Welcome to the Party: Creating a Responsible Third-Party Litigation Finance Industry to Increase Access and Options for Plaintiffs

Christopher Mendez

Follow this and additional works at: https://dc.law.mc.edu/lawreview

Part of the Law Commons

Recommended Citation
Available at: https://dc.law.mc.edu/lawreview/vol39/iss1/5

This Comment is brought to you for free and open access by MC Law Digital Commons. It has been accepted for inclusion in Mississippi College Law Review by an authorized editor of MC Law Digital Commons. For more information, please contact walter@mc.edu.
WELCOME TO THE PARTY:
CREATING A RESPONSIBLE THIRD-PARTY LITIGATION FINANCE INDUSTRY TO INCREASE ACCESS AND OPTIONS FOR PLAINTIFFS

Christopher Mendez*

I. INTRODUCTION

Third-party litigation financing has the potential to address blind spots in the American civil litigation landscape and improve the system as a whole. Traditional litigation financing arrangements have left many Americans out in the cold, lacking the proverbial “key to the courthouse.” A rethinking of the current litigation financing system can offer more Americans with meritorious, winnable claims the ability to pursue their claims; this change has the potential to substantially increase equal access to the courts for the average person and further public interests.

The term “third-party litigation financing” simply refers to a situation in which capital to pursue a lawsuit is provided by a party that otherwise has no connection to the case (not the party or his counsel).1 In exchange for an advance of funds to pursue a claim, the financier charges interest on the advance if the plaintiff recovers. There are several kinds of third-party litigation financing including corporate, consumer, claim, and defense.2 This Article focuses on consumer claim financing, meaning an individual plaintiff (as opposed to a corporation) who secures funding from a third party to litigate a claim.

Third-party litigation financing is a relatively new addition to American litigation and has not been without its critics. The predominant criticisms are that plaintiffs may end up with a smaller piece of the pie and that third-party financiers of litigation may take advantage of unsophisticated clients in what amounts to predatory lending in the form of high interest rates.3 These issues, however, can be addressed and remedied

* Christopher Mendez is a 2021 graduate of Mississippi College School of Law.


by a scheme of commonsense state regulations aimed at protecting consumers of litigation financing.

This Article’s intended audience includes state legislators and state agencies, as they have the power to implement the changes proposed here, as well as practicing attorneys, who may find the proposed changes provocative, but hopefully stimulating as well. Additionally, the general public may benefit from rethinking their relationship with the legal field; anyone could be a plaintiff at some point, and third-party litigation financing can empower the average plaintiff to take control of, or pursue at all, his meritorious claim.

The arguments laid out below have two main purposes: (1) to illustrate the positive role third-party litigation financing can play in the American legal system, and (2) to explain how states can create a structure that will allow the industry to increase access to civil justice and create more options without disadvantaging plaintiffs.

Section II of this Article provides a background on the history of third-party litigation financing and how agreements are typically structured. In Section III, the benefits of incorporating a third-party litigation financing are explored, focusing on the potential for increasing access for plaintiffs. Section IV specifically explores the benefits of third-party financing as compared with the most common form of litigation financing – the contingency fee. A proposal for how third-party litigation financing should be generally regulated to protect consumers is laid out in Section V.

Though seemingly dramatic, these proposed additions to the civil litigation sphere need not be frightening, and the great potential for increased equal access and fairness to the civil justice system can perhaps not be achieved by any other means.

II. BACKGROUND

A. What is Third-Party Litigation Financing?

Third-party litigation financing is the process by which a litigant secures funding from an outside party with no other interest in the litigation. In the case of plaintiff claim litigation financing, a plaintiff will secure funds from a lawsuit funding company. The capital is advanced to the plaintiff on a non-recourse basis meaning that if the plaintiff does not have a favorable outcome, he does not need to repay the loan. If the plaintiff does prevail, in exchange for the advance of capital, the funding company

5. Id.
will take a cut of the plaintiff’s recovery to repay the loan with interest. The amount of interest due typically increases depending on how long the claim takes to resolve. In short, litigation finance companies are investors in the outcome of the plaintiff’s case.

The role of third-party litigation financing runs parallel to the role of the contingency fee agreement. Both are intended to allow a plaintiff, otherwise unable to hire an attorney based on hourly rates, to gain better access to the courts. Before the advent of the contingency, both sides of a civil case would simply pay a lawyer an hourly rate for his services. This system greatly advantaged the rich over those in the middle and poorest classes as they had the capital to invest in their own legal redress. As the price of legal fees rose, more in the middle class were unable to pursue their claims. Contingency fees, first widely used at the beginning of the 20th Century, were a solution to this problem. Third-party litigation financing also seeks to address this issue; the advancing of funds (by a third party) allows those in the middle and poorer classes, who are unable to hire a lawyer on an hourly basis, to pursue their claims.

