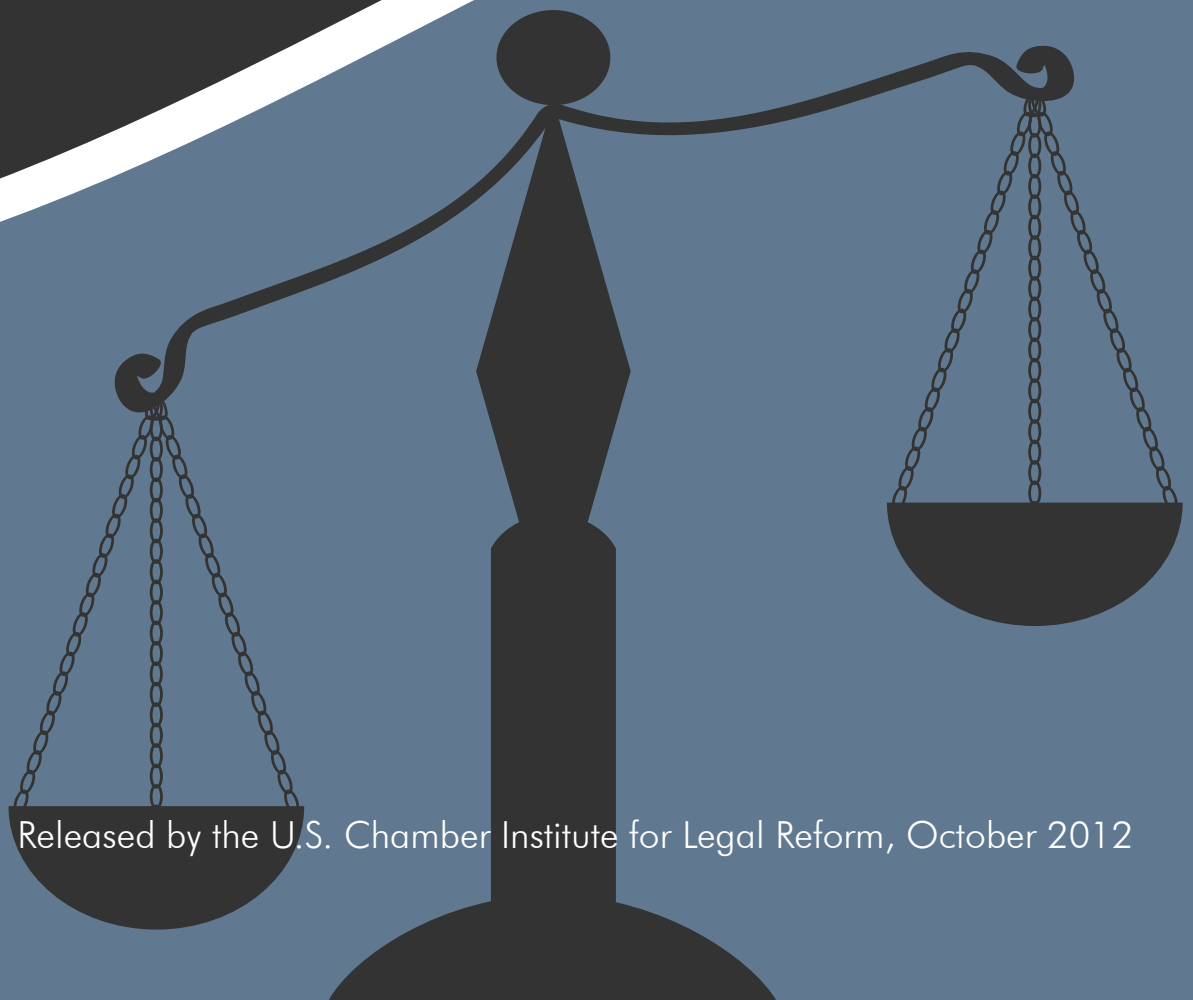


STOPPING THE SALE ON LAWSUITS: A PROPOSAL TO REGULATE THIRD- PARTY INVESTMENTS IN LITIGATION



Released by the U.S. Chamber Institute for Legal Reform, October 2012



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STOPPING THE SALE ON LAWSUITS: A PROPOSAL TO REGULATE THIRD-PARTY INVESTMENTS IN LITIGATION

I. EXECUTIVE SUMMARY

Third-party investments in litigation represent a clear and present danger to the impartial and efficient administration of civil justice in the United States. Such third-party litigation financing (“TPLF”) occurs when a specialized investment company provides money to a plaintiff (or counsel) to finance the prosecution of a complex tort or business dispute. In exchange for this financial assistance, the plaintiff (or counsel) agrees to pay the investor a portion of any proceeds obtained through the litigation.

TPLF investments create the threat of at least four negative public policy consequences for the administration of civil justice:

- TPLF investments can be expected to increase the volume of abusive litigation. TPLF companies view disputes as investments – and they

can hedge any “investment” against their entire portfolio of cases. This makes them more willing to put money into cases that are weak on the merits – but have at least a chance of a large award.

- TPLF undercuts plaintiff and lawyer control over litigation because the TPLF company, as an investor in the plaintiff’s lawsuit, presumably will seek to protect its investment, and can therefore be expected to try to exert control over the plaintiff’s and counsel’s strategic decisions.
 - TPLF investments prolong litigation by deterring plaintiffs from settling. The TPLF investor is a third party that, like the plaintiff and the plaintiff’s lawyer, demands a share of any litigation proceeds. The plaintiff’s obligation to satisfy this extra demand
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makes reasonable settlement offers less attractive.

- TPLF investments compromise the attorney-client relationship and diminish the professional independence of attorneys by injecting a third party into disputes. Lawyers will inevitably feel at least some obligation to the TPLF investors, who are paying their bills and who might be a source of future business. As a result, counsel may give less attention to the clients' interests, which should be counsel's sole concern.

