A COMPARATIVE LEGAL AND ECONOMIC APPROACH TO THIRD-PARTY LITIGATION FUNDING

Marco de Morpurgo[*]

ABSTRACT

This article represents the first attempt to apply a comparative legal and economic approach to the study of third-party litigation funding (TPLF)—one of the most innovative trends in civil litigation financing today. TPLF consists of the practice where a third party offers financial support to a claimant in order to cover his litigation expenses, in return for a share of damages if the claim is successful. The third party receives no compensation if the claimant loses the suit. While such practice has been rapidly developing in the common law world (Australia, United States, and United Kingdom), in the civil law world its existence is very limited (Germany, Austria, and Switzerland). On both sides of the Ocean, a heated debate is dividing supporters and critics of TPLF, regarding its legality and desirability.

Notwithstanding, the scholarly attention to TPLF has been unsatisfactory as it is too domestically oriented and scarce when compared to the long-term potential consequences of this innovative practice—only one among a series of trends based on interactions between the civil justice system and the world of finance. TPLF represents for the claimholder the possibility to deal with the costs and eliminate the risks of litigation, maximizing the expected value of his claim by bargaining with an investor over "property rights in litigation." From the economic analysis derives the conclusion that TPLF is efficient and increases access to justice, though some externality problems might exist. From the legal analysis emerges the fact that common problems and judicial

[*] Associate, Covington & Burling; Ph.D. candidate (Milan); LL.M. (Harvard); M.Sc. (IUC Turin). Thanks to Professors Steve Shavell, Anthony J. Sebok, Mauro Bussani, David Wilkins, Mitt Regan, Ugo Mattei, Duncan Kennedy.

orientations exist in all jurisdictions where TPLF has developed, particularly as far as the issue of control over the litigation is concerned. Finally, this Article opens to a reflection on why TPLF has not developed in the civil law world as it has in the common law and advances some hypotheses on future developments of the industry.

TABLE OF CONTENTS

I. INTRODUCTION

New trends in civil litigation financing are transforming the way in which we conceive the civil justice system. If, on the one hand, academic and political discourses directly concerning the substance of legal rights are of fundamental importance, equally significant are the discourses about how those rights are then to be enforced in practice. Litigation is an expensive process and its costs are often prohibitive. Hence, questions on the ways in which people and other economic actors can finance litigation to obtain the fulfillment of their rights are perhaps as important as the questions on the content of those rights themselves.

The traditional view of the litigation process—at least in the Western legal tradition[1]—contemplates the opposition of two parties, plaintiff and defendant, each assisted by respective lawyers, in front of an adjudicating authority. In the traditional view, the resources for financing the litigation come from the parties' personal assets or—in some jurisdictions—from their lawyers' assets.

Recent trends in civil litigation financing are breaking from the traditional way of looking at the litigation process. Increasingly, interrelationships between the civil justice system

---

1 This includes both the Roman and the common law traditions. *See* DIEGO E. LÓPEZ MEDINA, TEORÍA IMPURA DEL DERECHO: LA TRANSFORMACIÓN DE LA CULTURA JURÍDICA LATINOAMERICANA 12 (3d ed. 2004).

and the world of finance are acquiring importance, making financial investors and capital markets play a fundamental role in (directly or indirectly) sustaining litigant parties when interacting with the civil justice system. On the one hand, a trend is taking place according to which third parties invest in litigation providing capital to plaintiffs and/or their lawyers. On the other hand, another tendency sees law firms—traditionally organized as partnerships and poorly capitalized—devise new solutions to raise capital, e.g., through private placements[2] or public offerings.[3]

As the legal system becomes increasingly more expensive, particularly in certain sectors, the long-existing problem of litigation costs often prevents claimholders from using the civil justice system to enforce their rights. Throughout history, the mechanisms created to obviate the problem of litigation costs have been varied. These mechanisms have essentially responded to two types of concerns. First, in the "personal sphere" realm, exists the problem of access to justice: those who cannot afford to bear litigation costs cannot turn to the civil justice system in order to defend a right. Second, in the commercial realm, the financial risks connected to litigation are inevitable and highly problematic: claimholders have to deal with the risk of losing when they decide to bring a case to court.

As far as access to justice is concerned, various attempts have been made in the direction of increasing access to the law and to the legal system. A significant historical parenthesis is represented by governments' efforts to increase access to justice through providing free legal assistance to the poor (legal aid). Legal aid has been criticized for being costly, inefficient, and arbitrary, and has come under attack at the end of the twentieth century. Recently, governments have cut public spending on legal aid.[4] The market has responded to those cuts in a way that shows its potential to acquire a new role in promoting solutions that are

---

2 Dewey & LeBoeuf LLP—a New York-based, 1,200-attorney law firm—raised $125 million in a bond offering in April 2010. Carlyn Kolker, *Dewey & LeBoeuf Issues Bonds to Refinance Debt, as Law Firms Seek Capital*, BLOOMBERG, Apr. 17, 2010, http://www.bloomberg.com/news/2010-04-16/dewey-leboeuf-sells-125-million-of-debt-as-law-firms-search-for-capital.html.

3 An Australian law firm, Slater & Gordon, held the world's first I.P.O. for a law firm in May 2007. Anthony Notaras, *Law firms: to list or not to list?*, INTERNATIONAL BAR ASSOCIATION, http://www.ibanet.org/Article/Detail.aspx?ArticleUid=e2d1bfa3-e5c7-49e5-8e4f-7171c31c119e (last visited Apr. 8, 2011).

4 Ugo Mattei, *Access to Justice. A Renewed Global Issue?* 11.3 ELECTRONIC J. COMP. L. 1, 2-4 (2007).

beneficial in terms of increasing access to justice.

As far as the financial risk connected to litigation is concerned, turning to the civil justice system for the enforcement of a legal right is a risky investment, as starting a lawsuit requires substantial disbursements that not everyone is willing to undertake. Litigation is inevitably part of any business activity and, therefore, for any business litigation cost risks exist. In general, virtually all risks connected to a business activity can be eliminated or spread through the market, but that does not hold true for the risk of litigation, which traditionally cannot be transferred to whom is better able to bear it.[5] It is in light of this scenario that alternative methods for litigation risk distribution have developed. From the "traditional" systems for risk sharing, like the U.S. contingency fees or litigation expenses insurance, more innovative systems have recently emerged.[6] Those are private and market-based systems for spreading litigation risk, and are based on a conception of the claim as an object of "property rights"—in an economic sense—which can be bargained for, thereby, favoring an efficient allocation of risk.

Among the most innovative systems for financing civil litigation is the after-the-event third-party investment in litigation, a practice that contemplates third parties—with no previous connection to a claimholder—investing in a claimholder's litigation, covering all his litigation costs in exchange for a share of any proceeds if the suit is successful, or, in the alternative, nothing if the case is lost. This practice, which this article refers to as "third-party litigation funding" (TPLF), emerged in the mid-1990s, and has been developing in both the common law world and—to a limited extent—in the civil law world.

Until recently, the scholarly interest in TPLF—and, more generally, in alternative ways to finance civil litigation—has been scarce, and certainly not proportionate to the long-term potential consequences that the establishment of these innovative practices might produce both on the legal system[7] and on the way in which we conceive the civil justice system.

5 Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367, 368-378 (2009).

6 *See infra* Section II.B.

7 On the influences that differences in rules governing the costs of litigation have on the development of substantive law, see J. Robert S. Prichard, *A Systemic Approach to Comparative Law: The Effect of Cost, Fee, and Financing Rules on the Development of the Substantive Law*, 17 J. LEGAL STUD. 451 (1988).

The scholarly attention that TPLF has received has been unsatisfactory, as it is too sector-based—failing to draw the "big picture" of changes that have been taking place in civil litigation financing—and too domestically oriented—failing to show recent transformations as part of broader transnational trends. As a result, existing scholarship has been unable to show, in broad terms, what changes are taking place and toward which direction we are moving in a global, comprehensive, and comparative perspective. In today's world, looking at economic and legal phenomena exclusively from inside the box of national borders is no longer satisfactory. It also no longer makes sense to limit the examination to a disciplinarily isolated process. This article represents the first attempt to apply a comparative legal and economic approach[8] to the study of third-party litigation funding. This practice is to be considered as one specific epiphany of a broader trend toward the enhancement of the interrelationships between the civil justice system (composed of its protagonist parties and institutions) and the world of finance, although in this article it is conceptually isolated from other similar practices for purposes of analysis. These interactions—as it is argued in this article—are in part founded on a conception of the lawsuit as the object of "property rights" which can be the object of bargaining between claimholders and investors.

Section II of the article exposes a theory of the lawsuit as the object of property rights and provides a survey of the private and market-based solutions for financing civil litigation that has developed. Section III defines TPLF as it is considered in this article, outlines the emergence of the industry, and summarizes the debate that has arisen concerning the permissibility and desirability of TPLF. Section IV offers an economic analysis of TPLF, explaining its functionality via an analysis of the incentives it creates for parties involved in the TPLF agreement (the plaintiff and the funder). It draws a basic economic model and discusses its lessons, explaining why the parties come into contract and identifying the externality problems that TPLF creates. Section V offers a comparative analysis of the legal status of TPLF in the main jurisdictions where it has developed, and opens to a examination of the reasons for why it has not developed—with few

[8] On the benefits derived from the interaction between the two "strongest nonpositivistic approaches to legal analysis," namely comparative law and law and economics, see UGO MATTEI, COMPARATIVE LAW AND ECONOMICS ix. (1997).

exceptions—in the civil law world. Section VI concludes.

II. FINANCING CIVIL LITIGATION

A. Property Rights in Litigation

In the law and economics literature on property law,[9] consideration is given to how alternative "bundles of rights" create incentives to use resources efficiently.[10] Property is not understood as a monolithic institution, but rather as a multifaceted right that describes what people may and may do with the resources they own. Modern law permits forms of property that were unthought of in the past, being the evolution of property law based on increasing opportunities of wealth creation.[11] Often a new form of property is created in order to take advantage of a previously unseen market opportunity.[12] The law sometimes reacts to such innovations by imposing limitations on what can be transferred as property. This usually happens when such innovations are considered undesirable. In particular, private law imposes limitations on the right to transfer, which is inherent to property, by denying contract enforcement and/or the protection that, in principle, is afforded to "entitlements" through injunction or money judgments.[13] In addition, the legal system uses regulation as a means to correct market failures.[14]

In the language of legal economists, a plaintiff (or potential plaintiff) holding a claim can be said to have "property rights" in

9 *See* ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS 74-118 (5th ed. 2008); STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 7-176 (2004).

10 COOTER & ULEN, *supra* note 9, at 78.

11 Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61, 63-67 (2011).

12 *Id.*

13 Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1090 (1972).

14 *See generally* SAMUEL BOWLES, MICROECONOMICS: BEHAVIOR, INSTITUTIONS AND EVOLUTION (2004); 1 ALFRED E. KAHN, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS (1988);
John O. Ledyard, *Market Failure*, *in* THE NEW PALGRAVE DICTIONARY OF ECONOMICS (S.N. Durlauf & L.E. Blume eds., 2d ed. 2008); Kenneth J. Arrow & Gerard Debreu, *Existence of an Equilibrium for a Competitive Economy*, 22 ECONOMETRICA 265 (1954); Francis M. Bator, *The Anatomy of Market Failure*, 72 Q. J. ECON. 351 (1958); Ronald H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1 (1960); Bruce C. Greenwald & Joseph E. Stiglitz, *Externalities in Economies with Imperfect Information and Incomplete Markets*, 101 Q. J. ECON. 229 (1986).

it, including possessory rights and right to transfer.[15] By selling his claim to an assignor, or by selling an interest in the outcome of the litigation to an investor, a plaintiff transfers all or part of his property rights in litigation. A rational claimholder—by definition—will be willing to maximize the value of his property right in the lawsuit. In order to do so, of the rights included in the "bundle," he will only decide to keep those specific rights that he values more than others. He will prefer to bargain over the other rights he holds with another person who values them more. This way the claimholder will maximize the expected value of his claim.[16] Furthermore, given that litigants are usually risk averse,[17] the elimination by a claimholder of the risk connected to the litigation is something for which a claimholder may be willing to pay a price—a factor capable of increasing the expected value of the claim.

TPLF is a practice through which claimholders can eliminate the risk connected to the potentially unfavorable outcome of litigation. As this article will demonstrate, a plaintiff may be willing to transfer part of his property rights in a lawsuit to a third party in exchange for having that risk eliminated, thus increasing the expected value of his claim.

There are many ways in which a claimholder can transfer his property rights in litigation. As a result, and given the highly expensive and unpredictable nature of civil litigation,[18] a multicolored industry of financial services has emerged around property rights in litigation. This article focuses on the "narrow" definition of TPLF: the specific practice in which a third party offers financial support to a claimant in order to cover his litigation expenses, in return for a share of damages if the claim is successful,

15 On the use of the term "property rights" in the law & economics literature, see SHAVELL, *supra* note 9, at 9-11.

16 *See infra* Sections IV.A.1.b and 2.b.

17 *See* SHAVELL, *supra* note 9, at 258-259, 406-407, 430. *See generally* Anthony Heyes, Neil Rickman & Dionisia Tzavara, *Legal Expenses Insurance, Risk Aversion and Litigation*, 24 INT'L REV. L. & ECON. 107 (2004); W. Kip Viscusi, *Product Liability Litigation with Risk Aversion*, 17 J. LEGAL STUD. 101 (1988).

18 *See generally* ROBERT B. CALIHAN, JOHN R. DENT & MARC B. VICTOR, AMERICAN BAR ASSOCIATION, THE ROLE OF RISK ANALYSIS IN DISPUTE AND LITIGATION MANAGEMENT (2004); Gretchen A. Bender, *Uncertainty and Unpredictability in Patent Litigation: The Time is Ripe for a Consistent Claim Construction Methodology*, 8 J. INTELL. PROP. L. 175 (2001); Joseph A. Grundfest & Peter H. Huang, *The Unexpected Value of Litigation: A Real Options Perspective*, 58 STAN. L. REV. 1267 (2006); Evan Osborne, *Courts as Casinos? An Empirical Investigation of Randomness and Efficiency in Civil Litigation*, 28 J. LEGAL STUD. 187 (1999).

or nothing if the case is lost, ensuring the financier a passive role who assumes no control over the litigation. In order to clarify this "isolation" within the spectrum of ways in which a claimholder can transfer his litigation property rights so as to maximize the expected value of his claim, the following section offers a survey of a series of practices and markets that have developed to assist plaintiffs in financing civil litigation.[19] These practices are so closely related to TPLF that, in some cases, they are blended together by legal scholars and policy analysts. It is important, however, to emphasize their distinctions.

B. Private Sources of Financing for Litigation

This section briefly summarizes methods for financing civil litigation based on transfer of "property rights" in litigation. As a starting point, the article assumes a simplified world where no financial instruments are available to claimholders so as to finance their lawsuits. Starting from there—where the only means to finance a lawsuit is personal assets—alternatives are explored through which the (actual or potential) claimholder has access to external capital for covering litigation expenses.

1. Self-funding

If no form of external capital is available, the plaintiff must use his or her own assets to finance the lawsuit. This is the default situation in any jurisdiction. Depending on the jurisdiction, legal costs can be either borne by each party respectively (*American rule*)[20] or by the losing party ("loser-pays-all" or *English rule*).[21] The legal and economic logic of this basic situation has been

19 For a survey of recent research on empirical analysis of various ways for funding civil litigation, see Paul Fenn & Neil Rickman, *The Empirical Analysis of Litigation Funding*, *in* NEW TRENDS IN FINANCING CIVIL LITIGATION IN EUROPE 131 (Mark Tuil & Louis Visscher eds., 2010).

20 *See* Kathryn E. Spier, *Litigation*, *in* THE HANDBOOK OF LAW & ECONOMICS 262 (A. Mitchell Polinsky & Steven Shavell eds., 2007). *See also* SHAVELL, *supra* note 9, at 387-418.

21 *See* Ronald R. Braeutigam, Bruce Owen & John Panzar, *An Economic Analysis of Alternative Fee Shifting Systems*, 47 LAW & CONTEMP. PROBS. 173, 174 (1984); John C. Hause, *Indemnity, Settlement, and Litigation, or I'll Be Suing You*, 18 J. LEGAL STUD. 157, 157 (1989); Avery Katz, *Measuring the Demand for Litigation: Is the English Rule Really Cheaper?*, 3 J.L. ECON. & ORG. 143, 144 (1987); SHAVELL, *supra* note 9, at 428-432; Spier, *supra* note 20, at 300-303.

widely explored in the literature under both types of rules.[22]

2. Lawyer Funding

Some countries permit lawyers to take clients on a "no-win-no-fee" basis, which enables lawyers to invest in their clients' lawsuits. In the American contingency fee system, introduced in the United States (U.S.) at the turn of the twentieth century and now accepted in all U.S. states,[23] the plaintiff pays the lawyer a fraction of any positive recovery from settlement or judgment, and nothing otherwise.[24] Under the UK conditional fee scheme, introduced in England and Wales after the drastic reduction of legal aid at the end of the 1990s,[25] the plaintiff pays the lawyer's cost plus an upscale premium, unrelated to the adjudicated amount, if the case is successful, and nothing otherwise.[26] In both the contingency and the conditional fee schemes, the plaintiff essentially gives up a portion of his award (either a percentage or an unrelated upscale premium) in exchange for the elimination of the risk connected to an unfavorable outcome of the litigation.

3. Third-party Litigation Funding

As articulated previously, TPLF is a practice in which a third party offers financial support to a claimant in order to cover his litigation expenses, in return for a share of damages should the claim is successful, or nothing if the case is lost. The logic is similar to the U.S.-style contingency fee scheme, except that the funds come from a third party and not from the plaintiff's lawyer. TPLF will be the object of closer analysis, but it is useful to point out here that, through a TPLF contract, a plaintiff agrees to assign to the funder a portion of the potential award in exchange for the elimination of the risk deriving from starting a lawsuit using his own resources.

---

22 *See supra* notes 20 and 21.

23 Sebok, *The Inauthentic Claim*, *supra* note 11, at 99-100.

24 On contingency fees, see Neil Rickman, *Contingent fees and Litigation Settlement*, 19 INT'L REV. L. &. ECON. 295 (1999).

25 LORD CHANCELLOR'S DEPARTMENT, ACCESS TO JUSTICE WITH CONDITIONAL FEES, 1998, at 3.3; VICKI WAYE, TRADING IN LEGAL CLAIMS: LAW, POLICY & FUTURE DIRECTIONS IN AUSTRALIA, UK & US 81-82 (2008).

26 For an economic model of the conditional fee scheme, see Fenn & Rickman, *supra* note 19, at 7.

4. Insurance Based Solutions

Insurance companies offer a variety of products to both plaintiffs and potential plaintiffs in order to lower the risks associated with litigation. Legal expenses insurance is a type of insurance policy that covers policyholders against the potential costs of a legal action. There are two main types of legal expenses insurance: (1) before-the-event (BTE) insurance and (2) after-the-event (ATE) insurance—the "event" is an incident that entitles a party to a legal action.

Under BTE legal expenses insurance contracts, the insurer obliges itself in advance, in exchange for a premium, to cover the counterpart's litigation costs in case the latter starts a lawsuit. On one hand, from the perspective of the third-party, BTE legal expenses insurance is based on a mechanism of third-party investment in (potential) litigation. Indeed, by obliging itself to pay for future possible litigation costs in exchange for a premium, the insurer indirectly invests in the insured's litigation acting as a third party. On the other hand, from the plaintiff's perspective, BTE legal expenses insurance is a means by which a potential plaintiff can bargain, in advance on his property rights in (potential) litigation, in exchange for eliminating the risk of having to pay for litigation expenses should an event occur that entitles him to bring suit.