B. History of Third-Party Litigation Funding & Historical Prohibition

As the new kid on the block (compared to contingency fees), opponents of third-party litigation financing frequently turn to an historical argument to attack the practice: the ancient concept of champerty. Champerty is an agreement that divides the proceeds of litigation between the owner of the claim and a party unrelated to the lawsuit (who helps to support the claim). Champerty has traditionally been disallowed in the

7. Id.
8. Contingency Fees are explained in Section V of this Article.
9. This Article focuses on plaintiffs who want to acquire representation or who would not pursue a claim in the absence of counsel. A plaintiff can always pursue a claim pro se, however statistical analysis of outcomes show that a represented plaintiff has much greater favorable outcomes than unrepresented ones, especially when the defendant is represented, and the plaintiff is not. For a detailed analysis on litigation outcomes see Shauna Strickland, Scott Graces, & Richard Schauffler, Virginia Self-Represented Litigant Study: Outcomes of Civil Cases in General District Court, Juvenile & Domestic Relations Court, and Circuit Court, National Center for State Courts (2017).
11. Id. at 622
12. Id.
13. Id.
14. Steinitz, supra note 2, at 1286.
United States, but its roots are of ancient Europe. The prohibition on champerty grew out of situations in which less wealthy landowners would convey their property to much wealthier landowners in order to combat others' claims to the land (a powerful outsider trying to take the land of the smaller landowner). Once conveyed, the wealthier man would overwhelm the courts and secure a victory for the less wealthy man, while taking a piece of the property for himself. The practice was abused and allowed wealthy lords to acquire even more land and influence.

Champerty laws are quite inconsistent among the states. Some states including Arizona, California, Louisiana, New Jersey, and Texas permit champerty or do not see third-party litigation financing as champerty. While in other states, including Alabama, Delaware, Georgia, Minnesota, Mississippi, New York, and Pennsylvania, champerty prohibition is alive and well, and third-party financing can be found as a violation; a defendant can invoke the champerty law, and litigation will come to a stop.

In 20th Century America, champerty laws had a revival in southern states as a means of stifling civil rights litigation. Civil rights claims following the Supreme Court's Brown v. Board of Education decision often had civil rights organizations attached as amicus curiae. Champerty laws were strengthened and invoked to stymie such suits and limit civil rights litigation.

From champerty's outdated purposes to its modern misuse, it can be argued that the doctrine is somewhat obsolete. The inconsistent application of champerty among the states points to the need for updating. Champerty, one of the main historical arguments against third-party litigation financing, is an archaic concept that should be weakened or removed from the American civil litigation sphere. This would help clear the road for a responsible third-party litigation financing industry to develop consistently across the states. Once there is a consistent rejection of champerty laws (or at least exceptions built in for consumers of third-party litigation financing),

15. Id. at 1287.
16. Id.
17. Id.
19. Id.
20. Id.
21. Steinitz, supra note 2, at 1287.
22. Id.
23. Id.
third-party litigation financing can be used to empower plaintiffs by increasing their options in pursuing their cases.

C. Features of a Third-Party Litigation Financing Agreement

The agreement between the plaintiff and his third-party financier includes that the advance is a nonrecourse loan. This means that if the plaintiff loses, he does not need to repay the loan or any interest. Additionally, if the plaintiff does win, but his proceeds do not exceed his loan plus interest, the plaintiff does not owe the deficit; in other words, a debt cannot be created that is greater than judgment received by the plaintiff. The loan agreements usually include a sliding scale of interest rates; the longer the claim takes to resolve, the higher the interest rate. These rates will vary based on the financier and the nature of the case. For the sake of illustration, a simple sliding interest rate schedule may look like this:

<table>
<thead>
<tr>
<th>Time from Issue of Loan to Resolution of Claim</th>
<th>Interest Rate</th>
<th>Time from Issue of Loan to Resolution of Claim</th>
<th>Interest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-3 Months</td>
<td>20%</td>
<td>12-18 Months</td>
<td>50%</td>
</tr>
<tr>
<td>3-6 Months</td>
<td>30%</td>
<td>18-24 Months</td>
<td>80%</td>
</tr>
<tr>
<td>6-12 Months</td>
<td>40%</td>
<td>&gt; 24 Months</td>
<td>100%</td>
</tr>
</tbody>
</table>

Some finance companies do not use this sliding scale interest rate system and instead charge a monthly interest rate on the amount borrowed. This rate is usually in the neighborhood of 15% per month and non-compounding. In this type of arrangement, a plaintiff who borrowed $10,000, would accrue an additional $1,500 of interest for each month that passed before the claim was resolved. This second type of arrangement may be beneficial for a plaintiff whose case is very quick to resolve, but the potential for ballooning interest raises concerns. For instance, a plaintiff who borrowed $10,000 on a 15% per month basis would owe the financier...

25. Id.
26. Id.
28. Misty L. Sheffield, What You should Know About Litigation Lending, Atlanta Paralegal Services (June 5, 2012).
29. Id.
$28,000 ($10,000 principal and $18,000 in interest) if the case took 12 months to resolve—a whopping 180% interest. Because the monthly interest rate model has the potential to overwhelm plaintiffs with exorbitant interest, the proposed regulations below advocate for a sliding scale agreement instead.

III. BENEFITS OF THIRD-PARTY LITIGATION FINANCING

A. Increasing Equal Access to Justice & Furthering Public Interests

As state above, the acceptance of third-party litigation financing allows more middle class and less advantaged Americans to engage in civil litigation and seek redress for wrong perpetrated against them. It is worth exploring how third-party financing can increase access for plaintiffs who cannot afford to pay a lawyer on an hourly basis.

There is little doubt that all Americans do not share equal access to the civil justice system. With the need for legal representation seemingly ever expanding, it is essential that more people get the legal assistance they need. Everything from filing a claim under the Americans with Disabilities Act, to filing an employment discrimination claim, to product liability claims, and many other claims benefit from the services of an attorney. Women, minorities, immigrants, the elderly, and the impoverished are more likely to require legal assistance.