Given the risks inherent in third-party investments in litigation, the U.S. Chamber Institute for Legal Reform ("ILR") supports establishing a robust oversight regime to govern this type of TPLF at the federal level. The risks of TPLF are simply too acute to be left to industry self-regulation. And since TPLF substantially affects interstate commerce and the federal courts, the federal government has jurisdiction to oversee TPLF on a uniform, nationwide basis.

The focus of a federal oversight regime should be on TPLF investors. The lawyers

involved in TPLF-funded cases should continue to be governed by state bar associations and courts, and the states' respective rules of professional conduct. ILR has engaged vigorously in recent and ongoing debates about the impact of TPLF investments on professional conduct issues and will continue to do so. But at this point, the most pressing need is for investor oversight.

ILR favors legislation that appoints a federal agency to regulate third-party investments in litigation – an agency empowered to make rules and regulations in pursuit of its mandate and to enforce any laws, rules, or regulations governing TPLF. Substantively, the federal oversight regime should include legislative and rule-based safeguards against the risks inherent in TPLF, including statutes and court rules requiring the disclosure of TPLF investments and requiring TPLF investors to pay costs associated with the litigation they generate (particularly defendants' discovery costs).



“TPLF investments compromise the attorney-client relationship and diminish the professional independence of attorneys by injecting a third party into disputes.”

II. INTRODUCTION: WHAT IS TPLF?

Third-party litigation financing (“TPLF”) describes the practice of a stranger to a lawsuit providing money to a party in connection with the lawsuit for profit. TPLF generally falls into two broad categories:

- **Consumer Lawsuit Lending**, which typically involves individual personal-injury cases, and
- **Investment Financing**, which includes investments in large-scale tort and commercial cases and alternative dispute-resolution proceedings.

In consumer lawsuit lending, a lawsuit lending company advances money to an individual plaintiff to cover living or medical expenses – essentially giving him or her “upfront cash” – while his or her lawsuit is still pending. The plaintiff agrees to repay the lender, with interest, out of any proceeds from the lawsuit. Interest rates on these loans are commonly in the range of 3-5% per month (which, even without compounding, can mean 60% annually). These loans are generally nonrecourse, which means the plaintiff need not repay the loan if the lawsuit is not successful.

In the investment financing variant of TPLF, which is the subject of this paper, a specialized investment firm provides financing to plaintiffs or their attorneys for litigation costs (including attorneys’ fees, court costs, and expert-witness fees) regarding litigation to which the investor

has no other connection. In exchange, the investor is promised a portion of any recovery from the dispute. The nominal borrower in these cases may be a company involved in commercial litigation or an individual or group of individuals. In cases involving individuals or groups, the plaintiffs’ law firm typically is heavily involved in finding and securing the third-party financing and, in some instances, is the real party in the TPLF relationship that receives the funds.

In TPLF investment financing, the investor’s return is usually a portion of any recovery that the plaintiff receives from the resolution of the dispute, whether through litigation or settlement. The amount of recovery the TPLF provider will receive usually turns on several factors, including the amount of money advanced, the length of time until recovery, the potential value of the case and whether the case is resolved by trial or settlement. In this type of TPLF, the financing entity essentially invests money in the outcome of the plaintiff’s case, betting that it will be successful. TPLF financing arrangements generally are nonrecourse (in whole or in part); the recipient of the funds obtains money to pursue a proceeding and is required to provide a return to the TPLF company only if the recipient is awarded damages at trial or settles on favorable terms.¹

III. PROBLEMS POSED BY TPLF INVESTMENT FINANCING

As noted in the executive summary, TPLF investments have at least four negative consequences for the sound administration of civil justice. Several ILR publications, as well as commentary by other authors, have explained these consequences in more detail. Briefly, however, they are as follows:

First, TPLF can be expected to prompt an increase in the filing of questionable claims. TPLF companies are mere investors – and they base their funding decisions on the present value of their expected return, of which the likelihood of success at trial is only one component. In addition, TPLF providers can mitigate their downside risk by spreading the risk of any particular case over their entire portfolio of cases and by spreading the risk among their investors. For these reasons, TPLF providers can be expected to have higher risk appetites than most contingency-fee attorneys and to be more willing to back claims of questionable merit.²

The most notorious example of this problem was the investment by a fund associated with Burford Capital Limited in a lawsuit against Chevron filed in an Ecuadorian court alleging environmental contamination in Lago Agrio, Ecuador. Burford made a \$4 million investment with the plaintiffs' lawyers in the Lago Agrio suit in October/November 2010 in exchange for a percentage of any award to the plaintiffs. In February 2011, the Ecuadorian trial court awarded the plaintiffs an \$18

billion judgment against Chevron, which is on appeal.³ In March 2011, Judge Lewis Kaplan of the Southern District of New York issued an injunction against the plaintiffs trying to collect on their judgment because of what he called "ample" evidence of fraud on the part of the plaintiffs' lawyers.⁴ Indeed, long before Burford had made its investment in the case, Chevron had conducted discovery into the conduct of the plaintiffs' lawyers under a federal statute that authorizes district courts to compel U.S.-based discovery in connection with foreign proceedings, and at least four U.S. courts throughout the country had found that the Ecuadorian proceedings were tainted by fraud.⁵

According to a December 2011 press release, as a result of "[f]urther developments," Burford "conclude[d] that no further financing w[ould] be provided" in the Lago Agrio case.⁶ Nevertheless, its year-long involvement – and its initial decision to invest \$4 million with the plaintiffs' lawyers despite allegations of fraud in the proceedings – powerfully demonstrate that TPLF investors have high risk appetites and are willing to back claims of questionable merit.