From the viewpoint of third parties, ATE insurance is another way to invest in the outcome of litigation. ATE insurance is a particular type of insurance that can be taken out after an event, such as an accident that has caused an injury, to insure the policyholder for disbursements, as well as any costs should he lose his case. ATE insurance is fairly common in the United Kingdom (UK), where it was introduced at the end of the 1990s, together with conditional fees, as a result of the policy shift by the English government to reduce publicly funded legal aid and support privately funded systems for guaranteeing access to justice.[27] Once an event has taken place, thereby giving a claimholder the right to bring suit, ATE insurance policy indemnifies the claimholder's liability in the case of loss for adverse cost orders and the holder's own legal costs where a conditional fee agreement is not available.[28]

27 ACCESS TO JUSTICE WITH CONDITIONAL FEES, *supra* note 25.

28 WAYE, *supra* note 25, at 87.

Lastly, another market in which a (potential) claimholder can bargain over his property rights in (potential) litigation is that of first-party insurance contracts containing a subrogation clause. Under those contracts, in case of an accident that entitles the insured with compensation by the insurer, the insurer pays the insured and is then subrogated into the rights of the insured towards the wrongdoer, so that the insurer can directly sue the wrongdoer on behalf of his client. In these contracts, the potential claimholder "sells" his property rights in litigation in exchange for a premium discount. However, insurers do not acquire complete ownership and control over the prosecution and proceeds of the insured's prospective claims. The subrogation is limited,[29] as the insurer can only recoup from the defendant the amount paid or owed to the insured.[30] In particular, insurance contracts do not include non-pecuniary losses. Thus, insurance companies do not compensate the insured for those losses and subrogation is not allowed in the right to sue the defendant for the losses. Damages for non-pecuniary harm are often substantial in personal injury claims, but—at least in the United States—there is something that courts are not inclined to accept in the idea of selling a claim that is so "personal" as that for non-pecuniary harm in personal injury.[31]

5. Assignment of Claims

Especially in the common law world, legal and economic scholarship has recently supported liberalization in favor of the formation of "markets in legal claims."[32] The idea of such markets is based on the mechanism known as "assignment." Assignment places the third party acquiring the claim "in the shoes" of the party who originally had the right to bring the lawsuit.

29 For a proposal for deregulating insurance subrogation in order to establish a regime of unlimited subrogation in tort claims, see David Rosenberg, *Deregulating Insurance Subrogation: Towards an Ex Ante Market in Tort Claims*, Harvard Law School, Public Law Research Paper No. 43 (2002), Harvard Law and Economics Discussion Paper No. 395, available at http://ssrn.com/abstract=350940 or doi:10.2139/ssrn.350940. For a specific focus on medical malpractice liability, see Kenneth S. Reinker & David Rosenberg, *Unlimited Subrogation: Improving Medical Malpractice Liability by Allowing Insurers to Take Charge*, 36 J. LEGAL STUD. 261 (2007).

30 Rosenberg, *supra* note 29, at 308.

31 *Id.* at 309.

32 Traditionally, the common law doctrine of non-assignability of choses-in-action has prevented this type of market to develop. *See* Sebok, *The Inauthentic Claim*, *supra* note 11, at 81.

The idea of a market for legal claims, based on the mechanism of assignment, is not new,[33] although recently it has received increasing attention by legal scholars.[34] In such a market, the claim holder would be able to sell his claim to a third party who would then pursue the claim against the defendant.[35] The original claimholder would be paid the expected value of the claim (grossly, the amount likely to be won multiplied by the probability to win).[36] In its most advanced hypothetical version—like in most traditional financial markets—a secondary market would develop, where legal claims would be traded as securities, thereby becoming a negotiable instrument based on a securitization made through normal succession of assignments.[37] In other words, a third party could be assigned a claim and not bring it to court straight away, but rather transfer it again to a new assignee for a higher price.[38] As it has been noted:

> This speculation can be interesting for investors because the value of the claim can change between the moment it was first transferred and the date of a final ruling on the issue. Not only "natural" causes could modify the value of the claim, but also legal causes, like the modification of a line of case law or a practice of a court in measuring damages, or a lower court decision held in the lawsuit in which rights for action have been assigned.[39]

The plausibility, efficiency, and desirability of a so-designed market in legal claims are the objects of fascinating speculations and discussions, but this is not among the objectives of this article,

---

33 *See* Marc J. Shukaitis, *A Market in Personal Injury Tort Claims*, 16 J. LEGAL STUD. 329 (1987).

34 *See* WAYE, *supra* note 25; Andrea Pinna, *Financing Civil Litigation: The Case for the Assignment and Securitization of Liability Claims*, *in* NEW TRENDS IN FINANCING CIVIL LITIGATION IN EUROPE 109 (Mark Tuil & Louis Visscher eds., 2010); Michael Abramowicz, *On The Alienability of Legal Claims*, 114 YALE L.J. 697 (2004); Isaac M. Marcushamer, *Selling Your Torts: Creating a Market for Tort Claims and Liability*, 33 HOFSTRA L. REV. 1543 (2005); Molot, *supra* note 5; Sebok, *supra* note 11.

35 *See* Shukaitis, *supra* note 33, at 329.

36 This is the (simple model) definition of expected gains from trial in the basic economic theory of litigation. *See* SHAVELL, *supra* note 9, at 401-02.

37 Pinna, *supra* note 34, at 17.

38 As suggested by A. Pinna, two problems would arise immediately under such an outlined system. The first has to do with prescription: indeed, as known, a claim has to be brought to court before it is time barred; however, the legal claim could be traded even once the action is brought. The other problem has to do with the date at which damages would be assessed, i.e., either at the date of the judgment (France) or at the date of the harm (England). *Id.* at 17-18.

39 *Id.* at 17.

so I limit myself to reference to the existing literature.[40] However, the question on assignment of legal claims also has a current and much more practical application, concerning TPLF. In principle, the market for TPLF is different from a market for legal claims because in TPLF the control over the lawsuit is not transferred to the third party. This limits its intervention to the passive funding of the litigation expenses. This is different from TPLF—where the original claimholder formally and substantially remains the plaintiff and the third party investor maintains a passive role—because, in a market for legal claims, the buyer of the claim would also receive control of the litigation, being placed "in the shoes" of the original claimholder. This metaphor can either indicate a formal substitution of the holder of the claim (from the original plaintiff to the assignee), or indicate a substantial substitution where the original claimholder remains the plaintiff.

Indeed, the central issue around which the distinction between the practice of selling claims and TPLF—in its "narrow" sense—is control over the litigation.

We can easily imagine two opposite situations: one in which the claimant receives from the funder coverage of all litigation costs, in exchange for a share of the award, but maintains full control over the litigation (choosing counsel, deciding settlement, and so on); and another in which the original plaintiff sells his claim to a professional investor, who acquires complete control over the lawsuit, although the plaintiff formally remains the original claimholder. While the former situation is certainly identifiable as TPLF, and the latter as assignment of claims, many "grey areas" exist. This is far from a purely hypothetical problem: courts of law have sometimes based the validity or invalidity of litigation funding agreements on the contractual allocation of control over the lawsuit.[41]

6. Litigation "Loans"

A market that presents very close similarities and connections to TPLF, particularly well-developed in the United States, is one in which private companies provide "litigation loans" to (needy) plaintiffs for covering their expenses (mainly living and medical)[42]

40 *See supra* notes 32 and 33.

41 *See, e.g.*, Ahmed v. Powell, [2003] P.N.L.R. 22 (Eng.).

42 The main factor that determined the development of such practices seems to be the prohibition on attorneys, under the ethical and professional responsibility rules, to provide

pending the outcome of a lawsuit, on a non-recourse basis, in exchange for a share of the proceeds of any settlement or judgment recovered (only in case a favorable outcome of the pending case results).[43] These cash advances are commonly referred to as "loans," although such a word is misleading because all advances are conditional in nature and repayable only upon receipt of a cash recovery by the plaintiff.[44] The litigation loan industry presents several problems—many of these concerns have been partially addressed by legal scholarship, almost unanimously expressing itself in favor of litigation "loan" agreements, on the grounds of improving access to justice and correcting an imbalance of power between plaintiffs and wealthy defendants.[45] Although no scholar has called for the prohibition of third-party litigation "loans," some scholars have proposed that the industry be properly regulated.[46] Litigation "loans" present several problems, namely the unequal bargaining position of the customer and the financing firm, the financial duress prompting the customer to sign a loan agreement, the usurious profit by the financing firm, and the ethical pressures placed on the attorney-client relationship.[47]

In contrast to TPLF, the United States litigation loan market has traditionally been small scale and consumer oriented.[48] It is characterized by a large number of small firms that advance small

any financial assistance to their clients to meet their day-to-day living expenses. Julia H. McLaughlin, *Litigation Funding: Charting a Legal and Ethical Course*, 31 VT. L. REV. 615, 646-647 (2007).

43 *See* Susan L. Martin, *The Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed*, 10 FORDHAM J. CORP. & FIN. L. 55, 55 (2004); Douglas R. Richmond, *Other People's Money: The Ethics of Litigation Funding*, 56 MERCER L. REV. 649, 650 (2005).

44 See Echeverria v. Estate of Lindner, No. 018666/2002, 2005 WL 1083704, at *6 (N.Y. Sup. Ct. Mar. 2, 2005), where Judge Warshawsky wrongfully considered a litigation funding agreement a "loan" based on the fact that a positive outcome of the suit was a "sure thing," given that the plaintiff was suing under a statute that imposed strict liability. That judgment has to be considered wrong because it cannot be said that all civil cases based on strict liability can be said to be "sure things." *See* Anthony J. Sebok, *A New York Decision That May Imperil Plaintiffs' Ability to Finance Their Lawsuits: Why It Should Be Repudiated, or Limited to Its Facts*, FINDLAW, Apr. 18, 2005, http://writ.news.findlaw.com/sebok/20050418.html.

45 For a synthetic survey of the dialogue between proponents and critics of "litigation loans," see Mariel Rodak, *It's About Time: A Systems Thinking Analysis of the Litigation Finance Industry and Its Effects on Settlement*, 155 U. PA. L. REV. 503 (2006).

46 Courtney R. Barksdale, *All that Glitters Isn't Gold: Analyzing the Costs and Benefits of Litigation Finance*, 26 REV. LITIG. 707, 735 (2007); Martin, *supra* note 43, at 68; McLaughlin, *supra* note 42, at 655.

47 McLaughlin, *supra* note 42, at 627.

48 WAYE, *supra* note 25, at 5.

amounts of cash (usually a maximum of $20,000[49]) to individual borrowers who need money to cover living and medical expenses pending the successful outcome of their claim.[50] This market—distinguished from TPLF in the "narrow" sense considered in this article, according to which funds are advanced to plaintiffs exclusively to cover litigation expenses—is more focused on the advancement of cash "up front"[51] for covering medical and living expenses pending the outcome of a lawsuit, in exchange for a share of any award received. The practice of litigation "loans" has developed in the United States primarily as a response to the broad prohibition against lawyers providing financial assistance to their clients in connection with a pending case, other than court costs and basic litigation expenses.[52]

The American Legal Finance Association (ALFA), a trade association made up of twenty-one firms, was created in 2004 in order "to establish industry standards in the Legal Funding industry, especially regarding transparency in transactions and clear disclosure to consumers."[53] Among the firms operating in the litigation "loan" market,[54] some operate in TPLF, broadly

49 George S. Swan, *Economics and the Litigation Funding Industry: How Much Justice Can You Afford?*, 35 NEW ENG. L. REV. 805, 824 (2001).

50 WAYE, *supra* note 25, at 5.

51 Terry Carter, *Cash Up Front: New Funding Sources Ease Financial Strains on Plaintiffs Lawyers*, 90 A.B.A. J. 34, 34 (2004).

52 Model Rules of Professional Conduct, Rule 1.8(e) reads as follows:

> A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that: (1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and (2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

MODEL RULES OF PROF'L CONDUCT R. 1.8 (2010). *See* James T. Moliterno, *Broad Prohibition, Thin Rationale: The "Acquisition of an Interest and Financial Assistance in Litigation" Rules*, 16 GEO. J. LEGAL ETHICS 223 (2003).

53 AMERICAN LEGAL FINANCE ASSOCIATION, http://americanlegalfin.com (last visited Apr. 3, 2011).

54 Among the firms is The Lions Group, which "'lends' money to individuals who would like to maintain their lawsuits but need money immediately. Their typical client would be an auto accident victim who needs cash to pay for medical expenses and cannot wait years to receive a jury verdict or a deferred settlement." Anthony J. Sebok, *Venture Capitalism for Lawsuits? Why It Doesn't Exist, and What Alternatives for Financing Exist Instead*, FINDLAW, Feb. 12, 2001, http://writ.news.findlaw.com/sebok/20010212.html. Others include: Interim Settlement Funding Corporation (Rancman v. Interim Settlement Funding Corp., 99 Ohio St.3d 121 (2003)); Future Settlement Funding Corporation (Rancman v. Interim Settlement Funding Corp., 99 Ohio St.3d 121 (2003)); Lawcash (Echeverria v Estate of Linder, No. 018666/2002, 2005 WL 1083704, at *6 (N.Y. Sup. Ct. Mar. 2, 2005)); Juris Capital; Magnolia Funding; Lawsuit Cash Advance; Plaintiff Support;

offering a variety of financing services designed to meet plaintiffs', attorneys', and law firms' needs for financial help. Most of these firms have consumer-friendly websites that attract both plaintiffs and potential plaintiffs to turn to litigation finance for covering their litigation and living expenses while waiting for a favorable judgment.

There are many similarities between the litigation "loan" market and TPLF, to such an extent that the two markets partially overlap. In fact, from the viewpoint of the funder, its decision to provide cash to a plaintiff for covering his living/medical expenses or financing his litigation costs is equally a bet on the outcome of a case: the funder advances cash and hopes to profit from his better guess; it does not matter what those funds are used for by the plaintiff. He will invest as long as the expected revenue from the investment is higher than the expected cost.[55] From the point of view of the claimholder, selling a portion of the future possible award in exchange for cash up front is a way to maximize the value of the claim bargaining over property rights in litigation.

However, the two mechanisms remain conceptually and practically distinct, and they do not present the same problems related to the need to protect the plaintiff, who in the case of TPLF does not ask for cash to satisfy essential needs such as his life or health. Furthermore, for the purposes of this article, the effects of the two systems on the incentives to litigate are different. Cash advances for covering living and medical expenses have a different impact on a plaintiff's incentive to bring suit or to settle. Of course, the influence is indirect (a needy plaintiff will be willing to settle sooner and for lower amounts), but it seems that having or not having external funding available for living and medical expenses does not directly determine the plaintiff's decision to bring or not to bring suit. Instead, TPLF has a primary direct effect on the plaintiff's incentives related to the litigation, as its scope is that of eliminating the risk connected to the unfavorable outcome of the case.

Preferred Capital Funding; Plaintiff Investment Funding LLC; PS Finance; Golden Pear Funding; Case Funding; Allied Legal Funding; The Law Funder; and Oliver Street Finance.

55 *See infra* Sections IV.A.1.a and 2.a.

III. THE EMERGENCE OF TPLF

A. Definition

The conceptual and practical interconnections between the various markets for property rights in litigation outlined above are extremely interesting and the boundaries that separate them are sometimes highly faded. A few of the authors that have devoted interest to alternative methods for financing civil litigation (including TPLF) have engaged in the discussion concerning conceptual and practical definitions of such boundaries.[56] However, the purpose of this article is not to explore the interconnections and draw lines between TPLF and other similar practices, but rather to conceptually isolate TPLF and analyze it from a comparative legal and economic perspective. For the purpose of this article, therefore, TPLF is to be intended as a specific financial service, which consists of third parties providing funds to plaintiffs to cover their litigation expenses. These funds are provided on a non-recourse basis and are advanced by funders who maintain a passive role, in exchange for the promise by the plaintiff to pay the funder a determined percentage of the award in the case of a favorable settlement or judgment.

B. A Factual Survey (Australia, United States, United Kingdom, and Continental Europe)

Third-party litigation funding started to develop in Australia at the beginning of the 1990s and soon spread over the rest of the common law world (United States, United Kingdom, New Zealand) and further, developing in some European civil law countries (Germany, Switzerland, Austria). At first, third-party contingency funding emerged in Australia as a statutory exception to the common law prohibition of maintenance and champerty[57] in the specific context of insolvency.[58] Successively, however, third-

---

56 In particular, for a discussion of the boundaries between assignment and TPLF, see Sebok, *The Inauthentic Claim*, *supra* note 11. *See also* WAYE, *supra* note 25.

57 Roughly speaking, "maintenance" indicates the action of one who assists a litigant in prosecuting or defending a claim. "Champerty" is a particular *form* of maintenance, namely one made for the purpose of gain. The prohibitions of maintenance and champerty are embodied in two ancient common law doctrines, which will be discussed in Section V.A.1.

58 LITIGATION FUNDING IN AUSTRALIA, Discussion Paper, Standing Committee of Attorneys General (May 2006), http://www.lawlink.nsw.gov.au/lawlink/legislation_policy/

party funding extended to other areas, though generally remained largely confined within the boundaries of commercial litigation.[59] Among other factors, the fairly favorable endorsement by Australian courts[60] of non-recourse litigation lending practices allowed the industry to find rapid success and growth in Australia. Since then, several companies, such as IMF (Australia) Ltd.,[61] Litigation Lending Services Ltd.,[62] and LCM Litigation Fund Pty. Ltd.[63] have engaged in the business of professional litigation funding.[64] Most funding of litigation is still conducted under the statutory exception for insolvency,[65] involving, for example, the pursuit of voidable transactions and misfeasance by company officers. Outside the insolvency context, litigation funding is usually limited to commercial litigation with large claims (over $500,000 or, for some companies, over $2 million), although an exception is constituted by class actions, where a large number of

ll_lpd.nsf/vwFiles/LitigationFundingDiscussionpaperMay06.pdf/$file/LitigationFundingDiscussionpaperMay06.pdf. *See* WAYE, *supra* note 25, at 55. For an example of an insolvency matter for which TPLF was provided, see *Anstella Nominees Pty Ltd v. St George Motor Finance Ltd.* [2003] FCA 466 (Austl.).

59 *See* WAYE, *supra* note 25, at 5, 18, 133; LITIGATION FUNDING IN AUSTRALIA, *supra* note 58, at 4-6. For two examples, see QPSX Ltd. v. Ericsson Australia Pty. Ltd. (2005) F.C.A. 933 (Austl.) and Fostif v. Campbell Cash and Carry (2005) N.S.W.C.A. 83 (Austl.).

60 *See* QPSX Ltd. v. Ericsson Australia Pty. Ltd. (2005) 219 A.L.R. 1 (Austl.); Campbell's Cash & Carry P/L v. Fostif P/L (2006) 299 A.L.R. 200 (Austl.).

61 IMF, which provides funding of legal claims and other related services where the claim size is over $2 million, is the largest litigation funder in Australia and the first to be listed on the Australian Stock Exchange. *See* IMF, http://www.imf.com.au (last visited Mar. 28, 2011).

62 Litigation Lending Services Ltd., set up in Sydney in 1999, has traditionally focused on the provision of litigation funding for insolvency market actions typically ranging from claims of between $200,000 and $10 million, though extending their services beyond insolvency to general commercial litigation, class actions and representative proceedings. *See* Litigation Lending Services, http://www.litigationlending.com.au (last visited Mar. 28, 2011).

