically injured.[60] In the same vein, scholars have pointed out that such arrangements improve plaintiffs' bargaining power when negotiating settlements.[61]

Providing a poor plaintiff with the resources to litigate a legitimate claim outweighs the costs, especially if a court supervises the financing.[62] As explained in subsection (F) *infra*, litigation financing by private investment funds yields the same type of advantages and disadvantages. Both mechanisms employ contingency fees where the financial provider bears the downside risk in exchange for the possibility of taking a cut of the final award.

[59] Compare the American and British experiences. The Americans solved the financing problem by allowing contingency fee arrangements, but not litigation finance. The British for a while achieved the same results by allowing litigation finance, but not contingency fee arrangements.

[60] *Id.* ("[S]ome litigants find themselves in urgent need of funds to pay living or medical expenses as they are accrued. Individual plaintiffs in tort actions may find themselves in this predicament. They may not have access to other sources of capital, such as bank loans or credit cards, and may discover that the most valuable asset against which they can obtain capital is a contingent share in an eventual judgment or settlement.").

[61] Molot, *supra* note ___, at ___ ("A plaintiff who uses a contingent fee arrangement can significantly enhance his or her bargaining power vis-à-vis the defendant. Indeed, a contingent fee plaintiff can file a lawsuit, and even reject low-ball settlement offers and proceed to trial, without any downside risk of losing money. Empirical studies comparing trial outcomes with settlement negotiations for a range of different cases suggest that plaintiffs who paid their lawyers a contingent fee were more willing to proceed to trial than plaintiffs who paid their lawyers by the hour.").

[62] Susan L. Martin, *The Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed*, 10 FORDHAM J. CORP. & FIN. L. 55 (2004).

C. Insurance

Table 4: Characteristics of Insurance Subrogation

Is the entity a **repeat player**?	Is the entity a **third party** to the initial controversy?	Is the entity **profit driven**?	Does the entity have **control over litigation** strategy?	Does the entity **own the claim**?	Is the entity free from **external regulations**?	Does the entity deal mostly with **corporate clients**?	Is there **moral unease** with the entity?
Yes	Yes	Yes	Yes	Yes	No	No	No

Definition

The essence of insurance is trading risk, and a significant portion of the insurance business revolves around acquiring future legal claims in exchange for fixed fees, a process that entails the insurance companies "selecting, paying, and directing the lawyer[s]."[63]

Consider the paradigm car accident where an insurance policyholder is negligently injured by another driver. The insurance company pays the policyholder and then sues the negligent driver for recovery. Without the insurer in the picture, the victim would have sued the negligent driver himself. This practice by the insurer is known as subrogation,[64] and it is essentially a form of claims trading,[65] only where the future claim is contracted to transfer before the underlying controversy occurs.

Liability insurance provides another illustration. Suppose that, in our paradigm car accident, the negligent driver himself also has an insurance policy. This stipulates that the insurer will assume the damages the negligent driver incurs, including the ability to dispute these claims in court. Indeed, liability insurers make payments to the vast majority of tort victims.[66] Similarly, most public companies in the United States and Canada carry liability insurance for their directors and officers.[67] A company purchases directors and officers insurance to protect them from personal liability if shareholders sue for violations

[63] Michelle Broadman, *Insurers Defend and Third Parties Fund: A Comparison of Litigation Participation*, 8 J.L. ECON. & POL'Y 673 (2011).

[64] *See* Spencer L. Kimball & Don A. Davis, *The Extension of Insurance Subrogation*, 60 MICH. L. REV. 841 (1962).

[65] *See* McGovern et al., *Third-Party Litigation Funding and Claim Transfer: Trends and Implications for the Civil Justice System* (2010), Conference Proceedings ("This is a form of claim transfer, although it is not commonly referred to as such.").

[66] Steven Shavell, *Economic Analysis of Accident Law*, The Harvard John M. Olin Discussion Paper No. 396 (2012).

[67] Chen Lin et al., *Directors' and Officers' Liability Insurance and Loan Spreads*, 110 J. FIN. ECON. 37 (2013).

of their fiduciary duty or securities laws. There are two types of policies for directors and officers. First, the insurer can offer to protect directors and officers when their company cannot indemnify them due to legal restrictions, insolvency, or by choice. Second, the insurer can cover the costs of indemnifying the directors and officers.[68] In both, the insurance providers are third parties with no stake in the original controversy.

Champerty

Such insurance contracting satisfies the literal definition of champerty: investment in litigation for profit. After all, if they were not executed for profit, why would insurance companies enter into them? For charity? In fact, insurance contracts are more extreme than mere champerty: they are the buying of the *entire* claim ex ante.

There was a debate on whether insurance subrogation fell into the scope of maintenance and champerty when the practice began to proliferate. In 1973, the Supreme Court of Connecticut held that subrogation in the case of an automobile accident was "in essence an assignment of a cause of action for personal injuries and, in the absence of legislative change in the common-law rule against such an assignment is contrary to public policy and impermissible."[69] That same year, however, the Supreme Court of Virginia decided in *Collins v. Blue Cross of Virginia* that contractual subrogation is in "no danger of champerty and maintenance" since the insurer sought to enforce a contractual right of subrogation "only to the extent of payments made for the [insured's] benefit."[70] The Supreme Court of Oklahoma also distinguished subrogation from champertous behavior by noting the prior relationship between the insured and the insurer.[71]

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[68] Lin et al., *supra* note ___.

[69] Berlinski v. Ovellette, 325 A.2d 239, 242 (Conn. 1973).

[70] 193 S.E.2d 782, 785 (Va. 1973).

[71] Aetna Casualty & Surety Co. v. Associates Transports, Inc., 512 P.2d 137, 141 (Okla. 1973). For similar decisions by other state courts, *see, e.g.*, Milkbank Ins. Co. v. Henry, 441 N.W.2d 143, 145 (Neb. 1989) ("Moreover, under subrogation an insurer's recovery is limited to the amount paid to the insured, whereas there is no such limitation on an assignee's recovery. Thus, subrogation simply does not create the same risk of maintenance or champerty as does assignment."); Hospital Service Corp. of R. I. v. Pennsylvania Ins. Co., 227 A.2d 105, 109 (R.I. 1967) ("Though both are voluntary transfers, an assignment is a transfer of a much more specific nature than is subrogation. Assignment involves dangers of champerty and maintenance. Subrogation does not."); D'Angelo v. Cornell Paperboard Products Co., 120 N.W.2d 70, 75 (Wis. 1963) (holding that subrogation is an equitable action and therefore not champertous).