Second, TPLF changes the traditional way litigation-related decisions are made. When no TPLF investment has been made, the plaintiff, advised by counsel, decides the legal strategy for pursuing the claims asserted. TPLF can be expected to change that dynamic. As an investor in the plaintiff's

lawsuit, the TPLF company presumably will seek to protect its investment, and can be expected to try to exert control over the plaintiff's strategic decisions. The plaintiff's lawyer, as the person being paid by – and possibly even retained by – the investor, may accede to those efforts. Even when the TPLF provider's efforts to control a plaintiff's case are not overt, the existence of TPLF funding naturally subordinates the plaintiff's own interests in the resolution of the litigation to the interests of the TPLF investor.

Recent commercial arbitration between a company called S&T Oil Equipment & Machinery Ltd. and the Romanian government provides an example. S&T had sought financing for its case from Juridica Investments Limited, and, under their agreement, Juridica paid some legal fees for S&T in exchange for a percentage of arbitration proceeds. After Juridica withdrew funding, causing S&T's case to collapse, a sealed complaint filed by S&T against Juridica in Texas federal court alleged that S&T's own lawyers had begun seeking legal advice from Juridica after Juridica began paying their fees, and that Juridica required the lawyers to share with Juridica their legal strategy for the arbitration and any factual or legal developments in the case.⁷

The lawsuit-investment industry makes no secret of its interest in protecting litigation investments by influencing cases. A principal of investor BlackRobe Capital Partners, LLC, was quoted as saying his firm would take a "'pro-active' role in lawsuits."⁸ A former Burford chairman said that his new investment company would

not "control" litigation, but would "do[] more than was done before."⁹

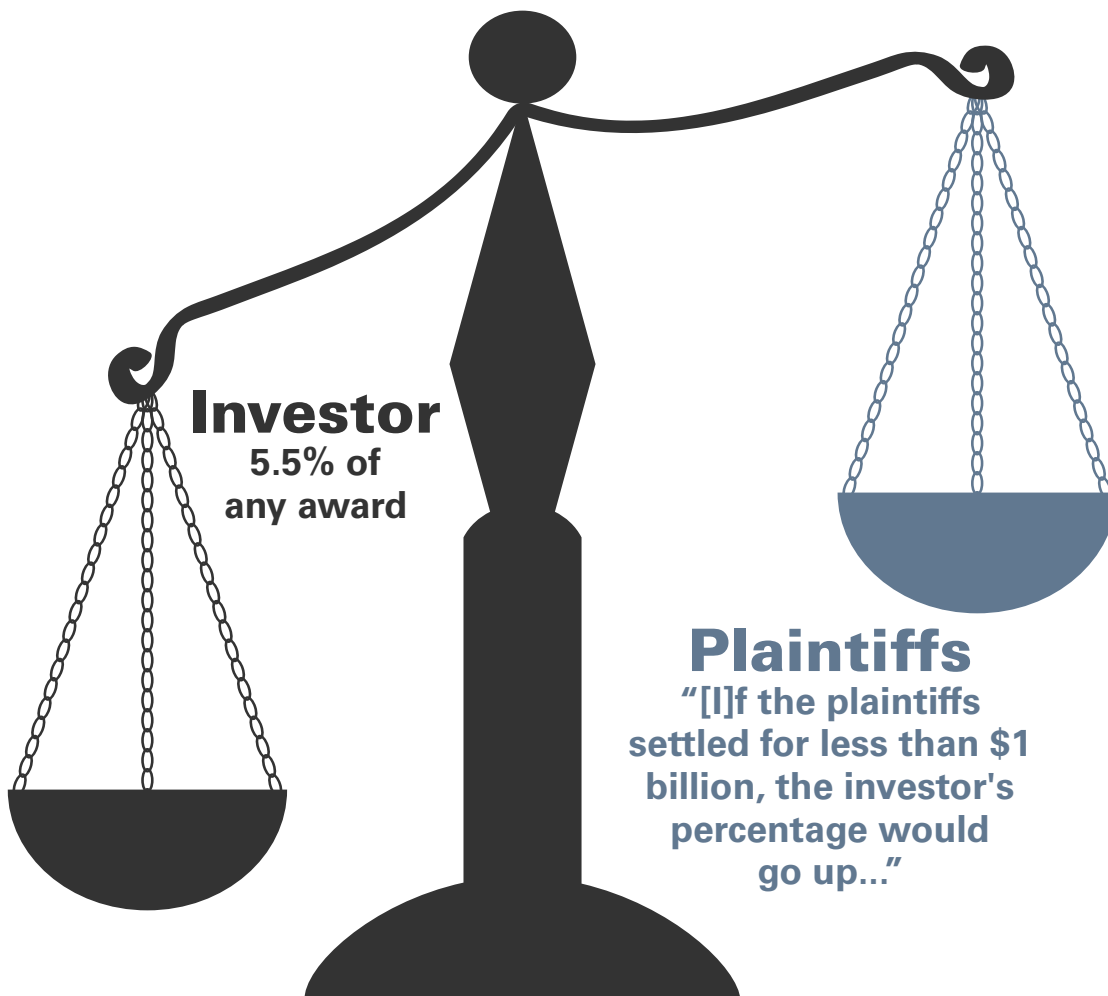
Third, TPLF prolongs litigation by deterring settlement. A plaintiff who must pay a TPLF investor out of the proceeds of any recovery can be expected to reject what may otherwise be a fair settlement offer, hoping for a larger sum of money.¹⁰ This problem is illustrated by litigation between a network-security company called Deep Nines and a TPLF provider that had invested in Deep Nines's prior commercial litigation against a software company. Deep Nines had entered into an agreement with the TPLF company to finance patent litigation with an \$8 million investment. Deep Nines had a strong case, and eventually, the case settled for \$25 million. After paying off the investor, as well as paying its attorneys and court costs, how much did Deep Nines actually keep? \$800,000 – about three percent of the total recovery. The TPLF investor took \$10.1 million (the return of its \$8 million investment, plus 10% annual interest, plus a \$700,000 fee). Remarkably, though, the investor wasn't satisfied and sued Deep Nines in New York state court for even more money.¹¹ More than four years after the TPLF company first invested in Deep Nines's suit, the parties finally settled in May 2011. No settlement terms were disclosed.¹²

The Chevron/Lago Agrio case also powerfully demonstrates this problem. The investment agreement in that case included a "waterfall" repayment provision, which provided for a heightened percentage recovery on the first dollars of any award. Under the agreement, Burford would receive

approximately 5.5% of any award, or about \$55 million, on any amount starting at \$1 billion.¹³ But, if the plaintiffs settled for less than \$1 billion, the investor's percentage would go up – in fact, all the way down to a mathematical floor of about \$70 million, the investor would get the same \$55 million. The effect of a waterfall is to maximize the investor's recovery early on, but it incentivizes plaintiffs to continue litigating in hopes of a higher settlement.