63 LCM Litigation Fund Pty Ltd (LCM) has been in business since 1998 and was previously known as Australian Litigation Fund Pty Ltd (until April 2008). "LCM primarily provides litigation funding to insolvency practitioners. However, LCM also provides funding to solvent companies and individuals with worthwhile commercial legal claims. . . . LCM prefers to undertake projects in which the relevant legal claim is for at least $2.5 million." LCM Litigation Fund, http://www.lcmlitigation.com.au (last visited Mar. 28, 2011).

64 As of 2006, five companies operated in the business of commercial litigation funding. LITIGATION FUNDING IN AUSTRALIA, *supra* note 58, at 4. As of May 2010, about six active funders operated in the market. Charlie Gollow, Inv. Manager, IMF (Austl.) Ltd., Trends and Developments in Australian Litigation Funding, Presentation at the RAND ICJ Conference: Alternative Litigation Finance in the U.S.: Where Are We and Where Are We Headed with Practice and Policy?, Washington, D.C. (May 21, 2010).

65 *See infra* Section V.A.2.

smaller claims can be processed economically.[66] Litigation funding firms in Australia are generally not involved in personal injury-type matters.[67]

Some Australian based companies also invest funding claims in foreign jurisdictions. Among them, Litigation Lending Services Ltd., based in Sidney, was involved in the funding agreement analyzed in the first judicial decision that ever dealt with the issue of litigation funding in New Zealand, given by the New Zealand High Court in 2000.[68]

In the United States, the industry of third-party investment in litigation started to develop in the mid-1990s. This is different from Australia, where TPLF has developed largely operating in a commercial environment, whereas in the United States, the industry of third-party investments in litigation has traditionally been small scale and more consumer-oriented.[69] In other words, the broad U.S. market for investments in legal claims is the one for litigation "loans" described earlier,[70] which distinguishes itself from TPLF as considered in this article. Notwithstanding, a market also exists that is specifically centered on commercially-focused TPLF. In the United States, this can be considered an "upper" market, where a small number of companies provide large dollar amounts to corporate actors who prefer turning to TPLF rather than risk their own assets to cover litigation costs.

The largest company operating in the sector, Juridica Capital Management Ltd., only invests in commercial claims (including IP, antitrust, commercial contracts, bankruptcy and insolvency, securities, and finance). It is the exclusive worldwide manager for Juridica Investments Limited, a UK-based investment company that typically invests amounts between $3 million and $10 million into claims of the size of at least $25-100 million.[71] Another of the largest litigation-finance firms, Burford Capital Limited, also invests in commercial litigation, "provid[ing] financing in support of significant corporate litigation, arbitration, and other disputes, working with clients in both the United States and

66 LITIGATION FUNDING IN AUSTRALIA, *supra* note 58, at 4.

67 LITIGATION FUNDING IN AUSTRALIA, *supra* note 58, at 4.

68 Re Nautilus Developments Limited (In Liquidation); Montgomerie v Davison (M1285/99; High Court, Auckland; Apr. 14, 2000).

69 WAYE, *supra* note 25, at 5.

70 *See supra* Section II.B.6.

71 Juridica Capital Management Ltd., http://www.juridicacapital.com/investments.php (last visited Mar. 28, 2011).

internationally."[72] Law Finance Group Inc, created in 1994, advances sums between $25,000 and $15 million, and up to $50 million for appeal cases. Law Funds LLC advances between $500 and $20 million in exchange for an assignment of the proceeds of a judgment or settlement.[73] These are four examples of companies operating in the TPLF market in the United States, but others include Credit Suisse and more specifically oriented companies like General Patent Corporation.[74]

Another important market for litigation funding in the common law world is the United Kingdom. This is different from what the Australian—and to some extent the U.S.—situation might lead one to think; the UK experience demonstrates that there is no reason to believe that litigation funding would be limited to commercial matters. Indeed, litigation funding in the United Kingdom has come to cover such areas as personal injury and family matters (divorces).[75] Private litigation funding in the United Kingdom is mainly the product of a combination of two factors that contributed to its development: (1) a public policy trend during the 1980s and 1990s that focused on the reduction of publicly funded instruments for easing access to justice (legal aid), and (2) a judicial endorsement of private funding practices justified under the rationale of access to justice.[76]

Since the 1980s, the English government started reducing legal aid on the grounds that it was too expensive. Meanwhile,

72 The investment advisor of Burford Capital Limited is Burford Group. Burford Group Ltd., http://www.burfordgroupltd.com/purpose.html (last visited Mar. 28, 2011).

73 WAYE, *supra* note 25, at 45.

74 For example:

> General Patent Corporation (GPC) . . . works on a 100% contingency basis. That means that if GPC accepts you as a client, the company covers ALL [emphasis in the original] fees and costs involved in the litigation. General Patent Corporation is not a law firm, so it will retain a law firm to actually try the case. It will, however, underwrite all legal fees and out-of-pocket expenses related to the lawsuit(s). . . . Patent enforcement firms recoup their expenses and earn their fees from the proceeds of the settlements or judgments that result from the lawsuit and share in license fees and royalty payments obtained by them through licensing the patent. General Patent's arrangement is a 50/50 split of all net recoveries. Should the patent enforcement firm fail to secure a settlement for the patent owner, however, they are out the money they invested in the case and the patent owner owes the patent enforcement firm nothing!

Financing Patent Infringement Litigation, GENERALPATENT.COM, http://www.generalpatent.com/financing-patent-infringement-litigation-0 (last visited Mar. 28, 2011).

75 WAYE, *supra* note 25, at 81.

76 *See infra* Section V.A.4.

government policy encouraged privately funded access to justice by way of conditional fee agreements and after the event (ATE) insurance agreements, though not mentioning in principle third-party litigation funding.[77] The new policy direction was precisely thought to shift the funding of non-commercial injury claims, i.e., damages claims involving physical or mental injuries, away from the public purse (legal aid) to the private sector.[78] Later on, however, litigation funding expanded to the commercial realm, in particular—as in Australia—in the field of insolvency.[79] Thus the United Kingdom was transformed into an attractive market where companies are willing to invest in a variety of fields that include family matters (divorces),[80] favoring access to justice in a highly expensive legal system like the UK one.[81]

Companies operating in the UK litigation funding market include IM Litigation Funding, Harbour Litigation Funding Ltd.,[82] and Juridica Investment Limited.[83] While these companies could, until recently, be characterized as "alternative investment firms,"[84] in 2007 Allianz Litigation Funding[85] became "the first mainstream

77 ACCESS TO JUSTICE WITH CONDITIONAL FEES, *supra* note 25, at 3.3. However, third party funding was introduced as a result of an amendment sought in the House of Lords. *See infra* Section V.A.4.

78 WAYE, *supra* note 25, at 82.

79 Norglen Ltd. (in liq) v. Reeds Rains Prudential Ltd. [1999] 2 A.C. 1 (Eng.); Ramsey v. Hartley [1977] 1 W.L.R. 686 (Eng.); Guy v. Churchill [1888] 40 Ch. 481 (Eng.); In re Park Gate Waggon Works Co. [1881] 17 Ch. 234 (Eng.); Seear v. Lawson [1880] 15 Ch. 729 (Eng.).

80 A famous case is that of "Harbour Litigation Funding . . . financing the legal battle of Michelle Young, wife of the property tycoon Scot Young, [claiming] to have lost most of what was once a £400m fortune." Elena Moya, *Hedge Funds, Investors and Divorce Lawyers – It's a Match Made in Heaven*, GUARDIAN.CO.UK (Oct. 16, 2009), http://www.guardian.co.uk/business/2009/oct/16/hedge-funds-divorce-litigation-funding.

81 For the most recent and exhaustive report on the costs of the UK civil justice system, see HON. LORD JUSTICE JACKSON, REVIEW OF CIVIL LITIGATION COSTS: FINAL REPORT (2010).

82 "Harbour Litigation funds claims with a claim value in excess of £3,000,000." Harbour Litigation Funding Ltd., http://www.harbourlitigationfunding.com (last visited Mar. 28, 2011).

83 Juridica predominantly invests in the United States, the United Kingdom, and in international arbitrations cases. Juridica Investments Ltd., http://www.juridicainvestments.com (last visited Apr. 3, 2011).

84 Juridica Investment Limited, for example, with over $200 million of assets under management, is listed on the London Stock Exchange's Alternative Investment Market (AIM: JIL). Juridica Investments Ltd., http://www.juridicainvestments.com (last visited Apr. 3, 2011).

85 Allianz Litigation Funding is the UK branch of Munich-based Allianz ProzessFinanz GmbH. Allianz Litigation Funding, http://www.allianz-litigationfunding.co.uk (last visited Apr. 3, 2011).

institution to enter the United Kingdom's fledgling market for third-party litigation funding."[86] Furthermore, third-party litigation funding is rapidly expanding, and the market certainly benefited from the recent global financial crisis, as the flood of litigation triggered by the credit crunch has prompted the formation of new companies that finance lawsuits.[87]

But third-party litigation funding in Europe is not at all limited to the United Kingdom. Claims Funding International, for instance, "is a litigation funding company incorporated in Ireland and managed from its office in Dublin. [Its] mandate is to identify, fund, manage, and resolve multi party (class action) and other significant legal claims in Europe and elsewhere."[88] However, there is even more than that. Third-party litigation funding is also fairly developed in some continental European civil law countries. Apart from (and before)[89] the United Kingdom, Allianz Prozessfinanzierung[90] has funded litigation costs to plaintiffs in Germany, Austria, and Switzerland, holding claims of at least €100,000, with a high probability of success and with a potentially divisible award that the company can share, in exchange for 20 to 30% of the proceeds (if any).[91]

In Germany, apart from subsidiaries of insurance companies like Allianz Prozessfinanzierung or Roland Prozessfinanz,[92] independent companies like FORIS Finanziert Prozesse,[93] the first German company operating in TPLF and recently incorporated, offer to advance court costs and fees necessary to initiate an action, as well as to assume the risk of a cost award if the plaintiff loses.[94] In Germany, there are a number of independent

86 Michael Herman, *Allianz to Fund UK Court Cases*, TIMES ONLINE, Oct. 18, 2007, http://business.timesonline.co.uk/tol/business/law/article2688587.ece.

87 Jane Croft, *Litigation Finance Follows Credit Crunch*, FINANCIAL TIMES, Jan. 27, 2010, http://www.ft.com/cms/s/0/7c98c38a-0ab1-11df-b35f-00144feabdc0.html.

88 CLAIMS FUNDING INTERNATIONAL, http://www.claimsfunding.eu (last visited Mar. 28, 2011).

89 Allianz entered the UK market in 2007. Allianz Litigation Funding, http://www.allianz-litigationfunding.co.uk (last visited Apr. 3, 2011).

90 Allianz Prozessfinanzierung, http://www.allianz-profi.com (last visited Mar 28, 2011).

91 Allianz Prozessfinanzierung, http://www.allianz-profi.de (last visited Mar. 28, 2011).

92 Roland Prozessfinanzierung, http://www.roland-prozessfinanz.de/de/roland_prozessfinanz (last visited Mar. 28, 2011).

93 Foris AG, http://www.foris.de (last visited Mar. 28, 2011).

94 Roland Kirstein & Neil Rickman, *FORIS Contracts: Litigation Cost Shifting and Contingent Fees in Germany*, CSLE Discussion Paper 2001-04 (2001), *available at* http://econpapers.repec.org/paper/zbwcsledp/200104.htm; Michael Coester & Dagobert Nitzsche, *Alternative Ways to Finance a Lawsuit in Germany*, 24 CIV. JUST. Q. 83, 84

competing companies that offer similar services, including FORIS, DAS Prozessfinanzierung AG,[95] Juragent[96] and Exactor AG.[97] It is interesting to note that, while FORIS initially demanded 50% of the client's return from settlement or trial, nowadays—with more competition in the market—it only claims 30%.[98] Two common features are that: (1) the asserted claim must be of a certain value (the minimum amounts required vary among the different financing companies ranging between €500 and €50,000);[99] and (2) the percentage of the claim to be paid to the financer is inversely proportional to the value of the claim.[100] In Austria and Switzerland, as well, independent companies are incorporated and offer litigation funding services to claimants.[101]

C. The Scholarly (and Institutional) Debate

The TPLF industry has substantially grown over the past fifteen years. Although TPLF has not developed at a pace determined by market forces, it has often encountered the adverse attitude of courts of law, which—in the common law world—have denied enforcement to TPLF agreements based on traditional common law doctrines which prohibit maintenance based on champerty and public policy grounds.[102] Although courts of law have gradually been relaxing said prohibitions, opening the path for TPLF to develop, the legal status of TPLF is still debated.

The proliferation and contextual uncertain legal status of TPLF agreements have attracted scholarly interest, and some work has been done in the direction of understanding the validity of the—for many, anachronistic—doctrines of maintenance and champerty in the modern world. Moreover, TPLF has attracted

(2005).

95 D.A.S. Prozessfinanzierung AG, http://www.das-profi.de (last visited Mar. 18, 2011).

96 Juragent Prozessfinanzierung, http://www.juragent.de (last visited Mar. 28, 2011).

97 ExActor, http://www.exactor.de (last visited Mar. 28, 2011).

98 Kirstein & Rickman, *supra* note 94, at 3-4.

99 *See* Schüffel, Survey, *Prozeßfinanzierung durch Dritte*, BERLINER ANWALTSBLATT, at 82 (2001).

100 Coester & Nitzsche, *supra* note 94, at 88.

101 For example, in Austria, AdvoFin Prozessfinanzierung AG, or Lexdroit. AdvoFin Prozessfinanzierung AG, http://www.advofin.at (last visited Mar. 28, 2011); LEXDROIT, http://www.lexdroit.at. (last visited Mar. 28, 2011). The first Swiss litigation financing company was Prozessfinanz. Prozessfinanz, http://www.prozessfinanz.ch (last visited Mar. 28, 2011). *See* Christian Toggenburger, *Financing Private Litigation – A European Alternative to Contingency Fees*, 4 EUR. J. LAW REFORM 603 (2002).

102 *See infra* Section V.A.

the attention of the law and economics literature, which has started to study third-party investments on litigation not from a legal perspective, but from the viewpoint of its long-term consequences and social desirability. The ongoing debate that currently faces supporters and critics of TPLF can be summarized as follows.

On one end of the spectrum, TPLF supporters argue that the industry is beneficial on the grounds of access to justice, playing an equalizing function—"leveling the playing field"[103]—between plaintiffs and defendants, providing the former, who is typically weaker, with the resources necessary to face typically wealthy and powerful defendants. Furthermore, a plaintiff who can rely on solid financial resources is assumed to be more credible in pretrial negotiations than a plaintiff who is experiencing financial pressures and is likely to accept lower settlement offers. Another argument brought by supporters of TPLF is that the industry is beneficial because of the positive deterrent effect it has on potential defendants' behavior, thereby contributing to the social goal of the minimization of the total cost of accidents.[104] Under the law and economics literature, if victims do not have the resources to sue injurers, or if risk-averse victims do not sue injurers, so as to avoid risking their own resources and thus do not bring suit, the resulting scenarios are similar to the reality in which there is no liability for wrongdoers.[105] As the literature points out, if there is no liability, injurers will not exercise any care, for doing so would entail costs but not yield a benefit to them.[106] Potential injurers, who are aware that the victims of their harmful behavior may be able to count on solid financial resources through TPLF, will have an incentive to take more care in order to avoid liability.[107]

On the other end of the spectrum, critics have raised objections on a variety of grounds. The first ground is that ethical violations are associated with TPLF: TPLF can create confusion concerning the party who controls the lawsuit and concerning the attorney-client relationship.[108] A second criticism of TPLF is that

103 LITIGATION FUNDING IN AUSTRALIA, *supra* note 58, at 7.

104 *See* SHAVELL, *supra* note 9, at 178.

105 *Id.* at 179.

106 *Id.*

107 For further discussion on the deterrent effect of TPLF, see *infra* Sections IV.C.2 and C.4.

108 *See* Fausone v. U.S Claims, Inc., 915 So.2d 626, 630 (Fla. Dist. Ct. App. 2005).

it allows the funder to take advantage of claimholders, in particular in light of the fact that the industry does not operate in a competitive environment.[109] A third major ground for criticism has to do with the social costs TPLF produces on society. It is argued that TPLF encourages frivolous and unmeritorious litigation, that it over-deters potential injurers' behavior,[110] and, in general, that it increases the overall (whether frivolous or not) level of civil litigation and its consequent costs for society.[111]

The potential consequences of the diffusion of TPLF are enormous. In fact, a widespread use of TPLF in civil litigation would radically change the way in which we conceive the civil justice system. This change would be characterized by an increasing interaction between law, finance, and capital markets (and a variety of professional figures) that challenges the traditional adversarial nature of civil litigation. But the changes posed by TPLF are not merely of theoretical or scholarly interest; they present important political implications. For this reason, the debate on TPLF has gone beyond the scholarly arena and has reached the institutional dimension. In the United States, the U.S. Chamber Institute for Legal Reform recently published the report "Selling Lawsuits, Buying Trouble: Third Party Litigation Funding in the United States,"[112] which firmly takes a position against TPLF. In the United Kingdom, conversely, a report by the Rt. Honorable Lord Justice Jackson on the costs of civil litigation was recently published that favors TPLF.[113]

Especially in the common law world, academic interest in TPLF has, as of late, increased and the debate has expanded beyond national frontiers, reaching a transnational dimension in which scholars from different jurisdictions are confronting

109 *See* Rodak, *supra* note 45.

110 Gary Young, *Two Setbacks for Lawsuit Financing: But the Practice is Still Alive*, N.J. L.J., Aug. 2003, at 21.

111 *See* PAUL H. RUBIN, THIRD PARTY FINANCING OF LITIGATION (2009) (presented at the panel on Third Party Financing of Litigation at the Fourth Annual Judicial Symposium on Civil Justice Issues, hosted by the Northwestern Searle Center on Law, Regulation, and Economic Growth, Northwestern University Law School, Judicial Education Program in December 2009); DAVID ABRAMS & DANIEL L. CHEN, A MARKET OF JUSTICE: THE EFFECT OF LITIGATION FUNDING ON LEGAL OUTCOMES (2009), home.uchicago.edu/~dlc/papers/MktJustice.pdf.

112 U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, SELLING LAWSUITS, BUYING TROUBLE: THIRD PARTY LITIGATION FUNDING IN THE UNITED STATES (2009).

113 HON. LORD JUSTICE JACKSON, REVIEW OF CIVIL LITIGATION COSTS: FINAL REPORT, *supra* note 81, at 117-24.

themselves in order to learn from each other's national experience with TPLF. A number of new projects have been launched and conferences organized to study the burgeoning TPLF industry. Among them, the RAND Law, Finance, and Capital Markets Program was recently launched in order to "analyze an emerging development in civil dispute resolution in the United States, namely, providing capital and capital market products for claim holders and those defending against claims, and their respective lawyers."[114] An "International Conference on Litigation Costs and Funding" was held in July of 2009 in Oxford, United Kingdom, which was organized by the Centre for Socio-Legal Studies and the Institute of European and Comparative Law University of Oxford. A conference titled, "Collective Redress and Litigation Funding," was held in Sydney and Canberra in December of 2009, which was organized by the Centre for Law and Economics at The Australian National University, aiming at "coordinating a major research program examining collective redress and litigation funding globally with a focus on the US, Europe, Australia and Asia."[115] The conference "New Trends in Financing Civil Litigation in Europe: A Legal, Empirical and Economic Analysis" was held at the Erasmus University in Rotterdam on April 24, 2009.[116] The conference "Third Party Litigation Funding and Claim Transfer: Trends and Implications for the Civil Justice System," was presented by the RAND Institute for Civil Justice and UCLA School of Law in June of 2009.[117] Lastly, in May of 2010 in Washington, D.C., the Conference "Alternative Litigation Finance in the U.S.: Where Are We and Where Are We Headed with Practice and Policy?," organized by the RAND Institute for Civil Justice, was held, which

114 *See* Law, Finance, and Capital Markets – A Rand Institute for Civil Justice Program, http://www.rand.org/icj/programs/law-finance (last visited Mar. 28, 2011).

