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Reshaping Third-Party Funding

Victoria Shannon Sahani*

Third-party funding is a controversial business arrangement whereby an outside entity—called a third-party funder—finances the legal representation of a party involved in litigation or arbitration or finances a law firm's portfolio of cases in return for a profit.

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Attorney ethics regulations and other laws permit nonlawyers to become partial owners of law firms in the District of Columbia, England and Wales, Scotland, Australia, two provinces in Canada, Germany, the Netherlands, New Zealand, and other jurisdictions around the world. Recently, a U.S.-based third-party funder that is publicly traded in England started its own law firm in England. In addition, some U.S. law firms are actively seeking advice (including from this Author) regarding partnering with third-party funders or starting their own internal third-party funders to fund their own cases, both of which are controversial practices. This Article analyzes the benefits and drawbacks of third-party funders becoming internal partners of U.S. law firms, rather than remaining as external investors. To that end, this Article diagrams the existing structure of the third-party funding transaction and suggests new possible structures. This Article then explores how those new structures may affect procedure, evidentiary, and ethics rules and reshape both the third-party funding industry and the legal services industry. This Article concludes that careful, limited experimentation would reveal whether such a practice is a viable, desirable addition to the menu of third-party funding transactions or whether the existing third-party funding transaction paradigm remains the best option. Ultimately, this Article aims to start a conversation about rethinking the structure of third-party funding transactions.

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> *My partners . . . taught me that in order to create wealth, I needed to pair up with people whose strengths compensated for my weaknesses.*
>
> —Kevin O'Leary, known as "Mr. Wonderful" on ABC's *Shark Tank* television show[1]

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1. Jonathan Long, *10 Kevin O'Leary Quotes Every Entrepreneur Can Learn from*, ENTREPRENEUR (June 29, 2015), http://www.entrepreneur.com/article/247789 (quoting KEVIN O'LEARY, COLD HARD TRUTH: ON BUSINESS, MONEY & LIFE 4 (2011)).

I. INTRODUCTION

There is a thin line between an investor and a partner. *The Oxford English Dictionary* defines an investor as "one who invests money or makes an investment" and defines a partner as "a person who takes part with another or others in doing something, esp[ecially] either of a pair of people engaged together in the same activity, occupation, etc.; an associate, companion, or accomplice; a participant."[2] Unlike passive financial investors who only contribute money, active partners also contribute advice and ideas to help protect their own investments and promote the company's overall success.[3] Third-party funders are entities that invest in litigation and arbitration for profit.[4] Although third-party funders are currently passive financial investors, many of them would prefer to be active partners.[5] Like the "sharks" on ABC's *Shark Tank* television show who invest in and partner with startup companies, third-party funders are looking to invest business savvy, advice, and mentorship into the law firms and parties with which they partner, not just money.[6] For example, the

2. *Investor*, OXFORD ENGLISH DICTIONARY, http://www.oed.com/view/Entry/99053?redirectedFrom=investor (last visited Jan. 23, 2017); *Partner*, OXFORD ENGLISH DICTIONARY, http://www.oed.com/view/Entry/138316?rskey=rPNvKl&result=1 (last visited Jan. 23, 2017).

3. *See, e.g.*, Shelly Schwartz, *Passive Investing Is Profitable, but There's a Time To Get Active*, CNBC: FA PLAYBOOK (Sept. 9, 2015, 8:00 AM), http://www.cnbc.com/2015/09/08/passive-investing-is-profitable-but-theres-a-time-to-get-active.html (noting that investors with a "hands-off" approach favor passive investment because active investment requires more risk, a "rigorous tool set," and "unique investment processes").

4. Some scholars use the term "third-party litigation funder" or "litigation funder" to refer to this type of investor. This Article intentionally uses the term "third-party funder"—without the word "litigation"—because this Article addresses entities that finance both litigation and arbitration, domestically and internationally.

5. *See* Radek Goral, *The Law of Interest Versus the Interest of Law, or on Lending to Law Firms*, 29 GEO. J. LEGAL ETHICS 253, 303 (2016).

> The issue of third-party capital involvement in the practice of law becomes increasingly important for the future of the legal profession. And . . . there is more to it than meets the eye. Law-firm financing is not limited to small-time personal-injury attorneys, nor is it a pricier variant of commercial lending. Compared to banks, third-party financiers take a more hands-on approach, and they often assume a position that far transcends that of a banker.

Id.; *see, e.g.*, *infra* note 7 and accompanying text.

6. *See, e.g.*, Sarah Field, *'Shark Tank' Casting: Producer's Advice for the Perfect Pitch*, INQUISITR (June 22, 2014), http://www.inquisitr.com/1312752/shark-tank-casting-producers-advice-for-the-perfect-pitch/.

> Getting past the casting hurdle is only the beginning of the journey for *Shark Tank* entrepreneurs. If they do make a deal, there can be a long road ahead. For many, they are looking not only for funds, but advice and mentoring. One pitcher, 'Ava

November 2015 press release from Bentham IMF, a U.S. third-party funder affiliated with IMF Australia and the world's largest third-party funder, states:

> [W]e've established close relationships with a number of smaller, top-tier [law] firms with whom we are partnering. We view our portfolio approach as a way of providing strategic capital to elite litigation specialists. We help them recruit talent, launch a promising new litigation specialty, or provide a safety net for their own risks, allowing them to pursue new cases. In short, we help incubate [law] firms and practice groups.
>
> Importantly, we plan for the long term success of our partners . . . . Of course, we're not a bank, which is why we are extremely selective about choosing firms with strong winning records and with an eye on growth and innovation.[7]

Bentham IMF currently partners with those law firms as an external investor.[8] Like the "sharks" of *Shark Tank*, however, it is likely that funders like Bentham IMF may soon begin to expect an equity stake in return for providing business savvy, advice, and mentorship to its clients.[9] For example, in October 2016, U.S.-based third-party funder, Burford, which is publicly traded on a U.K. stock exchange, "has launched a new legal arm dedicated to helping clients enforce their arbitral awards" called "Burford Law."[10] Burford Law is licensed as an "alternative business structure" under the Legal Services Act 2007 in the United Kingdom.[11] This law allows nonlawyer individuals and entities—like third-party funders—to have

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> the Elephant' creator Tiffany Krumins, who got a deal with [Barbara] Corcoran, has nothing but high praise for her investor: "She encourages me, inspires me and even puts me in my place when I need it. Although she has many years of life and business experience she has always treated me with respect when giving guidance."

Id.

7. *Bentham IMF Unveils New Portfolio Model for Litigation Funding*, BENTHAM IMF (Nov. 16, 2015), https://www.benthamimf.com/docs/default-source/default-document-library/portfolioannouncementclean.pdf?sfvrsn=2.

8. *See What We Fund: Law Firm Financing*, BENTHAM IMF, https://www.benthamimf.com/what-we-do/portfolio-funding (last visited Aug. 21, 2016) ("[Bentham funds] portfolios of cases for law firms on a non-recourse basis.").

9. *See, e.g.*, *id.*

10. *See* Lacey Yong, *Burford Launches New Firm with Former Akin Gump Counsel*, GLOBAL ARB. REV. (Oct. 5, 2016), http://globalarbitrationreview.com/article/1069002/burford-launches-new-firm-with-former-akin-gump-counsel.

11. *See ABS Rising: Burford Capital Launches Its Own Law Firm with Akin Gump Hire*, BURFORD (Oct 5, 2016), http://www.burfordcapital.com/newsroom/abs-rising-burford-capital-launches-law-firm-akin-gump-hire/.

partial ownership of law firms.[12] Burford hired an attorney away from the law firm Akin Gump Strauss Hauer & Feld LLP to lead Burford Law.[13] Burford Law "will handle English enforcement proceedings and act as a legal advisor to international counsel in enforcement proceedings where other jurisdictions are involved."[14] Chris Bogart, CEO of Burford, told Global Arbitration Review that "Burford has added the ability to be a law firm and to provide a more integrated service" and "that clients may retain Burford Law for advice on enforcement even if they are not receiving third-party funding or using the funder's judgment enforcement services."[15] These new developments bring the quickly evolving third-party funding[16] industry one step closer to resembling a venture capital investment and blurring the line between law firms and third-party funders.[17] The investments of third-party funders in both parties and law firms are highly controversial,[18] yet they may prove to be crucial to supporting the tumultuous legal services industry, promoting access to the courthouse for indigent clients,[19] and regulating the third-party litigation funding industry.[20]

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12. *See* Legal Services Act 2007, c. 29 (Eng.). See *infra* subpart IV.B.2, for more detail regarding the use of alternate business structures in the United Kingdom.

13. *See* Yong, *supra* note 10.

14. *See id.*

15. *See id.*

16. *See supra* note 4.

17. *See generally* Maya Steinitz, *How Much Is that Lawsuit in the Window? Pricing Legal Claims*, 66 VAND. L. REV. 1889 (2013) [hereinafter Steinitz, *Pricing Legal Claims*] (analogizing staged funding in venture capital to how third-party litigation funders should price legal claims).

18. *Compare* MAX VOLSKY, INVESTING IN JUSTICE: AN INTRODUCTION TO LEGAL FINANCE, LAWSUIT ADVANCES AND LITIGATION FUNDING 25 (2013) (explaining the benefits of third-party funding for small businesses, law firms, and individuals with financial difficulties), *with* John Beisner, Jessica Miller & Gary Rubin, *Selling Lawsuits, Buying Trouble: Third-Party Litigation Funding in the United States*, U.S. CHAMBER INST. FOR LEGAL REFORM (Oct. 2009), http://www.instituteforlegalreform.com/uploads/sites/1/thirdpartylitigationfinancing.pdf (discussing how third-party funding will destroy the dispute resolution system).

19. *See, e.g.*, Paul Grossinger, *Social Litigation To Produce Societal Change*, TECH.CO (Apr. 29, 2015, 6:00 PM), http://tech.co/social-litigation-produce-societal-change-2015-04.

> One New York crowdfunding startup, Justice Investor . . . , is melding the social media-crowdfunding strategy to revolutionize such litigation. By seeding cases nation-wide through crowdsourced and foundation-based donations, the hope is to bombard local, state, and national courts with enough merited cases to force Congress, the Supreme Court, and State Legislatures to write in much stricter policing laws to prevent further litigation.

In the United States, partnerships between funders and parties to disputes in the form of joint venture entities and co-owned corporations are already legal and are becoming increasingly common.[21] Funders serving as internal partners of law firms, however, would likely violate the attorney ethical prohibitions against nonlawyer ownership of law firms, fee splitting with nonlawyers, and the unauthorized practice of law by nonlawyers in most jurisdictions.[22] Nevertheless, law firms are looking for advice regarding partnering with third-party funders or starting their own internal third-party funders to fund their own cases—even this Author has been contacted.[23]

This Article explores the benefits and drawbacks of third-party funders becoming internal partners of law firms rather than remaining as external financiers as well as the question of whether the practice of third-party funders serving as internal partners of law firms may bend procedure, evidentiary, and ethics rules to an unacceptable breaking point or may instead reshape the third-party funding and

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> "JusticeInvestor.com is a B-Corp on the cutting edge of combining crowdfunding and social media to level the bench. We convert slacktivists into investors in lawsuits who take a stake in the recovery if plaintiffs win. Now with skin in the game, social media activism has a direct positive result on financing police brutality and social justice lawsuits—and can earni [sic] them both significant financial and social returns!" says Maxim Thorne . . . , CEO of JusticeInvestor.

Id.; *see, e.g.*, *What We Fund: Public Interest*, BENTHAM IMF, https://www.benthamimf.com/what-we-do/pro-bono-publico (last visited Aug. 21, 2016) ("Lawyers have traditionally provided pro bono services as part of their professional responsibility to offer wider access to the legal system, especially the discriminated, the poor and marginalized in our society. Bentham and IMF Bentham Limited are committed to this ideal, by contributing funds and time to pro bono projects. In addition, we encourage our employees to support organizations that provide legal services to persons of limited means.").

20. *See generally* Victoria A. Shannon, *Harmonizing Third-Party Litigation Funding Regulation*, 36 CARDOZO L. REV. 861 (2015) [hereinafter Shannon, *Harmonizing Regulation*] (proposing a regulatory framework for third-party funding).

21. *See, e.g.*, Maya Steinitz, *Incorporating Legal Claims*, 90 NOTRE DAME L. REV. 1155, 1160-62 (2015) [hereinafter Steinitz, *Incorporating Legal Claims*] (detailing three examples of funder-client partnerships through joint ventures).

22. *See* MODEL RULES OF PROF'L CONDUCT r. 5.4 (AM. BAR ASS'N 2016) (prohibiting nonlawyer ownership of law firms and fee splitting with nonlawyers); *id.* r. 5.5 (prohibiting the unauthorized practice of law by nonlawyers).

23. Due to confidentiality agreements in place, this Author unfortunately cannot be more specific with respect to these inquiries. However, one law firm interested in starting its own funder to fund its own cases did mention to this Author that, if the cases were unsuccessful, at least the law firm would have a lucrative funding business. This may prove to be a common sentiment among other law firms exploring this emerging and controversial business model.

legal services industries in beneficial ways.[24] The proposals in this Article regarding funders serving as internal partners are not meant to replace the traditional third-party funding transaction in which the funder remains an external, separate financier.[25] These proposals would merely expand the menu of available transaction structures.

To illustrate the benefits and drawbacks of funders serving as internal partners, this Article presents diagrams of the third-party funding transaction.[26] Diagramming the third-party funding transaction is important because the third-party funder has become a participant in dispute resolution without a clearly defined role.[27] Diagramming the transaction is a way to clarify the funder's role and thereby determine how to regulate that role.[28]

State regulators believe that they know what role the funder is playing, such as a lender or an insurer, and the regulators appear to believe that the funder is playing the same role in every funding instance.[29] When states have tried to regulate third-party funding, they have generally implemented one-size-fits-all regulations for the funding industry through statutes or case law, such as taking a preexisting statutory cap on traditional loan interest rates (i.e., usury laws) and applying that exact same cap to third-party funding rates of return.[30] However, the funder actually may be playing different roles

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24. *See supra* note 23; *see also* discussion *infra* Part III (exploring how to restructure the traditional model of third-party lending).

25. *See infra* Diagrams A & B; *see also* discussion *infra* Part II (explaining the features and risks of the traditional triangular third-party funding transaction).

26. *See infra* Diagrams A, B, C, & D.

27. *See* Victoria Shannon Sahani, *Judging Third-Party Funding*, 63 UCLA L. REV. 388, 399-402 (2016) [hereinafter Sahani, *Judging Third-Party Funding*] (listing the existing roles in dispute resolution into which a third-party funder does not fit).

28. *See* discussion *infra* Part IV (explaining how to alter the traditional conceptualization of third-party funding to allow the funder to have a role as part of the firm, client, or some other capacity).

29. *See, e.g.*, ME. STAT. tit. 9-A, § 12 (2016); Nonrecourse Civil Litigation Act, NEB. REV. STAT. §§ 25-3301 to 3309 (2015); OHIO REV. CODE ANN. § 1349.55 (LexisNexis 2016).

30. *See* sources cited *supra* note 29; Ben Hallman & Caitlin Ginley, *States Are Battleground in Drive To Regulate Lawsuit Funding*, CTR. FOR PUB. INTEGRITY (Feb. 2, 2011), http://www.publicintegrity.org/2011/02/02/2160/states-are-battleground-drive-regulate-lawsuit-funding; Amanda Robert, *New Jersey Lawmakers Introduce State's First Lawsuit Lending Bill*, LEGAL NEWSLINE (Dec. 30, 2014, 2:41 PM), http://legalnewsline.com/stories/510628314-new-jersey-lawmakers-introduce-state-rsquo-s-first-lawsuit-lending-bill. The vast majority of states that regulate third-party funding do not characterize third-party funding as a loan, but Colorado provides a notable exception. *See* Oasis Legal Fin. Grp., LLC v. Coffman, 361 P.3d 400, 406, 410 (Colo. 2015) (categorizing third-party funding as a loan and capping the rate of return at 12%). For a detailed presentation of the arguments for

or multiple roles, depending on the circumstances of the case, the client's needs, and the structure of the transaction.[31] In essence, the funder redefines its role on a case-by-case basis through its customized funding arrangements with each client.[32] Thus third-party funding may need more than one regulatory regime: a different regulatory regime to cover each of the funding transaction structures in which the funder plays a different role.[33] This approach is superior to one-size-fits-all regulations that may be overinclusive, underinclusive, or ineffective because each regulatory regime would be tailored to target the unique way in which each type of third-party funding transaction actually operates in practice.[34] To facilitate the development of specific regulatory frameworks tailored to transactional structures, this Article begins by diagramming the various roles of the funder in relation to the attorney and client.[35]

In addition, there are preexisting regulatory regimes that may apply to third-party funders if those funders are incorporated into existing roles through new transaction structures.[36] To the extent that those transactional structures resemble existing regulated transaction types or the funder's role resembles existing regulated roles (e.g., party, attorney, etc.), then that particular transaction structure for third-party funding can be regulated under the corresponding preexisting regulatory scheme.[37] To the extent that the funder is

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and against categorizing third-party funding as a loan, see Shannon, *Harmonizing Regulation*, *supra* note 20, at 892-96.

31. *See* discussion *infra* Part IV (presenting two examples of additional roles that the funder could play).

32. *See* ABA Comm'n on Ethics 20/20, *Informational Report to the House of Delegates*, ABA 8 (Feb. 2012), http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf [hereinafter *ABA White Paper*].

33. *See* discussion *infra* Part IV (explaining how to alter the traditional conceptualization of third-party funding to allow the funder to have a role as part of the firm, client, or some other capacity).

34. *Cf.* Sahani, *Judging Third-Party Funding*, *supra* note 27, at 409, 445 (discussing how a single regulatory definition of third-party funding would be inherently overinclusive, underinclusive, or both).

