Articles

Betting on the Client: Alternative Litigation Funding Is an Ethically Risky Proposition for Attorneys and Clients

By CAROL LANGFORD*

ALL LITIGATION REQUIRES some degree of financing, either by the parties themselves or, in the case of a contingency or pro bono case, by the firm extending credit and expense against the future proceeds of settlement or judgment. Some clients, however, lack the resources to fund litigation, regardless of the potential final award, or have medical or living expenses that must be paid before the suit is resolved and which the plaintiff's attorney cannot pay on the client's behalf.[1]

Alternative or third-party litigation funding is not new. Third-party litigation funding was historically classified as champerty, and its related generally-outlawed practices of maintenance, usury, and barratry.[2] "Put simply, maintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome; and barratry is a continuing practice of maintenance or champerty."[3] Champerty in particular is "[a]n agreement between an officious intermeddler in a lawsuit and a litigant by which the inter-

* Carol M. Langford is a lawyer providing ethics advice and State Bar defense to lawyers in the Bay Area. She is a lecturer at U.C. Berkeley Boalt Hall School of Law and co-author of the textbook *Legal Ethics in the Practice of Law*, and *The Moral Compass of the American Lawyer: Truth, Justice, Power and Greed.* Thanks to Elif Sonmez, 2014 USF Law graduate and 2014 USF Law Review Symposium Editor, for her extensive research and writing contributions to this Article.

1. *See* MODEL RULES OF PROF'L CONDUCT r. 1.8(e) (2013) ("A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation . . . ."); CAL. RULES OF PROF'L CONDUCT r. 4-210(A) (2013).
2. *See* Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61, 70 (2011).
3. *In re* Primus, 436 U.S. 412, 424 n.15 (1978).

meddler helps pursue the litigant's claim as consideration for receiving part of any judgment proceeds."[4]

The concept of third-party funding originated in ancient Greece,[5] then later emerged in Australia[6] and England during the Middle Ages.[7] In the 1990s, Americans began utilizing third-party funding as a way to give a few thousand dollars to plaintiffs.[8] This "law lending"[9] funded relatively small consumer suits, typically in matters relating to personal injury or divorce.[10] Currently, twenty-seven out of fifty-one jurisdictions—including Arizona, Colorado, California, New Hampshire, New Mexico, Texas, and D.C.—permit some form of champerty, so long as there is no intermeddling with how the litigation is conducted, the suit is not frivolous, and there is no malice champerty at play.[11] Defined generally by the American Bar Association (ABA), third-party litigation funders "provide capital used to support litigation-related activities, or to support clients' ordinary living expenses during the pendency of litigation."[12] Unlike traditional litigation funding from clients or firms, these sources of funding stretch into the realm of personal financing during the period when a client is engaged in litigation, and reach beyond support of the case itself.

Alternative Litigation Funding (ALF) can come in various forms. Consumer-based ALF typically targets personal-injury plaintiffs, and other clients with smaller claims.[13] In this type of ALF, the funder

4. BLACK'S LAW DICTIONARY 279 (10th ed. 2014).

5. *See* Ari Dobner, *Litigation for Sale*, 144 U. PENN. L. REV. 1529, 1543 (1996).

6. Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268, 1279 (2011).

7. Max Radin, *Maintenance by Champerty*, 24 CALIF. L. REV. 48, 60 (1935).

8. Terry Carter, *Cash Up Front*, ABA JOURNAL (Oct. 8, 2004), http://abajournal.com/magazine/article/cash_up_front/.

9. Maya Steinitz, *The Litigation Finance Contract*, 54 WM. & MARY L. REV. 455, 460 (2012).

10. *See* Steven Garber, *Alternative Litigation Financing in the United States*, RAND CORP. 9-10 (2010), http://www.rand.org/pubs/occasional_papers/2010/RAND_OP306.pdf.

11. ABA Comm'n on Ethics 20/20, Informational Report to the House of Delegates, at 11 (2011). *See also* Sebok, *supra* note 2, at 104-05 ("[M]alice champerty [is] 'the funding of *frivolous* litigation by an otherwise disinterested party, with the purpose of harming or discomforting the defendant.'"). Non-frivolous litigation is defined as

> [W]here the claim is based on (a) factual allegations that the plaintiff has a reasonable basis for believing could be proven true, and (b) law which the plaintiff has reason to believe a court could interpret in such a way so as to support a result in the plaintiff's favor.

Id. at 105.

12. ABA Comm'n on Ethics 20/20, Informational Report to the House of Delegates, at 5 (2011).

13. *Id.* at 6.

takes a partial percentage of a claim that is not yet settled.[14] Alternatively, commercial ALF lenders generally supply loans or lines of credit to lawyers or law firms as opposed to taking an interest in a claim from clients.[15]

The funding of class actions and other high-end litigation like patent matters also often no longer comes from the firm itself or a law firm line of credit.[16] Third-party litigation funders have seen the profits to be made and increased their funding efforts.[17] Alan Zimmerman, CEO and Co-CIO/Legal Counsel of LawFinance Group,[18] stated that he funded "$9 million in financings during Thanksgiving week alone, even with time off for turkey and stuffing."[19] Mr. Zimmerman, his company, and other similar companies view financing litigation as an investment.[20]

ALF is booming, and even investment funds are becoming involved in this practice.[21] This method of funding is largely unexamined, and it is currently unregulated by the federal government.[22] Surprisingly, there is little to no guidance for lawyers regarding the ethical issues that arise from working with third-party litigation funders in California.

Interest rates for loans can vary from 2.5-15%, compounded monthly.[23] What are the lawyer's duties regarding advising the client that a typical interest charge of 2.94% compounded monthly[24] can

14. *Id.*

15. *Id.* at 8.

16. *See id.*

17. *See* Garber, *supra* note 10, at 24-25.

18. *Alan L. Zimmerman*, LAW FINANCE GROUP, http://www.lawfinance.com/person/alan-zimmerman/ (last visited Sept. 26, 2014).

19. Paul M. Barrett, *Litigation Funder Adds Fuel to the BP Lawsuit Conflagration*, BLOOMBERG BUSINESSWEEK (Dec. 3, 2013), http://www.businessweek.com/articles/2013-12-03/litigation-funder-adds-fuel-to-the-bp-lawsuit-conflagration.

20. *See* Stuart L. Pardau, *Alternative Litigation Financing: Perils and Opportunities*, 12 U.C. DAVIS BUS. L.J. 65, 67 (2011).

21. *See, e.g.*, Garber, *supra* note 10, at 8; William Alden, *Litigation Finance Firm Raises $260 Million for New Fund*, N.Y. TIMES (Jan. 12, 2014), http://dealbook.nytimes.com/2014/01/12/litigation-finance-firm-raises-260-million-for-new-fund/?_php=true&_type=blogs&_r=1.

22. ALF is not regulated by the federal government, and only Maine, Ohio, Nebraska, and New York adopt some form of ALF regulation within their respective states. *See* Terrence Cain, *Third Party Funding of Personal Injury Tort Claims: Keep the Baby and Change the Bathwater*, 89 CHI.-KENT L. REV. 11, 14 (2014).

23. Martin J. Estevao, *The Litigation Financing Industry: Regulation to Protect and Inform Consumers*, 84 U. COLO. L. REV. 467, 475 (2013).

24. Carol M. Langford, *Viewpoint: Time to Shine a Light on Litigation Funding*, RECORDER (Mar. 6, 2014), http://www.therecorder.com/id=1202645951261/Viewpoint-Time-to-Shine-a-Light-on-Litigation-Funding.

end up being around 40% of the loan amount or more per year? Some loan agreements specify that the funder is entitled to the full judgment award if it is less than the amount financed, and not all agreements state that attorney's fees must be paid before the third-party litigation funders.[25] There is also a confidentiality risk if opposing counsel asks a client in an interrogatory if his case was funded.[26] If the client says yes, the opposing counsel may claim the right to view all documents the firm gave the funder, and to know everything the client and his lawyer said to the funder.[27]

Part I of this Article examines case law as well as bar association opinions regarding the attorney-client privilege when dealing with third-party litigation funders. Part II provides a hypothetical scenario demonstrating how ALF can present unexpected ethical issues for unwary lawyers. Part III discusses the arguments made by supporters of ALF, and subsequently casts doubt as to their strength. Part IV outlines another hypothetical situation designed to raise questions about a lawyer's ability to competently represent a client when dealing with third-party litigation funders. Part V argues that ALF needs to be regulated going forward. Part V also offers as potential solutions new state bar regulations, detailed attorney-client agreements, explicit contracting provisions that treat third-party litigation funders like insurance companies, and federal regulations. This Article concludes by emphasizing that lawyers have an obligation to act in their client's best interests and must be aware of the potential conflicts of interests that emerge when deciding to engage in ALF.