115 *See* Conference: Collective Redress & Litigation Funding, Sydney, Dec. 11 2009, Canberra, Dec. 12-13, 2009, law.anu.edu.au/cle/CRLF_Conf09/flyer.pdf.

116 *See* Conference: New Trends in Financing Civil Litigation in Europe: A Legal, Empirical and Economic Analysis, Erasmus Univ. Rotterdam, Apr. 24, 2009, http://www.frg.eur.nl/home/research/research_programmes/behavioural_approaches_to_contract_and_tort_relevance_for_policymaking/financing_civil_litigation (last visited Apr. 8, 2011).

117 Geoffrey McGovern, Neil Rickman, Joseph Doherty, Fred Kipperman, Jamie Morikawa, & Kate Giglio, Trends and Implications for the Civil Justice System, Presentation at Conference: Third-Party Litigation Funding and Claim Transfer, June 2009, http://www.rand.org/content/dam/rand/pubs/conf_proceedings/2010/RAND_CF272.pdf.

brought together litigation finance investors, legal practitioners, policymakers, academics and researchers to discuss and debate issues and trends related to alternative litigation finance in the United States and in other common law jurisdictions.[118]

IV. TPLF: AN ECONOMIC ANALYSIS

A. Basic Economic Model

In this section I provide a basic economic model of TPLF. I adopt as my starting point Shavell's basic theory of litigation,[119] and I analyze the incentives of the funder and the plaintiff with respect to TPLF, respectively under the "American" rule and the "English" rule for the allocation of legal costs. The economic model is based on the following assumptions: (1) all parties are rational and risk neutral; (2) if a plaintiff brings suit, there will definitively be a trial (i.e., I refrain from the possibility of settlement before trial); (3) we are in a simplified world, with only two time dimensions: T1 and T2 (the time of the TPLF agreement and the time of the judgment, respectively); (4) at T2 there are only two possible scenarios: plaintiff wins or plaintiff loses; (5) the lawyer is paid on a hourly basis, and that is included in the costs of litigation; and (6) there are no transaction costs.

1. American Rule[120]

a. The Third-party Funder

The funder, who is a profit maximizer, will be willing to fund a plaintiff's suit when his expected revenue (E(R)) from his investment is higher than his expected costs (E(C)), i.e., when his expected profit ($E(\pi)$) is positive, being $E(\pi) = E(R) - E(C)$. The funder will carefully evaluate the merit of the plaintiff's claim and estimate the size of the claim (R), i.e., the dollar amount likely to

118 At the center of the debate was the recent RAND paper. *See* STEVEN GARBER, ALTERNATIVE LITIGATION FINANCING IN THE UNITED STATES: ISSUES, KNOWNS AND UNKNOWNS (RAND Corp. 2010), http://www.rand.org/pubs/occasional_papers/2010/RAND_OP306.pdf.

119 *See* SHAVELL, *supra* note 9, at 387-443.

120 Under the American rule, each party pays for its own costs of litigation. *See supra* note 20.

be won, and the probability of success of the claim (λ).[121] Furthermore, the funder and the plaintiff will contractually determine the share of award that the funder will be entitled to after a judgment is reached (σ). The funder's expected revenue is the share of the amount likely to be won multiplied by the probability of winning, such that $E(R) = \sigma(\lambda R)$. The funder's expected costs are the plaintiff's legal expenses associated with the suit, which he is obliging himself to cover by signing the contract. The funder will invest if and only if $E(R) > E(C)$.

Suppose the plaintiff holds a claim worth $100,000, the funder believes that the plaintiff will win at trial with a probability of 70%, the contractually determined share of the proceeds for the funder is 30%, and the expected litigation costs are $20,000. Here, we will have:

$$R = 100{,}000 \qquad \sigma = 30\% \qquad \lambda = 70\% \qquad E(C) = 20{,}000$$

Thus, applying $E(R) = \sigma(\lambda R)$, we will have:

$$E(R) = .3(.7(100{,}000)) = 21{,}000$$

Under the given conditions, because $E(R) > E(C)$, the funder will invest.

b. The Plaintiff

Assuming that the plaintiff is also a profit maximizer and that he is bringing suit to receive the highest amount of money possible—and not, for example, personal vindication, which he may even be willing to pay for—we know from the basic economics of litigation that, in absence of third-party funding, the plaintiff will bring suit if his expected return from suit is higher than his expected costs.[122] In other words, the plaintiff tries to maximize his $E(\pi)$, where $E(\pi) = E(R) - E(C)$.

In the presence of the availability of TPLF, we have two possible scenarios. In the first scenario, one with no TPLF, plaintiff's $E(\pi) = E(R) - E(C) = \lambda R - E(C)$. In the second scenario, where the plaintiff receives TPLF, we indicate the

121 On applying risk analysis to litigation, see R.B. CALIHAN ET AL., *supra* note 18, at 5-33.

122 SHAVELL, *supra* note 9, at 390.

respective variables as $E(\pi)' = E(R)' - E(C)'$. For the plaintiff, because the funder is entitled to a share of the awards (σ), $E(R)' = E(R)\ (1-\sigma) = \lambda R\ (1-\sigma)$. By turning to TPLF, the plaintiff does not advance any money and bears no risk, so he eliminates his expected costs and his $E(C)' = 0$, and therefore $E(\pi)' = \lambda R\ (1-\sigma)$.

The plaintiff will be seeking third-party funding if and only if:

$$E(\pi) < E(\pi)'$$

Or

$$\lambda R - E(C) < \lambda R\ (1-\sigma)$$

In other words, the plaintiff will be willing to contract with a litigation financing company only if he expects that giving away a share of the proceeds will result in less of a loss than risking his own money to fund the litigation.

Before continuing with the explanation, it is necessary to notice that we can distinguish between two types of plaintiffs: (1) the plaintiff under a budget constraint (the "poor" plaintiff), who cannot afford to bring suit without third-party funding;[123] and (2) the plaintiff who does have the resources, but decides to receive external funding because he prefers it as a strategy to manage his risk associated with the litigation. Because he does not want to risk his own money, the latter is willing to pay for protection against risk.

The "poor" plaintiff's expected profit under a litigation funding agreement will always be higher than without external funding. The intuition is simple; without any external funding he would not be able to bring suit and his $E(R)$ would be zero. Instead, if he receives third-party funding, his $E(C)'$ will be zero and his $E(R)'$ will always be ≥ 0. Thus, the "poor" plaintiff is always better off getting third-party funding.[124]

Coming back to the plaintiff who is not under a budget constraint, consider the following numerical example:

123 In addition to poor people, this category includes creditors in the insolvency context, where it would be impossible to pursue wrongdoers due to lack of funds.

124 Here the comparison is only between the condition of poor people with or without TPLF. I am not discussing other alternatives for financing poor people's litigation.

$$R = 100{,}000 \qquad \sigma = 30\% \qquad \lambda = 70\% \qquad E(C) = 25{,}000$$

The plaintiff will be willing to receive external financing when:

$$E(\pi) < E(\pi)'$$

Thus,

$$\lambda R - E(C) < \lambda R\,(1-\sigma)$$

$$[(.7)\,100{,}000 - (25{,}000)] < [(.7)\,(.7)\,100{,}000]$$

$$45{,}000 < 49{,}000$$

In this example, we can conclude that the "non-poor" plaintiff would get third-party financing to cover all the costs of his litigation—eliminating any risk—and give up 30% of the award, rather than risk his own money with the hopes of keeping the entire award. After all, the plaintiff's expected profit with TPLF is higher than his expected profit without TPLF. Under all assumptions of the model he will get TPLF.

2. English Rule[125]

a. The Third-party Funder

Under the English rule, as well as under the American rule, the funder will be willing to invest as long as his $E(\pi)$ from the investment is positive, i.e., when his $E(R) > E(C)$. Because all costs are paid by the losing party under the English rule, the expectancies are not as linear as under the American rule. In a case that the plaintiff wins, the funder will have no costs, but if the plaintiff loses his costs will include the defendant's litigation costs $(C_p + C_d)$. Thus, for the funder, the $E(R)$ from the investment will be $\lambda(\sigma R)$, and his $E(C)$ will be $(1 - \lambda)(C_p + C_d)$. Consequently, the $E(\pi)$ for the funder looks as follows:

[125] Under the English rule, the losing party pays for all litigation costs. *See supra* note 21.

$$E(\pi) = \lambda(\sigma R) - (1 - \lambda)(C_p + C_d)$$

Consider the following numerical example:

$$R = 100{,}000 \qquad \lambda = 60\% \qquad \sigma = 30\% \qquad C_p = C_d = 20{,}000$$

Applying $E(\pi) = \lambda(\sigma R) - (1 - \lambda)(C_p + C_d)$, we will have:

$$E(\pi) = (.6)(.3)(100{,}000) - (.4)\,(40{,}000)$$

$$E(\pi) = 18{,}000 - 16{,}000$$

$$E(\pi) = 2000$$

In this numerical example, where there is a positive expected profit of 2000, the funder will decide to fund the lawsuit.

b. The Plaintiff

From the viewpoint of the plaintiff, the decision to turn to TPLF depends on whether the $E(\pi)$ with TPLF is higher than the $E(\pi)$ without TPLF. That is to say, recalling that the apostrophe (') is used to make reference to the scenario with TPLF, the plaintiff will turn to TPLF when:

$$E(\pi) < E(\pi)'$$

If the plaintiff sues the defendant with no external funding, then his $E(\pi) = \lambda R - (1 - \lambda)(C_p + C_d)$. If the plaintiff decides to turn to TPLF, then his $E(\pi)' = \lambda R\,(1 - \sigma)$.

Consequently, because the plaintiff will turn to TPLF as long as $E(\pi) < E(\pi)'$, he will do so when:

$$\lambda R - (1 - \lambda)(C_p + C_d) < \lambda R\,(1 - \sigma)$$

Consider the following numerical example:

$$R = 100{,}000 \qquad \lambda = 60\% \qquad \sigma = 30\% \qquad C_p = 20{,}000 \qquad C_d = 30{,}000$$

Here, the plaintiff will turn to TPLF if and only if:

$$(.6)\ 100{,}000 - (.4)\ 50{,}000 < (.6)(.7)\ 100{,}000$$

$$40{,}000 < 42{,}000$$

In this numerical example, the plaintiff will be better off turning to TPLF than by financing the lawsuit with his own resources.

A few words are worth mentioning here with respect to what I earlier referred to as the "poor" plaintiff, i.e., the claimholder under a budget constraint that prevents him from the possibility of suing the defendant. The "poor" plaintiff will also be better off turning to TPLF under the English rule, because, without external funding, he will not bring suit and his $E(\pi)$ will be zero. Instead, with TPLF, his $E(\pi)' = \lambda R\ (1 - \sigma) \geq E(\pi)$.

Under the English rule, one further possible scenario exists: a claimholder who has the resources to start a lawsuit (i.e., to pay for his own legal expenses), but who would not be able to bear the costs of an "adverse cost order" if he lost. A claimholder in such a situation would find TPLF beneficial because it eliminates the risk of an "adverse cost order" that would oblige him to pay for the winning defendant's litigation costs.

B. Lessons from the Economic Model

1. Why Do the Parties Enter into Contract?

The economic model has served the function of explaining when the funder and the plaintiff are willing to enter into a contract. As common intuition suggests, they will enter into a contract when the expected utilities of both are increased by the contract;[126] that is why this article represents TPLF as allowing Pareto superior allocations of property rights in litigation.[127] However, in order to see when and why the parties will actually contract, it is worthwhile to consider under what conditions TPLF will increase both parties' expected utilities.

If we assume that the two parties in a financing contract have symmetric information,[128] equal predictions about the outcome of

126 *See* SHAVELL, *supra* note 9, at 293.

127 A change from one allocation to another is *Pareto superior* when at least one party is better off and no one else is worse off. *See* ROBERT PINDYCK & DANIEL RUBINFELD, MICROECONOMICS, 590 (7th ed. 2009).

128 For a model of parties' litigation and settlement decisions under imperfect

the case, and are equally risk neutral, there is no room for gains from the financing contract—there is no possible σ that can be agreed upon to benefit both parties. As is demonstrated in the following subsections, this is true under both the American rule and the English rule for allocation of legal expenses.

a. American Rule

Assume that both the funder and the plaintiff believe that the outcome of the case will be favorable by a certain percentage λ, the value of the claim is of a certain amount R and that each party's litigation costs are $20,000. Under these conditions of perfectly symmetric information, there is no possible σ that the parties will agree upon. Unless their respective expected profit under the financing contract is equal to that without the contract, there will always be a σ by which one party gains and the other loses.

In fact, consider the following table, using apostrophe (') to indicate the situation with the funding agreement:

	Funder		Plaintiff	
No TPLF	$E(R) = 0$	$E(C) = 0$	$E(R) = \lambda R$	$E(C) = 20{,}000$
Yes TPLF	$E(R)' = \sigma(\lambda R)$	$E(C)' = 20{,}000$	$E(R)' = (1 - \sigma)\lambda R$	$E(C)' = 0$

Put in terms of $E(\pi)$, the following can be stated:

	Funder	Plaintiff
No TPLF	$E(\pi) = 0$	$E(\pi) = \lambda R - 20{,}000$
Yes TPLF	$E(\pi)' = \sigma(\lambda R) - 20{,}000$	$E(\pi)' = (1 - \sigma)\lambda R$

Because the funder and the plaintiff will only enter into contract if their respective $E(\pi)' > E(\pi)$, the following can be said of the two parties as to whether they will enter into contract:

information, see Lucian A. Bebchuk, *Litigation and Settlement Under Imperfect Information*, 15 RAND JOURNAL OF ECONOMICS 404 (1984). See also, specifically on the effects of legal-expenses insurance on settlement under asymmetric information (including after-the-event legal-expenses insurance), Yue Qiao, *Legal-Expenses Insurance and Settlement*, 1 ASIAN J. L. & ECON. no. 1, art. 4 (2010).

Funder iff | Plaintiff iff

$\sigma(\lambda R) - 20{,}000 > 0$ $\quad$ $(1 - \sigma)\lambda R > \lambda R - 20{,}000$

Or,

$\sigma(\lambda R) > 20{,}000$ $\quad$ $\lambda R - \sigma(\lambda R) > \lambda R - 20{,}000$

$\sigma(\lambda R) > 20{,}000$ $\quad$ $\sigma(\lambda R) < 20{,}000$

As a result, under the American rule, if both the funder and the plaintiff have perfectly symmetric information and are risk neutral, they will never enter into a contract.

b. English Rule

In this subsection I conduct the same test under the English rule and I reach the same conclusion. Assume that both the funder and the plaintiff believe that the claim is of a certain value R, the probability of winning λ is 60%, and the total litigation costs ($C = (C_p + C_d)$) are 40,000. Now consider the following table, which shows the expected payoffs of alternative scenarios (with and without TPLF) for the funder and the plaintiff respectively:

	Funder	Plaintiff
No TPLF	$E(\pi) = 0$	$E(\pi) = \lambda R - (1 - \lambda)\ C$
Yes TPLF	$E(\pi)' = \lambda\sigma R - (1 - \lambda)\ C$	$E(\pi)' = \lambda R\ (1 - \sigma)$

Because both the funder and the plaintiff will only be willing to contract if their respective $E(\pi)' > E(\pi)$, then the following can be said with respect to their willingness to contract:

Funder iff | Plaintiff iff

$\lambda\sigma R - (1 - \lambda)\ C > 0$ $\quad$ $\lambda R\ (1 - \sigma) > \lambda R - (1 - \lambda)\ C$

Or,

$\lambda\sigma R - C + \lambda C > 0$	$\lambda R - \lambda R\sigma > \lambda R - C + \lambda C$
$(.6)\ \sigma R - 40{,}000 + 24{,}000 > 0$	$-\lambda R\sigma > -C + \lambda C$
$(.6)\ \sigma R - 16{,}000 > 0$	$-(.6)\ R\sigma > -16{,}000$
$(.6)\ \sigma R > 16{,}000$	$(.6)\ R\sigma < 16{,}000$

As a result, under the described conditions, the funder and the plaintiff will never come into contract.

c. Different Perceptions and Attitudes Towards Risk

If under symmetric information the parties cannot agree on any σ and thus do not come into contract, what makes them do so? The reasons why the parties come into contract seem to be of two orders. On the one hand, the parties are likely to have different perceptions of R and even more so of λ.[129] On the other hand, they have different attitudes towards risk and different marginal disutility of loss.[130] While for an individual plaintiff a dispute is a single episode, a litigation financing company is a repeat player that can spread the risk across the large pool of cases it decides to finance. Consequently, while the individual claimholder is risk averse, a financing firm is more risk neutral.

2. Efficiency of TPLF

It has been demonstrated and explained why, under the right conditions, both parties are made better off by TPLF, which consequently has demonstrated itself to be efficient with respect to the funder and the plaintiff.

From the point of view of the funder, a TPLF contract is essentially an investment. Some concerns have been raised with respect to the fact that third parties can profit from other people's litigation in which they have no interest other than financial. However, as it has been shown earlier, investing in litigation is something that already happens—more or less directly—in other

129 Compared to the individual plaintiff, litigation financing firms are likely to have greater expertise and thus a higher ability to evaluate the probability of the success of a claim.

130 In fact, a $20,000 loss is likely to negatively affect an individual plaintiff more than a well-financed litigation funding company, for which such a loss might not be as significant.

markets that have developed around property rights in litigation.[131] Furthermore, in the business world, virtually any risk other than that of litigation can be spread or eliminated via the market.[132] There is no actual difference between other markets and TPLF that would justify its prohibition on purely ethical grounds. Instead, TPLF is a system that allows claimholders and investors to efficiently manage litigation risk, because it allows the risk to be transferred from the risk-averse individual claimholder to an investor who is able to spread the risk over a large pool of cases.

From the point of view of the claimholder, different problems arise. At first glance, it might seem that the funder unduly profits at the expense of the plaintiff, who would be worse off because he has to give up a share of the awards. Instead, both parties are made better off by the contract. In fact, in terms of expectations—at T1—even the plaintiff is better off. Of course, he eventually will find himself with less money after the judgment, but that is the price he has decided to pay in exchange for the elimination of risk. The plaintiff prefers to eliminate the risk of an unfavorable outcome of the litigation and is willing to pay for it. By bargaining over property rights in litigation, the expected value of his claim increases. TPLF creates gains from trade in property rights in litigation and is thus efficient.

Another possible problem might exist, from the perspective of the plaintiff, concerning the issue of whether he comes into contract voluntarily. One example is that of the "poor" plaintiff, who finds it necessary to receive TPLF in order to bring suit. I demonstrated earlier that in these cases, the plaintiff is still better off with TPLF rather than without it. However, the plaintiff might have agreed on contractual conditions that he would not have otherwise agreed on had he not found himself in a state of necessity. Another example is that of a plaintiff holding a claim with a high probability of success, who might be unaware of the high value of his claim, and bargains with a funder for a disproportionately high σ in case of success. In such a case, the funder might be taking advantage of the plaintiff's lack of awareness. This issue becomes problematic especially in the case

131 *See supra* Section II.B.