Fourth, TPLF investments compromise the attorney-client relationship and diminish the professional independence of attorneys by inserting a new party into the litigation equation whose sole interest is making a profit on its investment. In recent litigation

regarding injuries to 9/11 Ground Zero workers, for example, one of the plaintiffs' firms representing the workers was financed by a TPLF investment that provided for passing the interest on the investment on to the plaintiffs, to be paid out of any recovery by them. After settling with the defendants, the firm sought to pass along \$6.1 million in interest payments to the plaintiffs. The plaintiffs' lawyers argued strenuously in support of their position. The judge overseeing the settlement acknowledged that passing on the interest to the plaintiffs may be permissible, but disapproved doing so in this case because it wasn't clear that the plaintiffs had understood or approved the charges.¹⁴



IV. THE NEED FOR FEDERAL OVERSIGHT OF TPLF INVESTORS

A. TPLF Investors Should Be Regulated

Given the serious risks to the sound administration of civil justice posed by TPLF investments, an oversight regime that implements safeguards against these risks is necessary. This raises the threshold question, however, whether such a regime should be targeted to TPLF investors, to attorneys who represent clients receiving TPLF investments, or to both.

ILR believes that the focus for safeguards should be on the TPLF investors, whose activities are presently not subject to regulation. To be sure, attorneys involved in funded cases need oversight as well. But merely regulating such attorneys will not address most risks posed by TPLF. That can only be achieved by direct regulation of the investors, the parties who provide the financing and therefore yield the clout. In any event, attorneys are already governed by existing state bar requirements and rules of professional conduct at the state level.¹⁵ The American Bar Association (the “ABA”) currently is analyzing how the Model Rules of Professional Conduct apply to TPLF, including by soliciting the views of stakeholders. ILR has engaged in this important discussion and has highlighted for the ABA the inherent dangers of TPLF to the administration of civil justice and to the legal profession. ILR will continue to be engaged in that debate to ensure that existing rules

for attorneys are not compromised, and to continue to build awareness of the dangers of TPLF and the need for reform. While ILR addresses the ethical dangers of TPLF with the ABA, it is simultaneously addressing TPLF’s other policy dangers through public advocacy, including the proposals contained in this paper.

B. Government Oversight Is Necessary

ILR proposes to implement safeguards against the dangers inherent in TPLF through a regime of government oversight and regulation. ILR believes that the risks posed by TPLF investments are so serious, and the incentives for misconduct by TPLF investment companies so great, that industry self-regulation is not a viable option to protect the administration of civil justice. Government oversight and regulation is particularly appropriate because TPLF investors use litigated proceedings – and compulsory court process – as their investment vehicles. In other words, TPLF investors make money by co-opting the coercive power of government to command defendants to appear in court or before arbitrators, turn over documents, and defend themselves. In these circumstances, regulating TPLF investors’ actions is an entirely proper function of government.

C. Government Oversight Should Be Federal

Having concluded that government oversight of TPLF investments is necessary and proper, the next question is whether federal or state regulation is most appropriate. ILR supports a robust federal regulatory regime for at least four reasons:¹⁶

First, TPLF investors operate nationally (and internationally), and use the means and instrumentalities of interstate commerce (e.g., the mails, telecommunications, and money transfers) to carry out their business. Congress accordingly has the power to regulate TPLF investors because they are engaged in interstate commerce, or, at least, are engaged in economic activity that substantially affects interstate commerce.¹⁷ Under the “effects” test for federal jurisdiction enunciated in *United States v. Lopez*, Congress may regulate economic activity that “substantially affects” interstate commerce,¹⁸ as TPLF does. Moreover, Congress could even enact legislation governing a TPLF investor that operates only in a single state and does not provide financing or engage in any economic activities beyond its borders as a “necessary and proper” component of an effective national effort to regulate interstate TPLF.¹⁹ After all, if domestic providers could escape uniform federal regulation by forming entities that only operate intrastate, they could thwart efforts to create a unified national regulatory regime.²⁰

Second, in addition to interstate commerce, TPLF also implicates commerce with foreign entities. Many of the largest TPLF

investors are organized under foreign laws. For example, Burford and Juridica are both registered in Guernsey; Calunius Capital LLP is organized under the laws of England & Wales; and IMF (Australia) Ltd., which operates a subsidiary in the United States called Bentham Capital LLC, is organized under the laws of Australia. Congress may regulate foreign TPLF investors based on the portion of the Commerce Clause that empowers Congress to regulate commerce “with foreign Nations,” provided that a nexus exists between the foreign providers’ financing activities and the United States.²¹ Such a nexus exists when foreign TPLF providers engage in TPLF in connection with matters pending in the United States.

Third, as discussed below, one of the prongs of ILR’s proposed safeguards regime involves amending court rules to address cases in which TPLF is involved. Since TPLF naturally flows into large, complex cases, we believe most TPLF investment activity will occur in the federal court system, and focusing on amending federal court rules is therefore logical. In addition, many states have modeled their rules of civil procedure on the federal rules and periodically adopt changes in the federal rules for use in their own courts. Thus, amending the federal rules would influence state court rules as well.