I. Gaps in Authority Regarding the Attorney-Client Privilege

Few courts have opined on the confidentiality of the funding process, but *Leader Technologies, Inc. v. Facebook, Inc.*,[28] *Dodd v. Cruz*,[29] ethics opinions from the New York City Bar Association,[30] and an ABA informational report issued by the Ethics 20/20 Commission suggest that lawyers must be mindful of waiving the attorney-client privilege.

25. *Id.*
26. *Id.*
27. *See* 32 AM. JUR. 3D *Proof of Facts* 189 (1995) (explaining that information and documents shared with a third party can be subject to discovery if the attorney-client privilege is waived).
28. 719 F. Supp. 2d 373, 376 (D. Del. 2010).
29. 167 Cal. Rptr. 3d 601, 605 (Cal. Ct. App. 2014).
30. N.Y.C. Bar Ass'n Comm. on Prof'l Ethics, Formal Op. 2011-2 (2011), *available at* http://www.nycbar.org/ethics/ethics-opinions-local/2011-opinions/1159-formal-opinion-2011-02.

These authorities also remind attorneys to be aware of conflicts of interest and the duty of loyalty to the client.[31]

A. ***Leader Technologies, Inc. v. Facebook, Inc.***

Leader Technologies, Inc. v. Facebook, Inc. illustrates the risk to attorneys and their clients in sharing privileged information with a third-party litigation funder. *Leader Technologies* was a patent infringement case brought by Leader Technologies against Facebook.[32] Leader Technologies shared privileged technical documents with a litigation financing company,[33] and the magistrate judge compelled production of these documents.[34] Leader Technologies asserted that the documents were protected under the common legal interest privilege.[35] The common legal interest, Leader asserted, was the company's interest in financing the litigation, and the documents were shared only after the company provided the litigation funding.[36] The court was not persuaded by Leader Technologies' privilege claim.[37] In order to give "sufficient force" to a common interest claim of privilege, there must be a demonstration that "the disclosures would not have been made but for the sake of securing, advancing, or supplying legal representation."[38] Further, for a communication to be protected, the interests must be "identical, not similar, and be legal, not solely commercial."[39] Consequently, the court found that Leader Technolo-

31. *See Dodd*, 167 Cal. Rptr. 3d at 606–07 n.3 ("MedFi has taken the position that the amount of its lien is the full amount of Coast's bill, and that it expects to be paid by Dodd for the full amount regardless of what a trier of fact decides is the reasonable value of Coast's services. This appears to raise a conflict of interest for Dodd's attorney."); N.Y.C. Bar Ass'n Comm. on Prof'l Ethics, Formal Op. 2011-2 ("A conflict also may arise in the event the lawyer is asked to advise the client about financing when the client cannot afford to commence or continue litigation absent a third party advance of the lawyer's fees."); ABA Comm'n on Ethics 20/20, Informational Report to the House of Delegates, at 39 (2011) ("Lawyers must adhere to principles of professional independence, candor, competence, undivided loyalty, and confidentiality when representing clients in connection with ALF transactions.").

32. *Leader Technologies, Inc.*, 719 F. Supp. 2d at 375.

33. *Id.* at 376.

34. *Id.* at 375.

35. "The common interest doctrine is an exception to the general rule that the attorney-client privilege is waived following disclosure of privileged materials to a third party." *Id.* at 376.

36. *Id.*

37. *Id.*

38. *Id.* (quoting *In re* Regents of Univ. of Cal., 101 F.3d 1386, 1389 (Fed. Cir. 1996) (internal quotation omitted)).

39. *Id.* (quoting *In re Regents*, 101 F.3d at 1390).

gies waived its privilege claim by sharing information with a third-party litigation funder.[40]

B. *Dodd v. Cruz*

Dodd v. Cruz also illustrates the risk of waiving any potential privilege in documents by sharing them with a third-party funder, as well as the conflict of interest that an attorney places onto himself by making an independent financial investment in a client's legal action. In *Dodd*, the plaintiff received post-accident surgery paid for by a third-party. The payment secured a medical lien against his litigation claim.[41] The president of the third-party company, which bought the lien from the health care provider, was the plaintiff's attorney.[42] The conflict of interest created was that the attorney now had two mutually exclusive fiduciary duties: his fiduciary duty to his company to collect as much as possible from the client on the lien,[43] and his duty of loyalty to his client to reduce the amount of the lien and achieve the best litigation outcome.[44]

Although the third-party lender stated in court documents that it expected all debtor-plaintiffs to pay the full book value of the health care provider's charges, regardless of the litigation's outcome, nothing in the court's record indicated that the plaintiff was aware of that expectation or had agreed to it.[45] The defendant filed a motion to access the funding agreement between the plaintiff and the third party, so as to assess the plaintiff's reasonable damages.[46] The third-party litigation funder objected to the production of documents related to its "lien contracts" on the grounds that they were "confidential, proprietary and irrelevant."[47] However, the court held that the information was discoverable, regardless of any privilege the lender or plaintiff might assert, because it was reasonably calculated to lead to discoverable information on the rational value of the medical services

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40. *Id.*

41. Dodd v. Cruz, 167 Cal. Rptr. 3d 601, 603-04 (Cal. Ct. App. 2014).

42. *Id.* at 604.

43. *See* BLACK'S LAW DICTIONARY 617 (10th ed. 2014) ("A duty of utmost good faith, trust, confidence, and candor owed by a fiduciary (such as a lawyer or corporate officer) to the beneficiary (such as a lawyer's client or a shareholder); a duty to act with the highest degree of honesty and loyalty toward another person and in the best interests of the other person (such as the duty that one partner owes to another).").

44. *See* MODEL RULES OF PROF'L CONDUCT r. 1.2(a) (2013); MODEL RULES OF PROF'L CONDUCT r. 1.7(a)(2) (2013).

45. *Dodd*, 167 Cal. Rptr. 3d at 604.

46. *Id.* at 606.

47. *Id.* at 604.

administered to the plaintiff.[48] The documents were particularly relevant because they might have revealed that the plaintiff was not actually responsible for the costs incurred,[49] or that the value of the medical care was less than the amount of the lien, as the lien would have also accounted for the costs of lending.[50]

C. Association of the Bar of the City of New York Formal Ethics Opinion 2011-2

The Association of the Bar of the City of New York Committee on Professional Ethics Formal Opinion 2011-2 (the "New York Opinion") specifically addresses the ethical concerns and safeguards attorneys should take when their clients are accessing ALF, specifically regarding non-recourse loans.[51] Non-recourse loans in this context are repayable by the litigant out of the proceeds of settlement or judgment awards. The financiers are entitled to repayment as well as special fees, often a percentage of the total settlement or award.[52] In general, non-recourse debt or loans do not allow the lender to seek recovery for anything more than the collateral used to secure the loan, and the borrower is not held personally liable for the debt.[53]

As the New York Opinion illustrates, in determining whether to fund a given action, the third-party litigation funder must contact the claimant's attorney for confidential and privileged information regarding the case.[54] The funding agreement may also require periodic updates from the attorney and access to the client's file as terms of the funding contract.[55] According to the New York Opinion, it is the lawyer's duty to advise the client against entering into an agreement that is *de facto* unlawful because it is champertous or charges usurious

48. *Id.* at 609.

49. *Id.* at 608.

50. *Id.*

51. N.Y.C. Bar Ass'n Comm. on Prof'l Ethics, Formal Op. 2011-2 (2011), *available at* http://www.nycbar.org/ethics/ethics-opinions-local/2011-opinions/1159-formal-opinion-2011-02; *see also Non-Recourse Debt*, INVESTOPEDIA, http://www.investopedia.com/terms/n/nonrecoursedebt.asp (last visited Sept. 25, 2014) ("A type of loan that is secured by collateral, which is usually property.").

52. N.Y.C. Bar Ass'n Comm. on Prof'l Ethics, Formal Op. 2011-2.

53. *Recourse vs. Non-recourse Debt*, IRS U.S. DEP'T OF THE TREASURY, http://apps.irs.gov/app/vita/content/36/36_02_020.jsp?level=advanced (last visited Nov. 2, 2014).

54. N.Y.C. Bar Ass'n Comm. on Prof'l Ethics, Formal Op. 2011-2.

55. *Id.* (citing *The Funding Process*, LAWMAX LEGAL FINANCE, http://litigationfinancing.com/the-funding-process/ (last visited Feb. 2, 2011) ("We . . . ask . . . that we be kept aware of any developments in the case.")).

rates.[56] Whether ALF funding can be usurious or champertous is not yet settled.