Concerns

Per Table 4, insurance subrogation is very similar to contingency free arrangements. The one exception is that the insurance company owns the claim, which means the concern of misaligned incentives is mitigated. And, despite the literal violation of champerty, it is clear that society views the benefits of having this practice as outweighing the costs.

Indeed, in 1996, the Supreme Court of Connecticut to overturned its ruling by carving subrogation into conventional and equitable subrogation.[72] Matters of insurance subrogation are equitable[73] and deemed consistent with public policy:

> [T]he public policy reason most often cited as supporting the rule disallowing the assignment of actions to recover for personal injuries, namely, champerty, simply does not exist in the context of equitable subrogation. As an equitable subrogee, the insurance company in *Berlinski,* rather than acting as a volunteer or complete stranger to the action, made payment to its insured as the result of a preexisting contract of insurance. Upon payment, the insurer became subrogated to the rights its insured may have had against the party responsible for the loss. Under such circumstances, we need not be concerned about "unscrupulous interlopers and litigious persons [who are] to be discouraged from purchasing claims for pain and suffering and prosecuting them in court as assignees."[74]

Today, subrogation is a standard procedure in the toolkit of all American insurance companies.

D. Factoring

Table 5: Characteristics of Factoring

Is the entity a **repeat player**?	Is the entity a **third party** to the initial controversy?	Is the entity **profit driven**?	Does the entity have **control over litigation** strategy?	Does the entity **own the claim**?	Is the entity free from **external regulations**?	Does the entity deal mostly with **corporate clients**?	Is there **moral unease** with the entity?
Yes	Yes	Yes	Yes	Yes	Yes	Yes	No

Definition

Like insurance subrogation, there are well-known activities within financial services that can lead to third-party involvement in litigation. Consider "factoring," which is the practice of a third party purchasing an accounts receivable from a company. The accounts receivable is an invoice (an "IOU") that is owed by a debtor. Thus, the three parties involved are (i) the original debtor

[72] *See* Westchester Fire Ins. Co. v. Allstate Ins. Co., 672 A.2d 939, 944 (Conn. 1996).
[73] *Id.* at 944.
[74] *Id.* at 945.

who must pay the liability, (ii) the original holder of the liability, and (iii) the financier who purchases the liability from the original holder.

Factoring is used by banks as a form of basic finance: the third-party buyer is willing to assume the downside risk in exchange for a greater expected payout, and the seller of the invoice receives liquidity.[75] For instance, the seller might need additional cash on hand to meet its monthly payroll. Importantly, the third-party buyer of the accounts receivable does not pay full price for the debt. He buys the accounts receivable at a discount, with the assumption that his expected future payout (discounted to present value) will exceed his purchase cost. If, for some reason, the original debtor does not pay up, the third-party buyer has the claim to litigate in court.

Champerty

A straightforward, and obviously champertous, way in which factoring applies to litigation occurs after settlement. When litigation ends, the winning side does not see the money immediately. Third-party financiers can call the class action attorneys and say, "We will give you 95 cents on the dollar."[76] The lawyers and their clients receive money up front, which could be crucial if they need it for immediate expenditures.

In recent months, factoring has also crept into the domain of "Big Law." It was reported that numerous law firms sold parts of their accounts receivables (unpaid debt by clients) to Gerchen Keller, a Chicago-based litigation finance fund. The mechanics are simple: Gerchen buys the invoices at a discount with the hope of reaping the full sticker price in the future; the law firms relieve themselves of the payment uncertain for cash.[77] In addition, equity partners at the law firms benefit from this arrangement. Suppose the law firm has an invoice due in February of the following year and that it is currently December and the law firm's fiscal year is ending. Because equity partners receive their share of the profits at the end the end of the fiscal year, they want the invoice paid now. Thus, they are willing to sell the invoice to a third party in exchange for, say, 95 percent of its face value in cash. While this practice is not considered controversial, it would clearly violate champerty laws if litigated.

[75] *See* Erin Marie Daly, *Wells Fargo Snaps Up GMAC Factoring Unit*, Law360 (Mar. 24 2010), *available at* https://www.law360.com/articles/157509/wells-fargo-snaps-up-gmac-factoring-unit

[76] *See, e.g.*, Law Finance Group, *Settlement Finance* (Mar. 4, 2017), *available at* http://www.lawfinance.com/services/settlement-finance/

[77] *See* Andrew Strickler, *Litigation Funder Makes Bid For BigLaw's Unpaid Fees*, Law360 (Feb. 26 2016), *available at* https://www.law360.com/articles/762407/litigation-funder-makes-bid-for-biglaw-s-unpaid-fees

Concerns

This funding mechanism is broadly used in all commercial industries because companies are all liquidity constrained at some point and they need outside cash. To obtain cash, they are willing to sell parts or all of their legal claims. This is essentially Finance 101. Yet if one stops to think carefully about the moving parts of the funding apparatus, it has all the characteristics that would lead to unwanted litigation externalities discussed in previous subsections. But nobody would say that factoring should be proscribed under the doctrine of champerty. This contradiction will become even more evident in the next subsection, where the analysis focuses on the twin sibling of factoring—bankruptcy claims trading.