Finally, from a practical standpoint, we believe that attempting to implement a federal regulatory regime to govern TPLF will be more effective than attempting to achieve harmonized state regimes. Adopting federal TPLF rules, laws, and regulations

would ensure that one oversight regime is in place that covers all 50 states. Such an approach would avoid a checkerboard of disparate state laws, rules, and regulations that apply only within any given state, and which, owing to the differences among the state oversight regimes, likely would funnel TPLF-financed cases to the state courts in the jurisdictions with the weakest oversight regimes. In this respect, ILR believes that seeking adoption of uniform state-level oversight regimes in all jurisdictions would be far more difficult than simply adopting a single federal standard. Moreover, implementing uniform state-level regulations might not be possible, because some states might not possess a regulatory apparatus with the maturity and expertise to regulate TPLF adequately.

For these reasons, ILR proposes creation of a uniform federal system as the most sensible way to regulate a cross-border industry like TPLF.

D. Regulating TPLF: Policy or Ethics?

Before discussing the substance of ILR's proposed regulatory regime, we note that we are proposing laws, regulations, and rules to address TPLF as a *policy* (rather than an *ethical*) matter. As noted above, the ABA recently considered TPLF from the point of view of lawyer ethics, and ILR contributed to that discussion.²² The ABA concluded that, while attorneys are not per se prohibited from representing clients who have received TPLF, TPLF does implicate a number of professional responsibility rules, and attorneys should

therefore exercise extreme caution in such cases. In our submissions to the ABA in connection with its TPLF consultation, we noted that TPLF could result in violations of a number of ethical standards, and the ABA commission studying TPLF adopted that position in the *Informational Report to the House of Delegates on Alternative Litigation Finance* that the commission submitted after concluding its analysis.

As noted above, ILR will continue to remain engaged in the ABA debate about TPLF, to raise awareness about its dangers, and to build support for ethics reforms. In this paper, however, we address a more fundamental question whether TPLF has serious adverse effects on the administration of civil justice beyond those concerned with existing ethical rules. Thus, this paper is part of ILR's continuing effort to address TPLF broadly as a policy matter.

V. THE SUBSTANCE OF THE PROPOSED OVERSIGHT REGIME

ILR proposes a three-pronged approach to federal TPLF oversight: (a) designation of a federal agency to oversee TPLF investors and make regulations concerning TPLF investments, (b) a regime of statutory safeguards to be enforced by the federal agency; and (c) court rules requiring disclosures when TPLF is being used. We address below what would be involved in each of these efforts.

A. Appointment Of A Federal Agency To Oversee TPLF Investments

The first step in our proposed oversight regime is to appoint a federal agency to regulate TPLF. ILR believes that Congress should empower the Federal Trade Commission to regulate the TPLF investment industry. The FTC was created in 1914 to prevent unfair methods of competition in commerce. This agency has a long, successful record of bringing enforcement actions against entities that engage in unfair or deceptive acts or practices. In the past year, for example, the agency has obtained over \$9 million in civil penalties from companies that engaged in unfair or deceptive practices.²³ During this same period, the FTC has obtained numerous cease-and-desist, disgorgement, and civil-contempt orders against companies that have violated the Federal Trade Commission Act.²⁴

If it is designated as the federal agency to oversee TPLF investments, the FTC should be given three specific grants of authority: (1) to license TPLF investors, (2) to make rules and regulations governing TPLF investments, and (3) to enforce any laws, rules, and regulations governing TPLF investments.

1. Licensing

ILR proposes that the FTC should be empowered to create and oversee a licensing regime for TPLF investments. Licensing will permit effective oversight of TPLF investors and guard against potential abuses by them. ILR proposes that any applicant for a license to invest in lawsuits be required to pay a \$1 million fee. This money would remain in an account administered by the FTC, with any interest or dividends going to fund enforcement and oversight activities by the agency.

2. Rules And Regulations

As the TPLF regulator, the FTC must be authorized to promulgate such rules and regulations as are necessary to carry out its mandate. We would anticipate that the FTC would, over time, create a comprehensive regulatory regime appropriate to carry out the intent of Congress in enacting our proposed legislative safeguards, much as the Securities and Exchange Commission has done with respect to the various statutes, like the Securities Act and the Securities Exchange Act, that are within its purview.

3. Enforcement

Finally, the FTC should have meaningful authority to enforce all laws, rules, and regulations governing TPLF investments. As part of this authority, the FTC should be empowered to bring lawsuits in federal court and obtain civil penalties for violations. Again, Congress's grant of authority to the SEC to bring civil actions to enforce the securities laws and its rules and regulations is instructive. The FTC should (like the SEC) have the power to seek scaled monetary penalties against violators, based upon the seriousness of the offense and to seek enhanced penalties for repeat violations.

B. Statutory Safeguards Against Abuses In TPLF Investments

In addition to legislation designating the FTC to oversee TPLF investments, ILR also believes that Congress should, by legislation, implement specific safeguards that the FTC may enforce. These safeguards would be of two types: statutory provisions that would govern TPLF investors generally, and statutory provisions governing TPLF investors' conduct in particular disputes.

1. Provisions Governing TPLF Investors Generally

a) Prohibition On Ownership By Law Firms Or Investors With Interests In Law Firms

TPLF companies should not be owned by law firms or have membership interests in

law firms; nor should persons who engage in TPLF be permitted to hold themselves out to the public as attorneys for hire. Permitting TPLF investors to become part of a law firm or to offer legal advice to others would diminish the quality of legal advice available to clients. There is a substantial risk that non-lawyer owners of firms will focus only on their own profit and not on client interests or the advancement of the legal profession (of which they are not a part). For similar reasons, non-lawyer involvement in law firm management would threaten to further dilute the already-diminishing role of the client in the U.S. legal system because lawyers may feel pulled by the interests of influential investors more so than the interests of their clients.