35. *Cf.* LISA BENCH NIEUWVELD & VICTORIA SHANNON, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION 3–11 (2012) (explaining and diagramming the various possible relationships between the funder, client, and attorney, including the triangular relationship discussed in this Article).

36. *See* Sahani, *Judging Third-Party Funding*, *supra* note 27, at 397-98.

37. *See* discussion *infra* subpart IV.A (examining the currently allowed and increasingly employed structure of a funder serving as a co-venturer along with the original party to the case by creating a joint venture entity that would own the legal claim).

creating a new transaction type or a new role in the transaction, then creating new regulations would be appropriate.[38]

It is important to note, however, that the structures mentioned in this Article do not contemplate every possible third-party funding transaction.[39] For example, some funding transactions not addressed by the new structures explored in this Article include a full assignment of the entire claim to the funder, the funder retaining its own separate legal counsel, an insurance company indemnifying either the legal expenses or the underlying liability (or both),[40] or the existence of external creditors who may have a claim to amounts recovered by the winning client.[41] Still, at its core, every funding transaction starts with three entities—a client, an attorney, and a funder—so the tripartite structures presented in this Article provide a good foundation upon which additional complexity can be built.[42]

This Article builds on prior scholarly work that proposes a framework for regulating third-party funding in three categories: the procedural, transactional, and ethical categories.[43] This proposed

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38. *See* discussion *infra* subpart IV.B (exploring how to allow funders to have an ownership stake in law firms by revising Model Rule of Professional Conduct Rule 5.4). For example, this structure is already allowed in the District of Columbia and in the United Kingdom pursuant to the Legal Services Act of 2007. *See infra* notes 159-160.

39. For simplicity, this Article models the funding transaction structure for a single plaintiff bringing a single claim against a single defendant. There are many other lawsuit structures possible, which may then require different structures for the funding transaction. For example, the structures in this Article do not directly address third-party funding arrangements involving outright assignments, multiparty lawsuits, or lawsuits involving cross-claims or counterclaims. In addition, this Article does not directly address defense-side funding, which requires a different third-party funding transaction structure than claim-side funding.

40. *Cf.* Charles Silver, *Litigation Funding Versus Liability Insurance: What's the Difference?*, 63 DEPAUL L. REV. 617, 618 (2014).

> By purchasing insurance, a potential defendant trades a fixed loss in the present for a carrier's willingness to bear an uncertain loss in the future. Third-party litigation funding is the mirror image of this arrangement. A plaintiff accepts a fixed gain today in return for giving a funder a share of a gamble that may or may not pay off. The claim that liability insurance should be permitted while third-party funding is barred boils down to the assertion that it should be lawful to trade in potential litigation-related losses but not in potential litigation-related gains. I do not see how this proposition can be maintained.

Id.

41. *See supra* note 39.

42. *See infra* Diagram A.

43. *See* Shannon, *Harmonizing Regulation*, *supra* note 20, at 868, 911-12 (proposing a regulatory framework for procedural, transactional, and ethical regulations). *See generally* Sahani, *Judging Third-Party Funding*, *supra* note 27 (discussing procedural regulations

framework would implement key regulations within each of those three categories and would link those regulations together through cross-references to create a harmonized regulatory framework.[44] This Article focuses on the transactional regulations and suggests new structures for the third-party funding transaction to mitigate the risks involved, bring down the cost of capital,[45] and increase access to third-party funding for both consumer and commercial clients.[46] This Article also addresses some of the related attorney ethical regulations embodied in the American Bar Association (ABA) Model Rules of Professional Conduct.[47]

The remainder of this Article proceeds as follows. Part II of this Article explains the existing structure of the third-party funding transaction and details the inherent risks in that structure, such as the dispute resolution system's uncertainties, human behavioral risks, and the risks of inadequate regulatory compliance. Part III of this Article explores whether changing the structure of the third-party funding transaction would somewhat mitigate those risks, thereby reducing the price of third-party funding and increasing access to capital for more parties. To that end, Part IV explores radical new "T"-shaped structures for the third-party funding transaction in which the funder enters into a joint venture with either the client or the law firm. Funder-client joint ventures currently exist, but this Article proposes and explores funder-law firm joint ventures for the first time in academic literature. These two new structures fundamentally change the third-party funder's role from an external funding source to an internal partner of either the client or the law firm. Part IV also explores the benefits and drawbacks of these two new structures and whether these two new structures would mitigate many of the inherent risks in the third-party funding transaction described in Part II. Part V concludes.

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within the context of the Federal Rules of Civil Procedure, evidentiary privileges, and rules of international arbitration procedure).

44. *See* Sahani, *Judging Third-Party Funding*, *supra* note 27, at 408-10, 429-31, 445 (discussing the need for a unified regulatory definition for "third-party funding" and "third-party funder"); Shannon, *Harmonizing Regulation*, *supra* note 20, at 868, 911-12 (cross-referencing the regulations among the three categories of regulations: procedural, transactional, and ethical).

45. *See, e.g.*, MIGHTY, https://mighty.com/mission (last visited Aug. 22, 2016) (explaining how legal funding gives plaintiffs a financial advantage over defendants).

46. *See* discussion *infra* Parts II, III, & IV (describing those risks and presenting new transactional structures to mitigate those risks).

47. *See* discussion *infra* subpart IV.B.

II. THE PROBLEM: THE RISKY TRIANGULAR THIRD-PARTY FUNDING TRANSACTION

A. Diagraming the Triangular Transaction

This Article addresses structural aspects of the third-party funding transaction by diagraming the funder's relationship to the legal representation.[48] Normally, the funder, client, and attorney remain three separate entities involved in the funding transaction leading to some variation of the following triangular diagrams.[49]

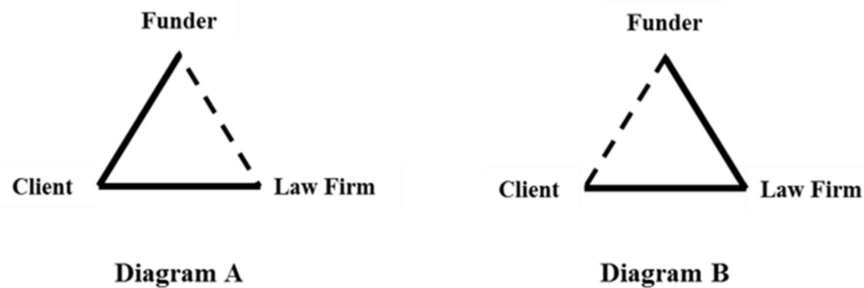

Diagram A **Diagram B**

These traditional triangular depictions of the third-party funding relationship assume that the funder is a separate entity from the client and attorney.[50] This Part explains why the traditional depiction of the third-party funding relationship is triangular. Part IV of this Article then explores the possibility of making the funder part of the client—which is currently allowed and is increasingly common—or making the funder part of the law firm—which is currently prohibited under attorney Rules of Professional Conduct.[51] In other words, this Article explores structures in which the funder does not remain separate but rather combines with the client as a coventurer or combines with the attorney as a coadvisor.[52]

Presently, there are at least four common structures involving a third-party funder, which is a financier entity that could be a bank,

48. *See* discussion *supra* Part I.

49. If the funder takes a full assignment of the claim, then the funder becomes the party to the case, and only the funder and the attorney would be involved in the actual case. For an in-depth discussion of assignment and insurance policies in the third-party litigation funding context, see sources cited *infra* note 58 and accompanying text.

50. *See supra* Diagrams A & B and accompanying text; discussion *infra* notes 64-70 and accompanying text (noting that the triangular framework requires three separate entities).

51. See *infra* Part IV, for a discussion of both structures.

52. See *infra* Part IV, for a discussion of both structures.

hedge fund, insurance company, or some other entity or individual.[53] First, the quintessential third-party funding arrangement usually has the following three characteristics: "(1) the funder contracts directly with the original party to the case (i.e., not with the client's attorney); (2) the original party remains a party to the case; and (3) the funder does not become a party in the case (i.e., not an assignment of the underlying claim or liability)."[54] In this paradigmatic arrangement, if the funded client is a plaintiff, the funder usually contracts to receive a percentage or fraction of the proceeds from the case if the plaintiff wins.[55] Unlike a loan, the funded plaintiff does not have to repay the funder if it loses the case or does not recover any money.[56] "If the funded [client] is the defendant, then the [funder] contracts to receive a predetermined . . . payment from the defendant, similar to an insurance premium," and the agreement may include an extra payment to the funder if the defendant wins the case.[57]

Second, if the structure is instead an assignment of a claim, then the original client sells the entire claim and walks away leaving the funder to pursue the claim as a party.[58] Thus the funder may become a party to the dispute through assignment.[59] Depending on the structure of the funding arrangement, the funder may legally control or

53. *See* NIEUWVELD & SHANNON, *supra* note 35, at 4-13, 19-34 (describing the various types of third-party funding arrangements); Shannon, *Harmonizing Regulation*, *supra* note 20, at 863 n.3 (same).

54. Shannon, *Harmonizing Regulation*, *supra* note 20, at 863 n.3 (describing the quintessential funding arrangement).

55. *See id.* at 863.

56. *See id.* at 892.

57. *Id.* at 863, 894.

58. For an in-depth discussion of assignment and insurance policies in the third-party litigation funding context, see Terrence Cain, *Third Party Funding of Personal Injury Tort Claims: Keep the Baby and Change the Bathwater*, 89 CHI.-KENT L. REV. 11, 19 (2014); Anthony J. Sebok, *Betting on Tort Suits After the Event: From Champerty to Insurance*, 60 DEPAUL L. REV. 453, 462-71 (2011); Marc J. Shukaitis, *A Market in Personal Injury Tort Claims*, 16 J. LEGAL STUD. 329, 329-30 (1987); Silver, *supra* note 40; Paul Bond, Comment, *Making Champerty Work: An Invitation to State Action*, 150 U. PA. L. REV. 1297, 1297-98 (2002). It is important to note, however, that third-party funders cannot buy a claim in investment treaty arbitration and pursue it separately from the original claimant due to jurisdictional requirements in the treaty regarding the nationality of the investor-claimant and the claimant's specific investment in the territory of the host state. *See generally* Christoph Schreuer, *Jurisdiction and Applicable Law in Investment Treaty Arbitration*, 1 MCGILL J. DISP. RESOL. 1 (2014) (explaining that the claimant's nationality is a requisite for jurisdiction under treaties and that the Tribunal has jurisdiction to determine whether nationality requisites under domestic law are fulfilled).

59. *See* sources cited *supra* note 58.

influence aspects of the legal representation or may completely take over the case and step into the shoes of the original party.[60]

Third, if the structure is a liability insurance arrangement that also funds legal expenses, then the insurer-funder may remain a nonparty or may be impleaded as a third-party defendant under Rule 14 of the Federal Rules of Civil Procedure or an analogous state rule of procedure.[61]

Fourth, funders may finance law firms instead of individual parties.[62] The funder may finance a single case or all or part of a law firm's portfolio of cases.[63] Law firm funding is often structured like a loan secured by the law firm's accounts receivable or expected contingent fees.[64]

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60. *See* NIEUWVELD & SHANNON, *supra* note 35, at 8 (explaining that some third-party funding arrangements are structured as an assignment in which the third-party funder becomes the claimant in the case and the original party is no longer involved); *see also* sources cited *supra* note 58 (discussing assignment and insurance policies in the third-party litigation funding context).

61. *See* Shannon, *Harmonizing Regulation*, *supra* note 20, at 863 n.3; sources cited *supra* note 58. Also, for an in-depth discussion of insurance that specifically covers legal expenses, see NIEUWVELD & SHANNON, *supra* note 35 (discussing the use of third-party funding in the forms of after-the-event insurance, before-the-event insurance, and insurance for legal expenses in various jurisdictions around the world).

62. For an examination of lawyer lending, see Nora Freeman Engstrom, *Lawyer Lending: Costs and Consequences*, 63 DEPAUL L. REV. 377 (2014) [hereinafter Engstrom, *Lawyer Lending*] (discussing the consequences and structures of alternative legal financing to lawyers); Nora Freeman Engstrom, *Re-Re-Financing Civil Litigation: How Lawyer Lending Might Remake the American Litigation Landscape, Again*, 61 UCLA L. REV. DISCOURSE 110 (2013) [hereinafter Engstrom, *Re-Re-Financing*] (discussing specific instances, and the increased frequency of, lawyers contributing capital to their cases).

63. *See* NIEUWVELD & SHANNON, *supra* note 35, at 3-13, 19-34 (describing the various types of third-party funding arrangements); Engstrom, *Re-Re Financing*, *supra* note 62, at 116-18.

64. *See generally* Susan Lorde Martin, *Litigation Financing: Another Subprime Industry that Has a Place in the United States Market*, 53 VILL. L. REV. 83, 87-88 (2008) (analogizing third-party lending to subprime lending in home mortgages); Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268 (2011) [hereinafter Steinitz, *Whose Claim Is This Anyway?*] (defining third-party funding). A party may also engage both a contingency fee attorney and a third-party litigation funder to work together on its case. *See* NIEUWVELD & SHANNON, *supra* note 35, at 4-11 (describing the players in third-party funding, the types of funding relationships, and the effect of the type of funder on the attorney-client relationship); Engstrom, *Lawyer Lending*, *supra* note 62, at 397 ("Indeed, these loans have helped to finance some of the most important tort cases initiated over the past two decades . . . ."); Engstrom, *Re-Re-Financing*, *supra* note 62, at 118 (discussing the rising trend in which personal injury attorneys rely on third-party funding to ease the burden of "using yesterday's payday to fund tomorrow's payout"); Goral, *supra* note 5, at 261 ("Lawyers whose net worth is stranded in lawsuits go about their cash flow volatility and demand for capital in the same way that any other business would: they look for financial backup."); Anthony J. Sebok, *What Do We Talk About When We Talk About*

Each of these four structures has its own benefits, drawbacks, and regulatory challenges.[65] This Article focuses on the first and fourth structures, depicted in the triangular diagrams above, because those are the only two structures in which the original party remains a party to the case and the funder does not become a party in the case. Diagram A, above, depicts the first structure, and Diagram B, above, depicts the fourth structure. Both the first and fourth structures are traditionally conceptualized as a triumvirate of funder, attorney, and client, as depicted in Diagrams A and B.[66] It is important to note that under current law in many countries, the attorney, funder, and client are not normally all parties to any single agreement that makes up the funding transaction.[67] Current law in the United States allows contractual lines to be drawn between only two of the three participants (funder, client, and attorney) at any given time.[68]

Control?, 82 FORDHAM L. REV. 2939, 2943-48 (2014) (discussing the ethical implications of fee splitting and litigation investment in the context of loan repayment).

65. *See* W. Bradley Wendel, *Alternative Litigation Finance and Anti-Commodification Norms*, 63 DEPAUL L. REV. 655, 655-56 (2014).

> A different anti-ALF argument relies on the effect of third-party financing on the attorney-client relationship. We have also been down this road already in the context of the long debate among insurance law and professional responsibility scholars over the triangular relationship among insurer, insured, and defense counsel. One might argue that if the law has managed the problem successfully in the area of insurance defense representation, there is no cause for alarm when a non-insurer third party provides the financing for legal representation. On the other hand, one might point to uncertainties that persist in the "eternal triangle" and be reluctant to open a similar can of worms in an area with relatively little existing law to stabilize the relationships among the parties. Significantly, both of these versions of the anti-ALF argument concede that ALF is similar enough to existing economic relationships to be deemed prima facie acceptable; the only question is how best to regulate it to prevent abuse.

Id.; *see* discussion *infra* Part IV (comparing the implications from each framework).

66. *See generally* NIEUWVELD & SHANNON, *supra* note 35 (discussing the law of third-party funding in over thirty countries).

67. *See id.* at 3-13, 19-34 (describing the various types of third-party funding arrangements); Shannon, *supra* note 20, at 863 n.3 (same).

68. *See, e.g.*, Matthew Bogdan, Note, *The Decisionmaking Process of Funders, Attorneys, and Claimholders*, 103 GEO. L. J. 197, 207 (2014).

> Establishing a relationship with a funder can create complications for the attorney when it comes to sharing fees, providing collateral for loans, dealing with removal of counsel, and protecting client confidences. These prohibitions may make it legally impermissible to enter into an agreement in the first place, or may make it so that the attorney does not view the arrangement as feasible in light of the additional burdens.

Id. The implication here is that the funder can have an agreement with *either* the client *or* the law firm, but not both at the same time. *See ABA White Paper*, *supra* note 32, at 16-18.

Diagrams abstracting the third-party funding arrangement often adopt a triangular shape in which the solid lines between each of the points on the triangle represent signed contracts between those participants in the funding transaction, even though all three points of the "triangle" may not be connected.[69] This is why there is a combination of solid and dotted lines in Diagrams A and B. Regardless of the structure of the transaction, however, the funder, attorney, and client may all interact with one another at least informally in order to work together toward their common goal of winning the case—hence the traditional triangular illustration.[70]

Diagram A depicts a quintessential third-party funding arrangement involving a single dispute (litigation or arbitration) in which the funder directly finances the party to the dispute.[71] In Diagram A, the client-attorney and client-funder lines are solid, and the line between the attorney and the funder is dotted.[72] The client-attorney solid line represents the attorney retainer agreement, and the client-funder solid line represents the third-party funding contract.[73] The dotted line between the funder and attorney indicates that the two are working together at the inclination of their mutual client and that they are prevented from signing a separate contract defining their relationship with one another in light of the attorney's professional and ethical obligations to the client.[74] In some jurisdictions, a client's funding agreement with the funder and its retainer agreement with its

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> The analysis of conflicts of interest here assumes that a client-lawyer relationship exists only between the lawyer and the client seeking the services of an ALF supplier. If the lawyer also has a professional relationship with the ALF supplier, then a conventional concurrent conflict of interest arises, which must be analyzed under the principles of Model Rule 1.7. A professional relationship with the supplier may arise by express contract or by implication from the conduct of the parties. . . . In particular, [if] the lawyer had performed legal services for the supplier in the past, suggesting it was permissible to infer that the lawyer had intended to represent both the plaintiff and the supplier in the funding transaction.