132 As J. Molot puts it, "companies not only spread business risk through the capital markets, but also dispose of some risk that they simply do not want to bear." Molot, *supra* note 5, at 367.

of individual plaintiffs outside the commercial context (not corporate actors or professionals), and even more so in the market for litigation "loans."[133]

Both situations in the two examples are problematic. However, they are not distinct from other problems that commonly emerge in social and economic life and which are addressed by the legal system in a variety of ways. A number of alternative solutions can be contemplated. In the first place, standard remedies available under contract law can be applied to TPLF contracts: for example, the common law doctrine of unconscionability could apply to vitiate particular instances of unfair TPLF dealings.[134] In the second place, regulatory strategies like mandatory provisions of information, licensing, default rules, codes of conduct[135] and others might be implemented.[136] In the third place, the benefits from a competitive market for litigation financing could be substantial, as competition among litigation financing companies would induce them to offer financing for percentages of awards closer to the real expected costs of financing. Moreover, as far as the benefits from competition are concerned, the availability of TPLF to plaintiffs would force attorneys working under contingency fee agreements to compete with litigation funders, thus disabling the monopoly enjoyed by lawyers on the determination of the percentage of their retainer, which could thus be lowered under the pressure of competition.[137]

All this being said, in a competitive market where contract law and regulatory strategies ensure that no party takes advantage of the other, TPLF per se is efficient with respect to the parties involved.

C. Externalities

We have learnt from the economic model that TPLF is in principle efficient. At this point, the following question comes up: if TPLF is efficient, why has it received judicial and institutional resistance? And why is the question of its desirability receiving

133 *See supra* Section II.B.6.

134 WAYE, *supra* note 25, at 153.

135 See, e.g., the consultation paper produced by the Civil Justice Council in the United Kigdom: CIVIL JUSTICE COUNCIL, A SELF-REGULATORY CODE FOR THIRD PARTY FUNDING (2010). All information is available at www.civiljusticecouncil.gov.uk.

136 WAYE, *supra* note 25, at 161-88.

137 *Id.* at 134-35.

scholarly attention? On the one hand, TPLF has been contested from a rather formalistic and non-consequentialist perspective: third-party support of litigation has traditionally been prohibited by the common law doctrines of maintenance and champerty, and as such it is assumed to deserve prohibition. On the other hand, TPLF has been attacked on the grounds that it creates negative externalities.[138] To be accurate, the scholarly debate has highlighted both positive and negative externalities, which are in fact what the most recent scholarship has pivoted on. The main externalities TPLF is argued to produce are increasing access to justice, the deterrent effect on potential injurers, the increasing amount of frivolous litigation, and the increasing overall volume of litigation. I will address each of these in the next subsections, and try to highlight the most salient arguments contained in the literature.

1. Access to Justice

Access to justice is a vague concept. Both terms "access" and "justice" can be interpreted in various ways, which can then combine into a variety of meanings of the concept.[139] In broad terms, access to justice is defined as the set of conditions that allows those who wish to enforce or defend their legal rights the reasonable opportunity to do so.[140] In particular, access to justice has been framed in terms of access to the legal process and access to the courts.[141] Furthermore, access to justice has been defined as access to due redress.[142] This article does not address the question of what should be meant by access to justice, and it will limit itself to consider access to justice in the general sense, referring to one's opportunities to defend his legal rights and to obtain due redress for the wrongs received.

I mentioned earlier that TPLF increases the chances that a claimholder will act for the protection of his rights. In fact, both the "poor" plaintiff and the "non-poor" plaintiff benefit from TPLF.[143] On the one hand, the claimholder who cannot afford to

138 *See* RUBIN, *supra* note 111.

139 *See* 4 ACCESS TO JUSTICE (Mauro Cappelletti ed., 1978-1979); CHRISTINE PARKER, JUST LAWYERS AND REGULATION OF ACCESS TO JUSTICE (1999); DEBORAH L. RHODE, ACCESS TO JUSTICE (2004); Mattei, *Access to Justice*, *supra* note 4.

140 RHODE, *supra* note 139, at 5.

141 *See* RT. HON. LORD WOOLF, ACCESS TO JUSTICE: FINAL REPORT (1996).

142 WAYE, *supra* note 25, at 16.

143 *See supra* Sections IV.A.1.b and 2.b.

bring suit will do so if he has external funding available. On the other hand, the chances that a risk-averse "non-poor" plaintiff brings suit against a wrongdoer will also increase if he does not bear the risk of litigation. This beneficial effect (from the viewpoint of the claimholder) is not to be considered an externality because it is "included" in the Pareto improvement obtained through TPLF in relation to the parties involved.

Conversely, it can be inferred that the existence of a system which provides broader access to justice, which as such increases the level of equality within a given society, produces the external effect of increasing all individuals' utilities, because individuals possess, in connection with a notion of morality that includes equality, a set of tastes that affect their utility.[144] Under the classical utilitarian measure of social welfare, the overall level of social welfare rises when any individual's utility increases. Furthermore, under other measures, not just the sum, but also the distribution of utilities generally matters, and more equal distributions of utility may be superior to less equal distributions.[145] In light of these arguments, TPLF produces a positive external effect that increases social welfare.

2. Deterrence

The possibility for a claimholder and an investor to bargain over property rights in litigation and to come to a TPLF agreement, apart from making both parties better off, produces an external effect on potential defendants that the law and economics literature refers to as the "deterrence" effect.[146] If potential defendants know in advance or reasonably expect that individuals, who might potentially sue them, will not do so because of lack of funds or risk aversion, then the former will have either no or at least a lesser incentive to avoid the occurrence of those events which would entitle the latter to a legal claim against the former.

Optimal deterrence requires potential injurers to be aware of the fact that they will bear full costs of the harm they produce.[147] If potential injurers are aware of that, they will optimally

144 SHAVELL, *supra* note 9, at 601.

145 *See id.* at 597.

146 *See* SHAVELL, *supra* note 9, at 177; Steven Shavell, *Strict Liability Versus Negligence*, 9 J. LEGAL STUD. 1, 1 (1980).

147 Robert Cooter, *Commodifying Liability*, *in* THE FALL AND RISE OF FREEDOM OF CONTRACT 139, 141-42 (F.H. Buckley ed., 1999).

internalize the costs of their actions so as to engage in their harmful activities to the extent that the private benefits are not outweighed by the costs, which, if the injurers are held fully liable, become private costs. The rationale that applies here is similar to that which explains why strict liability induces injurers to choose socially optimal levels of care in the economic analysis of tort law.[148] If potential injurers expect that potential victims will not sue them because of lack of funds or risk aversion, then they will be led to take a sub-optimal level of care that will result in too many wrongs.

TPLF provides funds to claimholders under a budget constraint and increases the expected value of a claim held by risk-averse plaintiffs. Consequently, the availability on the market of TPLF functions as a signal for potential defendants that their counterparts will count on solid financial resources to sue them. Thus, behaviors likely to create more losses than benefits, which their actors would be held responsible for, are discouraged by the availability of TPLF.

3. Frivolous and Unmeritorious Litigation

TPLF has been criticized on the grounds that it encourages frivolous[149] and unmeritorious litigation.[150] It has been argued that, as a matter of simple economics, increasing the amount of money available to plaintiffs makes litigation cheaper and, thus, as it happens when something becomes cheaper, there is more of a demand for it, which results in an increase of the volume of claims litigated.[151] Moreover, "third-party financing particularly increases the volume of questionable claims,"[152] because such financing eliminates the incentives not to invest on non-meritorious litigation.[153]

TPLF proponents have discredited this argument.[154] The central counterargument underpinning this position is that investors carefully scrutinize the cases brought by their potential

148 *See* SHAVELL, *supra* note 9, at 179-80.

149 On the idea of "frivolous" claims, see Robert G. Bone, *Modeling Frivolous Suits*, 14 U. PA. L. REV. 519, 529-33 (1997).

150 U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, *supra* note 112, at 5-7.

151 *Id.* at 5.

152 *Id.*

153 *Id.*

154 *See generally* Sebok, *The Inauthentic Claim*, *supra* note 11.

clients.[155] Litigation financing firms "engage in stringent due diligence when evaluating potential investments,"[156] and only invest in claims with "good prospect of success."[157] The selection of cases by the financing company works as a "filter" that leaves out frivolous and unmeritorious claims,[158] in the same way attorneys working on a contingency basis do not accept cases that are not likely to be successful. The result of this is that TPLF can be beneficial (both for "society" and for defendants) because it allows "good" claims to be litigated, while it does not support unmeritorious claims.

But what is a "good" claim? A counterargument against the claim that litigation-funding firms only invest in "good" claims (identified as claims with high probability of success) is that financiers, who are risk neutral and able to spread the risk on large pools of cases, reason in terms of expected values. For a risk neutral investor, the expected value of a $500 million claim with only a 5% chance of success is equal to that of a $25 million claim with 100% probability to win. Because investors make their decision to invest based on the comparison between E(R) and E(C), they might be attracted by highly risky (unmeritorious) claims with huge damage awards at stake.[159]

4. Increasing Overall Volume of Litigation

Closely connected to the issue of frivolous litigation is the concern for the increasing overall (frivolous or not) volume of litigation. This is perhaps the most problematic negative externality discussed by scholarship on TPLF. Roughly speaking, by increasing the funds available to claimholders to pursue litigation, TPLF would cause an increase in the overall number of

155 In particular on the pre-check by financing companies in Germany: Coester & Nitzsche. Kirstein & Rickman, *supra* note 94, at 89.

156 Juridica Capital Management, http://www.juridicacapital.com/how.php (last visited Mar. 28, 2011).

157 Allianz Litigation Funding, www.allianz-litigationfunding.co.uk (last visited Mar. 28, 2011).

158 At the present status of the industry, the selection is often very stringent. For example, IMF (Australia) Ltd, in its 2001-2010 experience, only funded 5% of the matters considered. Similarly, Juridica Capital Management only funded 6% of the cases considered. Data provided at the RAND ICJ Conference in Washington D.C. Conference: Alternative Litigation Finance in the U.S – Where Are We and Where Are We Headed with Practice and Policy?, Washington, D.C., May 20-21, 2010.

159 U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, *supra* note 112, at 6.

claims, resulting in a more costly civil justice system.[160] It has been asserted that "[e]ven if this were true, why would this be a bad thing?"[161] If the funded claims are not fraudulent and are based on valid law, then it would not be a bad thing for these cases to increase in number, because it would mean that more legal wrongs are repaired and more wrongdoers are held accountable.[162] Perhaps society should devote more resources to the civil justice system.

The question regarding the volume of litigation can also be addressed from a different perspective, namely, the social versus the private incentive to bring suit in a costly legal system.[163] This perspective does not focus on the costs of the court system that are borne by taxpayers. Instead, it focuses on the relationships between, on the one hand, the private and social costs of litigation, respectively (C_p) and ($C_p + C_d$), and, on the other, the private and social benefits of litigation, respectively λR, and the external effect on the behavior of potential defendants generally.[164] Assuming that the overall level of litigation increases due to TPLF, the question to address is whether the absolute value of the increasing social costs ($C_p + C_d$)—determined by the amount of litigation that depends on the private incentive to litigate under TPLF (which in turn depends on the private costs and benefits)—outweighs the absolute value of the social benefits of litigation, which can be defined as the decrease of social costs due to the precautionary activities of defendants which decreases the probability of loss to victims from p to q, where $p > q$. If the absolute value of litigation costs outweighs the absolute value of the deterrence benefits, then TPLF is socially undesirable; in the opposite case, TPLF is desirable. This is true under a perspective where the criterion for desirability is assumed to be the minimization of total social costs, which equals the sum of expected losses, prevention costs and expected legal expenses.[165]

The following model depicts the social desirability of TPLF

160 For the first attempt of empirical investigation in this direction, considering the experience of Australia, see ABRAMS & CHEN, *supra* note 111.

161 Sebok, *The Inauthentic Claim*, *supra* note 11, at 68.

162 *Id.* *See* New Hampshire Ins. Co. v. McCann, 707 N.E.2d 332, 337 (Mass. 1999); Kevin Pennell, *On the Assignment of Legal Malpractice Claims: A Contractual Solution to a Contractual Problem*, 82 TEX. L. REV. 481, 494-96 (2003).

163 *See* Steven Shavell, *The Social Versus the Private Incentive to Bring Suit in a Costly Legal System*, 11 J. LEGAL STUD. 333, 333-339 (1982).

164 *Id*. at 334.

165 *Id*. at 335.

from the perspective of the social versus private incentive to bring suit, adopting as the starting point Shavell's model[166] and assuming the American rule for allocations of legal costs applies. Define l = loss suffered by plaintiff, where $l > 0$; p = probability of loss if defendants do not engage in preventive activity, $p > 0$; q = probability of loss if defendants do engage in preventive activity, $p > q > 0$; x = cost to a defendant of preventive activity; a = plaintiff's legal expenses, $a > 0$; b = defendant's legal expenses, where $b > 0$. Under Shavell's model, legal expenses apart, a social interest in affecting defendants' behavior exists when:

$$x + ql < pl$$

Now two scenarios will be modeled. The first is one in which plaintiffs are expected to bring suit (because of their private incentives), and thus defendants will engage in preventive activities. The social costs are:

$$x + q(l + a + b)$$

In the second scenario plaintiffs are not expected to bring suit; thus, defendants will not engage in precautionary activities. The social costs are:

$$pl$$

Consequently, when considering legal expenses, a social interest (plaintiffs bringing suit) exists when:

$$x + q(l + a + b) < pl$$

TPLF is capable of affecting plaintiffs' private incentives to bring suit. I have shown in the basic model of TPLF[167] that, with no TPLF available, the plaintiff will bring suit when $\lambda R - C_p > 0$ and, if TPLF is available, the plaintiff will turn to TPLF when $\lambda R (1 - \sigma) > \lambda R - C_p$. Consequentially, TPLF might become problematic when it creates higher incentives for the plaintiff to bring suit. When $\lambda R (1 - \sigma) > \lambda R - C_p$, the plaintiff will have a higher incentive to bring suit if TPLF is available than if it is not

166 *Id.* at 334-36.

167 I consider the model under the American rule. *See supra* Section IV.A.1.

available. This point is crucial when it comes to questioning the social desirability of TPLF. Allowing a claimholder to bargain over his property rights in litigation with a third party increases his incentives to bring suit when there are gains from trade. Thus, allowing TPLF permits the possibility of higher incentives to bring suit; prohibiting TPLF does not.

In light of the theory surrounding the social versus private incentive to bring suit, the question of the social desirability of TPLF looks as follow: does TPLF increase plaintiffs' incentives to bring suit to such an extent that the total increase in social costs—the amount which depends on the "new" incentive—outweigh the social benefits, which derive from the deterrence effect determined by the existence of TPLF on the behavior of potential defendants?

If the answer is no, then TPLF is to be considered desirable. If the answer is yes, then TPLF is socially undesirable under this theory. The question, however, cannot be answered unequivocally in general terms. Instead, the social desirability of TPLF depends on many factors to be taken into consideration on a case-by-case basis. The answer will depend, apart from the costs of litigation, on the nature of defendants' activities, which could be activities for which harmfulness may or may not be substantially reduced with little marginal effort.

V. TPLF: A Comparative Legal Analysis

A. Common Law World

1. Traditional Prohibitions

TPLF has been growing throughout the common law world during the past fifteen years.[168] However, the pace of its development has not yet been determined by free market forces as the industry has encountered resistance from courts of law which have long been debating the legal status of TPLF. On the one hand, in general terms—the range of which is broader than TPLF as "narrowly" considered in this article[169]—third-party financing of litigation has encountered its biggest obstacles in the common law

168 *See supra* Section III.B.
169 *See supra* Section III.A.

prohibitions of assignment and maintenance.[170] On the other hand, in particular, the main challenge to the validity of TPLF "narrowly" considered is embodied in the common law doctrine of champerty.[171] This single doctrine will be the focus of our discussion.

Although there is a disagreement about what precisely constitutes "champerty," it has been defined as "an agreement between an officious intermeddler in a lawsuit and a litigant by which the intermeddler helps pursue the litigant's claim as consideration for receiving part of any judgment proceeds."[172] Although many common law jurisdictions have abolished champerty as a tort and criminal offence,[173] the doctrine of champerty continues to survive as a rule of public policy that can been raised to render TPLF agreements void and unenforceable.[174] As a result, the legal status of TPLF is disputed.

In general terms, what characterizes the experience of TPLF in the common law world is a tendency that traces back from an original broad prohibition of champertous agreements, towards a gradually increasing relaxation of that doctrine and contextual liberalization of the practice of third-party financial support of litigation. Before beginning the exploration of how such relaxations have taken place in the three main common law jurisdictions where TPLF has developed (Australia, the United States and the United Kingdom), it is useful to briefly explain what champerty is, its rationale, and its historical origins.[175]

Champerty is considered a species within the wider category

170 Sebok, *The Inauthentic Claim*, *supra* note 11.

171 *See* Paul Bond, *Making Champerty Work: An Invitation to State Action*, 150 U. PA. L. REV. 1297 (2002); Barksdale, *supra* note 46; Martin, *supra* note 43; McLaughlin, *supra* note 42; Richmond, *supra* note 43; Rodak, *supra* note 45; Sebok, *The Inauthentic Claim*, *supra* note 11.

172 BLACK'S LAW DICTIONARY 262 (9th ed. 2009).

173 Criminal Law Act, 1967, c. 13 (U.K.). Identical provision was made for Northern Ireland by Section 16 of the Criminal Justice Act, 1968, c. 28 (N.Ir.). Australian states: Maintenance, Champerty and Barratry Abolition Act 1993 (N.S.W); Civil Law (Wrongs) Act 2002 (A.C.T.); Criminal Law Consolidation Act 1935 (S.A.). In the United States, only a few cases seem to have applied champerty as a tort in the last hundred years. *See* WAYE, *supra* note 25, at 14.

174 Wallersteiner v. Moir, [1975] Q.B. 373 (Eng.); Trendtex Trading Corp v. Credit Suisse, [1982] A.C.Q.B. 629, 702 (Eng.); Roux v. Australian Broadcasting Comm'n [1992] 2 V.R. 577, 605 (Austl.); Quach v. Huntof Pty. Ltd. [2000] 32 M.V.R. 263 (Austl.); Smits v. Roach [2002] 42 A.C.S.R. 148. (Austl.).

175 I make reference to the existing literature for more in-depth discussions of what I summarize in this section.

of maintenance, where to "maintain" indicates the action of one who "assist[s] a litigant in prosecuting or defending a claim."[176] In particular, champerty is considered to be an illegal form of maintenance.[177] In the words of Justice Benjamin Cardozo, "maintenance inspired by charity or benevolence has been sharply set apart from maintenance for spite or envy or the promise or hope of gain."[178] Charitable maintenance is considered legal, while spiteful or envious maintenance, and maintenance for gain—actions encompassed by the terms champerty— are illegal.[179] An agreement in which a third party supports another's litigation in exchange for a share of the proceeds if successful but nothing in the case of loss, and where the funder's interest is solely financial, is understood to fall under the category of champertous agreements and is thus, at least in principle, considered void.