Additionally, if the attorney is recommending a funding source, the lawyer should discuss with the client the costs and benefits of a non-recourse loan, and highlight the limitations on a client's actual recovery due to loan repayment and percentage-fees combined with the existing costs and fees of litigation.[57]

With regard to conflicts of interest, the New York Opinion focuses on the fundamental ethical tenent that an attorney cannot put his own interests above the client's.[58] In addition to third-party litigation funders paying a client's personal, medical, and living expenses, it can be safely assumed that the attorney's fees and costs of litigation are also paid out of these funds.[59] If the client cannot legitimately begin or continue litigation, the attorney's duty of candor compels a frank discussion with the client about ALF, even if the client ultimately does not pursue the litigation.

The vulnerability of the attorney-client privilege is readily apparent in ALF because attorneys share client information to obtain financing. While the question of whether sharing client and case information with a third-party funder waives privilege and confidentiality is not definitively settled, but the argument that the common interest privilege does not apply to a strictly financial interest in the litigation's outcome is persuasive, as shown above in *Leader Technologies* and *Dodd*.[60] For very large claims, third-party litigation funders additionally often reserve the right to further disclose the case and the client's information to additional third-party financiers.[61] The New York Opinion cautions that the third-party disclosure cannot ethically occur without the client's informed consent,[62] which brings the attorney back to the duty of candor with the client about the potential risks in ALF.

The final ethical concern raised in the New York Opinion is perhaps the most threatening to a client's interests in litigation: losing

56. *Id.*

57. *Id.*

58. *Id.*; *see also* MODEL RULES OF PROF'L CONDUCT r. 1.7(a)(2) (2013) (explaining that an impermissible concurrent conflict of interest is created if there is a significant risk that the lawyer's representation will be materially limited by a personal interest of the lawyer).

59. *See* ABA Comm'n on Ethics 20/20, Informational Report to the House of Delegates, at 5 (2011).

60. *See supra* Part I.A-B.

61. N.Y.C. Bar Ass'n Comm. on Prof'l Ethics, Formal Op. 2011-2.

62. *Id.*

control over the legal proceeding. In order to maximize its return, a third-party litigation funder may object to steps that would benefit the client if it would either reduce the potential award or settlement amount, or increase litigation costs and diminish the available profit margin.[63] The client may consent to this intermeddling, however, it is the responsibility of the attorney to act on her client's behalf, ensuring that he is apprised of what he may be giving up in exchange for this type of non-recourse financing.[64]

D. ABA Commission on Ethics 20/20 Informational Report on Alternative Litigation Funding

The ABA's Commission on Ethics 20/20 Informational Report (the "Informational Report") is currently the most comprehensive report on the ethical issues of ALF. However, the Informational Report suffers from the same defects as other ethics opinions: it examines the problems, but does not resolve or offer definite solutions to any of the risks posed by ALF. The Informational Report discusses (1) conflicts of interest;[65] (2) interference with an attorney's independent professional judgment;[66] (3) implicit interference in the plaintiff's calculation of whether to settle a claim and for how much;[67] (4) confidentiality, privilege, and work product;[68] (5) reasonableness of fees when costs of financing may be passed along to the client;[69] and (6) the ethical entanglements when the attorney either recommends ALF, or obtains a personal financial interest in the outcome of the claim because of an investment through a third-party litigation funder.[70] An attorney's involvement in the funding process could limit the attorney's capacity for undivided client advocacy and would require the client's informed consent to the attorney's representation.[71] Withdrawal from representation would leave the client in no better position because of the costs associated with starting over with a new attorney, but the attorney would be free from the ethical dilemmas presented by ALF.

63. *Id.*
64. MODEL RULES OF PROF'L CONDUCT r. 1.7 cmt. 13 (2013).
65. ABA Comm'n on Ethics 20/20, Informational Report to the House of Delegates, at 15 (2011).
66. *Id.* at 25-26.
67. *Id.* at 27-29.
68. *Id.* at 30-36.
69. *Id.* at 36-38.
70. *Id.* at 24-26.
71. *Id.* at 39.

Avoiding ALF is not a long-term solution, as the ABA's Commission on Ethics 20/20 (the "Commission") recognizes. The Commission concludes that because the market demands this type of financing, transactions between third-party litigation funders, clients, and attorneys will continue to evolve and exist.[72] Nevertheless, the Commission determined that attorneys must adhere to the core ethical duties of professional independence, candor, undivided loyalty, competence, and confidentiality.[73] The crux of the conflict is how an attorney can actually continue to adhere to those ethical loyalties while engaging in ALF transactions. The discussion does not offer any applicable, practical advice on how to meet market demands while adhering simultaneously to these ethical duties. The Informational Report identifies the relevant ethics issues ALF creates, provides several hypothetical scenarios,[74] and lists the relevant ABA Rules that apply to third-party litigation funders. However, it does not offer any practical guidance to practitioners beyond a caution that attorneys "not experienced in dealing with these funding transactions" become fully informed, either through study or by partnering with more experienced counsel.[75] In a field that the Informational Report acknowledges as a "still-evolving industry,"[76] even purportedly experienced attorneys operate under scant guidance on regulation, hence impairing their licenses and their client's interests in the process.

II. Scenarios Presenting Potential Conflicts of Interest

Even when provided guidance from the Informational Report and available opinions, questions remain unanswered. In addition to the scenarios in the example cases and advisory sources, ALF is infested with other potential conflicts of interests for the unwary lawyer. Among them are conflicts with the following circumstances:

- When the attorney provides a letter identifying the worth of the claim;
- When the client wants to settle for quick cash while the lawyer wants to negotiate further to get more, but the client pays the compounding interest rate;

72. *Id.*
73. *Id.*
74. *Id.* at 13-15.
75. *Id.* at 4.
76. *Id.* at 3.

- Where a lender wants to prolong the litigation to recover on their investment and refuses to allow the client to settle by forcing the settlement issue to arbitration;
- Where so much interest is owed that the lawyer simply cannot settle and has to try for more at trial;
- Where funding is withdrawn and the attorney cannot afford to fund the discovery needed to prepare the case;
- When the lawyer may recover his fee but the client could potentially recover nothing because of what the client owes in interest.

How do these conflicts arise? Imagine that Clare Client, who was injured in a car accident, hires Laura Lawyer. Laura has calculated the damages for which Clare can reasonably sue and the costs of bringing suit. Laura determines that the case is meritorious, as she is likely to prevail at trial or settle for an amount sufficient to cover Clare's damages and her attorney's fees. If the case runs a typical course, Laura will be able to take the case on a contingency fee. Laura knows that she ethically cannot pay Clare's current bills and expenses, even though Clare is unable to work, and Clare cannot obtain traditional financing due to her poor credit. In order to maintain her mortgage and other bills, Clare contacts a third-party consumer legal funder that caters to plaintiff's litigation clients. Two scenarios could then occur: (1) Clare enters into a contractual financing agreement with the lender without consulting Laura, or (2) she consults with Laura, but Laura is unfamiliar with this type of financing. In order to help Clare secure the financing, Laura provides the third-party litigation funder her estimate of what the case is worth. Laura fails to scrutinize the contract for elements that would run contrary to her ethical duties, knowing only that her client needs to pay her bills while litigation is pending on her valid claim.

In this hypothetical, neither Clare nor Laura understood that the financing contract contains an enforceable provision giving the lender the right to accept or reject settlement proposals.[77] Contractually, this provision is valid, as it is part of the bargained-for exchange and not necessarily unconscionable. However, it is a huge ethical landmine for Laura. She unknowingly allows her client to exchange control over the litigation and settlement for third-party funding without advising Clare of the risks, as recommended by the ABA and ex-

77. *See id.* at 27-29.

isting ethics opinions.[78] Additionally, the terms of the financing include the typical 2.94% compounded interest rate discussed earlier in this Article.[79] The interest starts to accrue on the money borrowed from the third-party litigation funder, incentivizing Clare to quickly settle. Laura accepted the case based on a monetary calculation that did not include financing from the third-party litigation funder, and now Laura is incentivized to press for a higher settlement in order to minimize her mounting costs and interest. The third-party litigation funder's priority is to recoup its loan and fees, regardless of the client's interests or the attorney's ethical obligations. Third-party litigation funding, as the ABA and California Rules of Professional Conduct make clear, is allowed so long as it does not interfere with the lawyer's independent judgment or loyalty to the client.[80] But the focus for all parties—Clare, Laura, and the third-party litigation funder—is now on settling as quickly as possible for as much as possible, in order to pay back the loan rather than to serve the interests of the injured client.