Id.

69. *See supra* Diagrams A & B.

70. *See generally ABA White Paper*, *supra* note 32 (discussing what lawyers must do to comply with the Rules of Professional Conduct when a third-party funder is involved in a case).

71. *See supra* Diagrams A & B.

72. *See supra* Diagrams A & B.

73. *See supra* Diagrams A & B.

74. *See* Douglas R. Richmond, *Other People's Money: The Ethics of Litigation Funding*, 56 MERCER L. REV. 649, 651-52, 659-64 (2005); Steinitz, *Whose Claim Is This Anyway?*, *supra* note 64, at 1276; *ABA White Paper*, *supra* note 32.

attorney must be completely separate agreements.[75] The retainer agreement is represented in Diagram A by the solid line connecting the client and attorney.[76]

In addition, the funder must be cautious with respect to potentially intruding on the attorney-client relationship and the attorney's professional and ethical obligations to the client.[77] For example, if there is a funder-client agreement regarding financing and a client-attorney retainer agreement in a particular case, then a funder-attorney contract regarding the same case is prohibited due to constraints on attorneys under the Rules of Professional Conduct.[78] In Diagram A, this prohibition is represented by the dotted line between the funder and the attorney, indicating that the funder and attorney may not have a contractual relationship although they may work together for the benefit of the client.

Diagram B depicts the situation in which a funder is funding a law firm rather than a party to a dispute.[79] If there is a funder-attorney contract (i.e., lending directly to the law firm) and a client-attorney retainer agreement, then there will not be a funder-client agreement in the same transaction.[80] This is represented in Diagram B by the dotted

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75. *See, e.g.*, State Bar of Mich. Prof. Ethics Comm., Op. RI-321 (June 29, 2000) (striking down a three-way funding arrangement in which the attorney agreed to refer clients to the funder; the funder agreed to fund those clients solely if the client hired the same attorney, and the client would have to agree to limited liberty with respect to control of the litigation, termination of the attorney, and settlement of the claim); Maya Steinitz & Abigail C. Field, *A Model Litigation Finance Contract*, 99 IOWA L. REV. 711, 749 (2014) (positing a model funding contract that distinguishes from the retainer agreement).

76. *See supra* Diagram A.

77. *See* Richmond, *supra* note 74, at 651-52, 659-64; Steinitz, *Whose Claim Is This Anyway?*, *supra* note 64, at 1324–25; Neil Rose, *Something for Nothing?*, RACONTEUR ON LEGAL EFFICIENCY, Mar. 25, 2010, at 8, 8-9.

78. *See, e.g.*, State Bar of Mich. Prof. Ethics Comm., Op. RI-321 (June 29, 2000) (striking down a three-way funding arrangement in which the attorney agreed to refer clients to the funder; the funder agreed to fund those clients solely if the client hired the same attorney, and the client would have to agree to limited liberty with respect to control of the litigation, termination of the attorney, and settlement of the claim); *see also* MODEL RULES OF PROF'L CONDUCT r. 1.7 (AM. BAR ASS'N 2016) (detailing prohibited actions based on concurrent conflict of interests involving current clients); *id.* r. 1.8 (detailing prohibited actions based on conflicts of interest involving financial transactions with clients, financial assistance to clients, and the lawyer taking a financial interest in the client's case); *cf. supra* Diagrams A & B (diagraming the different possible relationships between the law firm, client, and funder when they remain separate entities).

79. *See supra* Diagram B; *infra* notes 80-82 and accompanying text.

80. *See* Engstrom, *Lawyer Lending*, *supra* note 62, at 403 (discussing the role of the retainer agreement and client consent in third-party funding).

line between the funder and the client.[81] The reason for this is that the funder is funding the law firm directly, and the law firm in turn represents its clients who pay their bills as indicated according to their individual retainer agreements with the law firm. The client is not a party to the law firm's funding arrangement with the funder. Conversely, in Diagram A, the client-funder agreement addresses how the law firm will be paid, even though the law firm is not a party to the agreement. Therefore, the funder will typically structure the agreement to fund either the law firm involved in the case or the individual party to the case, but will not make funding agreements with both the client and the law firm at the same time regarding the same case.[82]

Just like in Diagram A, the attorney-client retainer agreement is represented in Diagram B by the solid line connecting the client and attorney.[83] Since attorneys require a retainer agreement with a client in order to represent them, there would never be a case in which there is a funder-client agreement and funder-attorney agreement but no attorney-client retainer.[84] Diagrams A and B therefore represent the full universe of options for funding arrangements in which the funder is a separate legal entity from both the client and the attorney.[85]

B. The Risks of the Triangular Transaction

There are a multitude of risks in any financial transaction, and third-party funding is no exception.[86] The financial risks of third-

81. *See* Shannon, *Harmonizing Regulation*, *supra* note 20, at 863 n.3 (describing the quintessential funding arrangement). *See generally* NIEUWVELD & SHANNON, *supra* note 35 (discussing the law of third-party funding in pvery thirty countries).

82. *See supra* Diagrams A & B.

83. *See* Shannon, *Harmonizing Regulation*, *supra* note 20, at 863 n.3 (describing the quintessential funding arrangement). *See generally* NIEUWVELD & SHANNON, *supra* note 35 (discussing the law of third-party funding in pvery thirty countries).

84. *See* MODEL RULES OF PROF'L CONDUCT r. 1.5(b) (AM. BAR ASS'N 2016) ("The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing . . . . Any changes in the basis or rate of the fee or expenses shall also be communicated to the client.").

85. *See supra* Diagrams A & B.

86. *See, e.g.*, Bogdan, *supra* note 68, at 209-25 (discussing the financial risks of the third-party funding transaction); Steinitz, *Incorporating Legal Claims*, *supra* note 21, at 1197-1204 (discussing various risks and problems created by third-party funding including control, conflicts of interest, information asymmetry, the attorney client privilege, pricing, transparency, commodification, and transaction costs, among others); Steinitz, *Pricing Legal Claims*, *supra* note 17, at 1903-19 (discussing risks relating to human behavior, negotiating

party funding are well documented in the existing literature and are not the focus of this Article.[87] This Article does not address the financial risks because changing the structure of the third-party funding transaction in the ways explored in this Article will not mitigate the financial risks directly. In addition, the third-party funding industry exists because funders are uniquely positioned to handle financial risks that parties and law firms are less equipped to handle; this is precisely why parties and law firms seek the services of the third-party funder.[88] In essence, the financial risks are not a problem that changing the structure of the third-party funding transaction can solve or even should solve.

Instead this Article focuses on the nonfinancial risks that affect third-party funding.[89] First, third-party funding carries the risks inherent in the dispute resolution system's rules, procedures, inefficiencies, inadequacies, and uncertainties that affect whether the client will win, the amount of the judgment, and the amount of the costs.[90] Second, third-party funding carries risks that those involved in the case—parties, attorneys, witnesses, judges, arbitrators, and funders—will not behave as expected or as promised, either by making errors or by being deceptive.[91] The timing, nature, and

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principles, financial theory, economic valuation, and accounting principles); *see also* discussion *infra* Part III (analyzing ways to mitigate the risks discussed in this Part).

87. *See* sources cited *supra* note 86.

88. *See* Joanna M. Shepherd & Judd E. Stone II, *Economic Conundrums in Search of a Solution: The Functions of Third-Party Litigation Finance*, 47 ARIZ. ST. L.J. 919, 922 (2015).

> The financier's need to ensure a safe return on investment without a direct method for compelling litigation settlement (or non-settlement) puts him in an economically vulnerable position. Sophisticated financiers therefore include various *ex ante* and *ex post* devices in the third-party litigation financing agreement itself to mitigate this risk. The financier's choice of clients, and the collateral or conditions the financier may require, protect the financier from this risk in light of his fundamental and nearly irreconcilable alienation from the attorney/client relationship.

Id.; *cf.* sources cited *supra* notes 35, 86. *See generally* Elizabeth Chamblee Burch, *Financiers as Monitors in Aggregate Litigation*, 87 N.Y.U. L. REV. 1273 (2012) (discussing the financial risks of class action litigation and nonclass aggregate litigation and arguing that third-party litigation funders can bear the financial risk in order to remove pressure and conflicts of interests from class counsel).

89. *See* sources cited *supra* note 86.

90. *See* sources cited *supra* note 86.

91. *See* Sahani, *Judging Third-Party Funding*, *supra* note 27, at 422-27 (discussing the existing corporate disclosure requirement under Federal Rule of Civil Procedure 7.1 and proposing adding a new Rule 7.2 to require disclosure of the identity of the third-party funder to the judge); Shannon, *Harmonizing Regulation*, *supra* note 20, at 866 & n.19 (talking about

severity of the error or deception may actually change the amount that the funder will pay for the legal costs or the calculation of the funder's fee, based on the parameters included in the funding arrangement.[92] These risks underline the necessity of trust in any transaction or procedure, but even with trust, the risk of deception is ever-present.[93] Furthermore, third-party funding carries the risks of a confusing, inadequate, or nonexistent regulatory scheme in many jurisdictions, which makes compliance uncertain or difficult.[94] This, in turn, increases the risks related to the dispute resolution system and human behavior, since those who have to work within the dispute resolution system and honor the agreement may be confused regarding how they may carry out their obligations under the law.[95]

The dispute resolution systemic risks, behavioral risks, and regulatory compliance risks are the reasons why the outcome of the case is uncertain, even if one side has stronger evidence, better lawyers, or more money to spend on the case.[96] These risks affect the underlying clients, attorneys, and decision makers (judges and arbitrators) involved in the dispute, in addition to increasing the funder's financial risks in the transaction.[97] All of these risks contribute to the funder's calculation of the price that a winning funded client must pay to the funder in the event that the dispute is resolved successfully.[98] That price is the portion of the judgment,

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an unscrupulous client running away with money after winning a case and not paying funder); Steinitz, *Pricing Legal Claims*, *supra* note 17, at 1910-17 (discussing the behavioral risks inherent in litigation and in third-party funding); *see also, e.g.*, Weaver, Bennett & Bland, P.A. v. Speedy Bucks, Inc., 162 F. Supp. 2d 448 (W.D.N.C. 2001), *subsequent determination*, No. 1:00CV249 2007 WL 3028305 (W.D.N.C. Oct. 15, 2007) (awarding a law firm triple damages against a third-party funder that secretly undermined the law firm's contingency fee arrangement, such that the attorney received no fee after the client won); Rancman v. Interim Settlement Funding Corp., 789 N.E.2d 217 (Ohio 2003) (examining a funded client who won a windfall judgment and then refused to repay the funder and instead challenged the funding agreement in court).

92. *Cf.* sources cited *supra* note 91.

93. *See* Martin, *supra* note 64, at 88-89 (discussing *Rancman* as an example of a firm hiking its recovery percentage for the money it advanced to the client injured in an automobile accident); sources cited *supra* note 91.

94. *See* Shannon, *Harmonizing Regulation*, *supra* note 20, at 868.

95. *See id.*

96. *See* sources cited *supra* note 86.

97. *See, e.g.*, Bogdan, *supra* note 68, at 202 (describing the financial risks that vary with each transaction for the funder, including rate of interest, size of investment, and the type of commercial litigation).

98. *See id.* Successful resolution normally includes a judgment in favor of the funded party or a settlement involving a monetary payment to the funded party. The funds

award, or settlement that the funded client must pay to the funder under their funding agreement.[99] The larger the funder's share, the higher the price.[100] The remainder of this subpart examines these risks in greater detail.

With respect to the dispute resolution systemic risks, the quintessential risk in any litigation or arbitration matter is the risk of losing the case.[101] No case has an outcome that can be predicted with absolute certainty before the case is even filed.[102] Yet, in most instances, the funder makes the decision regarding whether to fund a case before that case is filed.[103] Thus, the funder is taking on the risk of loss because the funder will not be paid if the case is lost.[104] In situations in which a funded party has hired both a third-party funder and a contingency fee attorney, the attorney is also bearing some of the risk of loss as well because the attorney's fee is still tied to whether

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awarded due to a judgment or settlement must be recoverable from the opposing side in order to trigger the repayment obligation to the funder. Of course, a funded party to a case that loses the case on the merits and is awarded no money usually does not have to pay anything to the funder at all. (The structure may be slightly different if the funder is funding a law firm, such that the law firm may have to pay something.) Thus the risk of loss is fully on the funder, and the funder includes the risk of loss in the risk-based price as well. However, this Author does not view "risk of loss" pricing as problematic because the structure in which the funder takes on the entire cost of the risk of losing the case on the merits (without agreeing to pay the underlying judgment) offers the greatest benefit to the underlying client. Therefore, the structures presented in this Article do not attempt to mitigate the "risk of loss" portion of the risk-based pricing scheme.

99. *See* Bogdan, *supra* note 68, at 201-02 (discussing methods of loan repayment upon settlement).

100. *See id.* (explaining the degrees of risk and factors that affect recovery and funding).

101. This includes the reputational risks of losing the case, not just the financial risks.

102. Economic theory predicts that if the outcome of the case could be predicted with certainty (or even a high degree of certainty), it would be settled. *See* Hal R. Varian, *What Use Is Economic Theory?*, U.C. BERKELEY SCH. INFO. 5 (Aug. 1989), http://people.ischool.berkeley.edu/~hal/Papers/theory.pdf (discussing opportunity costs and benefit analysis). Arguably, even a case that ends in a consent decree might have a 99% certainty regarding the outcome, but there would still be some uncertainty, however slight. *See* John Bronsteen, *Some Thoughts About the Economics of Settlement*, 78 FORDHAM L. REV. 1129, 1134-35 (2009) (weighing the benefits and costs of settlement considering risk assessment of the outcome of litigation).

103. It is important to note that funders also may fund pending cases or cases that have already been filed. In addition, defense-side funders often have to make a decision regarding whether to fund the defendant after the case has been filed since the defendant may not even be aware of the dispute until the case is filed.

104. *See* NIEUWVELD & SHANNON, *supra* note 35, at 20 (discussing the funder taking an interest in the "proceeds" of the case, implying that the funder receives nothing if there are no proceeds, which would occur if the funded client loses or if the opposing side is judgment-proof).

the client prevails on the merits.[105] If the funder is funding a law firm directly, the arrangement may be structured such that the law firm is passing on some of that risk to its underlying clients.[106] That risk may be passed along to the underlying client in controversial ways, such as charging clients the interest on money the law firm receives from the third-party funder, either as part of the law firm's overhead costs or as a direct interest payment, thereby reducing the client's recovery amount from the awarded judgment.[107] This is controversial because forcing clients to pay such interest could dramatically increase the cost of litigation for many plaintiffs, particularly those bringing tort claims as individuals or as a class.[108]

The funded party is also bearing the risk of loss on liability to the extent that the party would have to pay a judgment or award rendered on a counterclaim or set-off if it loses.[109] The funded party bears the risk of loss on liability because third-party funders do not pay judgments or awards—one of the many ways in which third-party funders differ from liability insurance providers.[110] A funded claimant who prevails on the merits but is unable to recover enough (or any) money from the losing defendant would likely not have to reimburse

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105. This is because the attorney may receive either less than its full fee or no fee if the client loses the case. The court fees and evidentiary costs of the litigation are borne by the funder during the litigation. This is an advantageous arrangement for an attorney working on contingency because the attorney ordinarily would bear all of the costs himself when working alone. With the funder's involvement, some of the cost-based risk is shifted from the contingency attorney to the funder.

106. *See* Engstrom, *Lawyer Lending*, *supra* note 62, at 380 ("This means that, if lawyers borrow funds and then deduct [from the client's judgment] interest on those funds, they stand to significantly increase the litigation costs their clients incur. It also means that to permit the deduction of interest is possibly to authorize a multi-*billion*-dollar annual reduction in tort plaintiffs' recoveries.").

107. *Id.* This Article does not express an opinion on the propriety of charging clients this interest.

108. *Id.* at 379-80 ("For starters, whether to allow—or disallow—interest pass-throughs will have a significant effect on the cost of tort litigation. Studies suggest that plaintiffs' out-of-pocket expenditures (excluding legal fees) average on the order of 3%-5% of plaintiffs' gross compensation. In a tort system that delivers to plaintiffs roughly $172 billion in gross compensation each year, a conservative (though admittedly back-of-the-envelope) estimate is that plaintiffs' litigation expenditures equal $5 billion. Increasing that sum, even marginally, would be nontrivial.") (internal footnotes omitted).

109. *See* Sahani, *Judging Third-Party Funding*, *supra* note 27, at 400, 414-16 (explaining that funders do not pay a losing client's judgment, whether on the defense side or on a counterclaim).

110. *See id.* at 400, 409, 413-16 (discussing why funders are not insurance that must be disclosed under Rule 26 partly because the funder will not pay the underlying judgment); *see also* sources cited *supra* note 58.

the funder in full (or at all) for the costs depending on the terms of the funding agreement.[111] In such circumstances, the winning funded party would likely not receive the full amount (or any) of the judgment or award, which is also a cost absorbed by the party itself.[112]

With respect to the regulatory compliance risks, academic literature and state regulators have unsuccessfully attempted to solve the potential problems of third-party funding while working within the confines of the seemingly immutable triangular structure described above in subpart A.[113] In addition, as earlier explained in this Article, the existing legislation is necessarily underinclusive by targeting only third-party funding transaction structures in which the funder operates as an independent entity.[114]

Examples of potential problems that third-party funding may cause that regulators have not thoroughly addressed or not addressed at all include: the possible waiver of the attorney-client privilege or the work product doctrine for documents and information disclosed to the funder by current or prospective funding clients;[115] how much de

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111. *See* Shannon, *Harmonizing Regulation*, *supra* note 20, at 899-900 (discussing assignment and insurance policies in the third-party litigation funding context).