The doctrine of champerty is an ancient one. It developed in medieval England as the merchant class was growing in importance and the economic power of the feudal nobles was beginning to decline.[180] In particular, the doctrine developed as a judicial and statutory[181] reaction to a practice that was taking place among feudal lords, whereby they would underwrite the costs of suits carried out by others for the recovery of land in exchange for a share of the result. Through this means, the lords could become joint owners of estates at investment prices well below the market value of the land, increasing the size of their retinues and thus aggrandizing their political power.[182]

In light of this background, the doctrine of champerty seems to owe much of its rationale to a particular historical, economic, and social context that no longer subsists in the modern world. Legal rules are not unresponsive to social and economic changes; alternatively, they follow them, and adapt throughout time depending on new social contexts.[183] Due to the changes that differentiate current times from the Middle Ages, the doctrine of

176 BLACK'S LAW DICTIONARY 1039 (9th ed. 2009).

177 Sebok, *The Inauthentic Claim*, *supra* note 11, at 72-74.

178 In the Matter of the Estate of Gilman, 251 N.Y. 265, 271 (1929).

179 Sebok, *The Inauthentic Claim*, *supra* note 11, at 72-74.

180 Max Radin, *Maintenance by Champerty*, 24 CAL. L. REV. 48, 51-52 (1935).

181 The English legislature passed a series of statutory instruments prohibiting champerty between 1275 and 1541, which are well described in PERCY H. WINFIELD, HISTORY OF CONSPIRACY AND ABUSE OF LEGAL PROCESS 151 (1921), and in 3 W. HOLDSWORTH, A HISTORY OF ENGLISH LAW 395-400 (5th ed. 1942).

182 WAYE, *supra* note 25, at 12-13.

183 *See* Oliver W. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 469 (1897).

champerty seems to have lost its importance, which justifies loosening its severity and allowing TPLF to develop. However, according to a different view, valid reasons for prohibiting champerty still subsist. They include a desire to discourage frivolous litigation, quarrels, resistance to settlement, and interference with the attorney-client relationship,[184] which explains why courts from time to time continue to apply the prohibition of champerty to void TPLF agreements.

Apart from champerty, some argue that the other chief potential legal impediment to TPLF is usury statutes.[185] Usury, the act of lending money at an unlawfully high rate of interest, is another ancient legal doctrine.[186] In its common conception, a fundamental element of usury that distinguishes it from TPLF is the borrower's absolute obligation to repay with repayment not contingent on any other event or circumstance: in TPLF, the repayment is contingent upon the plaintiff's recovery of any proceeds. In other words, usury laws apply to loans but not to TPLF agreements, which cannot be qualified as loans.[187]

In the following sections, I will briefly survey how and to what extent the law in Australia, the United States, and the United Kingdom, respectively, has been moving away from a strict application of the prohibition on champerty, thus embracing an increasing liberalization of the practice of TPLF.

2. Australia

Maintenance and champerty were once torts and crimes in all Australian jurisdictions.[188] However, courts allowed TPLF

184 A.L.G., *The Effect of Champerty in Contractual Liability*, 79 L. Q. REV. 493, 494 (1963).

185 *See* Susan L. Martin, *Financing Litigation On-Line: Usury and Other Obstacles*, 1 DEPAUL BUS. & COM. L.J. 85, 89-94 (2002). Other opinions that consider the relevance of usury for TPLF include: McLaughlin, *supra* note 42; Rodak, *supra* note 45; Barksdale, *supra* note 46; Richmond, *supra* note 43; Martin, *supra* note 43; WAYE, *supra* note 25.

186 The world's first recorded usury law was part of the Babylonian Code of Hammurabi, circa 1700 B.C.

187 In *Echeverria v. Estate of Lindner*, No. 018666/2002, 2005 WL 1083704, at *6 (N.Y. Sup. Ct. Mar. 2, 2005), Judge Warshawsky wrongfully considered a litigation funding agreement a "loan" based on the fact that a positive outcome of the suit was a "sure thing," because the plaintiff was suing under a statute that imposed strict liability. That judgment has to be considered wrong because recovery in civil cases is not a "sure thing" just for the fact of being based on strict liability. *See supra* note 44.

188 In Australia, the common law prohibition of litigation funding was justified in part by the concern that the judicial system should not be the site of speculative business ventures. However, the primary aim was to prevent abuses of court process (vexatious or

pursuant to settled common law exceptions: if there was a bona fide community of interest between the plaintiff and the funder, or if the plaintiff was impecunious and the funder was not acting with any collateral motive.[189] Today, legislation in the Australian Capital Territory, New South Wales, South Australia and Victoria has expressly abolished maintenance and champerty both as a crime and as a tort.[190] In these jurisdictions, however, courts may set aside a TPLF agreement if it is found to be inconsistent with public policy considerations upon which the prohibition was based at common law.[191]

Since 1995, a new statutory exception to the rule against champerty has developed. Under their statutory powers of sale,[192] insolvency practitioners may now contract for the funding of lawsuits if these are characterized as company property. Many such actions are for voidable transactions or misfeasance by company officers.[193] Litigation funding companies emerged to serve this market,[194] and most litigation funding continues to be under the statutory exception for insolvencies. However, a number of companies have begun to fund non-insolvency plaintiff lawsuits.[195]

The legitimacy of TPLF agreements outside insolvency was challenged by courts of law, producing a series of conflicting judicial decisions.[196] Central to the question on the legitimacy of TPLF is a series of conflicting public policy arguments. On the one hand, access to justice has become a powerful consideration

oppressive litigation, elevated damages, suppressed evidence, suborned witnesses) for personal gain. LITIGATION FUNDING IN AUSTRALIA, *supra* note 58, at 4.

189 *Id.* at 4.

190 Civil Law (Wrongs) Act 2002 (A.C.T.) s. 221 (Austl.); Maintenance, Champerty and Barratry Abolition Act 1993 (N.S.W.) ss. 3, 4, 6 (Austl.); Criminal Law Consolidation Act 1935 (S.A.) sch. 11, ss. 1(3), 3 (Austl.); Wrongs Act 1958 (Vic) s. 32 (Austl.); Crimes Act 1958 (Vic) s. 322A (Austl.).

191 *See, e.g.*, Maintenance, Champerty and Barratry Abolition Act 1993 (N.S.W.) s. 6 (Austl.); Wrongs Act 1958 (Vic) s. 32(2) (Austl.).

192 For example, the powers of disposal given to a receiver to dispose of a company's property under the Corporations Act 2001 (Cth) s. 420(2)(b) and (g) (Austl.). See also the powers of disposal accorded to a liquidator by Corporations Act 2001 (Cth) s. 477(2)(c) (Austl.). Statutory powers of sale also arise from provisions of the Bankruptcy Act 1966 (Cth) (Austl.), and for trustees in all jurisdictions.

193 LITIGATION FUNDING IN AUSTRALIA, *supra* note 58, at 5.

194 *See supra* Section III.B.

195 For two examples, see *QPSX Ltd v. Ericsson Australia Pty. Ltd.* (2005) F.C.A. 933 (Austl.) and *Fostif v. Campbell Cash & Carry* (2005) N.S.W.C.A. 83 (Austl.).

196 The key cases are discussed in *Fostif v. Campbells Cash & Carry Pty. Ltd.* (2005) N.S.W.C.A. 83 (Austl.).

for courts in approving these new funding arrangements. On the other hand, defendants challenge courts arguing the traditional prohibitions of maintenance and champerty. Access to justice has played a fundamental role in leading courts in Australia (as well as in the United Kingdom) to approve funded proceedings[197] to such an extent that, despite numerous challenges in the last decade, no funding agreements have been stricken down in Australian courts. Until recently, however, TPLF in cases other than insolvency cases was still uncertain.

In 2006, the Australian High Court in *Campbells Cash & Carry Pty Ltd v. Fostif Pty Ltd*[198] resolved the conflict and gave its *imprimatur* to litigation funding.[199] Since then, TPLF has been growing and other judges have endorsed commercial litigation funding for its potential to "inject a welcome element of commercial objectivity into the way in which [litigation] budgets are framed and the efficiency with which litigation is conducted,"[200] as well as to foster the aims of Australian class action legislation.[201]

Support for commercial litigation funding has also come from outside the courts, namely from the Law Council of Australia,[202] the NSW Young Lawyers Civil Litigation Committee & Pro Bono TaskForce,[203] and the Law Institute of Victoria.[204] Furthermore, the Federal Financial Services Minister recently commenced an inquiry as to how litigation funders might be regulated by the Australian Securities and Investment Commission (ASIC), which is the Australian equivalent of the U.S. Securities and Exchange Commission, and stated that it is possible that some form of

197 *See also* WAYE, *supra* note 25, at 63-67.

198 *Campbells Cash & Carry Pty. Ltd. V. Fostif Pty. Ltd.* (2006) 229 A.L.R. 58 (Austl.).

199 WAYE, *supra* note 25, at 55.

200 *QPSX Limited v. Ericsson Australia Pty. Ltd.* (2005) F.C.A. 933, at 54 (Austl.).

201 *Kirby v. Centro Prop. Ltd.* (2008) F.C.A. 1505 (Austl.).

202 *See* LAW COUNCIL OF AUSTL., STANDING COMMITTEE OF ATTORNEYS-GENERAL (Sept. 14, 2006), *available at* http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file_uuid=8C744AB2-1C23-CACD-2297-5D181CEBB545&siteName=lca.

203 NSW YOUNG LAWYERS CIVIL LITIG. COMM. & NSW YOUNG LAWYERS PRO BONO TASKFORCE, JOINT SUBMISSION TO THE STANDING COMMITTEE OF ATTORNEY GENERALS' REVIEW INTO LITIGATION FUNDING IN AUSTRALIA (2006), http://www.lawsociety.com.au/idc/groups/public/documents/internetyounglawyers/025814.pdf.

204 *See* Bernard Murphy & Camille Cameron, *Access to Justice and the Evolution of Class Action Litigation in Australia*, 30 MELB. U. L. REV. 399, 438 (2006); John North, *Litigation Funding: Much to be Achieved with the Right Approach*, 43 L. SOC'Y J. 66, 69 (2005).

regulation will be introduced during 2010.[205]

3. United States

The doctrines of maintenance and champerty traditionally are also found in U.S. state common law, where they typically relate back to the English common law doctrines which were previously received and maintained following the American Revolution.[206] The two doctrines are very much interrelated or, more precisely, champerty is a form of maintenance—namely an illegal form of maintenance.[207] Restrictions to maintenance exist in varying degrees across U.S. states. All states now permit at least one form of maintenance—lawyer's contingency fees[208]—while, conversely, all states prohibit at least what is referred to as "malice maintenance," i.e., when a third party supports a stranger litigant for pure spite of malevolence toward the target of the person aided by the maintainer.[209] As it appears from these two examples, many conceptions of maintenance exist that are prohibited in varying degrees across U.S. states.[210] What is of interest here is what is referred to as "profit maintenance," or champerty.

The legal status of champerty in the United States is not uniform and its picture is quite complex.[211] For the purpose of this section of the article—that of providing an overview of the status of TPLF in the common law world—I will use the following paragraphs to summarize the evolution of the legal status of TPLF in the United States, referring to the existing literature for more detailed observations.[212]

As in Australia, champerty is neither a tort nor a crime in

205 Charlie Gollow, Inv. Manager, IMF (Austl.) Ltd., Trends and Developments in Australian Litigation Funding, Presentation at the RAND ICJ Conference: Alternative Litigation Finance in the U.S.: Where Are We and Where Are We Headed with Practice and Policy?, Washington, D.C. (May 21, 2010).

206 Sebok, *The Inauthentic Claim*, *supra* note 11, at 98.

207 *See supra* Section V.A.1.

208 Lawyers' contingency fees have also been defined as an exception to the prohibition of champerty. See Martin, *supra* note 43, at 57; Sebok, *The Inauthentic Claim*, *supra* note 11, at 100.

209 Sebok, *The Inauthentic Claim*, *supra* note 11, at 102.

210 For a detailed discussion, see id. at 94.

211 For an in-depth analysis, see id. at 107. According to Sebok, restriction on champerty can be classified under three categories: (1) restrictions on *what* lawsuits may be maintained for profit; (2) restrictions on *how* lawsuits may be maintained for profit; and (3) restrictions on the *cause* of the maintenance for profit. *See id.* at 108.

212 *See id.* at 74; Bond, *supra* note 171, at 1333-41 (who offers an overview of champerty law in all fifty-two states).

most U.S. states, but its most visible impact is as a contract defense.[213] Until the emergence of TPLF,[214] however, U.S. courts rarely enforced the doctrine of champerty. When TPLF first emerged, American courts rarely enforced the doctrine of champerty to void TPLF agreements. Some courts expressly took the position in favor of the abolition of maintenance and champerty on the grounds that those doctrines no longer responded to the need of protecting against speculations in lawsuits, the bringing of frivolous claims, and other public policy concerns that could be addressed more efficiently by other means.[215]

At the turn of the new millennium, there has been a judicial backlash against commercial investment in litigation in the United States.[216] A number of U.S. courts have taken a negative view and have used champerty[217] and other doctrines—in particular usury[218]—as significant obstructions to commercial investments in litigation. The recent situation in the United States is not uniform and can be organized into four categories: (1) states where champerty is subject to statutory prohibition;[219] (2) states where its prohibition is embodied in the common law;[220] (3) states where it remains relevant only as a principle of public policy; and (4) states where it is permitted,[221] sometimes explicitly.[222]

---

213 As such, its visibility in case law is somehow proportional to the amount of champertous agreements. *Id.* at 1304.

214 *See supra* Section III.B.

215 Hardick v. Homol, 795 So. 2d 1107 (Fla. 5th Dist. Ct. App. 2001); Osprey, Inc. v. Cabana Ltd. P'ship, 532 S.E.2d 269 (S.C. 2000); Saladini v. Righellis, 687 N.E.2d 1224 (Mass. 1997).

216 WAYE, *supra* note 25, at 111.

217 Rancman v. Interim Settlement Funding Corp., 99 Ohio St.3d 121 (Ohio 2003).

218 See, e.g., the position of the lower courts then reversed by the Ohio Supreme Court in *Rancman*, 99 Ohio St.3d 121 (Ohio 2003).

219 *See, e.g.*, GA. CODE ANN. § 13-8-2 (West 2009); KY. REV. STAT. ANN. § 372.060 (West 1942); LA. CIV. CODE ANN. art. 2447 (1995) (but only applies to purchases by attorneys and officers of the court); MISS. CODE ANN. § 97-9-11 (West 1976); N.Y. JUDICIARY LAW § 489 (McKinney 2004).

220 *See, e.g.*, Midtown Chiropractic v. Illinois Farmers Ins. Co., 812 N.E. 2d 851 (Ind. Ct. App. 2004); Johnson v. Wright, 682 N.W.2d 671 (Minn. Ct. App. 2004); Fleetwood Area School Dist. v. Berks Cnty Bd. of Assessment Appeals, 821 A.2d 1268 (Pa. Commw. Ct. 2003); Toste Farm Corp. v. Hadbury, Inc., 798 A.2d 901 (R.I. 2002). The examples are among those reported by WAYE, *supra* note 25, at 112.

221 Based upon the survey offered by Bond, *supra* note 171 (Appendix), reported and updated by Sebok, *The Inauthentic Claim*, *supra* note 11, twenty-eight U.S. states permitted champerty as of 2002: ME. REV. STAT. tit. 9A, § 12-101 (2007) (partially amending ME. REV. STAT. tit. 17A, § 516(1) (1975)); OHIO REV. CODE ANN. § 1349.55 (West 2008) (reversing Rancman v. Interim Settlement Funding Corp., 99 Ohio St.3d 121

Even in states that have retained champerty, it has been argued that the doctrine is on the wane, in light of developments that have considerably broadened the exceptions to the champerty prohibition.[223] First, champerty only applies to TPLF where the party sharing in the proceeds has no legitimate interest in the outcome of the action.[224] Second, champerty (and maintenance) cannot be established unless there is officious intermeddling. Thus, the doctrines may not apply where the maintained party has initiated suit prior to entering a TPLF agreement, where the funder plays no role in the conduct of the litigation and where the terms of the financing agreements are fair.[225]

From these exceptions, one can conclude that the doctrine of

(Ohio 2003)); Landi v. Arkules, 835 P.2d 458 (Ariz. Ct. App. 1992); Abbott Ford, Inc. v. Superior Court, 741 P.2d 124 (Cal. 1987); Fastenau v. Engel, 240 P.2d 1173 (Colo. 1952); Robertson v. Town of Stonington, 750 A.2d 460 (Conn. 2000); Kraft v. Mason, 668 So.2d 679 (Fla. Dist. Ct. App. 1996); TMJ Hawaii, Inc. v. Nippon Trust Bank, 153 P.3d 444 (Haw. 2007); Wright v. Meek, 3 Greene 472 (Iowa 1852); Boettcher v. Criscione, 299 P.2d 806 (Kan. 1956); Martin v. Morgan Drive Away, Inc., 665 F.2d 598 (5th Cir. 1982); Son v. Margolius, Mallios, Davis, Rider & Tomar, 709 A.2d 112 (Md. 1998); Saladini v. Righellis, 687 N.E.2d 1224 (M.A. 1997); Smith v. Childs, 497 N.W.2d 538 (Mich. Ct. App. 1993); Schnabel v. Taft Broad Inc., 525 S.W.2d 819 (Mo. Ct. App. 1975); Green v. Gremaux, 945 P.2d 903 (Mont. 1997); Adkin Plumbing & Heating Supply Co. v. Harwell, 606 A.2d 802 (N.H. 1992); Polo v. Gotchel, 542 A.2d 947 (N.J. Super. Ct. Law Div. 1987); Leon v. Martinez, 638 N.E.2d 511 (N.Y. 1994); Odell v. Legal Bucks, LLC, 665 S.E.2d 767 (N.C. Ct. App. 2008); Interstate Collection Agency, Inc. v. Kuntz, 181 N.W.2d 234 (N.D. 1970); Mitchell v. Amerada Hess Corp., 638 P.2d 441 (Okla. 1981); Brown v. Bigne, 28 P. 11 (Or. 1891); Osprey v. Cabana Ltd. P'ship, Inc., 532 S.E.2d 269 (S.C. 2000); Record v. Ins. Co. of N. Am., 438 S.W.2d 743 (Tenn. 1969); Anglo-Dutch Petroleum Int'l, Inc. v. Haskell, 193 S.W.3d 87 (Tex. App. 2006); Giambattista v. Nat'l Bank of Commerce of Seattle, 586 P.2d 1180 (Wash. Ct. App. 1978); and Currence v. Ralphsnyder, 151 S.E. 700 (W. Va. 1929).

222 As reported by A. Sebok, sixteen U.S. states now explicitly permit champerty as a form of maintenance for profit: CO: Fastenau v. Engel, 240 P.2d 1173 (Colo. 1952); CT: Robertson v. Town of Stonington, 750 A.2d 460 (Conn. 2000); FL: Kraft v. Mason, 668 So. 2d 679 (Fla. 1996); IA: Wright v. Meek, 3 Greene 472 (Iowa 1852); KS: Boettcher v. Criscione, 299 P.2d 806 (Kan. 1956); ME: ME. REV. STAT. tit. 9A §12- 101 (2009) (partially amending ME. REV. STAT. 17A §516(1) (2009)); MD: Son v. Margolius, Mallios, Davis, Rider & Tomar, 709 A.2d 112 (Md. 1998); MA: Saladini v. Righellis, 687 N.E.2d 1224 (M.A, 1997); MO: Schnabel v. Taft Broad. Co., 525 S.W.2d 819 (Mo. App. 1975); NH: Adkin Plumbing & Heating Supply Co. v. Harwell, 606 A.2d 802 (N.H. 1992); NC: Odell v. Legal Bucks, LLC, 665 S.E.2d 767 (N.C. App. 2008); OH: ORC ANN. 1349.55 (2009) (reversing Rancman, 99 Ohio St.3d 121(2003)); OK: Mitchell v. Amerada Hess Corp., 638 P.2d 441 (Okla. 1981); OR: Brown v. Bigne, 28 P. 11 (Or. 1891); WA: Giambattista v. Nat'l Bank of Commerce of Seattle, 586 P.2d 1180 (Wash. App. 1978); and WV: Currence v. Ralphsnyder, 151 S.E. 700 (W. Va. 1929). Sebok, *The Inauthentic Claim*, *supra* note 11, at 99.