b) Prohibition On Contracts Between TPLF Investors And Lawyers

A robust safeguards regime would prohibit any direct funding contracts between a TPLF investor and a lawyer that does not also include the client as a party because such contracts would cut out the very person the lawyer is supposed to represent. Above, we discussed the attempt by the attorneys for the 9/11 Ground Zero workers to pass on to the workers \$6.1 million in interest payments on financing obtained by the firm without the workers' approval. Legislation should specifically provide that any person responsible for repaying a TPLF investment, or whose recovery may be diminished by any payment to the investor, must be a party to the investment agreement and must explicitly consent to all of its terms.

c) Case Control

Legislation should prohibit any attempt by TPLF investors to control the litigation they are financing. All litigation decisions must be made independently by the plaintiff, with the advice of his or her attorney, consistent with governing ethics rules. The interests of TPLF investors are not necessarily aligned with those of the plaintiffs. TPLF investors' incentives are to maximize the amount of their recovery, even at the expense of the plaintiffs' wishes. This safeguard will help assure that the plaintiff remains in control of the prosecution of the lawsuit.

2. Provisions Governing TPLF Investors' Conduct In Particular Cases

a) Requirement Of Bond

Each TPLF investor should be required to post a bond with respect to each lawsuit it funds. This bond would be posted with the clerk of the court in which the funded action is pending and would be in the face amount of 25% of the damages claimed by the TPLF investor's borrower. The bond would be for the benefit of the party not receiving TPLF and would help ensure that the TPLF investor has sufficient money to satisfy any adverse cost awards. The bond may be released at the conclusion of the case, and after the TPLF investor satisfies any order for costs issued by the court.

b) TPLF Provider Jointly And Severally Liable For Costs Awarded Against The Plaintiff

In the event that a plaintiff whose case is funded by a TPLF investor has an order

to pay costs entered against it, the TPLF investor should be jointly and severally liable with the plaintiff for satisfying the cost award. TPLF investors make litigation possible when they invest in claims and provide the funding for the conduct of litigation. They should also be responsible for paying all costs that the court awards to the opposing party.

c) Limited Fee Shifting

When the party that receives funding does not prevail in a civil action, the party and the TPLF investor that invested in the case should be jointly and severally liable for paying the attorneys' fees and costs of the prevailing party. The "American Rule" against fee shifting in civil actions is meant to ensure that a plaintiff who would not be able to satisfy an order to pay the defendant's costs, expenses, and attorneys' fees if the plaintiff loses the case will not be deterred from bringing a meritorious claim. When the plaintiff's case is funded by a TPLF investor, however, the need for the protection of the American Rule evaporates. Moreover, given that the TPLF investor stands to make a profit if the funded plaintiff prevails, it is fair to make the TPLF investor responsible for paying the expenses incurred by the prevailing party if the TPLF investor's party loses.

d) Shifting Discovery Costs

Generally, in U.S.-based litigation, parties are responsible for the costs they incur in responding to discovery requests by opposing parties. The original rationale for this policy is unclear – perhaps a concern

about facilitating court access for plaintiffs. But the practice is traceable to an historical era in which discovery costs were minimal. Plaintiffs are able to issue discovery requests to defendants that impose substantial costs because the defendants themselves generally are responsible for paying them. When a plaintiff's case is supported by a TPLF investment, however, any argument about facilitating court access disappears. Profit-seeking investors with the wherewithal to pay such costs are involved – indeed, they have deliberately involved themselves. In fairness, discovery costs should be borne by the investors who are backing the party making the request. ILR therefore proposes that in any action in which a plaintiff has received TPLF, if the plaintiff seeks to depose any person not receiving TPLF, the plaintiff must pay that person's travel and lodging expenses for appearing at the deposition. In addition, if such a plaintiff requests documents from any person not receiving TPLF, the plaintiff must pay the respondent's reasonable costs of production. Such safeguards would force investors to pay the costs of the litigation they make possible with their investments.

e) TPLF Prohibited In Class Actions

Congress should enact legislation barring TPLF in class actions. Proponents of TPLF insist that it is necessary to increase access to justice for plaintiffs. In the United States, however, we already have two methods to increase court access: contingency fees and the American rule against fee shifting. A plaintiff wishing to commence a suit can thus do so in the

United States without risk. There is no cost to the plaintiff to retain an attorney to file and prosecute the suit, and generally no consequences if the plaintiff loses. This is true from the simplest individual slip-and-fall case to the most complex class action. Because plaintiffs' attorneys are willing and available to take class representations on a contingency-fee basis that can produce far greater compensation than individual cases (and indeed, they often compete for the opportunity to do so), TPLF is simply not necessary in the class action context.

Moreover, by their nature, class actions already raise significant concerns regarding lawsuit abuse because the individual class members generally do not control the litigation, which is spearheaded by class counsel. In a large consumer class action, the average plaintiff often has only a dollar or two at stake. The "representative" plaintiffs who are empowered to speak for the class in such cases tend to be friends, neighbors or even employees of the attorney bringing the suit. As a result, the lawyers fully control the cases – not the plaintiffs.

This concern is exacerbated when the person driving the litigation is not even a lawyer with fiduciary obligations to the supposed clients or the court. In a case with a legitimately aggrieved plaintiff who is following the litigation and concerned about its outcome, there is, at least, someone watching the lawyer and the funding company – and that person can raise concerns if the funding company acts against his or her interests. In a class action,

by contrast, there is often no interested plaintiff. Thus, the TPLF company can effectively run the litigation with no check on its actions. For these reasons, TPLF should not be permitted in class actions.