While Americans are entitled to legal representation in criminal prosecutions against them, there is no such entitlement for civil cases. States and the federal government have tried to fill the gap between the need for civil representation and the representation available. For instance, in 1974, Congress created the Legal Services Corporation (LSC) to help low income individuals who need civil legal aid. The LSC estimates that 71% of low income households experienced at least one civil legal problem in the year 2017; of those households, the LSC estimates that 86% received inadequate or no legal help.


31. See supra Note 9 and accompanying text. This Article is predicated on the concept that plaintiffs who are represented fair better than plaintiffs who are not.

32. Id.

33. U.S. CONST. amend. VI.

34. Buckwalter-Poza, supra note 31, at 7.

by which low-income or disadvantaged individuals can apply for grants to address their civil legal needs.36

While these government programs help to address the issue of inadequate civil litigation access, they are quite imperfect. For instance, they may only be available to a certain category of people, such as those living in poverty; for people outside the category, assistance may be unavailable. The risk of pursuing litigation on an hourly rate basis is a risk for any plaintiff as an unfavorable outcome will result in the accumulation of legal fees. This risk has a vast deterrent effect on potential plaintiffs, even those who may be able to afford the legal fees.37

The most typical way for plaintiffs to shift the risk of litigation away from themselves is by entering into a contingency fee scheme with their attorney. If the plaintiff is victorious, the attorney will take a healthy piece of the proceeds, but the client is not required to pay attorney’s fees up front. This is a routine and well-established method for helping a client get his “key to the courthouse,” but it, too, is not without its flaws.38 One classic issue with contingency fees is the motivation of the attorney. It often makes more financial sense for counsel to settle cases early; this guarantees income for the attorney and doesn’t require substantial expense of time and resources on the attorney’s part.39 Once the risk shifts to the attorney, he may be much less conservative in his demands. Contingency fees and their relative function to third-party litigation financing are fully addressed in more detail in Section IV of this Article.

Third-party litigation financing offers an arrangement in which neither the plaintiff nor his counsel is bearing the risk of litigation. This will ease the burden on the parties who have an immediate interest in the suit. Attorneys will be free to approach the case in the way they feel is best without having to worry about the economics of each case. The plaintiff will suffer less financial and emotional stress knowing that he has the resources to pursue his meritorious claim.40 Further, the plaintiff may be able to secure better or more adequate counsel, increasing his likelihood of a favorable outcome.41

36. See generally Buckwalter-Poza, supra note 31, at 7.
37. Id.
38. Steinitz, supra note 2, at 1293.
39. Id. at 1301.
40. Id.
41. Id. at 1299.
B. Benefits of Increasing Access to Civil Courts

In the micro, the benefit of access to civil justice has a clear benefit for plaintiffs with meritorious claims – they will be able to utilize the legal system to realize their deserved remedy. With risk diverted to a third party, more claims can be pursued and more justice served via civil courts.

Beyond simply gaining access, third-party litigation financing offers an opportunity to advance the fairness and sophistication of civil litigation. In his work, *Why the “Haves” Come Out Ahead: Speculations on the Limits of Legal Change*, Marc Galanter explores the outcomes in civil litigation between “haves” (people with resources) and “have-nots” (people without resources).42 Perhaps “big guy” and “little guy” are better names for the purpose of this article. Often the plaintiff in a civil case is the little guy; an individual with little experience in civil litigation and limited resources.43 The defendant is often the big guy, perhaps a corporation. The big guy has plenty of experience with civil litigation, as he has been a defendant many times before; he is a repeat player in the game of civil litigation.44 He also has vast resources to allow him to pursue his defense to the end.

The disparity in experience and resources creates an advantage for the big guy.45 He can pressure the little guy to take quick settlements as he knows the little guy fears being able to afford an extended litigation process.46 Third-party litigation financing offers a chance to rebalance the scales in favor of the little guy. If defendants know that the plaintiff is backed by a financier, they will be more likely to offer a fair settlement rather than intimidate the plaintiff into taking an inequitable one.47 Further, the plaintiff may be able to see the claim through to a trial and recover a more equitable amount.

As litigation financing companies gain more experience via funding with plaintiffs, they will become repeat players and the advantage of big guy defendants will be diminished.48 Greater balance in civil justice will result.

In the macro, increased access to pursue meritorious claims will help to advance the public interest. Private litigation is essential to the

43. *Id.*
44. *Id.*
45. *Id.*
46. *Id.*
47. Steinitz, *supra* note 2, at 1304.
48. *Id.* at 1305.
progress of public interest changes. Litigation can be a tool to punish or persuade the private sector into making changes that benefit the public as a whole. That litigation and change can then be used to help governments develop statutes and regulations that further public interests.

An example to illustrate: a large company manufactures a product. A consumer is harmed by that product and files suit with the help of a lawyer. The consumer wins and is awarded punitive damages. This may encourage other consumers to file similar suits. The corporation is likely to make changes to the product design to prevent further injury to consumers and avoid paying future awards or settlements. Further, governmental agencies will be alerted to potential issues with products or manufacturers and implement regulations to protect the public. As discussed above, third-party litigation financing has the potential to increase access to pursue meritorious claims. More claims equate to more, and likely faster, advancement of issues that are in the interest of the public. This scenario, though simple, demonstrates how litigation can spark private and governmental progress toward addressing issues of public interest.