223 WAYE, *supra* note 25, at 113.

224 For examples and cases, see id. at 113.

225 *Id.* at 114.

champerty covers a much broader set of situations than TPLF (as "narrowly" considered in this article), namely a funding agreement where the funder acquires no control of the litigation.[226] As briefly mentioned earlier,[227] the issue of who retains control of the litigation is of fundamental relevance for the law. Assume to represent with a line a series of situations. On one end is TPLF narrowly considered where no control is transferred from the claimholder to the funder. On the opposite end is a funding agreement in which the claimholder transfers to the funder complete control over the lawsuit: this extreme situation coincides with what is referred to as "assignment" of claims. The assignment of a claim falls under a different doctrine, the common law rule of non-assignability.[228] Between these two extreme solutions is an indefinite quantity of intermediate situations that can fall under the realm of either common law doctrine. The distinction between maintenance, champerty, and assignment is extremely faded.

As far as TPLF in its "narrow" definition is concerned, as of late courts have broadened the exceptions to the prohibition of champerty, thus paving the way for further development of the TPLF industry.[229] Conversely, outside the courts, TPLF has been strongly attacked: the U.S. Chamber Institute for Legal Reform published in October of 2009 a report that takes a firm position against TPLF and advocates for its prohibition.[230]

4. United Kingdom

The experience of the United Kingdom is similar to the Australian one to the extent that TPLF first developed in the context of insolvency before expanding to the whole realm of commercial litigation. Furthermore, unlike Australia (and the United States), the UK experience has demonstrated that TPLF need not to be so confined, but it can expand outside the commercial context into what is commonly referred to as the personal injury sphere.[231]

Apart from the development of case law on litigation funding,

---

226 *See supra* Section III.A.
227 *See supra* Section II.B.5.
228 Sebok, *The Inauthentic Claim*, *supra* note 11, at 74.
229 WAYE, *supra* note 25, at 113.
230 U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, *supra* note 112. For comment, see *supra* Section IV.C.3.
231 WAYE, *supra* note 25, at 105.

the English government's substantial shift in public policy from public mechanisms of financing poor people's litigation (legal aid) towards market-based alternatives during the 1990s, was an important factor that contributed to the expansion of TPLF in the United Kingdom, especially for non-commercial matters. The reforms that were enacted at the end of the 1990s were stimulated by the increases in legal aid expenditure and were specifically adopted in order to shift the funding of non-commercial litigation away from the public purse. The Access to Justice Act of 1999 removed legal aid for all civil cases involving monetary claims and introduced conditional fees and after-the-event insurance as new, private and market-based alternatives to finance litigation.[232] The Act in principle did not mention litigation funding, which was introduced as a result of an amendment sought in the House of Lords,[233] which, however, has never been brought into effect.[234] The Access to Justice Act of 1999 can be considered the outcome of a general shift in public policy that matured during the 1990s concerning access to justice, which has been of important background relevance for the development of TPLF.

Until the beginning of the 1990s, the law on champerty and maintenance in the United Kingdom looked as follows: the common law principle was that contracts involving maintenance or champerty were void for public policy unless they fell within recognized exceptions, such as the common interest exception[235] or the statutory insolvency exceptions.[236] However, in 1994, *Giles v. Thompson*[237] represented a fundamental change in British judicial

232 *See* ACCESS TO JUSTICE WITH CONDITIONAL FEES, *supra* note 25.

233 *See* Access to Justice Bill, 1998-9, H.L. Bill [58B] cl. 38 (Eng.), *available at* http://www.publications.parliament.uk/pa/cm199899/cmstand/e/st990513/am/90513s01.htm.

234 WAYE, *supra* note 25, at 87.

235 Traditionally the common interest had to derive from the subject matter of the claim, rather than being a commercial interest coincidental to the claim (Alabaster v. Harness, [1895] 1 Q.B. 339 (Eng.)). However, in the 1990s, that requirement was relaxed allowing for any genuine commercial interest to be the basis for an exception to the common law position (see comments in Giles v. Thompson, [1993] 3 All E.R. 321, 333 (Eng.)).

236 As noted by WAYE, *supra* note 25, at 106-07, in England, the general position in relation to insolvency office holders such as liquidators or trustees in bankruptcy is that those office holders are exempt from prohibitions arising in champerty and maintenance preventing the assignment of legal claims. Norglen Ltd. (in liq) v. Reeds Rains Prudential Ltd., [1999] 2 A.C. 1 (Eng.); Ramsey v. Hartley, [1977] 1 W.L.R. 686 (Eng.); Guy v. Churchill, [1888] 40 Ch. D. 481 (Eng.); In re Park Gate Waggon Works Co., [1881] 17 Ch. D. 234 (Eng.); Seear v. Lawson, [1880] 15 Ch. D. 729 (Eng.).

237 Giles v. Thompson, [1994] 1 A.C. 142 (Eng.).

thinking with respect to maintenance and champerty. Following *Giles*, English courts tended to consider that there are no longer public policy reasons supporting the general prohibition of third-party funding agreements limited by some exceptions. Conversely, the new position of United Kingdom courts is that no prohibition on maintenance and champerty applies, with the exception of the case of wanton and officious intermeddling[238] and the case of trafficking in legal claims,[239] which are often intertwined.[240]

Once again, central to the evaluation of the validity of a litigation funding agreement is the issue of who controls the litigation. English courts maintain strong resistance against the cession of control from the claimholder to the funder. A TPLF agreement that contemplates full transfer of control to the funder is void for champerty.[241] However, absent the cession of control, agreements providing assistance to claimholders in exchange for a portion of the proceeds of the litigation (i.e., TPLF as considered in this article) are valid under current UK law,[242] provided that they do not involve litigators subject to the conditional fee regime.[243]

The TPLF industry is rapidly growing in the United Kingdom[244] in a climate that is moving towards increasing liberalization. This trend is supported both by the government through public policy and by courts through case law. Six years ago, *Arkin v. Borchard Lines Ltd.*[245] was the first case where the courts indicated that third-party funding should not only be tolerated but also encouraged as a useful tool for facilitating access to justice.[246] Furthermore, the climate of support that reigns in the United Kingdom has found recent expression in the report by the

238 Ahmed v. Powell, [2003] P.N.L.R. 22 (Eng.); Factortame & Ors v. Sec'y of State for Transport, Local Government and the Regions (No. 8) [2003] Q.B. 381 (Eng.).

239 Trendtex Trading Corp. v. Credit Suisse, [1982] A.C. 679, 683 (Eng.).

240 WAYE, *supra* note 25, at 104.

241 Ahmed v. Powell, [2003] P.N.L.R. 22 (Eng.).

242 This approach is confirmed by the recently proposed *Code of Conduct for the Funding by Third Parties of Litigation in England and Wales*, proposed for consultation by the Civil Justice Council to civil justice stakeholders in the summer of 2010. *See* CIVIL JUSTICE COUNCIL, *supra* note 135.

243 If a conditional fee regime applies, funding agreements must conform to its requirements. *See* Factortame & Ors v. Sec'y of State for Transport, Local Government and the Regions (No. 8) [2003] Q.B. 381 (Eng.); Awwad v. Geraghty & Co., [2001] Q.B. 570 (Eng.).

244 *See supra* Section III.B.

245 Arkin v. Borchard Lines Ltd., [2005] 2 Lloyd's Rep. 187 (Eng.).

246 WAYE, *supra* note 25, at 105.

Rt. Honorable Lord Justice Jackson on the costs of civil litigation that was published in January of 2010. Justice Jackson stated that "[i]n some areas of civil litigation costs are disproportionate and impede access to justice."[247] With the scope in mind of "propos[ing] a coherent package of interlocking reforms, designed to control costs and promote access to justice,"[248] Justice Jackson stated that third-party funding is beneficial and should be supported in that it promotes access to justice.[249]

B. Civil Law World

1. Traditional Prohibitions?

In the civil law world no specific legislative or judicial prohibitions seem to apply to TPLF. However, the industry is not developed. According to a recent report in the civil law world:[250] in Argentina "there is no regulation on this issue;" in Brazil "third party funding is not prohibited;" in Bulgaria "neither special regulation nor restrictions on third party funding are provided;" in Estonia "third party funding of claims is permitted based on the general rules governing the performance of obligation by third party;" in Finland "generally speaking, third party funding of claims is not restricted but not very common;" in France "third-party funding is not forbidden per se. As French lawyers can only be paid by their clients or the clients' agent (article 11.3 of the National Bar Association Rules), third-party funding appears possible under French law provided that the private party concludes a contract with the plaintiff governing the funding and apportioning of the damages obtained, and does not directly pay the lawyers' fees." In Italy, "third party funding is possible but not frequent;" in Latvia "there are no restrictions on third party funding of claims; however, it is not common practice in Latvia;" in Mexico "there is no express prohibition about third party funding neither on the Federal Bill nor in the Mexico City Bill;" in

247 HON. LORD JUSTICE JACKSON, *supra* note 81, at i.

248 *Id.*

249 *Id.* at 117. The Civil Justice Council (CJC) has expressed a similar view. *See* CIVIL JUSTICE COUNCIL, REPORT, IMPROVED ACCESS TO JUSTICE –FUNDING OPTIONS AND PROPORTIONATE COSTS, Chapter C and Recommendation 3, 53 (June 2007).

250 Here I am following the classification of legal systems offered by the research group JuriGlobe at the University of Ottawa. UNIV. OF OTTAWA, WORLD LEGAL SYSTEMS RESEARCH GROUP, http://www.juriglobe.ca/eng/index.php (last visited Mar. 28, 2011).

Slovakia "although third party funding is not prohibited (however not regulated) under Slovak law, if at all, it is rarely used;" in Spain "although nothing under Spanish law prohibits it, there is no experience of third party funding in the Spanish day-to-day practice."[251]

In all these countries, despite the absence of formal prohibitions, third-party funding of litigation is virtually nonexistent. Furthermore, in most Asian countries TPLF is not officially available, although some countries belonging to the civil law tradition, such as China and Japan,[252] are considering introducing it.[253] The only exceptions to the absence of TPLF in the civil law world—at least in the everyday practice—seem to be Germany, Austria and Switzerland.[254]

Because no prohibitions seem to apply, the reasons why TPLF has not developed in the civil law world are not clear. This article argues that possible explanations should be looked for in some general structural and cultural characteristics of civil law jurisdictions, rather than in any positive rule. A number of factors are worth underlying that might have significance in the explanation of why TPLF has not developed in the civil law world. Before entering that inquiry, however, it is worth briefly analyzing the German experience with TPLF from a legal point of view.

2. Germany

TPLF in Germany operates in the framework of the following context: as a rule, legal costs are borne by the losing party (or apportioned between the parties);[255] costs are often high, are fixed by law[256] and include court fees[257] and attorney fees;[258] additional

---

251 GLOBAL RESEARCH GROUP., INTERNATIONAL COMPARATIVE LEGAL GUIDE TO: CLASS & GROUP ACTIONS (2010), http://www.iclg.co.uk/khadmin/Publications/pdf/3167.pdf [hereinafter CLASS & GROUP ACTIONS 2010].

252 China and Japan are seen as belonging to the civil law world, though as "mixed systems of civil law and customary law," see the classification made available by JuriGlobe, *supra* note 250.

253 Y. Qiao, *supra* note 128.

254 "In Switzerland, a third party can agree to cover the costs of litigation. In return, the third party may agree to accept a share of the outcome of the litigation." CLASS & GROUP ACTIONS 2010, *supra* note 251, at 150.

255 Zivilprozessordnung [Civ. Pro. Code] § 91 (F.R.G.). For an economic model, see *supra* Section IV.A.2.

256 Gerichtskostengesetz [Court Fees Act] (F.R.G.) and Rechtsanwaltsvergütungsgesetz [Attorney Remuneration Act] (F.R.G.).

257 Court fees are directly proportional to the value of the claim, increasing at a

costs particular to a case, including witnesses and expert reports, may arise for the means of proof.[259] In light of this context, high litigation costs determine a financial risk that can be prohibitive for the plaintiff. Contingency fees, which might be a solution for the elimination of the plaintiff's risk, are prohibited.

This background scenario seems to have favored the emergence of TPLF, which relieves plaintiffs of the costs connected with initiating a lawsuit. TPLF was introduced in Germany by FORIS in 1998 and is now offered by a number of companies.[260] TPLF contractual agreements, previously unknown in Germany, seem now to have taken a quite harmonious default structure within the industry.[261] Of interest here, however, are not the contractual rules that govern the relationship between the parties, but rather how TPLF contracts are considered from the perspective of their legal character and validity.

As far as the legal character of TPLF contracts is concerned, the prevailing opinion in German literature[262] is that TPLF contracts create silent partnerships under the German Civil Code (*Stille Gesellschaft bürgerlichen Rechts*) between the funder and the plaintiff.[263] This partnership is not registered in the commercial register, and the personal liability of the parties is unlimited.[264] The financing contract is not considered a loan agreement[265] or an insurance contract.[266]

diminishing marginal rate. *See* Coester & Nitzsche, *supra* note 94, at 84.

258 INTRODUCTION TO GERMAN LAW 377 (Mathias Reimann & Joachim Zekoll eds., 2d ed. 2005).

259 Coester & Nitzsche, *supra* note 94, at 84.

260 *See supra* Section III.B.

261 For an in-depth analysis of the contractual agreement regulating the relationship between a plaintiff and a funder, see Coester & Nitzsche, *supra* note 94, at 87-94.

262 *See id.* at 95; N. Dethloff, *Verträge zur Prozessfinanzierung gegen Erfolgsbeteiligung*, NEUE JURISTISCHE WOCHENSCHRIFT 2225, 2227 (2000) (F.R.G.). *See also* DIRK BÖTTGER, GEWERBLICHE PROZESSFINANZIERUNG UND STAATLICHE PROZESSKOSTENHILFE: AM BEISPIEL DER PROZESSFÜHRUNG DURCH INSOLVENZVERWALTER (2008) (F.R.G.).

263 It is interesting to notice here the typical civil lawyer's attitude toward trying to bring back innovative contractual agreements within the pre-determined contractual "types" designed in the civil code. *See* MAURO BUSSANI, LIBERTÀ CONTRATTUALE E DIRITTO EUROPEO 28-35 (2005) (Italy).

264 Coester & Nitzsche, *supra* note 94, at 94.

265 A loan exists only where the borrower is obliged to pay back the received amounts under no contingency. In TPLF contracts, the plaintiff is only obliged to repay if he is successful and receives from the defendant the amount advanced by the funder. The same argument has been made in the context of U.S. law. Echeverria v. Estate of Lindner, 2005 WL 1083704, at *6. *See supra* note 44 and comments therein.

It is argued that a silent partnership under the German Civil Code arises in TPLF because the funder and the claimholder are pursuing a joint aim; the common goal of both parties is to assert the plaintiff's claim before a court and to achieve the highest possible award.[267] A comment deserves attention here. The existing literature on TPLF, both in the common law and civil law world, has highlighted the existence of possible conflicts of interest between the funder and the plaintiff. Consequently, if on the one hand, it is true that the funder and the plaintiff are moved by a common scope, then on the other hand, at some point, their interests and goals can diversify.[268]

The possible solution to this apparent contradiction concerns, once again, the issue of control. In my opinion, it moves from a descriptive toward a normative dimension. It has been argued that the partnership created by a TPLF contract is an undisclosed partnership, i.e., one in which only one partner—the plaintiff—is entitled to represent the partnership vis-à-vis third parties.[269] Furthermore, the plaintiff asserts the claim in his own name and decides on all steps to be taken independently.[270] This might certainly be a descriptive assertion (in that it describes what in fact happens), but in my view, it is relevant in a normative dimension—that is to say that a TPLF agreement should be considered a silent partnership, and, thus, valid, as long as the funder does not acquire any control over the lawsuit. Once again—as in the common law world—central to the validity of TPLF is the issue of control: if no control is transferred to the funder, TPLF does not seem to present any particular problem.

Another reason to interpret TPLF contracts as creating silent partnerships—as opposed to ordinary partnerships—is that no partnership asset exists. Notwithstanding the existence of a TPLF contract, the plaintiff's and the funder's assets remain strictly

266 An insurance contract requires that the insurance coverage be provided in return for a premium. *See* M. HENSSLER, RISIKO ALS VERTRAGSGEGENSTAND 373 (1994) (F.R.G.); Coester & Nitzsche, *supra* note 94, at 95.

267 Coester & Nitzsche, *supra* note 94, at 95.

268 Vicki Waye, *Conflicts of Interests Between Claimholders, Lawyers and Litigation Entrepreneurs*, 19 BOND L. REV. 225, 249 (2007) (discussing the existence of possible conflicts of interest between the funder and the plaintiff in common law); Toggenburger, *supra* note 101, at 627 (discussing the existence of possible conflicts of interest between the funder and the plaintiff in civil law).

269 Coester & Nitzsche, *supra* note 94, at 95.

270 *Id.*

separated.[271] The financing company, which is the silent partner, contributes to the partnership through the assumption of financial risk (through the advancement of payments) relating to the claimholder's lawsuit.[272] After the final court decision, the partnership is liquidated according to the rules established in the contract.[273]

As far as the validity of TPLF is concerned, the prevailing opinion is that TPLF is permissible. The main problem[274] it encounters lies in its relationship with the prohibition of lawyers' contingency fees. Contingency fees, according to which a lawyer advances all litigation costs of his client in exchange for a share of the proceeds in case of success and nothing in case of loss, are prohibited in Germany.[275] Critics of TPLF have argued that TPLF essentially serves the same function as contingency fees.[276] In fact, from the perspective of the plaintiff, having the lawsuit financed by the lawyer or by a third party funder is essentially the same, the result being the elimination of his risk in litigation costs.

The first issue is whether the prohibition of contingency fees should apply to TPLF. The answer is no, because the *Bundesrechtsanwaltsordnung*[277] contains ethical regulations for the Bar, and thus only applies to contractual relationships between lawyers and clients.[278] The financing contract is between the plaintiff and the funder only, the lawyer is neither part of the contract nor does he have any obligation under this contract.[279]

The second issue is whether TPLF contracts should be considered void because they circumvent the prohibition against contingency fees. In fact, under German law, legal acts that circumvent a prohibition are null and void if the regulation is designed to avoid the result reached by the circumventing legal act.[280] This argument is based on the assumption that the prohibition against contingency fees is designed to prevent the

271 *Id.*

272 *Id.*

273 *Id*. at 95.

274 For a description of other minor problems, see Coester & Nitzsche, *supra* note 94, at 98-101.

275 Bundesrechtsanwaltsordnung [BRAO] [Federal Lawyer's Act], Aug. 1, 1959, § 49(b) no. 2 (F.R.G.).

276 As reported by Coester & Nitzsche, *supra* note 94, at 95-98.

277 Toggenburger, *supra* note 101.

278 *See* Dethloff, *supra* note 262, at 2228; Coester & Nitzsche, *supra* note 94, at 96.

279 Coester & Nitzsche, *supra* note 94, at 96.

280 *See id.* at 96-97.

plaintiff from eliminating his litigation costs risk through recourse to external capital.