E. Bankruptcy Claims

Table 6: Characteristics of Bankruptcy Claims

Is the entity a **repeat player**?	Is the entity a **third party** to the initial controversy?	Is the entity **profit driven**?	Does the entity have **control over litigation** strategy?	Does the entity **own the claim**?	Is the entity free from **external regulations**?	Does the entity deal mostly with **corporate clients**?	Is there **moral unease** with the entity?
Yes	Yes	Yes	Yes	Yes	Yes	Yes	No

Definition

A type of financing that is very similar to factoring is the trading of bankruptcy claims, which came into prominence in the 1980s following a wave of large mergers and acquisitions.[78] In this area, sophisticated investors purchase the debt claims of bankrupt and near-bankrupt businesses and consumers at a discount—sometimes for pennies on the dollar—in the hope that they will be repaid at a higher amount later on.[79] The seller of the debt claim benefits from exiting the bankruptcy process for a host of reasons, including relaxing liquidity constraints, reducing administrative costs, avoiding an adversarial relationship with the debtor, or establishing a tax loss.[80] The seller can exchange these known

[78] *See* Frederick Tung, *Confirmation and Claims Trading*, 90 NW. U. L. REV. 1684 (1995) ("Traditionally scorned by the financial establishment, distress investment came into vogue with the 'megabankruptcies' that followed in the wake of the leveraged buyout boom of the 1980s. With its prospects for huge profits, claims trading in Chapter 11 became a Wall Street staple.").

[79] *See id.* (noting that the most important right for the buyer is the "right to demand payment in full on the claim, regardless of any discount in the purchase price").

[80] Adam J. Levitin, *Bankruptcy Markets: Making Sense of Claims Trading*, 4 BOOK. J. CORP. FIN. & COM. L. 64 (2010) (internal citations omitted).

undesirables attached to an unknown future payout to a willing buyer for a discounted cash payment now.

There are passive and active buyers in this market.[81] Passive buyers tend to sit on the sidelines and await repayment. They do not litigate the claims. They are simply betting that the timing will work in their favor: the company will restructure and pay off its debts in due course. Passive investors are more common in bankruptcy cases involving consumer debt.[82] In larger Chapter 11 cases, active investors seek to maximize profits by "attempting to influence the course of the bankruptcy case—by appearing and filing pleadings; by interfacing with the debtor-in-possession, the bankruptcy trustee, or the creditors' committee; and by trying to negotiate with other creditor constituencies."[83]

The sale of debt and the subsequent litigation by the activist investor is the embodiment of a self-interested third party meddling in a controversy to which he was not originally a party.[84] There is no clearer violation of champerty than this mechanism of trading and litigating bankruptcy claims.

Yet our legal system allows this. It is difficult to excuse this allowance on the theory that it has simply escaped notice. Bankruptcy claims trading is pervasive in our economy. Indeed, many argue that claims trading greatly strengthens capital markets.[85] It reduces the uncertainty of lengthy bankruptcy processes that in turn reduce the cost of financing for firms. Before the proliferation of claims trading, "[t]he average time a large public or private company spent in bankruptcy for 1989 cases was nearly 1000 days; for cases filed in 2013, that number dropped to 116 days."[86] The creditors' "ability to exit

[81] See *id.* ("As with consumer bankruptcies, there are simple passive arbitrageurs looking to make a spread between the price they pay for a claim and the ultimate payout, discounted for some time value. . . . Also, there are arbitrageurs, typically activist investment funds, who are active in the case, appearing in court, taking part in plan negotiations, and litigating to improve their payouts.").

[82] Eric Winston, *Understanding The Reasons Traders Buy Bankruptcy Claims*, Law360 (Jan. 8 2014), *available at* http://www.law360.com/articles/498711/understanding-the-reasons-traders-buy-bankruptcy-claims.

[83] *Id.*

[84] Kenneth A. Rosen, *Claims Trading Warps the Bankruptcy System*, WALL STREET JOURNAL (Jan. 14, 2016), *available at* http://blogs.wsj.com/bankruptcy/2016/01/14/claims-trading-warps-the-bankruptcy-system/.

[85] *But see* Victoria J. Haneman, *The Ethical Exploitation of the Unrepresented Consumer*, 73 MO. L. REV. 707(2006).

[86] Elliot Ganz, *Disclosing Claims-Trading Prices Would Hurt Debtors, Creditors*, The Wall Street Journal (Jan. 21, 2016), *available at* http://blogs.wsj.com/bankruptcy/2016/01/21/disclosing-claims-trading-prices-would-hurt-debtors-creditors/; *see also* Adam J. Levitin, *Finding* Nemo*: Rediscovering the Virtues of Negotiability in the Wake of* Enron, 2007 Colum. Bus. L. Rev. 83 (2007) ("The ability to sell bankruptcy claims provides an exit opportunity for creditors who do not wish to incur the hassle and expense of the reorganization process."). *But see* Levitin, *supra* note ___ (noting that "distressed debt traders may sacrifice the long-term viability of a debtor for the ability to realize substantial and quick returns

quickly increases their willingness to extend credit in the first instance at attractive rates,"[87] which could yield significant gains at the macroeconomic level because capital is allocated more efficiently. The main insight from considering the below examples is that these funding mechanisms are ubiquitous in our modern world. They touch every entity from large nations, to megacorporations, to ordinary individuals. And they all fit squarely into the definition of champerty.

Champerty

Business Debt

When Lehman Brothers collapsed in 2008 and filed for Chapter 11 bankruptcy, it was over $600 billion in debt, which included claims on office rent, various loans, and money owed on derivative contracts.[88] After the collapse, a group of sophisticated investors swooped in to buy a significant portion of that debt. They are the so-called "vulture funds." The original debtholders had no idea if or when they would be paid, so many decided to offload the risk in exchange for an immediate payment. Because of the uncertainty, some hedge funds were able to purchase the Lehman debt for as little as 7.5 cents on the dollar.[89] When many vulture funds were later able to recover, they made profits that were many times their initial investment.

A similar situation occurred after the revelation of Madoff's Ponzi scheme. Certain victims of this scheme were so liquidity constrained that they were willing to sell their claims to hedge funds for 30 cents on the dollar.[90]

The takeaway from the Lehman and Madoff examples is that valuing distressed debt is incredibly complicated,[91] partly because of the complexity and opaqueness of the Lehman and Madoff operations, but also because the value depends on decisions made by judges.[92] This is the definition of third parties placing bets on litigation outcomes; and these types of investments are allowed.

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on their investments" and may also "upset[] the community of interests involved in bankruptcy") (internal quotations omitted).

[87] *Id.*

[88] Kelly Bit & Lisa Abramowicz, *Hedge Funds Get Fat on Lehman's Remains*, BLOOMBERG (May 22, 2014), *available at* http://www.bloomberg.com/news/articles/2014-05-22/lehman-brothers-debt-pays-off-for-hedge-funds.