This hypothetical shows how clients and lawyers can find themselves unexpectedly entangled with a third-party litigation funder in a way that alters the course of the litigation. The Informational Report provides several other examples of hypothetical situations an attorney might encounter in the context of ALF. Additionally, it illustrates how this type of funding stream can have irregular effects on the course of litigation and settlement, due to and depending on the contractual specifics of the funding agreement.[81] At the ethical heart of these scenarios is an insurmountable conflict of interest between the lawyer and the client. The lawyer's duty of loyalty to the client is compromised when the client goes into debt to maintain her litigation—and to pay the attorney's fees.

A. Ethical Issues in Alternative Litigation Funding of Low-End Personal Injury Litigation

Litigation funding as an unregulated industry exacerbates ethical issues. The Securities and Exchange Commission (SEC) does not regulate this funding source, and it is unregulated by lender laws because

78. *See id.* at 28.
79. *See* Langford, *supra* note 24.
80. *See* MODEL RULES OF PROF'L CONDUCT r. 1.8 cmt. 11 (2013); CAL. RULES OF PROF'L CONDUCT r. 3-310(F)(1) (2013).
81. ABA Comm'n on Ethics 20/20, Informational Report to the House of Delegates, at 26-27 (2011); *see also* Steinitz, *supra* note 9, at 489-90.

third-party litigation funders claim not to be lenders. As discussed in the current scholarship, third-party litigation funders, particularly in the consumer lending context, structure themselves to avoid usury and champerty laws by charging fixed interest rates and issuing non-recourse loans.[82] These loans are not due unless the borrower prevails, making them unlike traditional loans, thus falling outside of the regulatory scheme of other types of lending. With the exception of the Ohio Supreme Court's decision in *Rancman v. Interim Settlement Funding Corp.*,[83] third-party litigation funders successfully argued in court that neither champerty prohibitions nor usury laws apply to non-recourse loans that are repayable solely out of litigation recoveries.[84] In order to overturn the *Rancman* opinion, the American Legal Financing Association (ALFA), the industry's largest association and lobbying group composed of thirty-one ALF companies,[85] successfully lobbied the Ohio legislature to write a law overturning the lone Ohio Supreme Court decision voiding an ALF contract as champerty and maintenance.[86] ALFA estimates that its members supply 90% of the ALF currently in the market and that over 60% of those consumers utilized this funding in order to avoid a client's eviction or foreclosure.[87] While ALFA presents this as evidence of its beneficial and pro-consumer purpose, a majority percentage of consumer-litigants dependent on these financing agreements are in a weak bargaining position, and the negative effects of making these deals should be highlighted.

However, rather than falling under the existing regulatory systems for loans, ALFA presents ALF as a beneficial and self-regulating industry. ALFA published a list of "Best Practices" for third-party litigation funders—a members' "Code of Conduct."[88] According to this "Code" members will not seek to own, interfere with, or participate in

82. *See* Jonathan T. Molot, *Litigation Finance: A Market Solution to A Procedural Problem*, 99 Geo. L.J. 65, 94 (2010).

83. 789 N.E.2d 217, 221 (Ohio 2003) ("[A] contract making the repayment of funds advanced to a party to a pending case contingent upon the outcome of that case is void as champerty and maintenance.").

84. Molot, *supra* note 82, at 94-95.

85. Am. Legal Finance Ass'n, http://www.americanlegalfin.com/ (last visited Sept. 25, 2014).

86. *Facts About ALFA*, Am. Legal Finance Ass'n, http://www.americanlegalfin.com/FactsAboutALFA.asp (last visited Sept. 28, 2014); *see also* Ohio Rev. Code Ann. § 1349.55 (West 2014).

87. *Facts About ALFA*, Am. Legal Finance Ass'n, *supra* note 86.

88. *Industry Best Practices—ALFA's Code of Conduct*, Am. Legal Finance Ass'n, http://www.americanlegalfin.com/IndustryBestPractices.asp (last visited Sept. 25, 2014).

a consumer's litigation and will not act to over-fund litigation or mislead consumers.[89] However, there is no apparent enforcement power behind these "Best Practices," and a survey of financing agreements in ALF case law shows that participation, ownership, and otherwise intermeddling are written into the terms of the agreements. ALFA, posing as a regulatory body, might be trying to avoid government regulation in its untested, grey-area of money lending. Without guidance and enforcement from the state bar associations or the ABA, the unwary attorney is given no regulatory guidance. Lack of regulation exacerbates any ethical dilemma, as it assumes lawyers are sophisticated dealers in this type of funding—a problematic assumption given the variety and evolution of funding products. Clients, often unsophisticated legal consumers and usually unaware of an attorney's ethical duties, do not necessarily understand how problematic the loans can be. This, in turn, complicates the ethics issues of attorney-client relations. Attorneys are placed in precarious situations as a result of their clients' independent actions.

Lack of industry regulation is particularly problematic for clients who have minimal personal funds to spend on litigation. Low-end consumer litigation funders like Pegasus,[90] Oasis,[91] or USClaims[92] appear to target the poor and injured, as evidenced by the websites' headlines and content.[93] Oasis's website prominently displays testimonials such as, "I really needed the money, me and my family had no food,"[94] or "The cash from Oasis has helped me not be homeless."[95] Pegasus's website shows potential borrowers a hand full of money, with the caption, "We can advance you cash today!"[96] The overt, easy-money salesmanship of these third-party litigation funders further shows the importance of an attorney's ethical obligations and the necessity of informing their clients of the costs, benefits, risks, and terms of an agreement accompanying this kind of funding.

89. *Id.*

90. Pegasus Legal Funding, http://www.mylawfunds.com/ (last visited Sept. 29, 2014).

91. Oasis Legal Finance, https://www.oasislegal.com/ (last visited Sept. 29, 2014).

92. USClaims, http://www.usclaims.com/ (last visited Sept. 29, 2014).

93. *See, e.g.*, *What We Fund*, USClaims, http://www.usclaims.com/what-we-fund (last visited Sept. 29, 2014) (listing common and workplace personal injury categories); *Legal Funding Resources*, Pegasus Legal Funding, http://www.mylawfunds.com/resources.html (last visited Sept. 29, 2014) ("Bad Credit No Problem! No credit check necessary!").

94. Oasis Legal Finance, *supra* note 91.

95. *Id.*

96. Pegasus Legal Funding, *supra* note 90.

B. Issues of Alternative Litigation Funding in High-End and Complex Litigation

High-end funders that typically fund lawyers and law firms are also involved in commercial cases. An example of a high-end commercial funder is Gerchen Keller.[97] Gerchen Keller funds corporations in lawsuits and also assists parties in evaluating the "strengths and weaknesses of litigation claims or defenses, the potential costs of litigation, the range of potential damage awards, and the expected economic benefit or cost of maintaining particular claims or defenses."[98]

The relevant ethical issue is whether Gerchen Keller can evaluate a funding opportunity without comprising client confidentiality. Gerchen Keller asserts that the company enters into a "consulting" agreement with the party or law firm.[99] "Thus, before any non-public information is shared . . . we ensure that we share a common interest in the litigation."[100]

The argument that a third-party litigation funder falls under the common interest privilege exception is less than foolproof.[101] In California, non-published information is considered confidential material of both the attorney and the client.[102] Describing a third-party litigation funder as a "consultant" is a strategy relating to Federal Rule of Evidence 26, under which experts who are retained only as consultants, and not as testifying experts, can be kept within the attorney-client privilege.[103] Labeled this way, third-party litigation funders can make the argument that their interests in the case are legitimate and non-adversarial, akin to sharing inside-information during a merger of business interests,[104] or between clients, attorneys, and insurance com-

97. GERCHEN KELLAR CAPITAL, http://www.gerchenkeller.com/ (last visited Sept. 29, 2014).

98. *Our Underwriting Process*, GERCHEN KELLAR CAPITAL, http://www.gerchenkeller.com/what-we-do/our-underwriting-process/ (last visited Sept. 29, 2014).

99. *Ethical and Regulatory Considerations*, GERCHEN KELLAR CAPITAL, http://www.gerchenkeller.com/what-we-do/ethical-regulatory-considerations/ (last visited Sept. 29, 2014).

100. *Id.*

101. *See supra* Part I.A-B.

102. *See* CAL. RULES OF PROF'L CONDUCT r. 3-100 (2013).

103. *See* FED. R. CIV. P. 26(b)(4)(B)-(C) (protecting documents and communications between a party's attorney if used to prepare for litigation). The attorney-client privilege may be invoked with respect to: (1) a communication; (2) made between privileged persons; (3) in confidence; and (4) for the purpose of obtaining or providing legal assistance for the client. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 68 (2000).