112. *See id.*

113. *See id.* at 864-68, 877-83 (discussing why existing regulations are inadequate). *See generally* NIEUWVELD & SHANNON, *supra* note 35, at 144-59 (providing a 51-jurisdiction survey of existing state laws as of early 2012); Jean Xiao, Note, *Heuristics, Biases, and Consumer Litigation Funding at the Bargaining Table*, 68 VAND. L. REV. 261, 271-75 (2015) (analyzing the laws on litigation funding in Maine, Ohio, Nebraska, Oklahoma, Tennessee, and other states); Richard A. Blunk, *Have the States Properly Addressed the Evils of Consumer Litigation Finance?*, MODEL LITIG. FIN. CONT. (Jan. 20, 2014), http://litigationfinancecontract.com/have-the-states-properly-addressed-the-evils-of-consumer-litigation-finance (describing the third-party funding statutes in Maine, Ohio, Nebraska, and Oklahoma); Heather Morton, *Litigation or Lawsuit Funding Transactions 2014 Legislation*, NAT'L CONF. ST. LEGISLATURES (Jan. 13, 2015), http://www.ncsl.org/research/financial-services-and-commerce/litigation-or-lawsuit-funding-transactions-2014-legislation.aspx (listing proposed and passed legislation by state). The states that have passed legislation either allowing or prohibiting third-party funding of consumer claims include Alabama, Arkansas, Colorado (via an opinion of the Colorado Supreme Court), Maine, Indiana, Ohio, Oklahoma, Nebraska, New York (allowed for large commercial disputes), Tennessee, and Vermont. The states that have proposed or pending legislation in this area include Arizona, Georgia, Illinois, Indiana (other bills proposed), Iowa, Kansas, Louisiana, Missouri, North Carolina, New Jersey, New York (additional regulation of terms in third-party funding contracts), Rhode Island, South Carolina, Tennessee (modifying its third-party funding statute), and Texas. Other states that do not have statutes may have case law or attorney ethics opinions addressing third-party funding.

114. *See supra* notes 29-38 and accompanying text.

115. *See* Shannon, *Harmonizing Regulation*, *supra* note 20, at 872-73, 879, 900-01, 909-10. But recent legislation is moving in the right direction toward protecting privileges for funded parties and their attorneys. *See, e.g.*, 2016 Ind. Acts 1557 (providing an exception

jure or de facto control (if any) the funder is allowed to exercise over the underlying legal representation;[116] whether the attorney is constrained from communication and coordination with the funder according to the applicable Rules of Professional Conduct for attorneys;[117] whether attorneys may refer clients to funders and, if so, whether the attorney may receive a referral fee for doing so;[118] giving guidance to attorneys and funders regarding how to handle conflicts of interest involving the attorney-funder and attorney-client relationships;[119] determining whether third-party funding must be disclosed to the judge or arbitrator for the purpose of assessing potential conflicts of interest;[120] determining the reasonableness of the attorney's fees when a third-party funder is involved;[121] whether the funder may influence the settlement negotiations, either expressly or indirectly;[122] "whether the funder should be required to cover possible costs if the funded client loses (either by posting a bond in court or by paying security for costs in arbitration);"[123] conflicts of interest that may arise when the client's attorney negotiates the funding arrangement on the client's behalf, including determining the attorney's own share of the winning judgment;[124] "uneven bargaining power between the client and funder during the negotiation of the funding transaction" (if the client is negotiating on its own behalf);[125]

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to waiver of the attorney-client privilege and work product doctrine for communications between parties and funders in Indiana); VT. STAT. ANN. tit. 8, § 2255 (2016) (providing that "communication between a consumer's attorney and the [funding] company shall not be discoverable" and providing an exception to waiver of the attorney-client privilege and work product doctrine for communications with funders in Vermont); NEB. REV. STAT. § 25-3306 (2010) (providing an exception to waiver of the attorney-client privilege and work product doctrine for communications with funders in Nebraska); *see also* Steinitz & Field, *supra* note 75, at 714 (describing recent movements to regulate litigation funding).

116. *See* Shannon, *Harmonizing Regulation*, *supra* note 20, at 872, 880, 906-07.

117. *See id.* at 872-73, 906-07.

118. *See id.* at 873.

119. *See id.* at 873, 906-07.

120. *See id.* at 873, 879, 903; Sahani, *Judging Third-Party Funding*, *supra* note 27, at 422-34. Scholars in this field have argued that the funding contract should also be disclosed to "provide courts with a credible signal from the private market regarding the merits of the case[,] improve the accuracy of adjudication, [and] cause funders to charge lower interest rates in an effort to demonstrate to courts the strength of the plaintiff's claim." Ronen Avraham & Abraham Wickelgren, *Third-Party Litigation Funding—A Signaling Model*, 63 DEPAUL L. REV. 233, 235 (2014).

121. *See* Shannon, *Harmonizing Regulation*, *supra* note 20, at 873.

122. *See id.* at 873, 906.

123. *Id.* at 879-80.

124. *See id.* at 880, 888, 905-06.

125. *Id.* at 880, 905-06.

and the possibility that courts and arbitrators may exercise jurisdiction over a nonparty funder directly or indirectly, even though funders do not have a defined role and have not signed the contract or arbitration agreement in dispute.[126] The regulatory holes and shortfalls left open by the existing patchwork of inadequate regulations create uncertainty in many aspects of the third-party funding transaction because the participants in the transaction may be confused regarding how to comply with the law.[127]

Current regulatory efforts focus on attempting to patch the holes in the existing regulations or introduce regulations where there previously were none.[128] This Article explores the benefits and drawbacks of a more radical regulatory alternative: changing the underlying relationships between the funder, client, and law firm, and thereby reshaping the third-party funding transaction. This means changing the structure of the third-party funding transaction and the role of the funder. If a new transaction structure solves at least some of the aforementioned problems without creating any additional problems, then that new structure would be superior to the triangular structure that currently exists.

As described above in Part II, the paradigmatic representations of the third-party funding transaction assume that the funder is an entity separate from the client and the law firm.[129] Part IV of this Article examines two potential structural solutions in which the funder becomes an internal part of the client or law firm and explores the benefits and drawbacks of those two possible structures. Part IV also analyzes whether these two potential structural solutions could address many of these regulatory problems and decrease uncertainty in the transaction without creating worse problems than those that already exist.

126. *Id.* at 879, 897-98.

127. *See* Shannon, *Harmonizing Regulation*, *supra* note 20, at 877-83.

128. *See* Martin, *supra* note 64, at 87-95 (explaining the effects of current state restrictions on third-party lending, including those on usury and champerty); Bogdan, *supra* note 68, at 203-04 (describing the "artificial barriers" that stand in the way of effective decisionmaking between parties in third-party litigation funding); Morton, *supra* note 113.

129. *See supra* Diagrams A & B.

III. THE SOLUTION: MITIGATING RISKS BY RESHAPING THIRD-PARTY FUNDING

The realization that the existing structure of the third-party funding transaction is problematic and risky challenges us to consider other compelling and useful transactional structures for further legislative and academic inquiry.[130] This Part first explains how funders currently mitigate these risks for themselves under existing structures and through their pricing mechanisms. It then explains how changing the structure might help mitigate these risks for the client and attorney as well as for the funder. In order for other transaction structures to be possible, however, the funder has to change its role from being an external investor to something else.[131] This Part introduces the ways in which the funder's role can shift and the new transaction structures that those shifts can create. Part IV then examines one existing alternative structure and one new transaction structure and hypothesizes whether those structures may be better suited to addressing at least some of the potential problems described in Parts I and II.

The risks inherent in the financial aspects of the third-party funding transaction and the systemic risks discussed in Part II also inflate the price of third-party funding capital.[132] From the funded party's perspective, the price of third-party funding capital can be defined as the dollar amount, percentage, or proportion that the funded party who won or settled the case has to pay to the third-party funder out of the proceeds of its judgment or award.[133] How does the uncertainty inflate this price? Third-party funders determine whether to finance a case based on the characteristics of the dispute, such as the amount claimed, the weight of the evidence, the likelihood and

130. *Cf.* Shannon, *Harmonizing Regulation*, *supra* note 20 (describing the various types of third-party funding arrangements and proposing a regulatory framework).

131. *See* discussion *infra* Part IV.

132. *See* sources cited *supra* note 86.

133. Essentially, the winning client is "paying" the funder for its services out of the proceeds from the judgment or arbitral award. After subtracting the funder's reimbursement for its costs, the additional fee that the client pays the funder from the proceeds of the successful case is the "price" that the client pays for having received the benefit of the funder's financial contribution during the case. This "price" is set by the funder based on the parameters of the case and the funder's calculation, which may be by an algorithm or formula involving a variety of inputs. *See* NIEUWVELD & SHANNON, *supra* note 35, at 26-33 (detailing the financial terms of a typical litigation funding agreement and how the funder calculates its fee).

difficulty of recovering money from the losing side, and the reputation of the party's attorney.[134] The funder's determination of what proportion or percentage of the judgment or award to take is largely based on the funder's calculation of the aggregate risk involved in the case.[135]

When combined with the risks inherent in any financial transaction, the risks described in Part II would make one wonder why third-party funders choose to make this kind of precarious investment.[136] The reason that the funder is willing to make this investment is that, unlike the client and attorney, the funder's business model is to mitigate certain risks to make the venture profitable.[137] For example, in the aggregate, the funder can mitigate the financial risks, dispute resolution risks, and behavioral risks by diversifying its portfolio and investing in multiple disputes at once.[138] The funder can mitigate these risks by creating a portfolio of cases such that a certain percentage of those cases are likely to be winners, which will generate a certain rate of return for the funder.[139] However, every one of the individual disputes in the funder's portfolio will still carry many of the risks described above, especially the regulatory, behavioral, and dispute resolution systemic risks.[140] By diversifying, the funder only

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134. *See* discussion and source cited *supra* note 133.

135. *See* discussion and source cited *supra* note 133.

136. *See* NIEUWVELD & SHANNON, *supra* note 35, at 28-32 (discussing how the funder ensures a rate of return over a period of years using a portfolio of cases).

137. *See id.*

138. *See id.*; *cf.* David S. Abrams & Daniel L. Chen, *A Market for Justice: A First Empirical Look at Third Party Litigation Funding*, 15 U. PA. J. BUS. L. 1075, 1077 (2013).

> Risk-averse individuals or firms will also eschew pursuit of positive expected-value claims, but not necessarily due to cost considerations. The uncertainty inherent in legal proceedings will reduce the value relative to a risk-neutral entity. Thus, the transfer of a claim from a risk-averse to a risk-neutral party [i.e. a third-party funder] should yield an increase in total claims pursued. The transferred claims would be riskier and be brought by more risk-averse entities.

Id. (internal footnotes omitted). It is also worth noting that attorneys working on contingency can also mitigate risks by assembling a diverse portfolio of cases as well. However, law firms do not have the additional cash flow that external investors provide to third-party funders. Thus when client loses the case, the detriment to the contingent fee attorney is likely higher than the detriment to the funder.

139. *See* NIEUWVELD & SHANNON, *supra* note 35, at 28-32 (discussing how the funder ensures a rate of return over a period of years using a portfolio of cases); *cf.* Abrams & Chen, *supra* note 138, at 1077.

140. See *supra* Part II, for a discussion of the risks inherent in every piece of litigation and, therefore, every litigation financing arrangement.

decreases the aggregate risk of its portfolio losing value; the funder does not decrease the internal risks inherent in an individual investment in an individual dispute.[141]

As a complementary strategy, reshaping the structure of the third-party funding transaction may reduce some of the risks inherently present within an *individual* dispute, not just a portfolio of disputes.[142] Furthermore, reducing those risks would benefit not just the funder but also the client and the attorney, who are likewise affected by those risks. Changing the structure of the third-party funding transaction may mitigate at least some of these risks and benefit the funder, client, and attorney in three important ways.

First, by changing the funder's role to a coventurer (i.e., an internal partner of the funded party) or a coadvisor (i.e., an internal partner of the law firm), as set forth in Part IV of this Article, several of the risks discussed in Parts I and II would likely be reduced or eliminated. These risks would likely be reduced or eliminated because the funder's new role under each of the new transaction structures presented in Part IV would be categorized as a party, a party's representative, or an agent of either the party or the party's attorney under the existing rules relating to evidentiary privileges, conflicts of interest, and the attorney Rules of Professional Conduct.[143] Since the funder's new roles would fall within the ambit of existing rules that govern the litigation system and the attorney-client relationship, then the risk of unsanctioned, lawless behavior by funders would be reduced. Those existing rules provide for sanctions for named participants, and the funders would be included within the reach of those sanctions.[144] The most effective sanction on a funder would likely be a monetary sanction or a public reprimand due to the funder's need to maintain its reputation and constrain costs in order to remain a viable business enterprise. The funder's knowledge of the threat of sanctions would very likely cause funders to ensure that their behavior complies with the existing rules. This would help reduce the risks discussed in Parts I and II.

Second, reducing or eliminating those risks would likely assert downward pressure on the price of third-party funding capital because "[f]unders are repeat players, and portfolio theory tells us that risk

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141. *See* sources cited *supra* note 86; discussion *supra* Part II.
142. See *supra* Part II, for a discussion of those risks.
143. *See infra* notes 168-169 and accompanying text.
144. *See, e.g.*, FED. R. CIV. P. 11, 37.

equals reward for the funders."[145] In other words, a lower risk equals a lower reward, which, for the funder, would mean a lower price charged to the funded party who won or settled its case.[146]

Third, in the future, more affordable access to cheaper third-party funding capital would likely give potential clients wider access to third-party funding and more bargaining power to keep a larger share of their winnings while still benefiting from third-party funding capital.[147]

Furthermore, reshaping the third-party funding transaction would likely help guide legislative choices by better defining the funder's role and the legal relationships that the regulators should constrain or encourage.[148] Regulators would benefit from having clearer definitions of the transaction types and relationships that they should seek to regulate, and restructuring the third-party funding transaction would allow regulators to create differently tailored regulations for each of the new structures of the third-party funding transaction detailed in Part IV.[149] Moreover, attorneys would benefit from receiving clarity regarding the role of the funder in each particular transaction structure and whether the funder may legally exert direct influence or control over the conduct of the legal representations—for example, whether the funder is a coventurer or coadvisor and, if so, how much influence the funder may wield.[150] Attorneys would also benefit from having a clearer sense of the effect of the third-party funding relationship on their obligations to the client under the professional ethics rules.[151] Additionally, judges and

145. Bogdan, *supra* note 68, at 217.

146. *See* Bronsteen, *supra* note 102, at 1138 ("[P]laintiffs [are] risk-averse, preferring a certain settlement to the risk of a trial; [but] defendants [are] risk-seeking, preferring a possible payout after adjudication to a certain but smaller one in settlement."); Jonathan T. Molot, *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L.J. 65, 95-96 (2010) [hereinafter Molot, *A Market Solution to a Procedural Problem*] (balancing factors of the costs and benefits of settlement).

147. *See* Molot, *A Market Solution to a Procedural Problem*, *supra* note 146, at 72-73 (examining the effects of risk aversion on bargaining power and noting the presence of "risk preferences that might otherwise threaten to overpower the merits in settlement negotiations").

148. *See* Shannon, *Harmonizing Regulation*, *supra* note 20, at 881-82.

149. *See id.*

150. *See ABA White Paper*, *supra* note 32, at 22-26, 39 (discussing the attorney's existing obligations under the Rules of Professional Conduct when third-party funding is involved in the case).

151. *See generally id.* (discussing the attorney's existing obligations under the Rules of Professional Conduct when third-party funding is involved in the case).

arbitrators would benefit from clearer regulations and clearer categories of transaction structures when trying to determine whether a third-party funding relationship exists when hearing a particular case or when trying to determine the propriety of a funding agreement in cases where the funding arrangement itself is in dispute.[152] For the foregoing reasons, reshaping the third-party funding transaction structure—if appropriate—would likely reshape the future direction of the industry.

Keeping in mind the potential effects of mitigating the risks described in Parts I and II, the next Part presents the two proposed new transaction structures and examines the advantages and drawbacks of each.

IV. RESHAPING PARTNERSHIPS: A TALE OF TWO "T"S

This Article fundamentally questions the notion that the funder will always remain as a separate entity and investigates two alternative transaction structures in which the funder becomes an internal partner of either the client or the law firm. Each of these two alternative transaction structures can be represented by a "T" shape.[153] Each of the two lines in the "T" would represent a contractual relationship. The horizontal line at the top of the "T" would represent an internal partnership between the third-party funder and either the client or the law firm. The vertical line at the bottom of the "T" would represent a contract between that partnership (or joint venture) and the third participant.

There are two ways in which this T-shaped structure can be used. The first way is that the funder could create a joint venture corporate entity in partnership with the original client (the horizontal line).[154] The original client would then assign its entire legal claim to the joint venture corporate entity. The attorney would then enter into a retainer agreement with the joint venture entity or funder-client co-owned corporation as its client (the vertical line).[155] This structure would be

152. *Cf.* Sahani, *Judging Third-Party Funding*, *supra* note 27 (discussing how judges and arbitrators should handle third-party funding when they encounter it in the cases they hear).

153. *See infra* Diagrams C & D.

154. *See infra* Diagram C.

155. *See infra* Diagram C.

most appropriate for commercial third-party funding and might not be suitable for consumer third-party funding.[156]

The second way is that the funder could become an internal partner or co-owner of the law firm (the horizontal line).[157] The joint funder-attorney team would then enter into a retainer agreement to provide combined legal and financial services to the original client (the vertical line).[158] This structure is currently possible in the United Kingdom under existing law.[159] By contrast, the only U.S. jurisdiction where this structure might perhaps be possible is the District of Columbia under Rule 5.4 of the D.C. Rules of Professional Conduct, and the funder-attorney partnership would have to be very carefully

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156. *See* Steinitz, *Incorporating Legal Claims*, *supra* note 21, at 1161-62.