[89] *Hedge Funds Reap Rewards from Bet on Lehman Carcass*, REUTERS (Sept. 14, 2013), *available at* http://www.reuters.com/article/lehman-fiveyear-creditors-idUSL6N0H11VJ20130914.

[90] Dan McCrum & Anousha Sakoui, *Bankruptcy Traders Hone in on Madoff*, Financial Times (Dec. 17, 2010), *available at* http://www.ft.com/intl/cms/s/0/ca23dc9c-0a0c-11e0-9bb4-00144feabdc0.html#axzz43N04KiPC.

[91] Note that many of these distressed debt investors are former lawyers.

[92] Bit & Abramowicz, *supra* note ___.

Sovereign Debt

Private funds also finance litigation over sovereign debt. The most recent example is the well-known row between Argentina and two American hedge funds.

After Argentina defaulted on over $80 billion of its bonds in late 2001,[93] the majority of its bondholders agreed to accept repayment at a fraction of the bonds' full value. Two hedge funds, however, NML Capital and Aurelius Capital Management, bought some of the debt at a discount on the secondary market and demanded to be paid in full. In order to compel payment, they sued Argentina. In *NML Capital, Ltd. v. Republic of Argentina*,[94] the United States Court of Appeals for the Second Circuit upheld a district court order forcing Argentina to repay NML Capital the bonds' full value at the same time as it pays the roughly 93 percent of bondholders who accepted earlier restructuring offers.[95] Argentina's opportunities to appeal the decision were exhausted when the Supreme Court denied certiorari in June 2014.[96]

To appreciate the extent of this litigation, lawyers for NML Capital traveled to Ghana and convinced a court to impound the *Libertad*, an Argentine ship.[97] Recall that NML Capital was not an original holder of Argentina's debt. Rather, it purchased the debt on the secondary market once Argentina had defaulted. In other words, NML Capital did not lend a single dollar to Argentina. Other parties lent money to Argentina; NML Capital purchased those debt claims for a small fraction of their par value, and subsequently litigated the claims of the original contracts between Argentina and its debtholders. This third-party profiteering off another's legal claims would seem to meet the definition of champerty.

Consumer Debt

Litigation financing by private funds does not stop with the debts of multibillion-dollar businesses and sovereign nations. It also reaches individual

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93 Lyle Denniston, *The Argentine Bond Saga, Made Simple*, SCOTUSblog (Jun. 11, 2014), *available at* http://www.scotusblog.com/2014/06/the-argentine-bond-saga-made-simple/.

94 727 F.3d 230 (2d Cir. 2013).

95 John Muse-Fisher, *Starving the Cultures:* NML Capital v. Republic of Argentina *and Solutions to the Problem of Distressed-Debt Funds*, Note, 102 CAL. L. REV. 1671 (2014), *available at* http://www.californialawreview.org/7starving-the-vultures-nml-capital-v-republic-of-argentina-and-solutions-to-the-problem-of-distressed-debt-funds/.

96 Republic of Argentina v. NML Capital, Ltd., 134 S.Ct. 2819 (2014).

97 Jonathan Blitzer, *Argentina's Unending Debt*, The New Yorker (Apr. 24, 2014), *available at* http://www.newyorker.com/business/currency/argentinas-unending-debt.

consumers.[98] Private funds acquire debt claims that span the entire range of consumer debt, from unsecured credit card debt, to auto loans, to student loans.[99] Moreover, they buy and sell these debt claims pre- and post-bankruptcy. There are markets for (1) consumer debt as part of securitization transactions; (2) delinquent debt of non-bankrupt consumers; (3) previously delinquent bankruptcy claims; and (4) bankruptcy-discharged "zombie" debt.[100] Unsurprisingly, the claims "are often bought by a handful of companies that specialize in consumer debt collection, have the resources to pursue a difficult collection effort, and have the liquidity necessary to withstand long repayment periods."[101]

Consider, for example, Heritage Pacific Financial, a fund that purchased promissory notes issued by California homeowners to institutional lenders at the peak of the housing bubble in 2005–06. The original value of the notes was north of $400 million.[102] After the housing market collapsed, the value of the notes plummeted as homeowners stopped paying, and Heritage bought them at a steep discount—some for *less than* a penny on the dollar. Heritage then sued the former homeowners for the outstanding balances.[103]

Concerns

Bankruptcy claims trading and factoring share the same underlying characteristics. Both are untouched by champerty even though they fall squarely into its boundaries. In all instances, these for-profit traders had no involvement with the original controversy. They seek to invest in a claim, litigate if necessary, and turn a profit. Notably, this is strikingly similar to contingency fee arrangements, but even better in one respect—claims traders do not create the same agency problem because they purchase and own the legal claims entirely.

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[98] *See* Guy B. Moss, *The Risks of Purchasing and Collecting Consumer Debt*, 10 AM. BANK. INST. L. REV. 643, 645-46 (2002) (noting that an individual's chapter 7 discharge "does not prohibit an unpaid creditor from selling the discharged debt, presumably at a steep discount, to a third party").

[99] *Id.*

[100] Levitin, *supra* note ___.

[101] Eric Winston, *A Close Look At Special Cases Of Bankruptcy Claims Trade*, Law360 (Jan. 29, 2014), *available at* http://www.law360.com/articles/505209/a-close-look-at-special-cases-of-bankruptcy-claims-trade.

[102] Gary Neustadter, *Randomly Distributed Trial Court Justice: A Case Study and Siren from the Consumer Bankruptcy World*, American Bankruptcy Institute Law Review (Forthcoming), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2722054.

[103] *Id.*

F. Litigation Finance Proper

Table 7: Characteristics of Litigation Finance Proper

Is the entity a **repeat player**?	Is the entity a **third party** to the initial controversy?	Is the entity **profit driven**?	Does the entity have **control over litigation** strategy?	Does the entity **own the claim**?	Is the entity free from **external regulations**?	Does the entity deal mostly with **corporate clients**?	Is there **moral unease** with the entity?
Yes	Yes	Yes	No	No	Yes	Yes	Yes

Definition

Litigation finance, as used in the popular press, refers broadly to the various private investment vehicles that profit from using a combination of contingency fee arrangements, factoring, bankruptcy claims trading, and investing in lawsuits. Here, "litigation finance proper" refers to investments in litigation of which the investor is not an original party.