104. Letter from Juridica Capital Management Ltd. to ABA Comm'n on Ethics 20/20, Comments to Issues Paper Concerning Lawyer's Involvement in Alt. Litig. Fin., at 66 (Feb. 2011), *available at* http://www.americanbar.org/content/dam/aba/migrated/2011_

panies[105] under a version of the common interest doctrine.[106] Confidential client information obtained by third-party litigation funders during the financing process would therefore remain privileged and protected from discovery requests. Furthermore, even without similar exceptions gleaned from other contexts, the attorney-client privilege is held by the client, not the attorney, and can be voluntarily waived without resulting in an ethical breach, so long as the attorney adequately advised the client about the consequences of disclosure. As demonstrated in a court opinion[107] and recent National Counsel for Professional Responsibility conference discussions,[108] it is also possible for the attorney to waive the attorney-client privilege in the documents shared with the lender, but still retain work-product privilege through a confidentiality agreement. What remains unsettled are the parameters of informed client consent, whether a confidentiality agreement solves the waiver problem, and the extent to which an attorney can advise or dissuade a client about entering into an ALF agreement.

The ethical problems in commercial litigation are similar to those in consumer ALF, as demonstrated by *Chevron Corp. v. Donziger*.[109] In the underlying suit, the plaintiffs' lead attorney Steven Donziger filed a class action lawsuit against Texaco on behalf of Ecuadorian Indians and farmers living near oil wells operated in the 1970's and 1980's.[110] Chevron became a party to the lawsuit when it acquired Texaco.[111] The plaintiff accused the oil company of causing widespread pollution

build/ethics_2020/comments_on_alternative_litigation_financing_issues_paper.auth checkdam.pdf.

105. *See infra* Part III.B.

106. *See* Pardau, *supra* note 20, at 75 ("Legislation specific to ALFs recently has been introduced in a few states based on the common interest doctrine. According to the legislation, the sharing of privileged information between a claimant and an ALF provider does not waive any applicable privilege.").

107. *See* Miller UK Ltd. v. Caterpillar, Inc., No. 10 C 03770, 2014 WL 67340, at *16-17 (N.D. Ill. Jan. 6, 2014) ("To avoid the risk of disclosure, Miller took precautions through confidentiality agreements with at least some prospective funders. . . . It perhaps could be argued that the assertions that Miller and one or more prospective funders 'agreed' and had an 'understanding' regarding confidentiality are merely legal conclusions, and that therefore the Declaration should not be considered.").

108. *See Commercial Litigation Funding, Ethics, and Law*, AM. BAR ASS'N, http://www.americanbar.org/calendar/2014/05/40th-aba-national-conference-on-professional-responsibility/conferencematerials/session9.html (last visited Oct. 12, 2014) (presenting the panel page for the ABA's 40th National Conference for Professional Responsibility).

109. 974 F. Supp. 2d 362 (S.D.N.Y. 2014).

110. *Id.* at 383.

111. *Id.*

and ill-health to the local population.[112] Philadelphia plaintiffs-litigation firm, Kohn, Swift, & Graf[113] and particularly its partner Joseph Kohn,[114] originally funded the case. Additional backers included personal investors, an international third-party litigation funder,[115] and hedge fund companies.[116] When Chevron's counsel successfully subpoenaed the plaintiffs' funding documents, the funding contract revealed that there were eight tiers of funders.[117] In a 485-page ruling, a verdict in favor of the plaintiffs was overturned.[118] The court found that Donziger engaged in fraud,[119] racketeering,[120] money laundering,[121] wire fraud,[122] extortion,[123] witness tampering,[124] Foreign Corrupt Practices Act violations,[125] and bribery[126] in connection with the funding obtained while pursuing the two-decade long case. The attor-

112. *In re* Chevron Corp., 633 F.3d 153, 156 (3d Cir. 2011).

113. Chris Mondics, *Venerable Center City Law Firm Embroiled in Chevron Fraud Case*, PHILLY.COM (Dec. 23, 2010), http://articles.philly.com/2010-12-23/news/26356087_1_chevron-request-ecuadorean-steven-donziger; *see also* William Langewiesche, *Jungle Law*, VANITY FAIR (May 2007), http://www.vanityfair.com/politics/features/2007/05/texaco200705.

114. Daniel Fisher, *Chevron Ecuador Case A Shambles, Former Backer Says*, FORBES (Dec. 17, 2010), http://www.forbes.com/sites/danielfisher/2010/12/17/chevron-ecuador-case-a-shambles-former-backer-says.

115. *See* Daniel Fisher, *Poker Magnate, London Firm Bankroll Chevron Plaintiffs*, FORBES (Jan. 27, 2011), http://www.forbes.com/sites/danielfisher/2011/01/27/poker-magnate-london-firm-bankroll-chevron-plaintiffs/.

116. *See* Roger Parloff, *Have You Got a Piece of This Lawsuit?*, FORTUNE (June 28, 2011), http://features.blogs.fortune.cnn.com/2011/06/28/have-you-got-a-piece-of-this-lawsuit-2/ [hereinafter Parloff, *Have You Got a Piece of This Lawsuit?*]; Roger Parloff, *Litigation Finance Firm in Chevron Case Says It Was Duped By Patton Boggs*, FORTUNE (Apr. 17, 2013), http://features.blogs.fortune.cnn.com/2013/04/17/burford-patton-boggs-chevron-suit.

117. *See* Parloff, *Have You Got a Piece of This Lawsuit?*, *supra* note 116; Chevron Corp. v. Donziger, 974 F. Supp. 2d 362, 576 (S.D.N.Y. 2014) ("In this case, the LAP team and its affiliates were a group of persons associated in fact for the common purpose of pursuing the recovery of money from Chevron via the Lago Agrio litigation, whether by settlement or by enforceable judgment, coupled with the exertion of pressure on Chevron to pay. The group included (1) Donziger, (2) the U.S. and Ecuadorian lawyers, including Kohn, Patton Boggs, and others, (3) Yanza, the ADF, and Selva Viva, (4) the investors who gave money to finance the operation, usually in exchange for shares of any recovery, (5) the LAPs' public relations, media, and lobbying arms, (6) the LAPs' technical people, including Stratus, Beltman, Maest, Russell, Calmbacher, Champ, Quarles, E–Tech, UBR, and 3TM, and (7) others.").

118. *Chevron Corp.*, 974 F. Supp. 2d at 644.

119. *Id.* at 560.

120. *Id.* at 603.

121. *Id.* at 593.

122. *Id.* at 590.

123. *Id.* at 582.

124. *Id.* at 595.

125. *Id.* at 598-99.

126. *Id.* at 596.

ney-client privilege protecting the requested documents would have been waived by the crime-fraud exception,[127] even though the putative plaintiffs—the Ecuadorian farmers affected by the oil contamination—had done no criminal wrong and likely had no idea how the litigation was being funded.[128]

The court also attempted to explain the web of third-party funding backing the plaintiffs' case, which provided the necessary links to find the attorney's actions illegal under anti-racketeering and money-laundering laws.[129] The $18 billion judgment in favor of the plaintiffs—later reduced to $9.5 billion—was thrown out. But it is unlikely that the Ecuadorians would have benefitted much from any monetary judgment. As of July 2013, Donziger's fraud defense attorney withdrew representation because, according to the attorney, Donziger could no longer pay his bills.[130]

Although the ethical dilemmas in small, personal injury cases and larger scale litigation are similar, *Chevron* emphasizes the additional potential liabilities a lawyer subjects himself to when using extensive amounts of funding to pursue a big case.

III. Defenses by the Third-Party Litigation Funders

A. High Risks Associated with Providing Funding

One of the strongest arguments in support of ALF is that third-party litigation funders provide money to people who would not otherwise have the funds to support themselves while prosecuting a lawsuit. However, this is not the only type of cliental third-party litigation funders serve, as such funding assisted the lawyers prosecuting the recent civil BP oil cases.[131] On the ALFA website, the funders argue that,

127. MODEL RULES OF PROF'L CONDUCT r. 1.6(b)(2) (2013) ("A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary . . . to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services.").

128. *See* William E. Thomson & Armen Adzhemyan, *Litigating the Crime-Fraud Exception:* Chevron Corp. v. Donzinger, INSIDE COUNSEL (Aug. 25, 2014), http://www.insidecounsel.com/2014/08/25/litigating-the-crime-fraud-exception-ichevron-corp.

129. *Chevron Corp.*, 974 F. Supp. 2d at 575-617.

130. Clifford Krauss, *Lawyer Who Beat Chevron in Ecuador Faces Trial of His Own*, N.Y. TIMES (July 30, 2013), http://www.nytimes.com/2013/07/31/business/steven-donziger-lawyer-who-beat-chevron-in-ecuador-faces-trial-of-his-own.html?hp&_r=1&.