One argument made by opponents of third-party litigation financing is the potential for a landslide of meritless claims being filed, adding to the lengthy logjams that exist in many court systems. This is a point used by the critics of contingency fees as well. However, third-party litigation financing actually has the potential to decrease frivolous suits as compared to the contingency fee scheme.

By injecting a third-party into the litigation process, the likelihood of a meritless claim being forwarded is likely not increased. This is because third-party financing creates a shifting of risk, not an elimination of risk. Litigation finance companies make an investment in the plaintiff's case. Accordingly, they are unlikely to invest in a claim that is frivolous as they will be the party incurring the loss if the plaintiff loses. Another set of eyes (or many added sets of eyes) may have the effect of filtering out meritless claims. Rather than relying on the judgement of a single lawyer or firm, the judgement of the financier is utilized and meritless claims can be stopped before they start.

Plaintiffs (and even attorneys) may have great emotional investments in their cases. Plaintiffs may feel personally wronged despite

50. Id.
51. Id.
52. Thus, likely improving the plaintiff's chances of winning.
53. Herschkopf, supra note 4, at 1.
54. Steinitz, supra note 2, at 1293.
55. Id. at 1314.
having a claim with no legal merit. Attorneys may lose sight of the claim's merits because they focus intensely on being a good advocate for the client rather than analyzing the winnability of the case. The injection of a third-party can cool the burning emotions that may be associated with lawsuits. In this way, the number of meritless claims is not likely to increase.

Increased access to the civil justice system for the average American is the greatest asset and potential for third-party litigation financing. Currently, there are millions of Americans lacking access and financing can be their key to admittance. Third-party litigation financing, more than any other method, has the greatest potential to quickly and efficiently boost access for the average citizen with a meritorious claim.

C. An Illustrative Vignette: Giving More Access to Poor Plaintiffs

Paige Plaintiff worked as a factory worker at BrandCo, an international conglomerate that manufactures and sells thousands of items. Paige worked for BrandCo for four years. BrandCo employs thousands of people across their American operation. One day, Paige's boss, Barney Boss, approached Paige during lunch and told her she was fired. Shocked and upset, Paige asked Barney what she had done to get fired. Barney responded, "Nothing, you didn't do anything wrong. I want to hire a man to do your job; the department has too many women – it's not macho enough."

Paige tried to find work for months but was unsuccessful. Reflecting on getting fired, Paige thought it was unfair that she lost her job simply because she was a woman. She thought that there must be a law against firing someone based on their sex. Paige called Lisa Lawyer and explained her situation. Lisa told Paige that she could probably sue BrandCo for employment discrimination. Paige said she would like to do so and, having never hired a lawyer before, wanted to know how it all worked.

Lisa explained that her hourly rate was $200 per hour, she expected to spend 100 hours working on the case, and that she would need a $5,000 retainer to start working on Paige's case. Paige explained that she had been out of work since she was fired and that she was having trouble making ends meet as it was; she didn't have $5,000 nor could she confidently say

---

56. This vignette focuses on a sexual discrimination claim. Under Title VII, a plaintiff must first file a complaint of sexual discrimination with the Equal Employment Opportunity Commission (EEOC) – a governmental agency. A claimant must wait (a maximum of 180 days) for the EEOC to give them permission to sue their employer. In the interim, the EEOC may try to mediate the issue themselves before allowing the plaintiff to sue.
that she would be able to pay Lisa's hourly rate (an estimated $20,000) if
she lost the case. Paige decided it was too risky for her to pursue her claim
on an hourly rate basis.

Lisa, who has experience with employment discrimination, told
Paige that for a claim like hers against a company as big as BrandCo, the
maximum recovery she could receive was $300,000 including any
compensatory and punitive damages. Lisa felt that Paige had a very good
claim as Lisa had won in a similar case against BrandCo just a few years
before. Lisa told Paige that if she couldn't afford to pay her hourly, a friend
of hers, Angus Attorney, took cases on a contingency basis. Lisa figured
that Angus would be interested in Paige's case as there was enough meat on
the bone for old Angus.

Paige visited with Angus to explain her situation. Angus has
litigated dozens of employment discrimination cases and concluded that,
from his experience, Paige's case was not worth $300,000. He explained
that punitive damages are usually reserved for extremely egregious cases or
cases in which the employer has a pattern of discrimination. Angus
estimated that Paige would be lucky to get $30,000 for her claim and it
would probably come in the form of a settlement. Further, Angus was not
confident that he could even get a settlement, or win at trial for that matter,
as BrandCo employed some of the best attorneys in the country. “Sorry,
lady. I only take on slam dunk cases. It's not worth the risk to me to take
on your case, those BrandCo guys are tough.”

Unable to afford to pay Lisa an hourly rate, nor persuade Angus to
take her case, Paige is without redress. She became frustrated, hopeless,
and disenfranchised. Paige decided not to further pursue her claim. Not
only is this unfortunate and deleterious for Paige, but society as a whole is
also injured because BrandCo's discrimination went unchecked.

If a third-party financier is injected into this scenario, the result can
change dramatically. Paige could reach out to a litigation finance company,
TP Finance Company, and explain her situation after she has already
spoken to Lisa.57 Instead of relying on one lawyer's experience with
employment discrimination, TP has data on thousands of previous
employment discrimination cases they have financed before. TP
determines that Paige has an 80% chance of winning and that she will likely
get the maximum ($300,000) as they have knowledge that BrandCo has a
long and repeated history of not checking this kind of discrimination. TP
confers with Lisa and agrees that the case will only take 100 hours to
resolve.