The investment decision goes as follows: The litigation financier receives descriptions of cases from anonymous (Internet) sources, from responses to public advertisements, and from law firms that have close connections to the financier. These are cases where one party, typically the plaintiff, has a winning case on the merits but does not have the funds to successfully pursue the case. After filtering through promising cases, the financier decides to invest or not. By investing, the litigation financier provides the party with the resources to hire a law firm's lawyers to pursue the case or to maintain a law firm that is already on the case. Similar to a contingency fee arrangement, the litigation financier does not own the underlying claim. He provides short-term funding and takes a cut upon resolution. However, an important difference with contingency fee arrangements is that the litigation financier does not have control of litigation strategy. That control belongs to the lawyer, who is an officer of the court and subject to disciplinary action by the bar.

Champerty

A well-publicized example of litigation finance proper comes from a defamation suit in Indiana.[104] In 2006, Indiana suffered from a severe hailstorm

[104] *See* Jan Wolfe, *Got Your Bank*, The American Lawyer (Feb. 2014); *see also* Nate Raymond, *State Farm Defamation Case Lifts Lid on Litigation Finance* (Dec. 16, 2013), *available at* https://www.benthamimf.com/docs/default-source/default-document-library/reuters-article-16-12-13.pdf?sfvrsn=2

that damaged tens of thousands of homes. A roofing contractor named Joseph Radcliff noticed that State Farm was turning down valid insurance claims—claims similar to ones accepted by other insurance companies—and decided to publicly push back against the insurance giant. State Farm sued Radcliffe for engaging in a fraudulent scheme to damage homes; Radcliffe countered by suing State Farm for defamation. After Radcliffe won the jury trial, Bentham IMF (an Australian litigation finance fund) stepped in and provided Radcliffe with the money to hire an appellate counsel and to pay off some of his business debts. In the end, Radcliffe won and State Farm had to pay $17 million plus interest. [105]

This is the classic David v. Goliath story repeated by proponents of litigation finance. And despite the social benefit provided in the above example, it is without a doubt that litigation finance proper meets the literal definition of champerty.

Concern

Recall the motivation at the beginning of the article. There is great unease with the expansion of litigation finance proper. First, one could worry about existing maintenance and champerty laws. But it is evident from the above examples that those laws are too broad and would ban—if applied literally—public interest organizations, contingency fee arrangements, insurance subrogation, factoring, and bankruptcy claims trading. Second, one could be concerned about an increase in frivolous lawsuits. This externality, however, is theoretically plausible in all cases of third-party funding because, all else equal, outside financing eases liquidity constraints by design and allows beneficiaries to bring more cases. Third, agency problems might spring up in this context since litigation financiers do not own the claims being litigated. Yet this is mitigated by the fact that they do not control the litigation strategy either; and, importantly, parties can contract around this to ensure compliance. These arguments, as well as corresponding counterarguments, are analyzed in depth in the following section.

IV. Policy Considerations

The modern analogues described in Part III *supra* are the best sources of "data" to test the main arguments for and against litigation finance proper. The analysis in this section focuses on the main externalities featured in the literature—frivolous suits, misaligned incentives, commoditization of and access to justice, and economic efficiency.

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[105] *See* Raymond, *supra* note ____

A. Frivolous Suits

Numerous scholars have observed that litigation finance proper is likely to raise the number of lawsuits brought each year. In theory, this may be problematic because the private incentive to bring a suit is not necessarily aligned with the social incentive.[106] While many have categorized this as a social cost, it is not obvious why it must be viewed negatively.[107] More suits might result in more rights vindicated, more injured parties compensated, more tortious actors deterred. If more litigation is bad, it can only be because the new cases to be brought are without merit. Accordingly, some have argued that litigation finance proper will increase the number of frivolous suits. Yet this potential problem is *not* unique to litigation finance proper. It exists for every single one of the third-party funding practices detailed in the previous section. As long as potential plaintiffs' liquidity constraints are loosened, there will be more frivolous suits all else equal.

The main argument offered by proponents of litigation finance proper is that their private investment funds are profit maximizing and that the cost of bringing a frivolous suit is nontrivial. If they bringing suit that is a loser, they stand to lose money. Why would any profit driven entity do that?

Notably, a counterexample hones in on whom they usually litigate against: large corporations. Consider the fact that current discovery rules place great financial burdens on defendants.[108] Discovery costs for Fortune 500 companies can reach eight figures.[109] Plaintiffs therefore have a rational profit-maximizing incentive to bring unmeritorious suits that impose discovery costs on defendants, and then offer to settle for less than discovery costs to the defendant, provided this sum is greater than the filing fee and attorney costs of the plaintiff.[110] Thus, litigation finance proper may incentivize those with unmeritorious claims to sue

[106] Steven Shavell, *The Social Versus the Private Incentive to Bring Suit in a Costly Legal System*, 11 J. L. STUD. 333, 333 (1982).

[107] *See id.* at 334 ("The private benefit of suit resides in the model in the payment that the plaintiff expects to receive from the defendants, but the social benefit of suit inheres in an 'externality'—its effect on the behavior of potential defendants generally. There is no necessary connection between the private benefit of suit and this social benefit. It may be that the social benefit exceeds the private benefit, that is, suit may lead to a reduction in losses caused by potential defendants that is greater than a plaintiff's expected gains, or it may be that the opposite holds true."); *see also* Steven Shavell, *The Level of Litigation: Private Versus Social Optimality of Suit and of Settlement*, 19 INT'L REV L. & ECON. 99 (1999).

[108] *See* William H. J. Hubbard, *The Discovery Sombrero, and Other Metaphors for Litigation*, 64 CATH. U. L. REV. _____ (2015, Forthcoming).

[109] *See id.* at _____ ("While a Fortune 500 company might spend $4 million on computer systems, it is the "tip of the iceberg" of preservation costs—and, as with icebergs, the tip is a mere 10 percent of the whole. Anecdotes about $4 million dollars in costs reflect real, but invisible, costs closer to $40 million.").