> Recognizing the full commodification of claims created by their incorporation and a liquid market in claims, I draw one major limit: I exclude from consideration the incorporation of noncommercial claims. Commercial claims, more than all others, involve damages that can be remedied through monetary compensation. When a claim's natural remedy is monetary, commodification does not distort justice. In all other instances, however, the drive toward commodification can distort justice. While this Article will identify ways to ameliorate this dynamic through deal structure at bottom, injuries that call for nonmonetary remedies need to be sheltered from commodification. Thus for the purposes of cleanly demarcating the incorporation of claims and its benefits, I exclude noncommercial claims.

Id. (internal footnotes omitted).

> American litigation finance serves two different markets. One is consumers bringing personal claims sounding, e.g., in torts, matrimonial, or workers' compensation law, who need bridge financing while their attorney delivers a settlement or judgment. The other is corporations, many repeat players, that want the money to pay the litigation's expenses so they can free up the capital for operations, or that are faced with a claim too big for them to bring without financing. The public policy concerns are quite different, in that consumers have less bargaining power and sophistication and therefore need more protection; personal claims are not always resolvable with cash alone, and the contracts involved are totally different. While consumers can enter form contracts, commercial claims are always negotiated deals.

Id. at 1161 n.11.

157. *See infra* Diagram D.

158. *See infra* Diagram D.

159. *See* Legal Services Act 2007, c. 29 (Eng.); Baker Tilly Int'l, *Climate Change: Forecasting the Impact of the Legal Services Act—Litigation Funding*, FULBROOK CAP. MGMT., LLC (Oct. 2010), http://www.fulbrookmanagement.com/climate-change-forecasting-the-impact-of-the-legal-services-act-litigation-funding/. This is also called the "Tesco law," by those who argued that the "standard of advice would fall" and that buying legal services would be as easy as shopping at a supermarket like Tesco. *See* Marion Dakers, *'Tesco Law' Rules Relaxed To Encourage More One-Stop Law Shops*, TELEGRAPH (Oct. 26, 2014), http://www.telegraph.co.uk/finance/newsbysector/supportservices/11187121/Tesco-Law-rules-relaxed-to-encourage-more-one-stop-law-shops.html.

structured to meet the requirements of this rule.[160] All states in the United States would need to modify their adopted version of the ABA Model Rules of Professional Conduct Rule 5.4 (or the equivalent rule in that jurisdiction) in order for this transaction structure to be possible.[161] Coincidentally, there is a longstanding debate regarding the prohibitions listed in Rule 5.4 that dates back to the genesis of the ABA Model Rules of Professional Conduct and is discussed further below in subpart B.[162] This Part will now examine the benefits and drawbacks of each of the two T-shaped structures in turn.

Diagram C

A. *Funder as Party's Coventurer*

The funder participating as the underlying party's coventurer is currently legally permissible and was first examined in the scholarly literature by Professor Maya Steinitz.[163] In this structure, the funder and client become joint owners (coventurers) of a joint venture entity or corporation to which the client would assign the legal claim, and then the joint venture entity or corporation would become the party to

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160. *See* D.C. RULES OF PROF'L CONDUCT r. 5.4 (D.C. BAR 2007).

161. See *infra* notes 337, 339-340 and accompanying text, for examples of literature explaining this debate.

162. *See infra* notes 283-291 and accompanying text (discussing the historical debate surrounding the prohibitions in Rule 5.4).

163. *See* Steinitz, *Incorporating Legal Claims*, *supra* note 21, at 1158.

> This Article offers an alternative theoretical and regulatory paradigm: the "incorporation paradigm," according to which litigation finance should be understood as a pocket of the finance industry rather than an extension of the contingency fee. According to this new paradigm, commercial legal claims can and should be "incorporated" (as defined in Section A below) in order to minimize or even resolve the concerns that both proponents and opponents of litigation finance are seeking to solve through the ethics paradigm.

Id.

the case and the client of the law firm.[164] Professor Steinitz also identified some third-party funding transactions in which this structure has already been used.[165] However, for this structure to be permissible, it is important to note that the original party must remain a co-owner of the joint venture and must not sell 100% of the claim to the third-party funder.[166] If the joint venture were to bring the claim in court with the third-party funder as its sole owner, then this would be impermissible in many state jurisdictions and would likely violate the "real party in interest" rule of the Federal Rules of Civil Procedure.[167]

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164. *See id.*

165. *See id.* at 1171-97 (discussing examples of this structure used in the real world).

166. *See, e.g.*, BSC Assocs. v. Leidos, Inc., 91 F. Supp. 3d 319, 326, 329 (N.D.N.Y. 2015).

> "[I]n order to fall within the statutory prohibition, the assignment must be made for the very purpose of bringing suit and this implies an exclusion of any other purpose. . . ."
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> . . . .
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> [A]n assignment of an action to "a shell formed exclusively for the purposes of litigating the instant action," which did not purchase the debt instrument underlying the action, was champertous. . . . "[I]t is champerty to sue . . . for debt that is not really your own. [This] is litigation by proxy and prohibited by section 489." In the present matter, Plaintiff's representations have made clear that Plaintiff was formed as a shell corporation to permit the Matthews family to litigate this action. The Court agrees with the *Koro* and *Justinian* courts that such a transaction falls squarely within Section 489's prohibition on corporations speculating in lawsuits. In light of Plaintiff's assertions that it was created to enable the Matthews family to pursue the instant claims, and numerous contentions that it received this cause of action from BSC Partners absent any related obligations or assets, the Court concludes that Plaintiff's acquisition of this action violated the doctrine of champerty. Accordingly, Defendant's motion to dismiss the complaint on the ground of champerty is granted.

Id. (citations omitted) (quoting Justinian Capital SPC *ex rel.* Blue Heron Segregated Portfolio v. WestLB AG, 981 N.Y.S.2d 302, 308 (N.Y. App. Div. 2014)). The only way this would be permissible is if the claim were transferred as part of a substantial sale of the assets of the original party, such as through corporate changes relating to merger, acquisition, restructuring, or insolvency.

> In [Fairchild Hiller Corp. v. McDonnell Douglas Corp., 270 N.E.2d 691 (N.Y. 1971)], the New York Court of Appeals concluded that an assignment of a claim did not violate the doctrine of champerty where the assignment was "an incidental part of a substantial commercial transaction" in which the plaintiff acquired the assignor's operating assets. Key to the court's analysis was the fact that the plaintiff's primary purpose in effectuating the transaction was to acquire the assignor's operating assets and not to bring an action on the assignment.

Id. at 328 (citation omitted).

167. *Id.*; *see also* FED. R. CIV. P. 17 ("An action must be prosecuted in the name of the real party and interest."); BSC ASSOCS., 91 F. Supp. 3d at 327-29 (denouncing the assignment of a claim).

This Article is the first to examine the benefits and drawbacks of this structure through the lens of a third-party funder serving as an internal partner of the client.

The first benefit of this structure is that no change in the existing law is required to allow this structure. Additionally, this structure solves the issue of the waiver of the attorney-client privilege and the work-product doctrine for information disclosed to the funder.[168] This is because the funder would be classified as a co-owner of the entity that is the party to the case, so the preexisting common interest exception to waiver of evidentiary privileges would apply to information disclosed to the funder.[169]

Furthermore, this structure solves many of the issues that relate to the participation of the funder in the litigation or arbitration procedure.[170] For example, this structure addresses the issue of how much de jure or de facto control the funder can exercise over the legal representation.[171] The funder is functioning essentially as an internal

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168. *See* Steinitz, *Incorporating Legal Claims*, *supra* note 21, at 1202-03 ("[P]rivilege issues for communications between [the funder and the plaintiff] would evaporate as they would be co-representatives of the SPV [single-purpose vehicle, i.e., the joint venture] client for all dealings with counsel.").

169. *See, e.g.*, J. Michael Martinez de Andino & M. Thomas Andersen, *Common Interest Doctrine in the Fourth Circuit*, VA. LAW., Feb. 2011, at 28, 28.

> The common interest doctrine is "an extension of the attorney-client privilege" or the work-product doctrine, and "applies when two or more parties consult or retain an attorney concerning a legal matter in which they share a common interest."
>
> Accordingly, the common interest doctrine requires an underlying privilege—either the attorney-client privilege or the work product doctrine. "The common interest doctrine . . . is not a privilege in its own right. Merely satisfying the requirements of the common interest doctrine without also satisfying the requirements of a discovery privilege do [sic] not protect documents from disclosure."

Id. (internal footnotes omitted) (first quoting United States v. Aramony, 88 F.3d 1369, 1392 (4th Cir. 1996); then quoting Hanson v. U.S. Agency for Int'l Dev., 372 F.3d 286, 292 (4th Cir. 2004) (citation omitted); then quoting Hunton & Williams v. U.S. Dep't of Justice, 590 F.3d 272, 280 (4th Cir. 2010)); *see also* Michele DeStefano, *Claim Funders and Commercial Claim Holders: A Common Interest or a Common Problem?*, 63 DEPAUL L. REV. 305, 342-52 (2014) (discussing the pros and cons of applying the common interest exception to waiver to funders).

170. See *supra* Part II, for a list of the issues that relate to the participation of the funder in litigation and arbitration procedure. *See generally* Sahani, *Judging Third-Party Funding*, *supra* note 27 (proposing rule revisions and reinterpretations to address the participation of the funder in litigation and arbitration procedure).

171. *See* Steinitz, *Incorporating Legal Claims*, *supra* note 21, at 1175 ("Each incorporation, whether loose or strict, is always coupled with a formal allocation of control and ownership of the claim, as well as a preemptive resolution of conflicts or a voting process by which such conflicts are resolved.").

partner of the underlying client when it becomes a co-owner of the joint venture entity or corporation along with the underlying client. Thus the funder could exercise an amount of control commensurate with the allocation of ownership and control detailed in the joint venture agreement with the client.[172] Such control may include directing the legal representation and making decisions regarding settlement.[173] In addition, this structure solves the issue of technical conflicts of interest with respect to the attorney-client relationship.[174] The attorney's client is a new corporation, rather than the original client or the funder, so the attorney should act in the best interests of the new corporation in consultation with both the funder and the original client.[175] Moreover, this structure solves the question of who would pay security for costs, adverse costs awards, or "loser pays" costs.[176] The joint venture would be liable to pay those costs, and the funder (and perhaps even the client) would contribute assets to the joint venture to cover those costs.[177] Likewise, this structure may address the question of whether the identity of the funder must be disclosed to the judge.[178] Federal Rule of Civil Procedure 7.1 requires all corporate parties to disclose "any parent corporation and any publicly held corporation owning 10% or more of its stock."[179] Under

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172. *See id.* However, unequal bargaining power of the funder and the client during the negotiation of the joint venture agreement is one of the drawbacks of this structure. *See infra* notes 198-201 and accompanying text.

173. *See, e.g.*, Steinitz, *Incorporating Legal Claims*, *supra* note 21, at 1189 ("The [funders] shall have the sole power and duty to direct and supervise all matters involving the Litigation (including trial strategies and planning and settlement strategy).") (internal quotation omitted).

174. *See id.* at 1191.

175. *See* NIEUWVELD & SHANNON, *supra* note 35, at 135-39.

176. *See* NIEUWVELD & SHANNON, *supra* note 35, at 26-27; Sahani, *Judging Third-Party Funding*, *supra* note 27, at 400 n.55, 433-35, 439-40 (discussing whether the funder will pay security for costs or adverse cost orders if the funded client loses the case); Shannon, *Harmonizing Regulation*, *supra* note 20, at 872, 879-80, 891 (discussing whether the funder will pay security for costs or adverse cost orders if the funded client loses the case).

177. *See* FED. R. CIV. P. 54(d) (discussing the award of costs other than attorney's fees and the award of attorney's fees to the prevailing party). As the party to the case, the joint venture would be liable to pay the costs. As owners of the joint venture, the funder and the client would be liable to fund the joint venture and thus, indirectly, pay the costs.

178. This structure alone does not solve the disclosure issue for arbitration. A new arbitration procedural rule would be required to mandate disclosure of the identity of the funder. *See* Sahani, *Judging Third-Party Funding*, *supra* note 27, at 406-09, 427-31 (discussing arbitration procedural rule to require disclosure of the funder's identity and the International Bar Association [IBA] Guideline requiring a party to disclose identity of funder to arbitrator).

179. FED. R. CIV. P. 7.1.

this Rule, a publicly held funder—such as Burford, Juridica, or IMF Australia—that owns 10% or more of the joint venture entity would have to be disclosed.[180] Whether this rule applies to a privately held funder, however, would depend on whether that privately held funder is a "parent corporation" of the joint venture entity.[181] Rule 7.1 (as well as its parent rule, Federal Rule of Appellate Procedure 26.1) does not define "parent corporation."[182] There are several definitions of "parent corporation" that may be applicable.[183] If the funder is a "parent corporation" under the appropriate definition, then it would have to be disclosed to the court, even if it is privately held.[184] Finally, an arbitrator or judge could likely exercise jurisdiction over a nonparty funder by piercing the corporate veil of the joint venture, although this is rarely done in practice.[185] In addition, a judge could directly sanction the joint venture as a party under the Federal Rules of Civil Procedure 11 or 37, thereby indirectly reaching the funder as a co-owner of the joint venture.[186]

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180. *See FAQ*, BURFORD, http://www.burfordcapital.com/faqs/ (last visited Aug. 23, 2016) ("Burford's equity and debt securities are publicly traded on the London Stock Exchange."); IMF BENTHAM, http://www.imf.com.au/about (last visited Aug. 23, 2016) ("IMF Bentham is a publicly listed company on the Australian Securities Exchange."); Sara Randazzo, *Litigation Funding Pioneer Hits a Road Block*, WALL ST. J.: L. BLOG, (Nov. 23, 2015, 12:46 PM), http://blogs.wsj.com/law/2015/11/23/litigation-funding-pioneer-hits-a-roadblock/ (describing Juridica as one of the three worldwide publicly listed litigation funders).

181. *See* FED. R. CIV. P. 7.1(a)(1) (requiring disclosure of any "parent corporation").

182. *See generally id.* R. 7.1 (using the phrase "parent corporation" several times without defining it); FED. R. APP. P. 26.1 (same).

183. *Compare Parent Company*, INVESTOPEDIA, http://www.investopedia.com/terms/p/parentcompany.asp (last visited Aug. 23, 2016) ("A parent company is a company that controls other, smaller businesses by owning an influential amount of voting stock or control."), *with* 26 U.S.C. § 1563(c)(2)(1) (2012) (providing a more precise definition of "parent corporation" as a corporation that "owns . . . 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock in another corporation").

184. *See* Shannon, *Harmonizing Regulation*, *supra* note 20, at 903-04. The vast majority of third-party funders are privately held. Only three funders are publicly traded: IMF, Juridica, and Burford. *See* sources cited *supra* note 180.

185. *See, e.g.*, Yaraslau Kryvoi, *Piercing the Corporate Veil in International Arbitration*, 1 GLOBAL BUS. L. REV. 169, 173 (2011).

186. *See* FED R. CIV. P. 11, 37; *Piercing the Corporate Veil*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/piercing_the_corporate_veil (last visited Aug. 23, 2016).

> Definition. A situation in which courts put aside limited liability and hold a corporation's shareholders or directors personally liable for the corporation's actions or debts. Veil piercing is most common in close corporations. While the law varies by state, generally courts have a strong presumption against piercing the corporate veil, and will only do so if there has been serious misconduct like abuse

Nevertheless, there are several drawbacks to this approach. First, this structure is viable mainly for commercial parties seeking funding.[187] Consumer third-party funding is considerably less likely to use this structure unless the costs and complexity involved in setting up a joint venture to own the legal claim are reasonable when compared to the amount of the potential recovery on the consumer claim.[188] Even if the costs and complexity are reasonable, however, the lower bargaining power of a consumer claimant makes it more likely that the consumer claimant may be marginalized in the joint venture agreement. This structure may therefore be undesirable for consumer funding, even if it is commercially viable for certain consumer claims.

Second, this approach is viable only for parties who are seeking commercial or financial remedies.[189] This structure does not work for clients seeking noncommercial or nonfinancial remedies (e.g., injunctions or declaratory relief) because there will be no judgment from which the funder can collect a fee.[190]

A third drawback relates to disclosure of the funder's identity to the court under Federal Rule of Civil Procedure 7.1.[191] As discussed above, Rule 7.1 requires disclosure of *publicly* held corporations that are 10% or greater owners of the party to the case, but the vast majority of funders worldwide are *privately* held corporations.[192] The

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> of the corporate form (e.g. intermingling of personal and corporate assets) or undercapitalization at the time of incorporation.

Id. (citations omitted).

187. *Cf.* Steinitz, *Incorporating Legal Claims*, *supra* note 21, at 1161 n.11 (distinguishing consumer clients of funding and excluding them from the framework set forth for incorporating legal claims).

188. *Cf. id.* at 1174-75 (describing the "efficient and commonsensical" nature of loose and strict claim incorporation).

189. *See id.* at 1161-62 ("I draw one major limit: I exclude from consideration the incorporation of noncommercial claims. Commercial claims, more than all others, involve damages that can be remedied through monetary compensation. When a claim's natural remedy is monetary, commodification does not distort justice. In all other instances, however, the drive toward commodification can distort justice. . . . [I]njuries that call for nonmonetary remedies need to be sheltered from commodification. Thus for the purposes of cleanly demarcating the incorporation of claims and its benefits, I exclude noncommercial claims.") (internal footnote omitted).

190. *Cf. id.* (excluding noncommercial claims from consideration).

191. *See* FED. R. CIV. P. 7.1.