57. Alternatively, Lisa may already have a relationship with TP Finance and
refer her clients to them when a client with a meritorious, winnable claim.
TP offers to advance Paige $40,000 ($20,000 to pay Lisa and $20,000 for living expenses while the case plays out). TP estimates that the case will take 12 months to resolve and communicates this to Paige. TP's agreement includes a 50% interest rate on the money it advanced to Paige in the event the case takes 12 months to resolve.

If Paige wins and receives the maximum judgment, Lisa will be paid her hourly rate as she expected. TP will profit $20,000 via the interest charged on the loan. Paige will receive the remainder of the settlement; this will be a net gain of $240,000, plus Paige was able to live on her loan for 12 months while the case was resolved and have the lawyer of her choice rather than being limited to lawyers who work on a contingency basis.

Further, Paige's victory sends a message to BrandCo that it will be punished for its continued violation of discrimination law. In addition, if many employees with similar experiences to Paige's are empowered to file suit thanks to the availability of third-party financing, BrandCo, or similarly situated companies, will be incentivized to better prevent discrimination. This serves the greater public interest of keeping the workplace free of discrimination.

If Paige does not win, the only loser is TP finance. Lisa would still get paid her hourly rate. Paige had the opportunity to pursue her claim (though the court ultimately decided it was not a winning claim) and paid her living expenses for 12 months. TP finance would lose $40,000. Why would a company be willing to take this risk when either a plaintiff or lawyer would not? The answer is in the more advanced risk analysis that a financier, as an investor, is likely to complete.

If TP calculates that it has an 80% chance of winning a case like Paige's, the math makes the risk worth taking for the company. Of ten cases similar to Paige's, the plaintiff will win eight times and lose two times. On those two losses, TP will lose $80,000 (assuming they advance the same amount of money to each similarly situated plaintiff). On the eight winning cases, TP will profit $160,000. After ten cases, TP knows they will profit $80,000. This makes it economically logical for TP to engage in business

---

58. This does not factor in any other associated fees Paige would have to pay such as filing fees or similar costs not directly included in Lisa's hourly rate.
59. Of the $300,000, Paige will repay TP $60,000 ($40,000 principal + $20,000 in interest) and has paid Lisa $20,000. Paige has also spent $20,000 on living expenses throughout the 12-month period. Paige's entire income from the loan and the judgment are $340,000 ($40,000 loan + $300,000 judgment). Therefore, Paige nets $240,000 ($340,000 [total income] - $60,000 [repaying the loan plus interest] - $20,000 [Lisa's wages] - $20,000 [living expenses] = $240,000).
60. $40,000 x 2 losses = $80,000
61. $20,000 of profit from interest x 8 wins = $160,000
as they become repeat players and can mitigate any losses. This is luxury that a single plaintiff or attorney often cannot afford.

IV. ADVANTAGES OF THIRD-PARTY FINANCING OVER CONTINGENCY FEES

A. Background

In the current American legal industry, the contingency fee is a staple of litigation funding. Contingency fees exist to ensure that people with meritorious claims, who would otherwise be unable to pay the costs of litigating a claim, gain access to counsel and the courts.62 This is in contrast to an hourly rate arrangement in which a client simply pays his lawyer on the basis of how many hours he works on the case.

Without a contingency fee system, a power disparity between plaintiff and defendant could rob a plaintiff the chance to litigate and recover.63 For instance, this could happen in a case in which the plaintiff is just an individual and the defendant is a corporation. Using an hourly arrangement, the corporation/defendant could bankrupt the plaintiff before the case is resolved, the plaintiff would stop pursing the case, and he would not receive justice nor be made whole.64

A contingency fee agreement usually requires no money upfront flowing from the plaintiff to the lawyer. Instead, the agreement promises to the lawyer a percentage of any judgment won by the plaintiff. Those percentages vary, but typically they will be roughly one third for a pretrial settlement, forty percent for a claim that goes to trial, and as high as fifty percent if an appeal is needed.65 If the plaintiff loses, he will typically pay the lawyer nothing for his work, but may still be responsible for paying court costs, the cost of depoing witnesses, or similar costs that are not direct attorney labor fees.66

Under a contingency fee system, the lawyer bears the brunt of the risk. The plaintiff's risk is relatively minimal in that he will only need to pay some costs as stated above. The lawyer risks receiving nothing for his work and also the opportunity cost of using that same time to pursue a case that would have made him money. Because the risk rests upon the attorney,

63. Id.
64. Id.
65. Id. at 624-25.
he must be discerning about which cases to take. Further, he makes up for this risk by requiring such a large piece of the pie when the plaintiff is successful.

B. Common Criticisms of Contingency Fees

Contingency fees are the norm for plaintiffs who cannot afford an hourly rate arrangement, but they are not without their critics. The main criticism is that the contingency fee warps the attorney's motivations. It forces an attorney to think more about money, risks, and outcomes, rather than justice for his client. This can lead to early, lower settlements or lawyers being so averse to risk that they only represent clients who have the most winnable, highest payoff claims. This leaves other clients unable to secure representation.