[110] *See* David Rosenberg & Steven Shavell, *A Model In Which Suits Are Brought For Their Nuisance Value*, 5 INT'L REV. L. & ECON. 3 (1985).

and receive settlement offers in return for dropping their harassing claims. Such behavior is ostensibly without any social utility.

Trolls, especially those dealing with the purchase and subsequent litigation of patents, have an incentive to file such frivolous suits when the expected value of a settlement offer is greater than the filing fee and attorney costs. Defendants will rationally settle with plaintiffs for any price less than the legal costs associated with going forward in the trial, including discovery; the caveat is that some defendants may wish to take the case to trial in an effort to deter future trolls from suing them later.

This is a significant problem in our legal system, but it is not unique to litigation finance proper. It also applies to other profit driven arrangements, for example, to bankruptcy claims trading. Recall that bankruptcy claims traders buy up claims in the way that certain third parties buy up patents, and then they litigate to recover on the claims. Some claims are clear and valid protections of creditors' rights. As such, there are ways to remedy this problem without implementing a blanket ban on all third-party funders—specifically, by creating disincentives to plaintiffs, to create fines for frivolous cases, or to make them bear the costs of discovery.[111] Some scholars have suggested fee shifting and related remedies; others have suggested giving defendants the option to have courts prevent settlement.[112] It should also be noted that, independent of third-party financing, the Supreme Court in *Bell Atlantic v. Twombly*[113] and *Ashcroft v. Iqbal*[114] instituted a heightened pleading standard, which theoretically makes it more difficult to bring a frivolous claim.

B. Misaligned Incentives

Another concern is the misalignment of incentives between the litigation financier and the owner of the claim. The idea is that the third-party financier could try to maximize his monetary payout at the expense of the client's probability of winning the suit or at the expense of the client's expected recovery amount. Again, this concern is *not* unique to litigation finance proper. This

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[111] Notably, on public actions in ancient Athens, those who initiated a claim had to gain at least 20 percent of the votes or they would incur a heavy fine.

[112] *See* David Rosenberg & Steven Shavell, *A Solution to the Problem of Nuisance Suits: The Option to Have the Court Bar Settlement*, 26 INT'L REV. L. & ECON. 42, 43 (2006) ("If the defendant knows he is facing a plaintiff who would not be willing to go to trial, the defendant would want to exercise his option to have settlements rendered unenforceable. For if the defendant does this, the plaintiff would not be able to settle for a positive amount, and since the plaintiff would not be willing to go to trial, he would drop his case. Indeed, anticipating that the defendant would elect to prevent settlement, the plaintiff would not bring his nuisance suit in the first place.").

[113] Bell Atl. Corp. v. Twombly, 550. U.S. 544 (2007).

[114] Ashcroft v. Iqbal, 556 U.S. 662 (2009).

problem arises when any third party does not own the claim yet has some form of control over the litigation strategy, as is the case with contingency fee arrangements and public interest organizations.

Some commentators point out that both contingency fee arrangements and public interest organizations are subject to external regulations. Specifically, they are subject to certain ethical rules, and the threat of sanctions keeps those lawyers in line and away from exploiting their clients. Litigation financiers, on the other hand, are not subject to such regulations.

There are a few counterarguments. First, it is unclear if bar or court oversight actually have any impact in this area.[115] This implies that contingency fee arrangements and public interest organizations are functioning without a legitimate overseer to mitigate the problem of misaligned incentives. Second, litigation financiers already purport to not interfere with litigation decisions, leaving those strategic decisions to the hired law firm(s) and accredited lawyers. Nevertheless, just to be sure, parties can easily contract around this problem by requiring the financier to not interfere in any way, shape, or form with the litigation strategy. If legislators are concerned, they could also pass legislation stating the same. In addition, they could require greater transparency in contracts signed between litigation financiers and potential clients, especially individual non-corporate clients who might be at a severe informational disadvantage. By explicitly taking the litigation financier out of the control equation—or providing greater transparency—the client who owns the original claim is less likely to be exploited by the financier. Again, this criticism applies to contingency fee arrangements as well; the lesson is that society can impose regulations to fix specific flaws without banning the entire enterprise.

C. Commoditization of and Access to Justice

A focal point of debate over litigation finance proper is the moral implications of such a regime. Some fear that it will be socially corrosive by commoditizing justice. Others feel a moral obligation to improve access to justice, thereby vindicating the rights of injured and oppressed citizens; and they view litigation finance proper as a promising mechanism to fulfill this moral obligation.

Some have argued that the expansion of litigation finance proper will change how people view lawsuits.[116] In particular, they suggest that the

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[115] David Rosenberg: "Courts purport to conduct such review in class and consolidation actions, but their effort proves only that they do not have the foggiest idea what's going on. There is no way a third party—a judge—can gather and evaluate the relevant information to make a refined judgment about whether investor or client interest is being maximized."

[116] *See generally* MICHAEL J. SANDEL, WHAT MONEY CAN'T BUY: THE MORAL LIMITS OF MARKETS 34 (2013) (arguing that when money can buy things that we consider beyond price, such as justice, it changes how we value them and, in that sense, corrupts the values they represent

commoditization of lawsuits will generate significant disutility. Once again, this concern is *not* unique to litigation finance proper. Consider the practice of trading bankruptcy claims, described in the previous section. Practitioners in that field have literally commoditized lawsuits by bundling and trading creditors' rights to recover. Moreover, litigation finance proper is hardly dissimilar from aspects of insurance, which is widely employed and tolerated without similar compunction. Overall, the hypothetical fear of commoditizing lawsuits thus far seem to have been sufficient to prevent legislatures from explicitly permitting litigation finance.

In particular, small claims are unlikely to become securitized in a widespread manner given the costs of commodification. Some, however, believe that commodification will inevitably lead to a market where people can trade the commodity. Some are unwilling to accept a norm under which traders could place bets on lawsuits the way they place bets on whether a company will default or not. To these critics, the courtroom should never become a casino. In addition, the monetary inflow comes from private entities like hedge funds and private equity funds, which do not enjoy the best reputation in the public eye. Against this backdrop, one should not be surprised that the Senate Judiciary Committee has requested several litigation finance funds to provide information and greater transparency. Senator Chuck Grassley, the chairman of the committee, voiced his concern by saying, "It's vitally important to our civil justice system that litigation decisions aren't unduly influenced by third parties."[117]

There is also a strong countervailing interest insofar as litigation finance promotes access to justice.[118] Many who disdain the commoditization of justice might also feel a moral obligation to improve access to justice in order to allow more injured parties to vindicate their rights. They view litigation finance as the most promising mechanism to fulfill this moral obligation.