C. Promulgation Of Court Rules

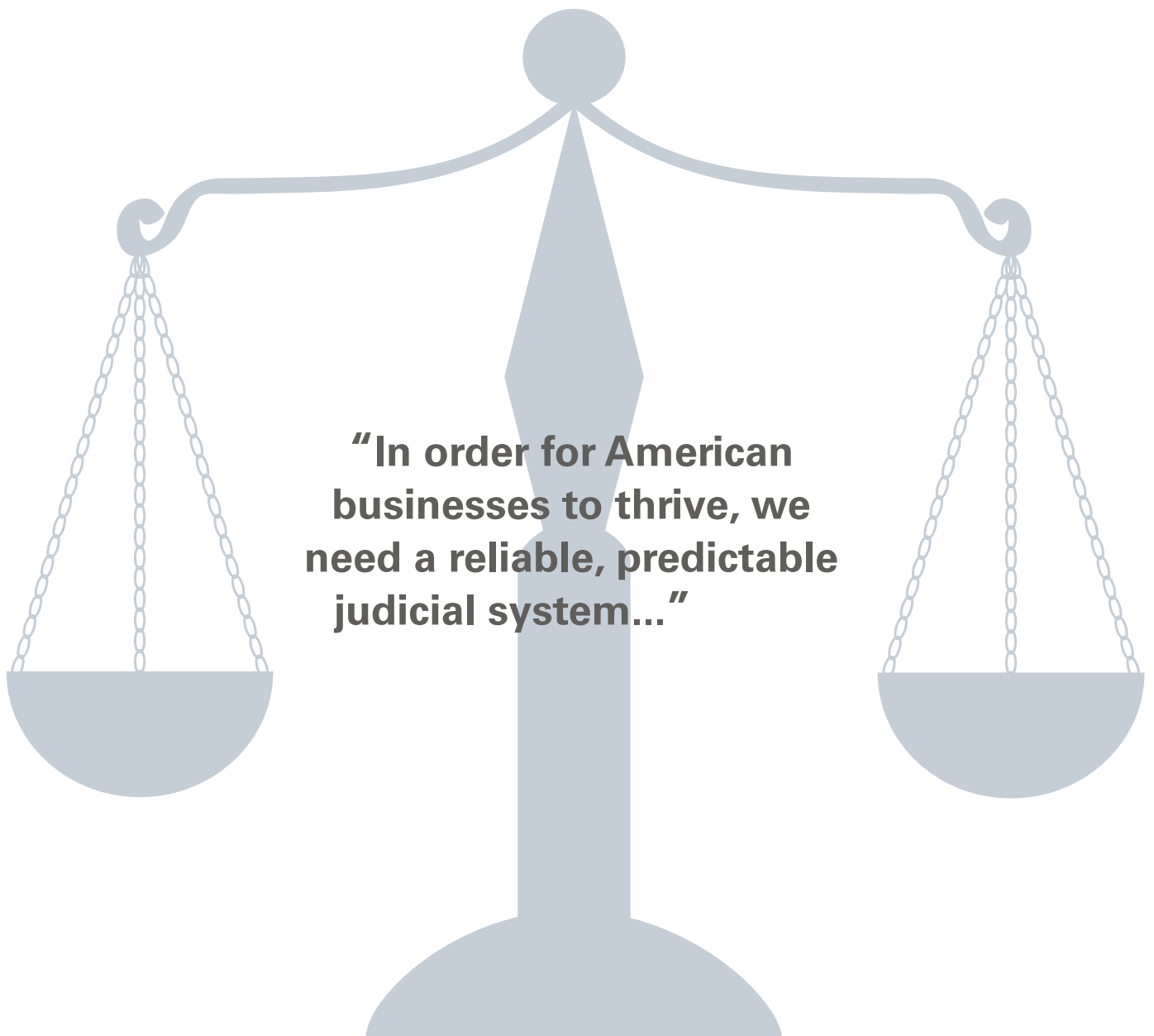
The last aspect of a comprehensive federal TPLF oversight regime would be new rules of civil procedure. The focus of such rules, like the proposed licensing scheme discussed above, would be disclosure of TPLF arrangements at the outset of civil litigation. Meaningful disclosure requirements would shine much-needed light on TPLF investments. As previously discussed, one of the biggest consequences of TPLF is the erosion of a plaintiff's control over his or her own lawsuit. Lawsuit investors seek to control their investments by managing strategic decisions in litigation they finance. As a result, TPLF undermines the bedrock principle that a party to a lawsuit has the ultimate decision-making authority with respect to that suit. The pernicious effect on defendants is clear: because TPLF agreements are typically made under a "veil of secrecy,"²⁵ a defendant facing a claim funded by TPLF may not even realize who is guiding litigation strategy and decisions on the other side, making it unfairly difficult to mount an adequate defense. Strong disclosure requirements will correct this problem.

In particular, ILR proposes amending Federal Rules of Civil Procedure 26 (requiring initial disclosures) and 7.1 (requiring corporate disclosure statements) to provide for specific disclosures of TPLF investments in funded cases. Requiring disclosure of information pertaining to TPLF investments through Rule 26 is sensible. If a company has an interest in litigation that is contingent on the outcome, it is in many respects a real party to the litigation (especially if it is funding it to any degree). Parties have the right to know who is on the other side. Thus, our proposed amendment to Rule 26 would require disclosure of any agreements that give rise to such contingent interests. Those agreements presumably would identify the parties, and, to the extent the agreements do not contain full information, the parties then could pursue additional information through discovery. In addition, ILR proposes an amendment to Federal Rule of Civil Procedure 7.1 to require parties funded by TPLF to disclose any TPLF funder.

VI. CONCLUSION

ILR is, and always will be, a champion of free enterprise. ILR believes, however, that TPLF is antithetical to all notions of free enterprise. In order for American businesses to thrive, we need a reliable, predictable judicial system whose judgments all of us – plaintiffs, defendants, consumers, businesses – trust as impartial.

TPLF is antithetical to the free enterprise system because it allows private parties to subject businesses involuntarily to the coercive effects of our litigation system, all for the purpose of profit. For these reasons, a federal oversight regime that implements the safeguards described in this paper is necessary.