Additionally, the large percentage taken by attorneys brings into the conversation a discussion of fairness. Plaintiffs may not fully understand that he will be giving such a great percentage of any judgment to his lawyer. Contingency fee agreements are often complicated and may separate costs from fees. The result is that the attorney not only gets his agreed upon percentage, but also large amounts in the form of legal costs. An agreement with a typical one-third pre-trial settlement agreement may, in reality, end up entitling the attorney to half the settlement after legal costs are added. The issue, of course, is that less money lands in the pockets of the plaintiff, who may be the victim of serious harm; this tarnishes the legal profession and likely contributes to the unsavory image of a personal injury lawyer held by many in the general public.

Another criticism of contingency fees is the potential for exploitation. A personal injury plaintiff may be in urgent need of assistance. Lawyers are in the more powerful position in this situation as they have specialized knowledge the general public does not have. This

---

68. Id.
69. In the most recent Gallup poll, Lawyers as a whole (not just personal injury lawyers) ranked in the bottom half of occupations in terms of people's rating of that occupation's honesty and ethical standards. Only 22% of people responded that they thought lawyers had a high or very high ethical standard, while 28% responded that lawyers have a low or very low ethical standard. This poll is sometimes used to rank the most and least trusted professions in the country. Lawyers consistently land just above members of Congress, business executives, and used car salesmen. The poll can be accessed at Gallup, *Honesty/Ethics In Professions*, (Sept. 16, 2020), https://news.gallup.com/poll/1654/honesty-ethics-professions.aspx.
makes it very tempting for attorneys to be less than forthcoming with the reality of the plaintiff's case. Perhaps the plaintiff's case is simple and a sure winner. An attorney may suggest a contingency fee knowing that he will have a big payday, when the client may have been able to afford his hourly rate. This, of course is unscrupulous and unethical, but it illustrates that contingency fees may allow lawyers to further take advantage of a tort victim who is in need.

C. Comparison to Third-Party Litigation Financing

Third-party litigation financing may offer plaintiffs an alternative to contingency fee agreements that will be much more advantageous for them. Third-party financing allows the plaintiff to hire a lawyer on an hourly rate basis. This means the pitfalls of the contingency fee are evaded and justice may be better served. Contingency fees leave an incongruent amount of power in the hands of lawyers as they are the more sophisticated and experienced party between themselves and the client, and they possess much greater bargaining power. Moreover, a poorer plaintiff has no choice; either he agrees to the contingency fee arrangement, or he has no channel through which to pursue his claim. By allowing plaintiffs third-party financing, a choice emerges. This acts to equalize the power differential between lawyer and client. Ultimately, the plaintiff can keep more of what he is owed and not be forced into a contingency fee ultimatum.

Personal injury lawyers, and others, will perhaps be uninterested in working for an hourly rate as that arrangement does not allow them to make the huge windfalls contingency fees offer. If third-party litigation financing gains a greater foothold, and poorer clients are given greater choices, the justice system will benefit. The justice system should be about justice, not making lawyers rich. Having greater choice gives the consumer more power, which germinates a more equal and fair legal system and ultimately a more equal and fair society.

D. An Illustrative Vignette: Contingency Fee v. Third Party Litigation Financing

The following scenario is a simple, yet explanatory narrative that demonstrates the issue with contingency fee agreements and the improvement third-party litigation financing could introduce into the American litigation landscape.

Peter Plaintiff is a 42-year-old sushi chef with two children and a mortgage. One morning, Peter retrieved his BrandCo ladder from his

71. Id.
garage to clean the leaves from his gutters. While on the ladder, a design flaw caused Peter to fall from a height of 15 feet. He shattered his left arm and required several surgeries to make his arm functional again. However, he never regained full use of his arm and can no longer perform his duties as a sushi chef. After six months of recovery, Peter was rehired at the restaurant, but he was relegated to dishwasher and received a significant pay cut.

BrandCo knew that their ladders were unsafe; they had discovered the design flaw two years before but did not issue a recall or take any other remedial measures. This fact was quickly and easily discoverable through BrandCo's internal documents. Peter secured Lenny Lawyer as his counsel. The case went to trial and Peter won; the court entered a judgement of $1,000,000.

When Peter was looking for a lawyer, he had very little money. Between surgeries, being unable to work, getting demoted, and still having to pay the expenses of life, Peter had wiped out his savings and had no friends or family willing or able to advance him money to secure a lawyer. Lenny offered to take Peter’s case and offered a contingency fee agreement by which Lenny would get forty percent of any judgment Peter won if the case went to trial. Peter was shocked at the percentage, but Lenny explained that he was taking all the risk; if Peter lost, Lenny would be out tens of thousands of dollars for his work.

Still unsure, Peter tried to negotiate the percentage down to twenty percent. Lenny refused and told Peter it would be forty percent, or he would not take Peter’s case. Lenny defied Peter to find any lawyer in town who would take his case for anything less than forty percent. Peter, unfamiliar with legal costs or practices, agreed to Lenny's terms.

Of the $1,000,000, Peter actually received $500,000 after all the legal costs and Lenny's fees were paid. Lenny worked for roughly two hundred hours on the case; his normal hourly rate is $200 per hour. Instead of the $40,000 Lenny would have received for his work, he received more than ten times that amount. It is clear that Lenny received a great windfall.