Litigation finance proper loosens liquidity constraints for clients, but a hotly debated question is whether litigation finance proper will improve access to justice for all, or only for the rich. Some have noted that litigation finance proper

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to us); Lincoln Caplan, *Lawyers and the Ick Factor*, The New Yorker (Jul. 9, 2015), *available at* http://www.newyorker.com/news/news-desk/lawyers-and-the-ick-factor; *see also* Zephyr Teachout, The Anti-Corruption Principle, 94 Cornell L. Rev. 341, {382} (2009).; cf. at 567 Geo. L.J. 104 GLJ 515 2016

[117] Sara Randazzo, *Lawmakers Taking Closer Look at Litigation Funding*, The Wall Street Journal (Aug. 27, 2015), *available at* http://blogs.wsj.com/law/2015/08/27/senators-call-for-transparency-in-litigation-funding/; Charles E. Grassley & John Cornyn, *Letter to Burford Capital*, US. Senate Committee on the Judiciary (Aug. 27, 2015), *available at* http://www.grassley.senate.gov/sites/default/files/judiciary/upload/2015-08-27%20CEG%2C%20Cornyn%20to%20Burford%20Capital%20%28Commerical%20Litigation%20Funding%29.pdf.

[118] Sasha Nichols, Note, *Access to Cash, Access to Court: Unlocking the Courtroom Doors with Third-Party Litigation Finance*, 5 U.C. IRVINE L. REV. 197 (2015).

seems to "mean helping millionaires pursue claims against billionaires."[119] Indeed, a growing segment of litigation finance proper is on the defense side, in which the financiers help corporate clients who are defendants in lawsuits. For example, a financier and a corporation could strike a deal where the corporation pays the financier $5 million to finance the litigation of the case. The financier then finds a law firm to supply lawyers for the job. If the final cost of the case is under $5 million—say, $3 million—then the financier pockets the $2 million difference as profit. In a sense, this is analogous to buying insurance. Another way to play this game is for the financier to fund the corporation's defense in a few cases in exchange for a stake in a few promising cases in which the corporation is a plaintiff. Is this necessarily a detriment to social welfare? Admittedly, this is not the traditional feel-good story of David v. Goliath, but this is still consistent with the view of litigation finance proper as a mechanism to reduce the aggregate social costs of litigation.

D. Efficiency Gains

We conclude this discussion of policy implications by noting the comparative advantage of third-party financiers in resolving litigation claims.[120] All of the third-party financiers described in the previous section have the energy to litigate,[121] are repeat players, can diversify risk better than lawyers, and are less liquidity constrained. This is why many of the victims of the Madoff Ponzi scheme rationally preferred to receive a certain payment today from a third-party

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[119] Mattathias Schwartz, *Should You Be Allowed to Invest in a Lawsuit?*, New York Times (Oct. 22, 2015), *available at* https://www.nytimes.com/2015/10/25/magazine/should-you-be-allowed-to-invest-in-a-lawsuit.html?_r=0

[120] The principal exponent of efficiency arguments is Jonathan T. Molot, a professor at Georgetown University Law Center and CIO of Burford Capital Ltd. Jonathan T. Molot, *The Feasibility of Litigation Markets*, 89 IND. L.J. 171 (2014); *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L.J. 65 (2010); *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367 (2009); *see also* Geoffrey J. Lysaught & D. Scott Hazelgrove, *Economic Implications of Third-Party Litigation Financing on the U.S. Civil Justice System*, 8 J.L. ECON. & POL'Y 645 (2012); George R. Barker, *Third-Party Litigation Funding in Australia and Europe*, 8 J.L. ECON. & POL'Y 451 (2012); Jeremy Kidd, *To Fund or Not to Fund: The Need for Second-Best Solutions to the Litigation Finance Dilemma*, 8 J.L. ECON. & POL'Y 613 (2012); George S. Swan, *The Economics of Usury and the Litigation Funding Industry:* Rancman v. interim Settlement Funding Corp., 28 OKLA. CITY U. L. REV. 753 (2003); Marc J. Shukaitis, *A Market in Personal Injury Tort Claims*, 16 J. LEGAL. STUD. 329 (1987); Maya Steinitz, *Incorporating Legal Claims*, 90 NOTRE DAME L. REV. 1155 (2015); Michael Abramowicz, *On the Alienability of Legal Claims*, 114 YALE L.J. 697 (2005); Michael Faure & Jef P. De Mot, *Comparing Third-Party Financing of Litigation and Legal Expenses Insurance*, 8 J.L. ECON. & POL'Y 743 (2012); Peter C. Coharis, *A Comprehensive Market Strategy for Tort Reform*, 12 YALE J. ON REG. 435 (1995); Robert Cooter, *Towards a Market in Unmatured Tort Claims*, 75 VA. L. REV. 383 (1989); Keith N. Hylton, *The Economics of Third-Party Financed Litigation*, 8 J.L. ECON. & POL'Y 701(2012); Isaac M. Marcushamer, *Selling Your Torts: Creating a Market for Tort Claims and Liability*, 33 HOFSTRA L. REV. 1543 (2005).

[121] Recall NML Capital sending its lawyers to Ghana to impound an Argentine ship.

funder, given that many of them had no intention of undertaking the grueling process of litigation to recover on their meritorious claims. Thus, litigation finance advances the goal of compensation by allowing: (1) more injured parties to recover; (2) injured parties to recover more; and (3) injured parties to recover sooner and with greater certainty.[122]

First, litigation finance empowers many plaintiffs with meritorious claims but insufficient or illiquid funds to bring suit.[123] In particular, liquidity constrained plaintiffs who otherwise could not prevail in a protracted litigation battle against well-funded defendants can endure such battles when they partner with a litigation financier.