This assumption is wrong. The sole aim of the prohibition of contingency fees is to preserve the independence of the lawyer from his client, i.e., no acts taken by the lawyer when representing his client should relate to his own profit and economic interest. It is not the interest of the client that is protected by the prohibition of contingency fees, but rather the independence of lawyers.[281] Under German law, legal acts circumventing a prohibition are null and void only if the act reaches the aim that the regulation is designed to avoid.[282] Thus, TPLF shall not be considered void, because TPLF does not interfere with the independence of the legal profession.[283]

The problem with independence of lawyers, from a broader perspective than that considered with regard to contingency fees, is the third major validity issue faced by TPLF. Apart from the specific prohibition of contingency fees, judicial decisions mandate that each lawyer must be personally and professionally independent from any third parties.[284] Accordingly, the validity of TPLF is challenged by the possibility that TPLF creates conflicts of interest between lawyers and clients.[285] A client's financing contract, however, does not create a conflict of interest. The lawyer is not bound in any respect to instructions from the financing firm and may completely disregard them.[286]

From the observation of the three main issues that jeopardize the validity of TPLF contracts, a common leitmotif exists: TPLF is deemed valid because of the fact that the lawyer's incentives in carrying out his work are not altered by the existence of the TPLF contract. Apparently, this is only a descriptive argument. However, in my view, it is a normative argument that is essentially based on the problematic issue of the control of the litigation. Let us reconsider the conditions under which TPLF is deemed valid under the perspective of the three issues raised above: (1) the financing contract is between the plaintiff and the funder only and the lawyer is neither part of the contract nor does he have any

281 DEUTSCHER BUNDESTAG [BT]12/4993, § 31 (F.R.G.).

282 *See* Coester & Nitzsche, *supra* note 94, at 97.

283 *Id.* at 97.

284 *See* Federal Constitutional Court, BVerfGE 76, 184; *see also* Busse, Freie Advokatur, AnwBl. 2001, 135, Federal Court of Justice, BGH, BGHSt 22, 157.

285 *See supra* note 255.

286 Coester & Nitzsche, *supra* note 94, at 100.

obligation under this contract; (2) TPLF does not interfere with the independence of the legal profession, the safeguard of which is the aim of prohibition against contingency fees; and (3) a client's financing contract does not create a conflict of interest between the lawyer and the client.

The three conditions above clearly do not matter in their descriptive dimension, but rather in their normative dimension. In other words, the point is not that TPLF is permissible because that is what happens *in fact*, but rather that TPLF contracts, in order to be valid, must respect the above conditions. Once again, the transfer of control of the litigation is what creates problems for the validity of TPLF. If control is transferred from the claimholder to the funder, then it is not true that the financing contract does not have an impact on the lawyer. The lawyer will follow instructions from the funder, will further the funder's interest and not the plaintiff's interest (when they diverge); he will have obligations to the funder (e.g., duties to inform and provide documents), and conflicts of interest will exist when the plaintiff and the funder have different interests.[287] Once again, transfer of control in third-party litigation financing contracts is a very delicate aspect. For our purposes, however, which are limited to "narrowly" considering the TPLF, TPLF contracts are to be considered valid under German law.

3. Absence of TPLF and Perspectives of Development in the Civil Law World

I mentioned earlier that TPLF is virtually nonexistent in the civil law world with the exceptions of Germany, Austria and Switzerland. Because no specific prohibition seems to apply,[288] it is unclear why TPLF has not developed. I argue that a number of structural and cultural factors, characteristic of the civil law tradition, should be taken into consideration to explain the fact

287 It is true—in principle—that both the plaintiff's and the funder's interest is to achieve the maximum possible award. However, their interests may diverge with respect to timing and—eventually—also to the amount of the award. While a plaintiff is usually a one-shot player, who will then try to maximize the awards, a financing company is a repeated player. The amount of awards it is interested in is a function of the investment, not at all related to the merit of the claim. Possibly, if things get "complicated" during the course of the litigation, the funder will be willing to accept any amount that is superior to the costs he incurred, and will prefer to bring that case to conclusion soon instead of investing further resources.

288 *See supra* note 242.

that TPLF has not yet developed in the civil law world. On the one hand, structural differences include the costs of the legal system and the civil justice system, alternative methods of compensation of attorneys and procedural rules.[289] That is to say that not just positive rules, but rather all *formants* of legal system should be considered in analyzing TPLF.[290] On the other hand, cultural differences include deep cultural models that are rooted in a legal system, sometimes even in a way that is "unconscious"—not realized by the people within that legal system—, but play a significant role in the evolution of the law and legal culture.[291]

First, litigation in common law jurisdictions is much more expensive than in civil law countries. The very structure of the American judicial process decentralizes power and activity: a large variety of activities within litigation which are labeled "official" in European legal systems, such as service of process, discovery,[292] and questioning of witnesses, are private matters in American law and are therefore paid for by the parties.[293] Furthermore, punitive damages are not contemplated in civil law countries thus reducing the margin of profit from funding litigation.[294]

Second, from a broader viewpoint, within the civil law-common law divide, the civil law culture is considered to be less "litigious" compared to its common law counterpart.[295] Third,

289 Some skepticism has been expressed with respect to the economical viability of the TPLF industry in Europe. Toggenburger, *supra* note 101, at 621-627.

290 Sacco, after dwelling on the different formative elements of a system—namely the legal formants—challenges the traditional standpoint adopted by domestic jurists in analysing their systems. In particular, he rejects the traditional static approach whereby the legal rule is considered uniform and all the legal formants of one legal system are regarded as being coherent with each other (thus giving the same answer to a question of law). To the contrary, he argues that only through a dynamic and anti-formalistic approach, whereby legal formants are in a competitive relation with each other, is it possible to unveil the analogies and differences between different legal systems and to fill the hiatus between operative rules and declamations. *See* Rodolfo Sacco, *Legal Formants: A Dynamic Approach to Comparative Law*, Inst. 1 & 2, 39 AM. J. COMP. L. 1, 343 (1991); P.G. Monateri & Rodolfo Sacco, *Legal Formants*, *in* 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 531 (P. Newman ed., 1998).

291 In the comparative law literature, these are known as *crittotipi*. *See* ROFOLFO SACCO, INTRODUZIONE AL DIRITTO COMPARATO, *in* TRATTATO DI DIRITTO COMPARATO 125 (5th ed. 2005).

292 FED. R. CIV. P. 26.

293 *See* RUDOLF B. SCHLESINGER ET AL., COMPARATIVE LAW: CASES, TEXTS, MATERIALS 428, 448 (6th ed. 1998); Ugo Mattei, *A Theory of Imperial Law: A Study on U.S. Hegemony and the Latin Resistance*, 3 GLOBAL JURIST FRONTIERS, Art. 1, 9, 36 (2003), *available at* http://www.bepress.com/cgi/viewcontent.cgi?article=1088&context=gj.

294 Toggenburger, *supra* note 101, at 620.

295 According to the data offered by Marc Galanter in 1983, the only countries, out of a

from an even broader perspective, common law legal systems—especially the United States and the United Kingdom—are the ones that have reached the highest level of "commodification" of justice and legal services among the world's legal traditions—a trend where legal services are treated as "commodities," and which has found further epiphanies, e.g., in contingency fee schemes, advertisement of legal services, aggregate litigation, and generally a more entrepreneurial-oriented class of legal professionals.[296] The increasing commodification of civil justice in the common law probably creates a cultural environment that is fertile ground for the development of markets based on the transferability of property rights in litigation like those for TPLF and other similar practices.

In the civil law world, the use of the legal system is traditionally seen more as a way for the victim of a wrong to have his day in court and receive compensation, rather than a system through which private incentives and commodified legal services combine within a market-inspired framework for the pursuit of social welfare and efficiency.[297] A hypothetical explanation of the prevalence of the latter conception of the legal system in the United States may be found in the success of the law and economics movement in American contemporary legal thought. The discipline of law and economics has not reached an equal

---

group of fifteen, that presented more than 40 yearly civil cases per 1000 people were Australia, Canada (Ontario only), Denmark, England/Wales, New Zealand and the United States. Among them, Denmark was the only civil law country (according to the classification of legal systems provided by the University of Ottawa, *supra* note 250). Among the others, Belgium, France, Japan, Norway, Sweden and West Germany were between 20 and 31 per 1000 people; while Italy, The Netherlands, and Spain were below 10. *See* Marc Galanter, *Reading the Landscape of Disputes: What we Know and Don't' Know (and Think we Know) about our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 4, 54 tbl. 3 (1983). On the litigiousness of the United States, see WALTER K. OLSON, THE LITIGATION EXPLOSION: WHAT HAPPENED WHEN AMERICA UNLEASHED THE LAWSUIT (1991); Macklin Fleming, *Court Survival in the Litigation Explosion*, 54 JUDICATURE 109 (1970); B. Manning, *Hyperlexis: Our National Disease*, 71 NW. U. L. REV. 767 (1977). *See also* THOMAS F. BURKE, LAWYERS, LAWSUITS AND LEGAL RIGHTS: THE BATTLE OVER LITIGATION IN AMERICAN SOCIETY (2002). For a more recent view on the level of litigation in a comparative perspective, see STEPHEN C. YEAZELL, CONTEMPORARY CIVIL LITIGATION 39-64 (2009).

296 *See* RICHARD SUSSKIND, THE END OF LAWYERS? RETHINKING THE NATURE OF LEGAL SERVICES 27 (2008).

297 This approach is also visible in other fields of the law and perhaps it mirrors a general attitude. Consider, for example, breach of contract: while in the United States the primary remedy for breach of contract is compensatory monetary damages and specific performance being the "exception;" in the civil law world, it is the other way around.

degree of prevalence in the civil law world.[298]

Traditionally, in civil law legal systems, the claim is considered something very "personal," which cannot be sold or assigned an interest on—as in TPLF—in exchange for money. The origin of that notion can be traced back to ancient Roman and Greek jurisprudence, which was dominated by the view that only the litigants and judges should participate in the judicial process.[299] Under that jurisprudence, if an action was pursued on behalf of someone other than the party affected, the maintained action was unworthy and seen as a vehicle of oppression.[300]

The factors and broad trends discussed above might be among a few of the reasons why TPLF is not developing in civil law countries as it is in the common law world. However, it does not seem unlikely that TPLF will soon develop in continental Europe and other parts of the world,[301] especially in countries that are devoting efforts to strengthening access to justice but are simultaneously experiencing difficulties in the publicly-funded systems for financing civil litigation for the poor—e.g., legal aid.[302] These prospects of growth are suggested by the observation that TPLF is economically viable in the context of the civil law world, as demonstrated both by the economic model studied earlier[303]

298 For an early, comprehensive work discussing the success of the economic analysis of law in civil law countries, see 11 INT'L REV. L. & ECON. (1991), containing: R. Cooter & J.R. Gordley, *Economic Analysis in Civil Law Countries: Past, Present, Future*, 261; U. Mattei & R. Pardolesi, *Law and Economics in Civil Law Countries: A Comparative Approach*, 265; C. Kirchner, *The Difficult Reception of Law and Economics in Germany*, 277; G. Hertig, *Switzerland*, 293; S. Ota, *Law and Economics in Japan: Hatching Stage*, 301; S. Pastor, *Law and Economics in Spain*, 309; G. Skogh, *Law and Economics in Sweden*, 319; W. Weigel, *Prospects for Law and Economics in Civil Law Countries: Austria*, 325; and G. Hertig, *The European Community*, 331. For later works, see MATTEI, COMPARATIVE LAW, *supra* note 8; LAW AND ECONOMICS IN CIVIL LAW COUNTRIES (Bruno Deffains & Thierry Kirat eds., 2001); EDGARDO BUSCAGLIA & WILLIAM RATLIFF, LAW AND ECONOMICS IN DEVELOPING COUNTRIES (2000); Richard A. Posner, *Law and Economics in Common-Law, Civil-Law, and Developing Nations*, 17 RATIO JURIS 66 (2004); Aristides N. Hatzis, *Civil Contract Law and Economic Reasoning: An Unlikely Pair?*, THE ARCHITECTURE OF EUROPEAN CODES AND CONTRACT LAW 159 (Stefan Grundmann & Martin Schauer eds., 2006).

299 Radin, *supra* note 180, at 48.

300 WAYE, *supra* note 25, at 12.

301 As mentioned earlier, in Asia, China and Japan are considering introducing legal-expenses insurance. *See* Qiao, *supra* note 128, at 1.

302 Russia, for example, is showing interest in learning about best practices in (and alternatives to) legal aid. *See, e.g.*, INST. OF L. AND PUB. POL'Y, Project, *Strengthening Access to Justice for the Poor in the Russian Federation 2008-2012*, http://ilpp.ru/page_pid_578_lang_2.aspx (last visited Mar. 28, 2011).

303 *See supra* Section IV.A.2.

and by the experience of Germany.[304] Moreover, the recognition of the fact that "[l]itigation funding by private third parties (e.g. companies specializing in financing litigation) is practiced successfully in some Member States" has also come from the European Commission.[305]

TPLF seems to have development potentials in the civil law world. Apart from the likelihood that favorable economic conditions exist for the development of the industry, which deserves to be carefully studied, what appears to be true is that claimholders would largely benefit from TPLF in many civil law countries, which could create a high demand for TPLF. Take the example of Italy, and consider the following quotation:

> The Italian John Doe who needs the support of a court in order to obtain the fulfillment of a right or of a legally protected interest is in a very unfortunate situation. . . . In Italy, contingent fees are forbidden by the law and lawyers will not bear the costs of a case by themselves without being paid for their work throughout the entire proceedings. Therefore, our John Doe will be required to pay in advance, and in the course of the process, all the money necessary to cover the costs of the case and at least a part of the attorney's fees, until the moment when the judgment allocates all these costs according to the "loser pays all" rule. This would not be a great problem if the time required to achieve the judgment were short. On the contrary, however, the length of civil proceedings in Italy is, in most cases, excessive. An average case may require three or four years to proceed through the court of first instance. . . . This means that our John Doe must be able to bear all the costs for several years, until the case comes to a conclusion in the court of first instance.[306]

The length of Italian civil proceedings generates high costs for plaintiffs, which are often prohibitive.[307] Although its effect on the length of civil proceedings is not easily predictable, TPLF might represent a solution to the problems faced by claimholders who cannot afford to bring a lawsuit or who, considering its outcome uncertain and indeterminable in time, choose not to bring suit because the expected value of the claim does not outweigh its

304 *See supra* Section V.B.2.

305 *Comm'n Green Paper on Consumer Collective Redress*, COM (2008) 794 final (Nov. 27, 2008) § 51.

306 M. Taruffo, *Civil Procedure and the Path of a Civil Case*, *in* INTRODUCTION TO ITALIAN LAW 159-160 (Jeffrey S. Lena & Ugo Mattei eds., 2002).

307 *Id.*

expected costs. The possibility for claimholders to bargain over property rights in litigation with third parties in a way that allows them to promise a share of the awards in exchange for having all litigation costs covered, would allow them to eliminate the risks connected with bringing suit, thus increasing the expected value of the claim and making them better off.

If TPLF were to develop in the civil law world, who should be investing in litigation? It has been argued that TPLF is a tough business:[308] it is a risky business that can lead to large losses very quickly.[309] The risk of litigation has to be evaluated very carefully.[310] On the one hand, a recent trend has been the establishment of financing companies by large insurance companies.[311] This development is not surprising, given that the business model of TPLF is similar to that of legal expenses insurance policies, and, therefore, fit into the product lines of many insurance companies. On the other hand, a recent trend has been the creation of litigation financing companies by large well-capitalized financial companies that raise capital on stock markets.[312]

VI. CONCLUSION

The ability of claimholders and third parties to bargain over property rights in litigation enables interactions between the civil justice system and the world of finance, which break with the traditional conception of the litigation process. This approach addresses a major problem traditionally considered inevitable: the costs and risks of litigation. Third-party litigation funding—one of the most innovative trends in civil litigation financing today—is based on the existence of gains from trade in property rights in litigation, and permits claimholders to eliminate the risk connected to litigation. In exchange for the elimination of risk, the claimholder pays a price, which is represented by the share of awards that he promises to give to the funder in case of a favorable outcome of the litigation.

The legal status of TPLF is currently at the center of a heated

308 Toggenburger, *supra* note 101, at 627.

309 Coester & Nitzsche, *supra* note 94, at 101.

310 On the role of risk analysis in claim evaluation and litigation management, see CALIHAN, DENT & VICTOR, *supra* note 18.

311 *See, e.g.*, Allianz Prozessfinanzierung, *supra* note 90.

312 *See, e.g.*, Juridica Capital Management, *supra* note 156.

debate among courts, institutions, professionals, and academics on both sides of the Ocean. This article proposes a comparative legal and economic approach to the study of TPLF. The economic and the legal issues created by this innovative practice—both in the "is" and in the "ought to be" dimensions—should be looked at from a transnational and interdisciplinary perspective.

Among the main results of this article, is the acknowledgment of the importance of control over litigation. That courts are highly concerned about control and have considered this analysis as one criterion for determining the validity of TPLF agreements, both in the common law and in the civil law world, emerges from this comparative legal analysis. Moreover, it has been determined that when no transfer of control is contemplated under the funding agreement, TPLF is permitted in all the jurisdictions considered. This jurisprudential orientation has proved to deserve approval and encouragement in light of the economic analysis, which has shown that TPLF—under the model—leads to efficient allocations of property rights in litigation, despite some remaining externality problems. TPLF requires further study, which should not prescind from a comparative approach. One observation should be kept in mind: as TPLF allows claimholders to eliminate the risk connected to litigation, the objective should be that such elimination of risk happens at the lowest possible price for claimholders, in order for the TPLF market to operate efficiently.

The following considerations are thus worth mentioning to conclude. First, TPLF should continue to be permitted, as a further development of the industry would allow a higher degree of competition among litigation financing companies. This would lower the price of TPLF to a level closer to the marginal costs.

Second, the issue of the control over the litigation should be studied more in depth. Currently, in all jurisdictions, the contractual transfer of control over the litigation from the claimholder to the funder is looked at with suspicion. Certainly, the funder benefits from acquiring control. However, that does not necessarily mean that the transfer of control harms the claimholder; the more control the funder acquires over the litigation, the lower will be the price (i.e., the share of awards) that he will require from the claimholder in exchange. This is not to say that the conflict of interest problems that can derive from the transfer of control are of minor importance, but I suggest that the control over the litigation has an economic value that should be given a price. If the parties of a TPLF contract were allowed to bargain over the transfer of control, this might lead to Pareto superior allocations of resources. In fact, the claimholder would be required to pay a lower price for TPLF if he transfers some portion of control power.

Third, further interactions between litigation and finance should be explored that might be beneficial in order to reduce the price that the claimholders pay for the elimination of risk in TPLF. Financial instruments that permit litigation funders to reduce the riskiness of their investments might be used, so that they could reduce the price they charge claimholders. For example, if the funder were able to use a credit-default-swap-like contract with a third party—making periodical payments in exchange for receiving a payoff (equal to the amount invested) in the case his client loses at trial—he would reduce the risk of loss linked to the plaintiff's loss at trial and thus could charge him a lower share of awards in case of success. This is just one example that demonstrates the further potential that the interrelationships between litigation and finance can offer in the service of the civil justice system, thus countering the problem of the costs and risk of civil litigation.

A greater liberalization of the ability of claimholders and investors to bargain over property rights in litigation, and the consequent increasing interrelationships between civil justice and finance, would produce efficient and socially desirable markets in litigation risk that could develop both in the common law and in the civil law world.