---

72. It may be argued the very existence of the contingency fee scheme depends on the possibility of attorneys receiving such windfalls. Homerun wins (in which the attorney earns large sums) allow him to take on other cases with higher risk or lower proceeds. However, the addition of a third party gives attorneys the ability to create more consistency in their income. Rather than chase the homerun, attorneys would be free to charge hourly rates for their work or agree upon a flat fee for the claim. Contingency fees and hourly rates offer attorneys different benefits and risk. Third-party financing may better incentivize attorneys to work on hourly rates, which in many cases will advantage the plaintiff as he receives a greater portion of the proceeds he needs to cope with his injury.
on the back of Peter's misery. Peter, meanwhile, is left with less money to cope with his permanent disability.

Suppose instead of entering into a contingency fee agreement with Lenny, Peter received funding from TP Finance Company to pursue his case. Peter still finds Lenny and tells him that he would like to hire him on an hourly basis. TP and Lenny confer, and Lenny estimates he will need to spend 200 hours on the case and that his hourly rate is $200 per hour. On this information, TP loans Peter $50,000 to pursue his claim and pay his living expense in the meantime. The terms of the contract with TP are that Peter will pay 50% interest on the loan if he recovers and will not have to repay the loan at all if he loses.

When Peter wins, Lenny has already been paid as Peter has used the loan to pay Lenny's hourly rate as Lenny worked on the case. Peter will need to repay his loan, plus $25,000 in interest. After all associated costs are paid including the loan and interest, Peter nets $850,000. In this situation, Lenny gets paid the rate he asked for, TP makes 50% interest on their loan, and most of the money goes to Peter – the victim of BrandCo's wrongdoing.

The above illustration shows that justice may be better served if a worthy, but poor, plaintiff engages with a third-party financier rather than engaging directly with his attorney through a contingency fee agreement. Who loses out in this scenario? Arguably, only the lawyer loses out on his potential massive windfall. This is a loss the legal industry can bear in order to increase fairness and recovery for aggrieved plaintiffs.

V. CREATING A RESPONSIBLE THIRD-PARTY LITIGATION FINANCE INDUSTRY

A. Creating A New Category

While third-party litigation financing can offer more and better options to plaintiffs, the industry must be regulated to ensure that it is the plaintiff, rather than financiers alone, who benefit most from the

73. As a third-party financing industry develops, attorneys may be likely to raise their rates knowing that there is a large sum to be won. This reality could threaten the objective of leaving more money in the pocket of the plaintiff. However, choice is likely to diminish this effect. A plaintiff can more easily shop for lawyers by simply comparing their hourly rates or flat fees rather than needing to calculate their potential costs. As a result, lawyers will compete to have lower hourly rates. Additionally, a plaintiff can weigh the choice for himself: agree to hourly rates or flat fees on his own, enter into a contingency agreement with an attorney, or enter into an agreement with a financier and hire an attorney at an hourly rate. Each has its own risks and rewards, but the increase in choice for the plaintiff is the goal.
arrangement. Third-party litigation financing is a relatively new phenomenon, emerging on the scene in the late 1990’s. The industry continues to grow, and states have taken different approaches to regulating the industry. Most state legislatures who have addressed litigation financing have enacted laws aimed at consumer protection. They might include the requirement that the financier be licensed and follow all the state laws associated with any other lender; in essence, litigation financing is treated like many other financial products.

Regulating litigation financing in the same manner as other loans is not the best approach. Simply using the consumer protection laws in place is an inadequate means to managing the industry and protecting the plaintiff; this approach attempts to put a square peg in a round hole.

Instead, this Article proposes that states carve out a unique space to allow for the existence of a healthy and responsible litigation finance industry. Financiers cannot be treated simply as lenders because the roles and relationships involved are much more complicated. The triangular relationship between the plaintiff, his counsel, and the financier is unlike anything that currently exists in the investment sphere.

B. Consumer Protection

Plaintiffs need the most protection in this complex relationship. The current litigation finance industry has been pegged as an industry that has the potential to engage in predatory lending practices. It has been compared to payday lending in that clients may be desperate, unsophisticated, and vulnerable. These concerns can be addressed through simple regulations similar to those that are aimed at other borrowers.

Transparency is an essential element to protect plaintiffs. A non-recourse structure should certainly be required to avoid indebting plaintiffs,

75. Id.
76. Id.
77. State of Nevada Department of Business and Industry Financial Institutions Division, Consumer Litigation Funding Guidance, (Sept. 30, 2019) http://fid.nv.gov/uploadedFiles/fid.nv.gov/content/Licensing/Installment_Loan_Company(1)/SB432_Consumer%20Litigation%20Funding%20Guidance%202009.30.2019.pdf
78. Paige Marta Skiba & Jean Xiao, Consumer Litigation Funding: Just Another Form of Payday Lending?, 80 LAW & CONTEMP. PROBS. 117 (2017).
79. Id.
but plaintiffs also need to be informed of the true cost of borrowing money to engage in litigation. Clear schedules should be enumerated in the agreements communicating to the plaintiff the amount to be repaid with honest schedules of how long a typical case of the sort takes to resolve. Monthly interest rates should be forbidden and sliding scale interest rates (based on time) should be the norm. Further, all contracts between plaintiffs and financiers should conform to the regulations already in place under the Truth In Lending Act—a federal law created "to ensure that consumers are treated fairly by businesses in the lending marketplace and are informed about the true cost of credit."