Second, such plaintiffs will not only win such cases if they go to trial, they will also have greater bargaining power in settlement negotiations.[124] Many plaintiffs are forced to accept low settlement offers because they lack the means to endure long litigation. Litigation finance proper allows plaintiffs to achieve greater liquidity of assets and thus more bargaining power in settlement negotiations.

Third, litigation finance proper also allows injured parties to recover sooner and with greater certainty. Consider the paradigmatic tort case. From the perspective of compensation, traditional tort liability has several shortcomings. A cause of action does not imply a plaintiff will win his meritorious claim; even if he wins, his recovery is delayed; even if he later recovers, the amount does not cover court costs and attorneys' fees; and even after all this, the defendant may well be judgment-proof. Thus, the individual who suffers $1,000 in damages today may only recover $500 a year from now.

Some states have created alternative compensatory frameworks such as workers' compensation. Under these systems, workers file simple paperwork indicating the type of injury they have suffered. An administrative rubric translates the type of injury into the predetermined compensatory award. Workers can thus receive immediate relief with minimal administrative costs, even if this level of compensation is only a rough approximation of the actual damage.

Litigation finance proper essentially provides a private market solution similar to this. A plaintiff with a meritorious claim for $1,000 in damages may have a greater need for certain payment today than for the chance at $500 next

[122] Peter C. Coharis, A Comprehensive Market Strategy for Tort Reform, 12 Yale J. on Reg. 435 (1995) (arguing that LF leads to quicker, higher, and more certain damage awards).

[123] *See generally* Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367 (2009); Jonathan T. Molot, *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L.J. 65 (2010); Jonathan T. Molot, *The Feasibility of Litigation Markets*, 89 IND. L.J. 171 (2014); *see also* See Abramowicz, Litigation Finance and the Problem of Frivolous Litigation, 63 DePaul L. Rev. 195, 196 (2014).

[124] Cassandra Burke Robertson, *The Impact of Third-Party Financing on Transnational Litigation*, 44 CASE W. RES. J. INT'L L. 159 (2011).

year. This is important as injured persons may systematically be disadvantaged: by construction, one who has suffered an injury is in immediate need of money. The injured plaintiff needing to pay present medical expenses has little need for an award of $500 in a year from now; but he has a great need for *some* money right now. Litigation finance proper therefore allows a third party to offer plaintiffs, say, $400 today, in the hope of recovering $500 a year from now and pocketing the $100 difference (less litigation costs).

In sum, it is worth noting that all of the third-party funding entities discussed in this article are variations of the same theme. Table 1 *supra* outlines the similarities. One plausible explanation for why this is the case is that, given our existing legal system, participants recognize the comparative advantages brought to bear by third-party repeat players. Plaintiffs and defendants who are liquidity constrained, information constrained, or risk constrained see forms of third-party funding as the most efficient way to maximize their welfare. Seen in this light, litigation finance proper is the latest development in an evolutionary process of maximizing efficiency for participants in our legal system.

V. Conclusion

Currently, the common law doctrines of maintenance and champerty form the primary barriers to litigation finance proper. Both have medieval origins, but scholars and the public alike have begun to argue over whether policy considerations justify their continuation.

Proponents of litigation finance proper trumpet its many virtues, including increased access to justice and economic efficiency. For example, litigation finance funds can assist local communities devastated by environmental contamination in bringing lawsuits against polluting corporations;[125] similarly, litigation finance funds can help small business owners even the playing field against larger counterparties.[126] Best of all, everyone benefits: (a) plaintiffs can bring meritorious claims they otherwise could never bring; (b) lawyers enjoy a greater demand for legal services and can reallocate risk from contingency fees to financiers able to eliminate the risk through diversification; and (c) investors can profit from investing in litigation risk, which has the added benefit of being uncorrelated with the market. The overarching theme is one of David versus Goliath, with litigation finance funds solidly in support of the underdog. Their cause is noble and highly lucrative, with the funds earnings profits that are

[125] Schwartz, *supra* note ___.
[126] Caplan, *supra* note ___.

oftentimes multiples of their initial investments. Among sophisticated funds, "[a] hundred-per-cent return is on the low side."[127]

Opponents are uneasy about so much private investment flowing into the justice system.[128] They justify this impulse by suggesting that litigation finance proper will inappropriately commoditize justice, transforming our civil justice system into a stock exchange. It also presents the risk that litigation financiers will impose usurious terms on poor litigants or exert inappropriate control over the litigation. Moreover, opponents challenge the access to justice narrative: "[w]hen litigation financiers talk about expanding access to justice and standing up for the little guy, they generally mean helping millionaires pursue claims against billionaires."[129] That is not the David versus Goliath story that most have in mind.

Both sides assume that litigation finance proper is about introducing financially motivated investors into American courts, and that there is an important conversation to be had over whether the law should allow such conduct. We contribute to this conversation by taking a broader view of the topic. The third-party litigation funding, far from being a novelty, is ubiquitous in modern society. Investors trade in business debt, sovereign debt, and consumer debt. Individuals sell claims to insurers. Lawyers offer contingency fee arrangements. Yet none are considered champertous. Likewise, legal defense funds, public interest associations, and impact litigation organizations fall within the literal terms of maintenance. Indeed, more things not called maintenance fit the definition than things actually called maintenance. Far from being noxious to point of proscription, these arrangements have significantly improved social welfare by increasing economic efficiency and facilitating social progress.

Based on the classification of third-party funding in Part III *supra*, litigation finance proper is merely a small variation of the existing infrastructure. Thus, the question becomes: why should these maintenance and champerty doctrines be applied to bar litigation finance proper when its characteristics are identical to existing forms of third-party funding? Litigation finance proper offers the same, if not better, upside than many of the existing forms of third-party funding, many of which provide significantly greater social welfare by increasing economic efficiency and facilitating social progress.

[127] *See id.*

[128] *See* Thurbert Baker, *Paying to Play: Inside the Ethics and Implications of Third-Party Litigation Funding*, 23 WIDENER L.J. 229 (2013); *see also* W. Bradley Wendel, *Alternative Litigation Finance and Anti-Commodification Norms*, 63 DEPAUL L. REV. 655 (2013) (describing the "ick factor" often associated with litigation finance).

[129] Schwartz, *supra* note ___.