1. The non-recourse nature of TPLF is what differentiates it from other forms of credit. TPLF does not include extensions of credit where the return to the investor is not contingent upon the outcome of a specified dispute.
2. See generally Paul H. Rubin, *On the Efficiency of Increasing Litigation*, paper presented to the Public Policy Roundtable on Third Party Financing of Litigation, Northwestern University Searle Center on Law, Regulation, and Economic Growth (Sept. 24, 2009).
3. The Ecuadorian trial court awarded \$9 billion in damages to the plaintiffs, which would be doubled if Chevron did not publicly apologize to them. Chevron did not apologize, and the damages were doubled to \$18 billion.
4. See *Chevron Corp. v. Donziger*, Case No. 11-cv-0691 (S.D.N.Y. Mar. 7, 2011), at 82-83. The Second Circuit later vacated Judge Kaplan's injunction on jurisdictional and procedural grounds, but his factual findings stand.
5. On the Lago Agrio suit, see generally Roger Parloff, *Have You Got a Piece of this Lawsuit? The Bitter Environmental Suit Against Chevron in Ecuador Opens a Window on a Troubling New Business: Speculating in Court Cases*, Vol. 163, Issue 8 (June 13, 2011), at 68.
6. See Press Release, Burford Capital Limited, Burford Reports Continued Activity and Entry into UK Market (Dec. 12, 2011), available at: <http://www.burfordfinance.com/pressroom/press-releases>.
7. See B.M. Cremades, Jr., *Third Party Litigation Funding: Investing in Arbitration*, Transnational Dispute Management, Vol. 8, Issue 4 (Oct. 2011), at 25-33, 27 n.105 (citing *S&T Oil Equip. & Mach. Ltd. v. Juridica Invs. Ltd.*, Civil Action No. H-11-0542 (S.D. Tex. Feb. 14, 2011), sealed complaint, ¶¶ 29, 30).
8. Nate Raymond, *Sean Coffey Launches New Litigation Finance Firm with Juridica Co-Founder, Vows to Move Beyond 'Litigation Funding 1.0'*, *The American Lawyer* (June 17, 2011).
9. *Id.*
10. See *Rancman v. Interim Settlement Funding Corp.*, 789 N.E.2d 217, 220-21 (Ohio 2003) (noting that the amount the plaintiff-appellant owed to litigation financiers was an "absolute disincentive" to settle at a lesser amount).
11. See Alison Frankel, *Patent Litigation Weekly: Secret Details of Litigation Financing*, *The Am Law Litigation Daily* (Nov. 9, 2009).
12. See *Altitude Nines, LLC v. Deep Nines, Inc.*, No. 603268-2008E (N.Y. Sup. Ct.); see also Joe Mullin, *Patent Litigation Weekly: How to win \$25 million in a patent suit – and end up with a whole lot less*, *The Prior Art* (Nov. 2 2009), http://thepriorart.typepad.com/the_prior_art/2009/11/altitude-capital-partners-altitude-nines-v-deep-nines.html.
13. See Funding Agreement Between Trec Financial Solutions and Claimants, *Chevron Corp. v. Donziger*, Case No. 11-cv-0691 (S.D.N.Y.), Docket No. 356, Ex. B.
14. See *In Re World Trade Center Disaster Site Litig.*, No. 1:21-mc-00100 (S.D.N.Y. Aug. 27, 2010).
15. Even when attorneys wish to practice before federal courts, they typically need only show that they are admitted to practice before the highest court of a state and are active and in good standing in the bar of that state.
16. We are proposing a federal regulatory regime for TPLF investments. The legislative activity related to consumer lawsuit lending has been at the state level, and ILR will continue to engage at the state level to prevent abuses in that form of TPLF.
17. See U.S. Const. art. 1, § 8, cl. 3 (granting Congress the power "[t]o regulate Commerce with foreign Nations, and among the several states").
18. 514 U.S. 549, 558-60 (1995) (holding that "[w]here economic activity substantially affects interstate commerce, legislation regulating that activity will be sustained"). This conclusion is unaffected by the recent opinion in *National Federation of Independent Business v. Sebelius*, which summarized existing Commerce Clause jurisprudence in concluding that it would not permit Congress to compel commercial activity – *i.e.*, purchasing health insurance – where none existed. See 132 S. Ct. 2566 (2012).
19. See *Gonzalez v. Raich*, 545 U.S. 1, 38 (2005) (Scalia, J., concurring) (quoting *Shreveport Rate Cases*, 234 U.S. 342, 353 (1914) (noting that Congress is empowered "to take all measures necessary or appropriate to the effective regulation of the interstate market, although intrastate transactions may thereby be controlled") (internal quotation marks and alterations omitted)).
20. This analysis depends upon courts recognizing that TPLF – which involves investing in litigation as a money-making endeavor – is an economic activity inasmuch as the Supreme Court has declined to use the Commerce Clause to regulate non-economic activity that affects interstate commerce. See *United States v. Morrison*, 120 S. Ct. 1740, 1750 (2000); *Lopez*, 514 U.S. at 549 (noting that where the Court had permitted Congress to regulate purely intrastate activities, they had at least been economic activities). The Supreme Court came close to outright classifying litigation as an economic activity in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), where it held that enforcement of arbitration clauses was an economic activity that Congress could regulate.
21. See Anthony J. Colangelo, *The Foreign Commerce Clause*, 6 Va. L. Rev. 949, 970-71 (2010); see also Restatement (Third) of the Foreign Relations Law of the United States § 402 (1987) (providing the bases upon which states have jurisdiction to prescribe law); Ronald D. Rotunda & John E. Nowak, *Treatise on Constitutional Law* § 4.2(a) (2007) (arguing that Constitution confers a broad congressional power to regulate foreign commerce).
22. See Am. Bar Ass'n Comm. on Ethics 20/20, *Informational Report to the House of Delegates on Alternative Litigation Finance* (Feb. 2012).
23. See *The FTC in 2012, Stats & Data*, Federal Trade Commission (Mar. 30, 2012), available at: <http://www.ftc.gov/os/highlights/2012/stats.shtm>.
24. *Id.*
25. Parloff, *supra* note 5, at 68, 72.



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