131. *See BP Gulf Oil Spill Lawsuit Funding*, LAWSUIT LOANS FUNDING, http://www.lawsuitloansfundings.com/BP-gulf-oil-spill (last visited Sept. 29, 2014); *Legal Funding for BP Oil Spill Plaintiffs' Attorneys*, RD LEGAL FUNDING, http://www.legalfunding.com/eligible-cases/bp-oil-spill-legal-funding/ (last visited Sept. 29, 2014).

on average, they only charge 10% of the "estimated net value of the case,"[132] creating the appearance that upon completion the borrower receives more than the lender regains on the loan principle, fees, and interest.

ALF supporters also justify their funding model by emphasizing their willingness to accept large amounts of risk. ALF loans are non-recourse, because the funders recoup nothing if there is no recovery.[133] But if there is any recovery, they take a substantial amount.[134] Loans must comply with usury laws, which typically set maximum interest rates.[135] ALF loans typically exceed these rates, despite being technically nonrecourse. ALFA argues that these non-recourse loans and their interest rates are high because of the elevated risk the third-party litigation funder assumes by issuing a non-recourse loan.[136] For example, if the borrower loses the case, the lender cannot recover. To avoid complying with states' usury laws, third-party litigation funders argue that they are not subject to the laws because they are making an investment rather than a loan, essentially placing a bet on the successful outcome of a litigation action.[137] To further justify the high interest rates and fees, third-party litigation funders contend that a typical car or home loan is secured by tangible property and is not nearly as risky as an investment in a lawsuit, which has no tangible collateral and no guaranteed outcome.[138] They claim to be entitled to a usuriously high annual interest rate because of the significant risk.[139]

However, lots of normal transactions, such as buying stock, always pose a risk due to the unpredictability of the market. When passengers get on an airplane flight and the plane crashes due to a faulty engine repair, they will certainly receive compensation from some party, whether it is the airline or the plane manufacturer.[140] Com-

132. *Frequently Asked Questions*, AM. LEGAL FINANCE ASS'N, http://www.americanlegalfin.com/faq.asp (last visited Sept. 29, 2014).

133. *See id.*

134. *See* Langford, *supra* note 24.

135. *See* 44B AM. JUR. 2D *Interest and Usury* § 91 (2007) ("A usury statute may impose a requirement that the lender 'charge' or 'demand' usurious interest as an element of usury.").

136. *See Frequently Asked Questions*, AM. LEGAL FINANCE ASS'N, *supra* note 132.

137. *See* ABA Comm'n on Ethics 20/20, Informational Report to the House of Delegates, at 12 (2011).

138. *See* Steinitz, *supra* note 9, at 491 ("In the case of litigation funding, the litigation is usually at an early stage and discovery of facts is preliminary at best.").

139. *See* ABA Comm'n on Ethics 20/20, Informational Report to the House of Delegates, at 12-13.

140. D.E. Buckner, Annotation, *Air Carrier as Common or Private Carrier, and Resulting Duties as to Passenger's Safety*, 73 A.L.R.2d 358 (1960) ("A common carrier of passengers for

pared to the risks in these everyday transactions, the risk in investing in litigation is not substantial, especially when the lender funds a case after discovery closes.[141]

B. Third-Party Litigation Funders are No Different than Insurance Companies

Third-party litigation funders also assert that they are no different than an insurance company funded by a pool of law firms to provide defense of malpractice suits.[142] Defendants' insurance companies that take on the burden of litigation and require the cooperation of the insured have long funded defense-side litigation.[143] ALF advocates in scholarship state that there is no great difference between liability insurance in litigation and ALF, and that the concerns over the legal ethics of ALF are misplaced.[144] However, the essential difference between ALF and other kinds of funding is that insurance companies are highly regulated.[145] ALF is not regulated,[146] and insurance companies do not charge 40% annual interest to people already hurt and entitled to seek civil damages.[147]

Finally, third-party litigation funders contend that the funding agreements are tailored to the needs of the specific case, making it difficult to regulate.[148] In reality, the agreements are not truly be-

hire by air is ordinarily said to be under a duty to exercise either a high or the highest degree of care for the safety of its passengers."). A plane crash resulting in injury would be a breach of that duty of care, and make the common air carrier liable for any damages suffered by the passengers. *See id.* at 362. Additionally, if the tort was due to a product defect in the plane, the manufacturer would be liable under strict liability. *See id.*

141. Provided that nothing legally precludes funders from offering their services at any time. Just as there are no laws directly regulating ALF, there is no regulation of how or when the client and the third-party litigation funder may enter into an agreement. Consumers are allowed to freely enter into agreements with private companies.

142. *See, e.g.*, Steven Gillers, *Waiting for Good Dough*, 43 AKRON L. REV. 677, 681 (2010).

143. *See* Steinitz, *supra* note 9, at 490; Michelle Boardman, *Insurers Defend and Third Parties Fund: A Comparison of Litigation Participation*, 8 J.L. ECON. & POL'Y 673, 686 (2012).

144. *See* Charles Silver, *Litigation Funding Versus Liability Insurance: What's the Difference?*, 63 DEPAUL L. REV. 617, 618 (2014); Michele DeStefano, *Nonlawyers Influencing Lawyers: Too Many Cooks in the Kitchen or Stone Soup?*, 80 FORDHAM L. REV. 2791, 2838-40 (2012).

145. *See* 54A AM. JUR. 2D *Monopolies and Restraints of Trade* § 808 (2009). *See generally* FEDERAL INSURANCE OFFICE, U.S. DEPT. OF THE TREASURY, HOW TO MODERNIZE AND IMPROVE THE SYSTEM OF INSURANCE REGULATION IN THE UNITED STATES (Dec. 2013), *available at* http://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/How%20to%20Modernize%20and%20Improve%20the%20System%20of%20Insurance%20Regulation%20in%20the%20United%20States.pdf.

146. *See supra* text accompanying note 22.

147. Langford, *supra* note 24.

148. ABA Comm'n on Ethics 20/20, Informational Report to the House of Delegates, at 3 (2011).

spoke; typical template provisions underlie each transaction. These template provisions (1) charge a usurious interest rate on the loan when calculated for annual compound interest and additional obligatory fees;[149] (2) allow the funder to discontinue future funding at any point if the litigation is not going as expected,[150] placing the client at the risk of losing control or being forced to abandon litigation; (3) allow the funder to force the client and lawyer to arbitrate settlements to give the funder assurance of the return on investment,[151] or conversely disincentivize settlement due to the terms of the loan;[152] (4) contain provisions that can adequately control the course of the case;[153] (5) allow information sharing by the funder with other investors, waiving the attorney-client relationship;[154] and (6) have negative covenants that disallow the plaintiff to execute any documents that might reduce the value of the funder's investment.[155]

IV. Promising ALF Regulatory Solutions

If ALF is similar to other types of financing already allowed in litigation—contingency fee agreements, third-party funding, and insurance—ALF arguably should be allowed in litigation as well. Like these other forms of funding, in ALF, the client agrees to give up some privilege or part of the damages awarded in exchange for funding to pursue or defend a legal claim. The flaw in this argument is that ALF sufficiently differs from these other types of funding. ALF has not been clearly regulated by the federal government, state governments, state bar associations, the ABA, or the courts. The preamble of the ABA's Model Rules of Professional Conduct states that it is a lawyer's

149. *See* Langford, *supra* note 24.

150. Steinitz, *supra* note 9, at 504.

151. *See* Jason Lyon, *Revolution in Progress: Third-Party Funding of American Litigation*, 58 UCLA L. Rev. 571, 602 (2010). "The funder directed the prosecution of the case and retained the authority to decide when and whether to settle." *Id.*

152. *See* Douglas R. Richmond, *Other People's Money: The Ethics of Litigation Funding*, 56 Mercer L. Rev. 649, 657 (2005) (discussing Rancman v. Interim Settlement Funding Corp., 789 N.E.2d 217 (Ohio 2003)).

153. Steinitz, *supra* note 9, at 508 ("Applying this insight to litigation funding, one could envision a recognized role for the litigation financiers in the day-to-day management of the litigation. Such a role can include the raising of additional funds, helping in formulating legal tactics and litigation strategy, and assisting in structuring the ultimate settlement agreement in the same manner as VCFs help structure key deals executed by portfolio companies.").

154. *See* Leader Technologies, Inc. v. Facebook, 719 F. Supp. 2d 373, 376 (D. Del. 2010) (holding that information sharing with a third party investor waived the attorney-client privilege).

155. Steinitz, *supra* note 9, at 509.

responsibility to serve as an advisor and advocate for the client.[156] A lawyer's job is not just to help clients after they get into legal trouble, but also to warn clients and the public about legal risks before such problems arise. The lack of guidance, combined with the opportunity for predatory actions on vulnerable and under-informed clients in ALF, creates a dangerous atmosphere that a prudent lawyer should not enter. When funders and lawyers have the potential to leave the injured client with little recovery from his suit, then it is time to implement regulation and guidance from both lawmakers and state bar associations.