192. *See id.*; Julie Triedman, *Litigation Funder Juridica Pulls Back After Bad Bets*, AM. LAW., Nov. 19, 2015, Lexis (noting that in 2015, there were only three publicly listed funding firms in the world); *cf.* sources cited *supra* note 180 (listing the only three publicly-held funders, to this author's knowledge).

joint venture's corporate structure may be arranged in such a way to prevent a privately held funder from meeting the definition of a "parent corporation" under Rule 7.1. In such a case, Rule 7.1 would not require disclosure of the identity of the privately held funder.[193] This Author has previously proposed adopting a new Rule 7.2 to require disclosure of the identity of the third-party funder *in camera* to the judge, which would solve this problem.[194]

A fourth drawback is that if the joint venture owns the legal claim, then it would be liable to pay a judgment, award, or setoff rendered on any successful counterclaims brought against it.[195] The funder, as a co-owner, would be partly liable to pay the amount awarded on the merits, which conflicts with the funder's normal role of only paying legal costs and attorney's fees.[196] A potential solution would be for the funder and client to stipulate in their joint venture agreement that the client alone will cover the amount of any judgment on a successful counterclaim against the joint venture. Alternatively, they can stipulate that the client will reimburse the funder for any funds contributed by the funder to the joint venture that went toward paying a counterclaim judgment. This will insulate the funder from the underlying liability while still enabling the joint venture structure for third-party funding arrangements. If the client is judgment-proof or has no assets, however, then the funder may be liable for the judgment on the counterclaim if the judge pierces the corporate veil

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193. *See* FED. R. CIV. P. 7.1.

194. *See* Sahani, *Judging Third-Party Funding*, *supra* note 27, at 424 ("[A] new Rule 7.2 should be adopted to require that any party—whether a natural person, corporation, or otherwise—supported by a third-party funder must disclose the identity of its third-party funder to the judge only, in camera, for reasons discussed further . . . .").

195. This would require the opposing party to have the ability to bring a counterclaim against the joint venture. In order for the opposing side to bring a counterclaim against the joint venture, the original client would have to transfer its obligations (i.e., those obligations under the contract at issue on the merits) to the joint venture, not just the claim itself. If the client does not transfer those obligations, then the opposing party could choose to bring a claim directly against the underlying client rather than a counterclaim against the joint venture. Alternatively, the opposing party could counterclaim against the joint venture and join the original party as a defendant on the counterclaim. *See* FED. R. CIV. P. 20(a)(2). A third possibility is that the joint venture defending against the counterclaim could implead the original party on the theory that the original party "is or may be liable to it for all or part of the [counterclaim] against it." *Id.* R. 14. This Author has not yet seen an example of this happening in the real world, so the foregoing analysis is purely theoretical.

196. *See* Sahani, *Judging Third-Party Funding*, *supra* note 27, at 400, 414-15 (stating that funders usually only pay legal costs, not judgments).

of the joint venture.[197] Thus this stipulation may not completely solve this issue.

A fifth drawback relates to the negotiation of the joint venture agreement and the attorney retainer agreement. The client may not have enough bargaining power to negotiate favorably regarding the ownership structure of the joint venture, so the funder may take an overwhelming or controlling stake in the venture.[198] If the funder takes a controlling stake in the joint venture, then the client may be able to invoke minority shareholder protections, depending on the contract provisions and the state law applicable to the joint venture agreement.[199] In addition, this structure creates two layers of conflicts of interest in that the attorney may negotiate with the funder on behalf of the client in order to decide the terms of the joint venture and then the same attorney may negotiate with the same joint venture regarding its own retainer agreement. A potential solution to both of these problems would be to require that the joint venture agreement be negotiated by a different attorney than the attorney who will ultimately represent the joint venture during the proceedings. This is a best practice but currently not a requirement.[200] The attorney negotiating the joint venture agreement should be paid solely by the original client, not by the third-party funder. For example, the original client's in-house attorney could negotiate the joint venture agreement or could hire an outside attorney to do so. Since, as mentioned above, this type of T-shaped structure would be most suitable for commercial third-party funding arrangements, having the client's in-house counsel

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197. *See supra* note 186.

198. *Cf.* Steinitz, *Incorporating Legal Claims*, *supra* note 21, at 1161 n.11, 1175 ("Each incorporation, whether loose or strict, is always coupled with a formal allocation of control and ownership of the claim, as well as a preemptive resolution of conflicts or a voting process by which such conflicts are resolved.").

199. *See, e.g.*, Kimble C. Cannon & Patrick J. Tangney, *Protection of Minority Shareholder Rights Under Delaware Law: Reinforcing Shareholders as Residual Claimants and Maximizing Long-Term Share Value by Restricting Directorial Discretion*, 1995 COLUM. BUS. L. REV. 725; Stephen D. Bohrer, *Protecting the Rights of Minority Shareholders in Privately-Owned Companies*, INSIGHTS, Apr. 2007, at 1; Ben Jumonville, *Minority Shareholders Receive Increased Protections Under New Louisiana Corporate Law*, LA. L. REV. (Apr. 7, 2015), https://lawreview.law.lsu.edu/2015/04/07/minority-shareholders-receive-increased-protections-under-new-louisiana-corporate-law/.

200. MODEL RULES OF PROF'L CONDUCT r. 1.8(a) (AM. BAR ASS'N 2016); *see ABA White Paper*, *supra* note 32, at 18-19.

or outside counsel negotiate the joint venture is a reasonable requirement.[201]

A sixth drawback is that this structure does not solve the problem of what the attorney should do if the funder and the original client disagree regarding what the joint venture entity wants from the dispute resolution process.[202] Since the funder has no true, merit-based interest in the underlying dispute, having the funder serve as a co-owner of the joint venture can lead to a distortion of the litigation goals to the detriment of the original client.[203] The solution to this problem proposed by Professor Steinitz is for the funder and client to negotiate and sign a litigation management agreement allocating control over the joint venture between the two of them.[204] This is a reasonable approach that has been used successfully.[205]

It may appear to the reader that the drawbacks of this funding model outweigh the benefits, or vice versa. Nevertheless, as mentioned earlier, this structure is legally permissible and is already being used. Therefore, further academic and legislative inquiry should focus on mitigating the drawbacks and improving this structure. If several of the foregoing drawbacks and limitations can be solved in the ways suggested in this subpart or in other beneficial ways, then the coventurer T-shaped structure may be superior to the original triangular structure for those clients and funders that can make use of it.

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201. *See* Steinitz, *Incorporating Legal Claims*, *supra* note 21, at 1161 n.11 (distinguishing consumer clients of funding and excluding them from the framework set forth for incorporating legal claims).

202. *See id.* at 1175 ("Each incorporation, whether loose or strict, is always coupled with a formal allocation of control and ownership of the claim, as well as a preemptive resolution of conflicts or a voting process by which such conflicts are resolved.").

203. *See id.*

204. *See id.*

205. *See id.* at 1181-82.

B. Funder as Law Firm's Internal Partner

Diagram D

Funders currently can invest in multiple law firms as passive investors providing loans to the firms.[206] In this T-shaped structure, however, the funder would join together with a *single* law firm and become an internal partner.[207] This partnership could arise between existing funders and law firms, or a funder could create a new law firm, or a law firm could create a new funder.[208] This T-shaped structure changes the relationship between the third-party funder and the law firm representing the party in the case, transforming the funder from an external financier to an internal partner of the law firm.[209] Under this new structure, the law firm and funder together would provide legal and financial services to their joint client—the party in the case.[210] That law firm would then contract with the client and offer the client a contingent fee arrangement.[211] Most states have a cap, formula, or sliding scale that applies to attorney contingent fees, so the contingent fee arrangement with the law firm would be subject to those same restrictions.[212] This is one example of how an

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206. *See, e.g.*, *supra* notes 7-8 and accompanying text. *See generally* Engstrom, *Lawyer Lending*, *supra* note 62 (noting the increased frequency of funders providing loans to law firms and providing specific examples of such occurrences).

207. *See supra* Diagram D.

208. *See supra* notes 10-15 and accompanying text (discussing third-party funder Burford's creation of a law firm called "Burford Law"); *supra* note 23 (regarding law firms contacting this Author about potentially creating their own third-party funding entities).

209. *Cf.* discussion *supra* Part I (providing an in-depth treatment of lawyer lending).

210. *Cf.* discussion *supra* Part I (providing an in-depth treatment of lawyer lending).

211. The Rules of Professional Conduct prohibit the law firm from acquiring a proprietary interest in the cause of action, so the funding arrangement would have to be structured as a contingency fee if the funder is an internal partner of the law firm. *See* MODEL RULES OF PROF'L CONDUCT r. 1.8(i) (AM. BAR ASS'N 2016).

212. *See, e.g.*, George Coppolo, *Medical Malpractice—Attorneys' Fees*, OLR RES. REP. (Sept. 25, 2003), https://www.cga.ct.gov/2003/olrdata/jud/rpt/2003-r-0664.htm

existing regulatory provision could be applied to third-party funding as a result of this new transaction structure for funders who choose to become an internal partner of a law firm.

In addition, the funder would provide expertise to the client and the law firm regarding the financial aspects of the case, including claim valuation, cost estimation, and budget control.[213] The funder already provides this expertise as a separate entity under the existing triangular structure described in Part II.[214] In this way, the funder and the law firm would become coadvisors to the client.[215] In addition, the funder would advise the law firm on practice management and financial matters, similar to a venture capital enterprise.[216] The funder and law firm could split the fee as joint venturers or partners, depending on the organizational structure they decide to adopt for their partnership.[217]

This type of arrangement between the funder and the law firm is commonly known as a multidisciplinary practice or nonlawyer ownership of law firms.[218] In the United States, both multidisciplinary practice and nonlawyer ownership of law firms are prohibited in all but one jurisdiction (i.e., the District of Columbia) and are highly controversial proposals.[219] Accordingly, this T-shaped structure is

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(comparing the caps, sliding scales, formulas, and other restrictions on contingent fees in twenty-three states for medical malpractice and other types of actions).

213. *See* discussion *supra* Part II.

214. *See* discussion *supra* Part II.

215. *See supra* note 211.

216. *See, e.g.*, *supra* note 7 and accompanying text; *see also* Steinitz, *Pricing Legal Claims*, supra note 17, at 1893 ("[Parties in third party funding] should deal with pricing in their contracts given the inherent difficulty in pricing legal claims. . . . [A] practical solution lies with *staged funding* in a manner similar to the funding of start-ups by venture capitalists.").

217. *See* NIEUWVELD & SHANNON, *supra* note 35, at 120 (explaining the connection between attorney contingency fees and third-party funding).

218. *See* Steinitz, *Whose Claim Is This Anyway?*, *supra* note 64, at 1285 n.54, 1330 n.215 (discussing multidisciplinary legal practice in the context of third-party funding); Victoria Shannon, *The Funder as Co-Counsel: A Glimpse into the Future of Law Firm Ownership*, MODEL LITIG. FIN. CONT. (Mar. 11, 2013), http://litigationfinancecontract.com/the-funder-as-co-counsel-a-glimpse-into-the-future-of-law-firm-ownership/.

219. For a general discussion of both sides of this debate, see John S. Dzienkowski & Robert J. Peroni, *Multidisciplinary Practice and the American Legal Profession: A Market Approach to Regulating the Delivery of Legal Services in the Twenty-First Century*, 69 FORDHAM L. REV. 83, 85 (2000) (examining multidisciplinary practice); Michael W. Loudenslager, *Cover Me: The Effects of Attorney-Accountant Multidisciplinary Practice on the Protections of the Attorney-Client Privilege*, 53 BAYLOR L. REV. 33, 54 (2001) ("With regard to the protection of attorney-client communications, the Commission stated that a multidisciplinary practice attorney must 'take measures to protect against a

currently prohibited by the attorney professional ethics rules in the United States.[220]

In 2011, the ABA Commission on Ethics 20/20 explored whether to allow "alternative business structures" (ABS) involving nonlawyer owners of law firms—including examining ABS regimes in the District of Columbia, England and Wales, Scotland, Australia, two provinces in Canada, Germany, the Netherlands, New Zealand, and other jurisdictions around the world.[221] In addition, recently a U.S.-based third-party funder that is publicly traded in England started its own law firm in England.[222] At the time of this writing, however, the ABA has chosen not to recommend changing the Model Rules of Professional Conduct to allow ABS. If the U.S. rules were changed to legalize this structure, however, then it could perhaps transform the legal services industry. This subpart analyzes the benefits and drawbacks of changing the rules to allow multidisciplinary practice or nonlawyer ownership of law firms viewed through the lens of third-party funding.

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potential impairment of the attorney-client privilege.'") (quoting ABA COMM'N ON MULTIDISCIPLINARY PRACTICE, REPORT TO THE HOUSE OF DELEGATES 8 (2000)); Melissa Pender, Note, *Multijurisdictional Practice and Alternative Legal Practice Structures: Learning from EU Liberalization to Implement Appropriate Legal Regulatory Reforms in the United States*, 37 FORDHAM INT'L L.J. 1575, 1600 (2014) (discussing the ABA Model Rules and their effects on regulation of multidisciplinary practices and nonlawyer ownership). *See also* E. Patrick McDermott & Ruth Obar, *"What's Going On" in Mediation: An Empirical Analysis of the Influence of a Mediator's Style on Party Satisfaction and Monetary Benefit*, 9 HARV. NEGOT. L. REV. 75, 85-87 (2004) (presenting an analysis of multidisciplinary practice in mediation); Alison Frankel, *Lawyers Remain Deeply Skeptical of Non-Lawyers Investing in Law Firms*, REUTERS: BLOG (May 9, 2016), http://blogs.reuters.com/alison-frankel/2016/05/09/lawyers-remain-deeply-skeptical-of-non-lawyers-investing-in-law-firms/ (discussing objections to nonlawyer investment in the legal community); Jacob Gershman, *Nonlawyer Ownership of Law Firms Is a Bad Idea, Say Bar Groups*, WALL ST. J.: L. BLOG (May 12, 2016, 11:41 AM), http://blogs.wsj.com/law/2016/05/12/nonlawyer-ownership-of-law-firms-is-a-bad-idea-say-bar-groups/ (same).

220. *See* MODEL RULES OF PROF'L CONDUCT r. 5.4 (AM. BAR. ASS'N 2016); *see also* Cindy Alberts Carson, *Under New Mismanagement: The Problem of Non-Lawyer Equity Partnership in Law Firms*, 7 GEO. J. LEGAL ETHICS 593, 593 (1994) (discussing Model Rule 5.4 and its consequences in law firm ownership).

221. *Cf.* Memorandum from ABA Comm'n on Ethics 20/20 Working Grp. on Alt. Bus. Structures to ABA Entities, Cts., Bar Ass'ns (state, local, specialty, & int'l), Law Schs., & Individuals (Apr. 5, 2011), http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/abs_issues_paper.authcheckdam.pdf [hereinafter ABA Memo].

222. *See* Yong, *supra* note 10.

1. Expanding Access to Capital and Choices for Parties

There are several ways that parties can benefit from this structure. One of the benefits of this structure is that authorizing funders and law firms to form multidisciplinary practices would allow clients to take advantage of the funder's expertise as an advisor to the case.[223] Currently, given the law firm's professional responsibility obligations and prohibitions with respect to its clients, funders must remain distant from the attorney-client relationship.[224] Although this may help protect the client from the funder's undue influence, it also may prevent the client from receiving the full benefit of the funder's expertise and advice regarding the economic aspects of litigation and settlement.[225] In a multidisciplinary practice, the funder could increase the value added to the client by assisting the attorney and the client in making strategic decisions about the conduct of the case while also taking a more active role in protecting the firm's investment in the case. In addition, the funder's advice could help increase the client's personal knowledge of the economics of dispute resolution.[226] Allowing the funder to take a more active role and work with the law firm directly would encourage the funder to reduce the risks outlined above in Parts I and II at each stage of the case. As mentioned in Part III, reducing those risks would likely decrease the cost of the third-party funding capital.[227] In a competitive market, some funders would likely be willing to offer their services cheaper than other funders. This could lead to stratification in the funding market, whereby the cheapest funders (i.e., those taking the smallest percentage of the judgment from the client) give no advice while the more expensive funders (i.e., those taking the largest percentage of the judgment from

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223. *See* sources cited *supra* note 218.

224. *Cf. ABA White Paper*, *supra* note 32, at 22-24 (discussing how attorneys should avoid third-party funders interfering with their independent professional judgment).

225. *See, e.g.*, Victoria A. Shannon, *The Impact of Third-Party Funders on the Parties They Decline To Finance*, KLUWER ARB. BLOG (July 6, 2015), http://kluwerarbitrationblog.com/blog/2015/07/06/the-impact-of-third-party-funders-on-the-parties-they-decline-to-finance/ [hereinafter Shannon, *Impact*] ("As a sophisticated potential investor, the funder invests considerable time, money, and effort into performing a thorough legal and financial analysis of the case during the due diligence period. Thus, the funder is extremely well positioned to offer a preliminary case assessment . . . .").

226. *See id.* ("I also predict that as the number of third-party funders and parties who seek funding grows, the most significant aggregate effect will be a dramatic increase in the number of better-informed parties, regardless of whether those parties actually receive third-party funding.").

227. *See* discussion *supra* Part III.

the client) would give full-service consulting services or multidisciplinary services in partnership with law firms.

A second benefit is that when the funder-law firm partnerships begin to offer more diversified services rather than purely money or purely legal advice, future funded clients would be able to choose the type of arrangement that is best for their cases along more of a spectrum rather than a binary "funding or nothing" model. At one end of the spectrum, a client could choose to keep a much larger percentage of the judgment, award, or settlement in the case by hiring a pure funder who offers no consulting, advising, or legal services. This arrangement would resemble Diagram A.[228] At the other end of the spectrum, a client could choose a funder-law firm partnership that offers a more robust menu of services—including guidance, advice, and mentorship—in exchange for giving the funder a larger percentage of the judgment, award, or settlement. This arrangement would resemble Diagram D.[229] In the end, this could become a lucrative symbiotic relationship, providing clients not only access to funding for adversarial processes but also access to general settlement services for a wider variety of dispute resolution procedures. Future funders partnered with law firms may even be willing to fund pure mediations; whereas under the current structure, for-profit funding of pure mediation is not economically viable.[230]

A third benefit is that this structure is workable for both consumer and commercial funding clients as well as for both commercial and noncommercial claims.[231] In this structure, the original party would remain the party to the case, so both consumer and commercial funding clients could benefit from this structure. In addition, the funder-law firm partnership could take on cases seeking injunctive or declaratory relief, which a separate third-party funder would be unlikely to accept due to the lack of a damages award. Finally, the funder-law firm partnership would be able to take on pro bono cases financed by the funder as part of the law firm's mission

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228. *See supra* Diagram A.