One frequent criticism of third-party litigation financing is that it disadvantages the plaintiff by taking money out of his (the victim’s) hand and putting it into the financier's hands. This is a fair criticism but is not unlike the relationship that already exists between attorneys and clients. Increasing access and shifting the burden of risk creates value for plaintiffs. If plaintiffs are accurately informed, they can make a measured decision whether or not to engage with a litigation financier. Also, the scenarios above illustrate circumstances in which the plaintiff ends up with more of the judgement than they might with a contingency fee. An added feature of a third-party litigation finance contract is that the attorney involved must work on an hourly rate rather than a contingency basis.

C. Control and Duties

Control over the case must remain with the plaintiff. This is another level of protection that should be extended to consumers as the plaintiff should always be the master of his complaint. Of course, financiers will want more control over the claim as they are the one footing the bill if the claim fails. Financiers should be allowed to exert a level of influence over the plaintiff. This can be in the form of information and suggested actions.

For instance, a financier can inform the plaintiff how much a case of the sort is typically worth, how long it usually takes to resolve, and suggest the client accept a settlement. However, the plaintiff must not relinquish ultimate control; in other words, financiers cannot be given the power to settle a case without the plaintiff's permission. The plaintiff should always have the final say. Most current third-party litigation financing reserves such power to the plaintiff, but regulators must be sure to preserve the relationship as such. This can help to ensure that the same

---

https://www.debt.org/credit/your-consumer-rights/truth-lending-act/
81. Herschkopf, supra note 4, at 1.
issues that exist in contingency fee arrangements (being quick to settle) do not manifest in the litigation finance industry.

Financiers must also assume a role that is atypical for a lender; they must operate in the best faith possible. Forces undoubtedly will lead financiers to seek quick and easy settlements if they are left to function as money-hungry lenders. However, imposing a high duty of good faith will mean that financiers will have to look out for the best interest of the plaintiff or face consequences.

Further, the doctrines of confidentiality and privilege must also extend to the financier-plaintiff relationship. As financiers will be privy to sensitive information, they must be sworn to the same confidentiality required for attorneys. Further, a financier's communication with the plaintiff or attorney and any work product of the financier must be protected as a privilege; the same as the attorney-client privilege.

These duties and privileges will allow financiers full access to the plaintiff's claim. This will allow financiers to better evaluate the plaintiff's claim. This allows the industry to develop its sophistication in navigating the courts and will ultimately benefit plaintiffs as financiers become savvier; this has the effect of balancing the scales between plaintiff and defendant. To facilitate this process, financiers must get accurate information from plaintiffs. Thus, contracts must also include clauses holding the plaintiffs to full truth and transparency when presenting information to the financier that is considering whether or not to finance the case.

Continuing the quest for transparency, disclosures must be made by all parties engaged in finance litigation. If a plaintiff is utilizing third-party financing, this must be disclosed to his attorney, the defense, and the court. This practice will help to clear any muddy waters surrounding the litigation. An added advantage of this disclosure is that the defense may be more generous with settlement offers if they know the plaintiff is financially backed. This is a signal to the defense that the plaintiff's claim is meritorious, and that the plaintiff is in for the long haul.

---

82. Steinitz, supra note 2, at 1328.
83. Id.
84. Id.
85. Id. at 1315.
86. Id. at 1332.
87. Id. at 1335.
D. Likely Outcomes

In addition to the regulations proposed above, states must also abolish their champerty laws, or at least create an exception to allow the litigation finance industry to consistently develop in a healthy environment.

The above proposed regulations may seem to impose a great deal of oversight onto litigation finance companies. This is a good thing. The industry has been battling a shady reputation since its inception and shining a light on it will be better for all. If the industry is consistently regulated as a more legitimate one than it is now, the certainty can help it develop into a reputable resource for plaintiffs.

Legislators should consider carving out a place for litigation financing and let the free market reign. If the industry flourishes, then many plaintiffs will have much greater access to the civil litigation system. If the industry fails, the landscape goes relatively unchanged and civil litigation remains largely the same as it is today.

VI. CONCLUSION

Adding a responsible litigation financing industry to the American litigation scene could increase civil judicial access for many Americans who currently and historically lacked fair admission to the court system. Third-party litigation financing offers an additional avenue by which plaintiffs can pursue their claims. More choice provides more opportunity for plaintiffs to find justice and for public interests to be advanced.

Third-party litigation financing is an alternative to the traditional way in which poorer plaintiffs could gain access to civil litigation redress: contingency fees. Third-party financing may be superior to contingency fees in that it can keep more money in the hands of the plaintiff. Also, third-party financing allows access for plaintiffs whom a lawyer may not want to represent under a contingency fee agreement. Adding more choices for plaintiffs will be a good thing as it puts more power in the hands of the aggrieved to control their claim, rather than having to submit to the few options currently available.

Though the potential for positive impact is great, the industry must be sufficiently regulated to create a healthy, fair industry that protects consumers from potential misuse. These regulations must include high levels of transparency, not threaten the power of the plaintiff to control his case and include a good faith responsibility from the financier to the client. These proposed changes likely have one, large, motivated group of opponents: those lawyers who currently operate on a contingency fee basis.

88. See Steinitz, Id. at 1278.
and are the beneficiaries of massive windfalls. The acceptance of a healthy third-party litigation finance industry could curb the disproportionate power that exists between plaintiffs and attorneys by redistributing risk and allowing more lawyers to work on an hourly basis, ultimately placing more power in the hands of the aggrieved: the plaintiffs.