A. Contracting Solutions

1. Language in Attorney-Client Agreements

Although not specifically about ALF, the State Bar of California Standing Committee on Professional Responsibility and Conduct's (COPRAC) 1994 Opinion (the "COPRAC Opinion") regarding structured settlements touches on the same personal financial interest concern regarding attorney-client transactions that arise in the ALF context.[157] The COPRAC Opinion advises the following:

> The best protection for both Attorney and Client against the anomalies presented by a settlement offer that may put Client and Attorney at odds may be the inclusion, per Business and Professions Code section 6147 (a)(2), of language which recognizes and anticipates these situations and discusses how they will be dealt with when they arise, thus fully amplifying in the fee agreement how Attorney's fee and Client's recovery are interrelated.[158]

Pursuant to the California Rules of Professional Conduct governing attorney-client transactions, the terms of any agreement that is reached between the attorney and client must be "fair and reasonable to client."[159] Currently, this is the best and clearest guidance given to attorneys to steer themselves through the multifaceted field of litigation financing because it relies on the generally understood and common mechanism of the fee agreement. Ahead of the client entering into a separate ALF financing agreement, the attorney can contract with the client to protect both herself and the client's interests in the litigation.

156. MODEL RULES OF PROF'L CONDUCT Preamble & Scope, ¶ 2 (2013).
157. Cal. State Bar Standing Comm. on Prof'l Responsibility & Conduct, Formal Op. 1994-135 (1994).
158. *Id.*
159. CAL. RULES OF PROF'L CONDUCT r. 3-300(A) (2013).

2. Contracts Between the Attorney, Client, and the Third-Party Litigation Funder

There are fundamental differences between consumer ALF and commercial ALF.[160] Guidance on how to operate within each differs due to the types of clients involved and the reasons for obtaining the financing. However, contract law does not differentiate between consumer and commercial contracts, and there are common, fundamental ethical issues underlying both.[161] Guidance on one will inevitably cross over to the other as the ALF field grows.

Maya Steinitz writes extensively on litigation financing, and her scholarship focuses, in part, on structural solutions for commercial litigation.[162] Steinitz proposes that litigation funders act like venture capitalists that are involved in a similar relationship between the lender and borrower.[163] This association is a contractual investment relationship, with funding tiered at important points in the litigation process.[164] Importantly, her scheme for commercial litigation funding relies on transparency in both contractual terms and with regard to the investment-litigation's likelihood of success.[165] This funding model combines the plaintiff-funder relationship with the attorney-client relationship through a funder-inclusive, attorney-client arrangement contract.[166]

This tri-partite negotiation has the potential, in both commercial and consumer litigation funding, to address the issues created by clients waiving the attorney-client privilege and unknowingly ceding control of the litigation contractually. This type of agreement between client, attorney, and funder should be required before litigation financers can claim a stake in the award or settlement. Attorneys would have an opportunity to investigate the terms of the ALF contract, advise their clients about risks and options, increase bargaining transparency, and increase the client's bargaining power with the funders. As a result, delayed realizations of what was exchanged for funding would be avoided.[167]

160. *See supra* text accompanying notes 13-15.
161. *See* Christina L. Kunz, *The Ethics of Invalid and "Iffy" Contract Clauses*, 40 Loy. L.A. L. Rev. 487, 488-90 (2006) (identifying five factual scenarios that raise ethical issues during the process of negotiating terms of a contract).
162. Steinitz, *supra* note 9, at 455.
163. *Id.* at 488-90.
164. *Id.* at 501-14.
165. *Id.* at 514.
166. *Id.* at 515-16.
167. *See supra* Part II.

Importantly, attorneys can control the way third-party litigation funders operate and negotiate with clients by building retainer agreements that require negotiated financing terms. These retainer agreements prevent clients from unknowingly jeopardizing their long-term interests, and binding the attorney to cumbersome third-party contract agreements. Julia McLaughlin explains that an agreement created to account for a third-party litigation funder's presence would insulate the attorney-client relationship from any potential intermeddling.[168] Therefore, any party who breaches the agreement would be held accountable through the enforcement of contract or tort law principles.[169]

Additionally, the already regulated and existing attorney-client trust account[170] can also be used to protect the client from any potential predation by third-party litigation funders. Any award or settlement funds, just as in the current system, should be held in a trust account and released to the funder only on the client's authorization. An attorney's duty of loyalty should preclude any conflicting contractual interests or agreements between the funder and the attorney.

B. Treat Third-Party Litigation Funders like Other Funders or Insurance Companies

As discussed earlier, ALF advocates view the client-attorney-funder relationship similarly to litigation where the insurance company assumes the case away from the client.[171] However, there are noteworthy differences. The insurance relationship begins before litigation, and its primary purpose is not an investment venture.[172] In both ALF and insurance contexts, once funding is accepted, the client assumes a duty to cooperate with the funder, and the funder has a

168. Julia H. McLaughlin, *Litigation Funding: Charting a Legal and Ethical Course*, 31 VT. L. REV. 615, 657-58 (2007).

169. *See* Anthony J. Sebok & W. Bradley Wendell, *Duty in the Litigation-Investment Agreement: The Choice Between Tort and Contract Norms When the Deal Breaks Down*, 66 VAND. L. REV. 1831, 1859-60 (2013) ("The economic loss rule denies recovery in negligence for a financial loss that is not causally connected to personal injury or property damage suffered by the same plaintiff." (internal quotations omitted)).

170. CAL. RULES OF PROF'L CONDUCT r. 4-100(A) (2013) ("All funds received or held for the benefit of clients by a member or law firm, including advances for costs and expenses, shall be deposited in one or more identifiable bank accounts labeled 'Trust Account,' 'Client's Funds Account' or words of similar import . . . . No funds belonging to the member or the law firm shall be deposited therein or otherwise commingled therewith . . . .").

171. *See supra* Part III.B.

172. *See* Boardman, *supra* note 143, at 681.

present and sometimes controlling interest in the litigation. The insurance company becomes a co-client of the attorney at the principle client's allowance.[173] Nothing ethically prevents a third-party litigation funder from being involved as a co-client if, as advocates argue, the interests are actually non-conflicting and the principle client gives informed consent.[174] Perhaps the ethical issues would be ameliorated if the litigation funder were treated as if it were simply another third-party funder, clearly bound by client-controlled and attorney-advised terms regarding privilege and litigation control.

C. Attorney Litigation Financing

If regulation of ALF is beyond the scope of the state bar associations, and attorneys are unable to wield sufficient contractual clout over third-party litigation funders to protect individual clients, one alternative is to change the professional ethics rules to allow attorneys to loan clients funds for living expenses.[175] Data shows that consumer litigation funding is not primarily used to pay the attorney or legal costs (which are usually already covered by the contingency system), but rather to provide for the client's living expenses during litigation.[176] If the legal profession is ethically threatened by the unregulated ALF industry catering to the clients' needs, then perhaps the legal profession should allow attorneys to make loans to their clients to ensure internal regulation of attorney-client relations, as well as the internal regulation of this type of lending. This structure ensures regulation because attorneys are still bound by the duty of loyalty to their clients, unlike third-party litigation funders who make these deals solely for commercial gain.

D. Legislation and Regulation

1. The Parallels with State Regulation of Payday Lending

Payday lending is a type of short-term, high-interest rate, consumer loan that is an advance paid back from the consumer's next paycheck.[177] These loans are technically non-recourse because the col-

173. Discussion of the ethical guidelines and rules governing attorneys working with insurance companies is beyond the scope of this Article.

174. Silver, *supra* note 144, at 627 ("Nothing prevents a funder, a plaintiff, and a contingent fee lawyer from agreeing that the funder will be a co-client.").

175. *See* McLaughlin, *supra* note 168, at 660-61.

176. *Id.* at 620.

177. Alex Kaufman, *Payday Lending Regulation* 5 (Federal Reserve Board, Finance and Economics Discussion Series, Staff Working Paper No. 2013-62), *available at* http://www.federalreserve.gov/pubs/feds/2013/201362/201362pap.pdf.

lateral is only the borrower's next paycheck or access to the borrower's checking account for the amount of the loan.[178] The fees on the amount borrowed are such that the annual percentage rate (APR) on amounts borrowed can be between 300-500% of the principal.[179] Much like ALF,[180] the research on payday loans shows that the majority of borrowers use the funds to cover ordinary, reoccurring expenses (e.g., rent, groceries, etc.) rather than extraordinary, unexpected expenses.[181]

Payday loans are not directly regulated by the federal government, although their activity does sometimes fall within the purview of the Federal Trade Commission (FTC), Truth in Lending Act,[182] Fair Debt Collection Practices Act,[183] and may be regulated in the future by the recently created Consumer Financial Protection Bureau.[184] Otherwise, individual states regulate the payday loan industry, which results in differing regulatory systems and requirements.[185] Similar to ALFA, the payday loan industry established its own member organization, the Community Financial Services Association of America. This organization is self-regulated—also through "Best Practices" guidelines[186]—and focuses on protecting its members' interests.[187]

Much like ALF, payday lending is perceived as one kind of lending system when, in actuality, it is a variety of lending products, vary-

178. *See id.*

179. *Id.*; *see also Payday Lending*, FED. TRADE COMM'N, http://www.ftc.gov/news-events/media-resources/consumer-finance/payday-lending (last visited Sept. 29, 2014).