229. *See supra* Diagram D.

230. *See* Shannon, *Harmonizing Regulation*, *supra* note 20, at 886 n.137.

231. This is true because the third-party funder would finance the lawyer or law firm, and all funded clients that remain a party to the case are represented by a lawyer or law firm. A funded client that does not remain a party to the case would assign its claim to the funder, so the lawyer would represent the funder directly rather than the underlying client. In any case, the existence of an attorney-client relationship is a shared characteristic of commercial and consumer funding of both commercial and noncommercial claims.

under the Rules of Professional Conduct, whereas separate third-party funders do not normally have an economic or ethical incentive to take on pro bono litigation.[232] This would improve the public image of funders and put less pressure on the finances of law firms, enabling law firms to take on more pro bono cases than they currently do.[233]

A fourth benefit is that, like the other T-shaped structure described above, this T-shaped structure solves many of the issues that relate to the participation of the funder in litigation or arbitration procedure.[234] First, this structure addresses the issue of how much de jure or de facto control the funder can exercise over the legal representation. In this structure, the funder is essentially serving as a coadvisor to the client along with the law firm. In such a role, the funder would have significant influence over the conduct of the legal representation—the "means" mentioned in the ABA Model Rules of Professional Conduct.[235] Nevertheless, the funder would also have the same ethical duty to the client that the attorney has under the Model

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232. *Cf. supra* note 19 (giving examples of funders that already fund pro bono or public interest litigation).

233. *See* NIEUWVELD & SHANNON, *supra* note 35, at 5-6 (discussing attorney pro bono work as a type of third-party funding). For example, many civil rights statutes grant attorney's fees to a winning plaintiff, which incentivizes law firms to take on expensive, plaintiff-side civil rights litigation. *See, e.g.*, *Foley Hoag Foundation*, FOLEY HOAG LLP, http://www.foleyhoag.com/our-firm/the-foley-hoag-foundation (last visited Aug. 23, 2016) (providing an example of a law firm, Foley Hoag LLP, that used its windfall of attorney's fees from the landmark school desegregation case, Morgan v. Hennigan, 379 F. Supp. 410 (D. Mass. 1974), to start the Foley Hoag Foundation to fund other pro bono projects and improve race relations in Boston). If a funder were involved in such a case, then the funder could relieve some of the financial pressure on a law firm representing meritorious plaintiffs during the typically long litigation trajectory of civil rights cases, which would likely incentivize the law firm to take on more of these cases. *See* Janet Buczek, Karen Stuth & April Faith-Slaker, ABA Standing Comm. on Pro Bono & Pub. Serv., *Supporting Justice III: A Report on the Pro Bono Work of America's Lawyers* (2013) (detailing the findings of the 2012 National Pro Bono Study, which indicate the degrees of pro bono work attorneys annually perform).

234. See discussion *supra* Part II, for a list of the issues that relate to the participation of the funder in litigation and arbitration procedure. *See generally* Sahani, *Judging Third-Party Funding*, *supra* note 27 (proposing rule revisions and reinterpretations to address the participation of the funder in litigation and arbitration procedure).

235. *See* MODEL RULES OF PROF'L CONDUCT r. 1.2 cmt. 1 (AM. BAR ASS'N 2016) ("With respect to the means by which the client's objectives are to be pursued, the lawyer shall consult with the client as required by Rule 1.4(a)(2) and may take such action as is impliedly authorized to carry out the representation."); *id.* r. 1.2 cmt. 2 ("Clients normally defer to the special knowledge and skill of their lawyer with respect to the means to be used to accomplish their objectives, particularly with respect to technical, legal and tactical matters."); *id.* r. 1.3 cmt. 1 ("[A] lawyer may have authority to exercise professional discretion in determining the means by which a matter should be pursued.").

Rules of Professional Conduct,[236] which would include ensuring client control of the "objectives" in the case.[237] Thus the funder would be required to put the client's needs first and could not control the client's decision making.[238] In addition, the funder could be sanctioned as part of the law firm under the Model Rules of Professional Conduct for not putting the client's needs and objectives first.[239] This is reasonable because funders are typically run by trained lawyers who are often still licensed when they join an existing funder or start a new funder.[240] Those lawyer principals within funders are fully aware of the ABA Model Rules of Professional Conduct, or the equivalent rules of professional responsibility in the jurisdiction(s) in which they are licensed, and what would be expected of an attorney in the same situation. As mentioned above, the most effective sanction on a funder would likely be a monetary sanction or a public reprimand due to the funder's need to maintain its reputation and constrain costs in order to remain a viable business enterprise.[241] Depending on the structure of the funder-law firm partnership, the funder might also directly or indirectly be subject to sanctions under the Federal Rules of Civil Procedure 11 and 37 as part of the law firm.[242] In light of the

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236. *See id.* r. 5.3 ("With respect to a nonlawyer employed or retained by or associated with a lawyer, . . . a lawyer . . . shall make reasonable efforts to ensure that the [nonlawyer's] conduct is compatible with the professional obligations of the lawyer [and] a lawyer shall be responsible for conduct of such a [nonlawyer] that would be a violation of the Rules of Professional Conduct if engaged in by a lawyer [under certain circumstances]."); D.C. RULES OF PROF'L CONDUCT r. 5.4 (D.C. BAR 2007) (stating that nonlawyer owners must adhere to the Rules of Professional Conduct).

237. *See* MODEL RULES OF PROF'L CONDUCT r. 1.2(a) (AM. BAR ASS'N 2016) ("[A] lawyer shall abide by a client's decisions concerning the objectives of representation . . . . A lawyer shall abide by a client's decision whether to settle a matter."); *id.* r. 1.2 cmt. 1 ("Paragraph (a) confers upon the client the ultimate authority to determine the purposes to be served by legal representation, within the limits imposed by law and the lawyer's professional obligations. The decisions specified in paragraph (a), such as whether to settle a civil matter, must also be made by the client."); *id.* r. 1.2 cmt. 2 ("[L]awyers usually defer to the client regarding such questions as the expense to be incurred and concern for third persons who might be adversely affected.").

238. *See supra* notes 236-237.

239. *See supra* notes 236-237.

240. *See infra* notes 307-308 and accompanying text (providing examples of well-trained lawyers serving as principals at major third-party funders).

241. *See* discussion *supra* Parts I and II.

242. *Cf.* Sahani, *Judging Third-Party Funding*, *supra* note 27, at 433-36 (explaining that funders are typically not liable under Federal Rules of Civil Procedure 11 or 37 because funders are not explicitly mentioned in those rules and do not present papers to the court, appear in court, or participate in discovery). If the funder becomes an internal partner of the law firm, then the funder may be subject to liability under these traditional sanctions rules.

foregoing, this structure would likely provide an enforcement mechanism to deal with the issue of the funder's influence over the attorney-client relationship or the client's decision-making authority.

A second benefit that relates to the participation of the funder in litigation or arbitration procedure is that if the funder were to choose to be an internal partner of the law firm, the funder would be classified as an attorney within the attorney-client privilege and work-product doctrine privilege directly as an attorney or agent of the attorney; the exceptions to waiver need not be invoked.[243] In fact, at least three states have already passed statutes providing for an exception to waiver of the attorney-client privilege and work product doctrine privilege for communications with third-party funders, thereby protecting client communications with funders.[244] Third, the funder and attorney would be legally allowed to share the fees gained from a winning client.[245] Fourth, this structure solves the question of whether the identity of the funder must be disclosed to the judge, since the funder would be part of the counsel of record in the case.[246] Fifth, this structure would make defense-side funding more viable in the United States, since law firms take on defense-side representations.[247] For example, for corporate defendants who are clients of the firm, the funder and law firm could work with the client's insurance company that would potentially pay the funded defendant's judgment if the defendant loses the case.[248]

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243. *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 70 (AM. LAW INST. 2016) ("Privileged persons . . . are the client (including a prospective client), the client's lawyer, agents of either who facilitate communications between them, and agents of the lawyer who facilitate the representation.").

244. Indiana, Vermont, and Nebraska have passed statutes protecting client and attorney communications with third-party funders. *See supra* note 115.

245. *See* MODEL RULES OF PROF'L CONDUCT r. 5.4(a) (AM. BAR ASS'N 2016) (prohibiting fee sharing with nonattorneys with a few exceptions, not including third-party funders).

246. This structure alone does not solve the disclosure issue for arbitration. A new arbitration procedural rule would be required to mandate disclosure of the identity of the funder. *See* Sahani, *Judging Third-Party Funding*, *supra* note 27, at 427-33 (proposing to introduce a rule mandating disclosure of the funding arrangement in arbitration).

247. Defense-side third-party funding is already being used successfully in many other jurisdictions. *See, e.g.*, Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367, 377-439 (2009) (proposing defense-side funding in the United States that would be similar to after-the-event insurance in Europe).

248. *See* NIEUWVELD & SHANNON, *supra* note 35, at 23-24 (discussing the provisions of the priorities agreement that funders normally include as part of the network of contracts that make up the funding arrangement). The priorities agreement determines the order in

2. Improving the Law Firm Business Model

There are also several ways that law firms can benefit from this structure. The traditional law firm billing model and organizational structure has become unsustainable over the long-term future of the legal industry for a multitude of reasons. For example, there is client pressure to cut costs and negotiate flat fees, thereby threatening the continuing viability of the billable hour.[249] In addition, there is a volatile job market for new and lateral lawyers, with attorney layoffs ever imminent.[250] Moreover, there is the unsustainable expense of hiring new law graduates who are not practice-ready and whom clients are no longer willing to pay to train.[251] Furthermore, megafirms of over 1000 lawyers have been known to collapse under crushing debt and mismanagement of funds due to their inability to sustainably finance themselves.[252] Finally, there is the increasing popularity of global vereins[253] that must work to comply with regulations in a variety of jurisdictions worldwide all at once.[254]

For these and other reasons, the legal services industry is in dire need of restructuring and external infusions of cash from investors experienced in turning around underperforming businesses.[255] An

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which creditors are paid if the funded claimant wins, usually with the funder taking first priority. *Id.*

249. *See* Leigh McMullan Abramson, *Is the Billable Hour Obsolete*?, ATLANTIC (Oct. 15, 2015), http://www.theatlantic.com/business/archive/2015/10/billable-hours/410611/.

250. *See* Kathryn Rubino, *Nationwide Layoff Watch: Biglaw Firm Cuts Headcount; Attorneys Among the Victims*, ABOVE L. (Jan. 14, 2016, 2:00 PM), http://abovethelaw.com/2016/01/nationwide-layoff-watch-biglaw-firm-cuts-headcount-attorneys-among-the-victims/.

251. *See* Jessica D. Gabel, *The Lean Legal Clinic: Cost-Effective Methods of Implementing Experiential Education*, 7 ELON L. REV. 261, 263-66 (2015).

252. *See* Rubino, *supra* note 250.

253. A Swiss verein is a law firm structure characterized by a loose association between multiple law firms operating in multiple jurisdictions. *See* Edwin B. Reeser & Martin J. Foley, *Are Verein-Style Law Firms Ignoring Fee-Splitting Ethics Rules?*, ABA J.: LEGAL REBELS (Oct. 1, 2013, 1:30 PM), http://www.abajournal.com/legalrebels/article/are_verein-style_law_firms_ignoring_fee-splitting_ethics_rules/.

254. *See* David Lat, *Be Afraid, Be Verein Afraid*, ABOVE L. (Oct. 1, 2013, 4:28 PM), http://abovethelaw.com/2013/10/be-afraid-be-verein-afraid/.

255. *See, e.g.*, Allan Dodds Frank, *The End of an Era: Why Dewey & LeBoeuf Went Under*, FORTUNE (May 29, 2012, 2:32 PM), http://fortune.com/2012/05/29/the-end-of-an-era-why-dewey-leboeuf-went-under/; Mark Harris, *Why More Law Firms Will Go the Way of Dewey & LeBoeuf*, FORBES (May 8, 2012, 10:32 AM), http://www.forbes.com/sites/forbesleadershipforum/2012/05/08/why-more-law-firms-will-go-the-way-of-dewey-leboeuf/print/; Noam Scheiber, *The Last Days of Big Law*, NEW REPUBLIC (July 21, 2013), https://newrepublic.com/article/113941/big-law-firms-trouble-when-money-dries ("The money is drying up—and America's most storied firms are terrified."); James B. Stewart, *A Lawyer*

investor will only be incentivized to spend the time giving business management advice to the law firm if the investor can have an equity stake in the success of the firm.[256] This subpart explains some of the historical reasons why today's law firms are facing these problems and explains how allowing third-party funders to become internal partners of law firms might be one way to help solve this problem.

The genesis of this problem dates back hundreds of years before the founding of the United States when the doctrines of maintenance and champerty were first developed in medieval England.[257] Maintenance and champerty are medieval terms that have many meanings.[258] For the purposes of this Article, the term maintenance refers to an outside individual or entity contributing money to finance someone else's lawsuit, and the term champerty refers to an act of maintenance with the expectation of receiving some of the proceeds from the winning law suit, either as reimbursement or profit.[259] In the United Kingdom and many jurisdictions within the United States, maintenance and champerty were once criminal offenses.[260] Contingent fees were once classified as a form of illegal champerty perpetrated by lawyers.[261]

In addition, at that time, English barristers were socially and legally barred from directly accepting payment for their services.[262]

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and Partner, and Also Bankrupt, N.Y. TIMES (Jan. 24, 2014), http://www.nytimes.com/2014/01/25/business/partner-in-a-prestigious-law-firm-and-bankrupt.html; James B. Stewart, *Dewey's Fall Underscores Law Firms' New Reality*, N.Y. TIMES (May 4, 2012), http://www.nytimes.com/2012/05/05/business/deweys-collapse-underscores-a-new-reality-for-law-firms-common-sense.html.

256. *See* sources cited *supra* note 255.

257. *See generally* JONATHAN ROSE, MAINTENANCE IN MEDIEVAL ENGLAND, ch. 1 (forthcoming Apr. 2017) (on file with the author) (explaining the origins of the terms maintenance and champerty).

258. *See id.*

259. *See generally id.* at ch. 13 (explaining how the terms maintenance and champerty acquired various meanings over the past several centuries).

260. *See generally id.* (summarizing how the medieval crimes of maintenance and champerty once viewed as "evil" became torts that carried merely civil damages penalties in modern times).

261. *See generally id.* (explaining that contingent fees were deemed to be a form of illegal champerty in England until 2013 when "damages based agreements" were legalized). The United States legalized attorney contingent fee arrangements several decades before England did. *Id.*

262. *See Why Do Barristers Wear Robes?*, W. AUSTL. B. ASS'N REV., June 2005, at 29.

> The theory is that since barristers were not openly paid for their work, clients placed ex gratia payment into counsel's pocket, literally behind their back, to

The impetus for this rule was the sentiment that barristers could not be seen soliciting payment in exchange for advocacy, and barristers could not let the amount of their payment affect the quality of their advocacy.[263] Thus, historically, the legal practice was divided into barristers who advocated and solicitors who handled financial transactions with clients.[264] Barristers still needed to earn a living, however, so a solution was devised whereby grateful clients would slip honoraria into a discreet pocket on the back of the barristers' robes.[265] When the barrister returned home after a day in court, he would remove the money from the pocket and count his earnings for the day.[266] Hence, the mistrust for mixing financial matters with dispute resolution and court advocacy is an aversion that runs centuries deep in the ethos of the common law tradition.

> preserve their dignity. From this is derived a 'backhand payment'. If barristers could not see how much they were being paid, the quality of their advocacy in court could not be compromised. Alternatively, barristers' performances depended on their fee being topped up in such rear pocket, a process which did not disturb the flow of their delivery.

Id.

> What do Barristers have to do with the term "receiving a backhander"? If any of you have had a chance to examine a barristers gown you will notice a strange and seemingly useless triangular scrap of cloth attached to the shoulder, a number of theories exist regarding the origin of this anomaly, yet the commonly accepted one was that in the early middle ages this was where the barrister's fees were placed, apparently it wasn't the done thing to pay barristers for their work so to preserve their dignity the clients would place their payments into this pocket and since they could not see how much they were being paid their level of advocacy was not compromised or based upon financial reasoning. Because it was done behind their back it was often referred to as a backhander and though the modern usage is quite different, it has its roots in this archaic quirk of the Bar.

Thomas E. Kingston, *Why Do Barristers Never Shake Hands? (and Other Interesting Bar Related Facts)*, LEXISWEB.CO.UK (Sept. 13, 2012), http://lexisweb.co.uk/content/why-do-barristers-never-shake-hands-and-other-interesting-bar-related-facts.

263. *See supra* note 262.

264. This rule was changed in 2004 to allow barristers to accept payment from clients directly under certain circumstances. *See Public Access Work: Guidance for Barristers*, LEGAL SERVICES BOARD 3 (Feb. 2010), http://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/public_access_guidance_for_barristers_2.pdf ("The Code of Conduct has been amended to permit barristers in self-employed practice to undertake work on direct instructions from lay clients, without the need for a solicitor or other professional client to be instructed."); *The Public Access Scheme: Guidance for Barristers,* B. STANDARDS BOARD (Apr. 2013), http://www.barcouncil.org.uk/media/205214/guidance_for_barristers_08_04_13_final.pdf; *cf. supra* note 262 (revealing that, historically, barristers were barred from directly accepting payment for their work).

265. *See* sources cited *supra* notes 255, 262.

266. *See* sources cited *supra* notes 255, 262.