180. *See* Garber, *supra* note 10, at 12.

181. PEW CHARITABLE TRUSTS, PAYDAY LENDING IN AMERICA: WHO BORROWS, WHERE THEY BORROW, AND WHY 13-14 (July 2012), *available at* http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/PewPaydayLendingReportpdf.pdf.

182. Truth in Lending Act, Pub. L. No. 90-321, 82 Stat. 146 (codified at 15 U.S.C. § 1601 (2012)); *Payday Lending*, FED. TRADE COMM'N, *supra* note 179; Kaufman, *supra* note 177, at 4.

183. Fair Debt Collection Practices Act, Pub. L. No. 95-109, 91 Stat. 874 (1977) (codified at 15 U.S.C. § 1692 (2012)).

184. CFPB OFFICE OF RESEARCH, CFPD DATA POINT: PAYDAY LENDING (Mar. 2014), *available at* http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf.

185. *See* PEW CHARITABLE TRUSTS, STATE PAYDAY LOAN REGULATION AND USAGE RATES (July 2012), *available at* http://www.pewtrusts.org/en/multimedia/data-visualizations/2014/~/media/Data%20Visualizations/Interactives/2014/State%20Payday%20Loan%20Regulation%20and%20Usage%20Rates/Report/State_Payday_Loan_Regulation_and_Usage_Rates.pdf; Kaufman, *supra* note 177, at Appendix A.

186. *CFSA Member Best Practices*, CMTY. FIN. SERVS. ASS'N OF AM., http://cfsaa.com/cfsa-member-best-practices.aspx (last visited Sept. 29, 2014).

187. *See* CMTY. FIN. SERVS. ASS'N OF AM., http://www.cfsa.net (last visited Sept. 29, 2014) ("We believe consumers deserve choices with simple, understandable loan terms and to be treated fairly throughout the process.").

ing in price, size, duration, and consumer use.[188] These different types of products call for varying types of regulatory applications, some of which can be carried over to ALF regulation. Two types of transferable regulation currently used by the states are price caps, which cap the APR charged, and size caps, which limit the maximum size of a payday loan.[189] Some states use price caps to prohibit payday lending by setting the APR cap too low for the lender to operate profitably.[190] Size caps limit the amount of debt that the borrower can assume.[191] Illinois is an example of a state that implemented loan limits in its Payday Loan Reform Act,[192] and combines limits on fees and the maximum amount borrowed.[193] Under Illinois law, no lender may make a loan that exceeds $1,000, 25% of the consumer's gross monthly income, or charge more than $15.50 per $100 loaned.[194] A lender is also prohibited from taking an interest in any of the consumers's personal property to secure the loan.[195]

If states can pass laws regulating payday loans in the interest of consumer protection, they should also be able to pass legislation regulating ALF as another type of high-interest, small-amount consumer loan. Capping the amount third-party litigation funders can receive from final settlements or awards has already been suggested. Data suggests consumer ALF is being used by client-consumers to finance living expenses—unlike commercial litigation, where ALF is used to fund only litigation efforts.[196] There does not appear to be any genuine difference between the types of consumers obtaining payday loans and ALF. However, ALF differs in that the loan is made in the context of litigation and implicates parties having an attorney-client relationship. State regulation of small, loan-related consumer ALF might effectively solve the attorney's "moral hazard" issues of intermeddling with the client's interest and control over the course of litigation and settlement. Capping or controlling the amount that a third-party litigation funder collects may reduce the conflicting interests in deciding whether to settle or proceed with litigation.

188. *See* Kaufman, *supra* note 177, at 3.
189. *Id.* at 6.
190. *Id.*
191. *Id.*
192. 815 Ill. Comp. Stat. 122 (2012).
193. 815 Ill. Comp. Stat. 122/2-5(e) (2012).
194. *Id.*
195. 815 Ill. Comp. Stat. 122/2-5(f) (2012).
196. *See* McLaughlin, *supra* note 168, at 659.

2. Federal Regulation of Non-Recourse Lending and Attorney Advocacy

If ALF develops to be less like payday loans and more like the non-recourse funding, then it falls under the regulatory power of the FTC, and potentially under the Consumer Financial Protection Bureau.[197] The third-party litigation funders, specifically consumer-litigation funders, follow the applicable federal laws concerning non-recourse loans, and hope to either avoid or shape federal laws about further regulation, as demonstrated by ALFA's active presence.[198] However, federal consumer financing regulation is surprisingly thin, covering broad, but shallow, aspects of the litigation funding industry. Thus, the legal profession must stress the ethical concerns to federal lawmakers and explain the impact of ALF in its current form on the legal profession.

Alternatively, if third-party litigation funders claim that they are investing—or gambling[199]—in litigation, and therefore entitled to charge high fees and interest rates, then the activity is arguably governed by the same rules as venture capital funds that pool capital to invest in securities.[200] Private venture capital investments under $150 million, however, are exempt from the Investment Advisers Act regulations as part of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act.[201] It appears that SEC regulation of ALF activities would occur only if the investment interests in cases were pooled together and sold, resulting in insider trading, market manipulation, or accounting issues.[202]

Conclusion

There are several ethics opinions from various states on litigation funding, but they fail to address the prescient issues. COPRAC's Formal Opinion 2002-159 trends in the ALF-regulation direction, but involves a lawyer advising the client to acquire a traditional loan in the

197. *See supra* Part IV.D.1.

198. *See supra* Part II.A.

199. *See* Anthony J. Sebok, *Betting on Torts Suits After the Event: From Champerty to Insurance*, 60 DEPAUL L. REV. 453, 456 (2011).

200. Steinitz, *supra* note 9, at 480.

201. *See* 15 U.S.C. § 80b-3 (2012); Pub. L. No. 111-203, 124 Stat. 1376, 1575 (codified at 15 U.S.C. § 80b (2012)).

202. Harvey L. Pitt et al., *SEC Enforcement Actions: An Overview of SEC Enforcement Proceedings and Priorities*, C700 ALI-ABA 167, 200 (1991).

form of a mortgage on the client's house to finance the litigation.[203] Los Angeles County Bar Association Formal Opinion 500 involves a lawyer going into the business of financing, and becoming a funder on a case in which he is not involved.[204] The closest to reaching the ethical issues presented by ALF is COPRAC's Formal Opinion 1994-135 regarding structured settlements, stating that a lawyer cannot take his fee in a way that defeats the very purpose of the client's desire to settle.[205]

With no real guidance, lawyers must conduct themselves with the utmost care when referring a client to a litigation funder or when seeking funding themselves. Lawyers should specifically explain to clients the issues that can arise from obtaining a loan having a compounding interest rate. An attorney must also discuss the potential discoverability of otherwise privileged statements and documents, as well as the ramifications if the client provides the statements and documents to a funder. In addition, potential conflicts of interest must be explored and consented to prior to discovering that any settlement offer would not cover both the funding and attorney's costs.

This Article proposes numerous potential solutions intended to curb the ethical dilemmas ALF presents to attorneys. First, contractual solutions could be implemented that combine the plaintiff-funder and attorney-client relationship to facilitate transparency and informed negotiation among all interested parties. Alternatively, third-party litigation funders could be treated similar to insurance companies that cannot become involved in the litigation without explicit client consent. Finally, states or the federal government could pass legislation capping the amount a particular lawsuit could receive using ALF. State bar associations create regulations in which attorneys must abide to ensure the legal system functions as intended. However, when a practice develops that noticeably challenges these fundamental ethical tenents, it cannot merely be discussed in nonbinding opinions, but must be appropriately regulated.

203. Cal. State Bar Standing Comm. on Prof'l Responsibility & Conduct, Formal Op. 2002-159 (2002).

204. L.A. Cnty. Bar Ass'n Prof'l Responsibility & Ethics Comm., Formal Op. 500 (1999).

205. Cal. State Bar Standing Comm. on Prof'l Responsibility & Conduct, Formal Op. 1994-135 (1994).