As a sign of the changing times and shifting sentiments, in 2004 the United Kingdom began to allow barristers to accept payment directly from their clients.[267] Furthermore, the U.K. Legal Services Act 2007 authorized "alternative business structures" in which nonlawyers could become partial owners of law firms, and this provision took effect in 2013.[268] This provision allows nonlawyers to have partial (but not complete) ownership in law firms and permits law firms to be publicly traded on stock exchanges.[269] As mentioned above, the ABA Commission on Ethics 20/20 found in its 2011 study that "alternative business structures" involving nonlawyer ownership of law firms are allowed in the District of Columbia, England and Wales, Scotland, Australia, two provinces in Canada, Germany, the Netherlands, New Zealand, and other jurisdictions around the world.[270]

The United Kingdom allows not only "alternative business structures" but also the self-regulation of third-party funding. The third-party funding industry in the United Kingdom has created the Association of Litigation Funders, "an independent body that has been charged by the Ministry of Justice, through the Civil Justice Council, with delivering self-regulation of litigation funding in England and Wales."[271] This combination of "alternative business structures" and self-regulating third-party funders uniquely positions the United Kingdom to allow experimentation in third-party funders serving as internal partners or nonlawyer partial owners of law firms. Indeed, one third-party funder—Burford—has already benefited from this experimental environment by creating its own law firm in England named Burford Law.[272]

As a former English colony, the United States inherited England's legal system, including its historical mistrust for mixing financial matters with dispute resolution and court advocacy. However, the historical experience of the U.S. legal industry with respect to the separation of law firms from financial interests arises in a different context.[273] Unlike the United Kingdom, the United States

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267. *See* sources cited *supra* note 262.

268. *See supra* note 159.

269. *See supra* note 159.

270. *See* ABA Memo, *supra* note 221.

271. *About Us*, ASS'N LITIG. FUNDERS, http://associationoflitigationfunders.com/about-us/ (last visited Aug. 23, 2016).

272. *See supra* notes 10-15 and accompanying text (discussing third-party funder Burford's creation of a law firm called "Burford Law").

273. *See, e.g.*, MODEL RULES OF PROF'L CONDUCT r. 5.4 (AM. BAR ASS'N 2016).

has a unified bar in which every licensed attorney can advocate in court, engage in transactional work, and negotiate their own fee arrangements with their clients. In the United States, the separation of law firms from financial interests instead arises in the context of attorney contingency fee agreements and the ABA Model Rules of Professional Conduct.[274] Contingency fees were prohibited in the United States from the nation's founding until the mid-twentieth century due to maintenance and champerty restrictions that the individual states had inherited from the English common law tradition.[275]

Gradually, changes in attitudes about the ability of lawyers to contribute to increasing access to the courthouse through contingent fees led to the repeal of the prohibition against contingent fees in all jurisdictions within the United States.[276] Today, one almost takes for granted that contingent fees are permissible throughout the United States.[277] Many countries worldwide that allow third-party funding still prohibit contingent fees, and third-party funding arguably serves as a substitute for contingent fees in those jurisdictions.[278] Some of those jurisdictions allow attorneys to charge "conditional" fees under which the attorney receives at least some payment from the client regardless of the outcome of the case, or "success" fees by which the attorney receives an extra or "uplift" payment upon winning the case, on top of the attorney's normal fee.[279] The United States does not formally recognize conditional or success fees, but many such arrangements are possible under the existing flexibility allowed regarding an attorney's negotiation of his or her fee agreements.[280] One flexibility that is not allowed, however, is an excessively high

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274. Gregory R. Hanthorn, *Ethical Principles Applicable to Alternative Fee Arrangements and Related Areas*, ABA (Apr. 2012), http://www.americanbar.org/content/dam/aba/administrative/litigation/materials/sac_2012/17-1_ethics_surrounding_attorneys_fees.authcheckdam.pdf.

275. *See supra* notes 257-261 and accompanying text.

276. *See, e.g.*, Stephan Landsman, *The History of Contingency and the Contingency of History*, 47 DEPAUL L. REV. 261 (1998); Adam Shajnfeld, *A Critical Survey of the Law, Ethics, and Economics of Attorney Contingent Fee Arrangements*, 54 N.Y.L. SCH. L. REV. 773 (2009-2010); Arthur L. Kraut, Comment, *Contingent Fee: Champerty or Champion?*, 21 CLEV. ST. L. REV. 15 (1972).

277. *See, e.g.*, MODEL RULES OF PROF'L CONDUCT r. 1.5 (AM. BAR ASS'N 2016).

278. *See generally* NIEUWVELD & SHANNON, *supra* note 35 (discussing the allowance or prohibition of contingent attorney fees in various jurisdictions worldwide).

279. *See, e.g.*, *id.* at 98 (explaining how success fees are used in the United Kingdom).

280. *See, e.g.*, MODEL RULES OF PROF'L CONDUCT r. 1.5 (AM. BAR ASS'N 2016).

contingency fee.[281] Every state has some sort of cap or limit on the contingency fee that an attorney may legally charge, which may be memorialized in that state's attorney ethics rules or state statutes.[282]

All states except California model their attorney ethics rules after the ABA Model Rules of Professional Conduct.[283] The first version of the ABA Model Rules of Professional Conduct was developed by the Commission on Evaluation of Professional Standards, also known as the Kutak Commission, named for its Chair, Robert J. Kutak.[284] The Commission initially proposed a version of Rule 5.4 that allowed nonlawyers to have ownership or managerial authority in law firms and share fees with lawyers, but this proposal was rejected by the ABA.[285] After vigorous debate and strong opposition from the ABA Committee on Unauthorized Practice of Law, the ABA instead adopted a version of Rule 5.4 banning nonlawyer partners and fee sharing with nonlawyers.[286] To date, this

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281. *Cf. id.* (suggesting the fee relationship between clients and their lawyers).

282. *See, e.g.*, *Courthouse Cornerstone: Contingency Fees and Their Importance for Everyday Americans*, CTR. FOR JUST. & DEMOCRACY 304, app. at 1-8 (Jan. 2013), https://centerjd.org/system/files/contingencyWPFull.pdf (summarizing various studies on the rates of contingen[cy] fees in the United and confirming ABA findings that "straight contingent fees typically range from 25% to 33%").

283. *See Model Rules of Professional Conduct*, ABA, http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct.html (last visited Aug. 24, 2016) ("To date, California is the only state that does not have professional conduct rules that follow the format of the ABA Model Rules of Professional Conduct."). Puerto Rico has also declined to adopt the ABA Model Rules of Professional Conduct. *See* Alberto Bernabe, *Supreme Court of Puerto Rico Rejects Proposal To Adopt ABA Model Rules*, PROF. RESP. BLOG (Oct. 18, 2014), http://bernabepr.blogspot.com/2014/10/supreme-court-of-puerto-rico-rejects.html.

284. *See* Justin Schiff, *The Changing Nature of the Law Firm: Amending Model Rule 5.4 To Allow for Alternative Business Structures Resulting in Nonlawyer Ownership of Law Firms*, 42 CAP. U. L. REV. 1009, 1013 (2014); *Model Rules of Professional Conduct*, *supra* note 283 ("This Legislative History traces the Model Rules of Professional Conduct (Model Rules) from the appointment of the ABA Commission on Evaluation of Professional Standards ('Kutak Commission') in 1977 through the year 2005.").

285. Schiff, *supra* note 284, at 1013-15.

286. *See* Susan Gilbert & Larry Lempert, *The Nonlawyer Partner: Moderate Proposals Deserve a Chance*, 2 GEO. J. LEGAL ETHICS 383, 390-91 (1988).

> [T]he ABA Committee on Unauthorized Practice of the Law was the first body within the ABA to voice its opposition to the Kutak proposal. Beyond raising the specter of nonlawyer ownership or management of a law firm, the committee pointed to the decision in *The Florida Bar v. Consolidated Business and Legal Forms, Inc.*, as evidence that the Kutak Commission proposal strayed from existing case law, rather than restating it. The committee further warned of the proposal's dangers: "The Commission's proposed Rule 5.4 fails to confront numerous needs for adequate client protection, including insuring the competence to judge the

version of Rule 5.4 has been adopted throughout the United States, with the notable exception of the District of Columbia, which instead adopted a revised version of the Kutak Committee's Rule 5.4 allowing nonlawyer partners and fee sharing with nonlawyers in a limited form.[287] The District of Columbia likely adopted its unique

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quality of the ultimate legal product, protecting the client-lawyer relationship and files in the event of the resignation or discharge of an employee, minimizing the impact of compensation structures on potential conflicts of loyalty to the client and to the employer, and preventing other incursions by an unqualified owner or manager into the lawyer's sphere of judgment and duty."

. . . .

The ABA Standing Committee on Unauthorized Practiced of the Law, notwithstanding its earlier objections, did not recommend deleting Rule 5.4 in favor of a total ban on nonlawyer involvement in entities offering legal services. Rather, the committee submitted an amendment proposing that Rule 5.4 be limited to prohibit firms from offering "an interest in the law firm to nonlawyers on a public financing basis." The General Practice Section, however, carried the banner of tradition, and ultimately it was that section's proposal—continuing the historical bans against sharing legal fees and forming law partnerships with nonlawyers—that was adopted verbatim by the House of Delegates as Model Rule 5.4.

Id. (internal footnotes omitted).

287. *Cf.* Gilbert & Lempert, *supra* note 286, at 392-93.

In the District of Columbia, a D.C. Bar committee chaired by Robert Jordan of Steptoe & Johnson took on the mission of thoroughly reviewing and, in many cases, proposing revisions of the *Model Rules* for consideration by the bar's Board of Governors.

Jordan Committee members were receptive to the idea of innovative affiliations. Mark Lynch, then an attorney with the American Civil Liberties Union (and now with Covington & Burling), was the member who authored a redraft of the Kutak Commission's Rule 5.4. As he would later explain, the committee perceived a market demand for one-stop shopping—for collaborative services of lawyers with such other professionals as accountants, lobbyists, social workers and economists. And they apparently saw no reason why that demand should not be met, as long as the lawyer's professional integrity and the lawyer-client relationship were adequately protected.

. . . .

What had been presented to the committee was a legal clinic brochure that listed "family and individual counseling," among other "special services" offered. The committee noted that apparently the nonlegal services could be furnished to clients of the firm "not merely in connection with legal services provided to the same clients, but also independently of any legal services." The committee reasoned that "the ethical restrictions on collaborative enterprises involving both lawyers and nonlawyers are concerned only with preventing improper lay involvement in the professional activities of lawyers and are not addressed to activities that do not constitute the practice of law, even if lawyers are in some manner involved in such activities."

Id. (internal footnotes omitted).

This rule rejects an absolute prohibition against lawyers and nonlawyers joining together to provide collaborative services, but continues to impose

formulation of Rule 5.4 due to the "revolving door" of politics, whereby influential nonlawyer government officials, lobbyists, economists, and politicians are then hired into law firms as partners when their political appointments or elected terms end and they have to leave government service.[288] The law firms that hire these former government officials hope that they will be "rainmakers" for the firm by using their many connections to generate business for the firm in exchange for all the benefits that go along with being a law firm partner, including profit sharing.[289] The proverbial "sky" has not fallen in D.C. due to its anomalous Rule 5.4.[290] Still, this exception only exists in D.C., and all the other jurisdictions in the United States have adopted the same substantive position as the Model Rules prohibiting partnerships with nonlawyers, fee sharing with nonlawyers, and the practice of law by nonlawyers.[291]

When detailing the history of how the District of Columbia came to adopt a revised version of the Kutak Commission's Rule 5.4, Susan Gilbert and Larry Lempert's 1988 article provides the most poignant explanation of the ethos of the D.C. Bar committee chaired by Robert Jordan of Steptoe & Johnson, known as the "Jordan Committee":

> What the Jordan Committee was challenging—with good cause—was the notion that the lawyer-nonlawyer relationship had to be one of employer and employee. Just as lawyers are professionals, so too are economists, psychologists, accountants, and lobbyists, to name a few. A nonlawyer professional with substantial experience in his or her

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> traditional ethical requirements with respect to the organization thus created. Thus, a lawyer may practice law in an organization where nonlawyers hold a financial interest or exercise managerial authority, but only [if the requirements of this rule are met].

D.C. RULES OF PROF'L CONDUCT r. 5.4 cmt. 4 (D.C. BAR 2007); *see also id.* r. 5.4 cmt. 7 ("For example, the rule permits . . . nonlawyer lobbyists to work with lawyers who perform legislative services . . . .").

288. *See supra* note 287.

289. *See, e.g.*, John Latimer, *Retiring Congressman Jim Gerlach Hired by High-Powered D.C. Law Firm*, TIMES HERALD (Dec. 29, 2014), http://www.timesherald.com/article/JR/20141229/NEWS/141229893; Joseph Morton, *Lee Terry No Stranger to D.C. Law Firm He's Joining as Senior Adviser*, OMAHA WORLD-HERALD (Jan. 13, 2015), http://www.omaha.com/news/nebraska/lee-terry-no-stranger-to-d-c-law-firm-he/article_d980c7b6-9a88-11e4-8e9b-7f70a236e1fc.html.

290. *See, e.g.*, Carolyn Elefant, *Is Starting a New Kind of Law Firm as Easy as Riding a Bike?*, MYSHINGLE (Feb. 26, 2014), http://myshingle.com/2014/02/articles/client-relations/starting-new-kind-law-firm-easy-riding-bike/.

291. *Compare* MODEL RULES OF PROF'L CONDUCT r. 5.4 (AM. BAR ASS'N 2016), *with* D.C. RULES OF PROF'L CONDUCT r. 5.4 (D.C. BAR 2007).

> field, who could be a partner in a venture with others in the same profession, might well resist joining a law firm as an employee. Employees can be well-paid, but partnership also brings prestige and a measure of power: one has equity in the firm, access to its financial data, a voice in its decision-making and is regarded as belonging on a senior level.[292]

Philosophically, the question of whether a third-party funder should be allowed to be an internal partner of a law firm echoes this debate. Like the Jordan Committee of the 1980s, this Article challenges long-held assumptions about the appropriate relationship between law firms and nonlawyers who provide professional services to their clients related to the subject matter of the same lawsuit.

With respect to the ABA's Model Rule 5.4, surprisingly, none of the prohibitions are absolute; each has well-defined exceptions to support clear policy goals.[293] For example, Rule 5.4 allows a law firm to share fees with a nonlawyer employed by the firm through a compensation or retirement program as long as the nonlawyers are not owners of the firm and the firm's sole business is the practice of law.[294] The Rule also allows a law firm or individual lawyer to "share court-awarded legal fees with a nonprofit organization that employed, retained or recommended employment of the [law firm or] lawyer in the matter."[295] The Rule also allows an in-house corporate counsel to practice law by representing the corporation, even though part of the lawyer's fee comes from an entity whose core business is not practicing law.[296]

Other examples can be found in the Comments to Model Rule 5.5; the Rule governs the unauthorized practice of law and the multijurisdictional practice of law, which occurs when lawyers licensed in one state may render legal services in another state in which they are not licensed without violating the rule against the unauthorized practice of law.[297] The Comments to Rule 5.5 identify several exceptions to this Rule that allow the participation of nonlawyers in assisting in the practice of law.[298] Comment 2 implies that the Model Rules do not define the practice of law by stating that

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292. Gilbert & Lempert, *supra* note 286, at 394.
293. *See, e.g.*, MODEL RULES OF PROF'L CONDUCT r. 5.4 (AM. BAR ASS'N 2016).
294. *See id.* r. 5.4(a)(3).
295. *See id.* r. 5.4(a)(4).
296. *See id.* r. 5.4(d)(2).
297. *See id.* r. 5.5.
298. *See id.* r. 5.5 cmt. 1-21.

"[t]he definition of the practice of law is established by [state] law and varies from one jurisdiction to another."[299] Comment 2 also expressly provides that lawyers may "employ[] the services of paraprofessionals and delegat[e] functions to them, so long as the lawyer supervises the delegated work and retains responsibility for their work."[300] This implies that those paraprofessionals may perform "delegate[d] functions" of the practice of law as long as they are supervised by attorneys.[301] Comment 3 states that lawyers "may provide professional advice and instruction to nonlawyers whose employment requires knowledge of the law" and that lawyers may even "assist independent nonlawyers, such as paraprofessionals, who are authorized by the law of a jurisdiction to provide particular law-related services" and "nonlawyers who wish to proceed pro se."[302] This supports the belief that nonlawyers *authorized* to practice certain types of law and lawyers advising such nonlawyer practitioners are more widespread than the wording of Model Rule 5.5 itself would suggest.[303]

Furthermore, the federal government and some states have created statutory exceptions for nonlawyers to carry out some activities that would normally be considered the practice of law, but only under appropriate supervision.[304] For example, nonlawyer accountants may appear and represent clients in federal tax court.[305] Similarly, Washington State adopted a rule allowing nonattorney Limited License Legal Technicians (LLLTs), "who meet certain educational requirements to advise and assist clients in approved practice areas of law."[306]

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299. *See id.* r. 5.5 cmt. 2.

300. *Id.*

301. *Id.*

302. *See id.* r. 5.5 cmt. 3.

303. *Id.*

304. *See infra* notes 305-306 and accompanying text.

305. *See* Katherine D. Black & Stephen T. Black, *A National Tax Bar: An End to the Attorney-Accountant Tax Turf War*, 36 ST. MARY'S L.J. 1, 39-40 (2004) ("Even though this type of representation would seem to be the quintessential definition of the 'practice of law,' the U.S. Tax Court, pursuant to its Rule 200(a), allows nonlawyers to appear and represent clients before it. The other two trial courts which hear federal tax cases do not.") (internal footnotes omitted). The Author thanks Brant Hellwig for this insight.

306. Anna L. Endter & A.J. Blechner, *Washington Limited License Legal Technician (LLLT) Research Guide*, GALLAGHER L. LIBR., https://lib.law.washington.edu/content/guides/llltguide (last updated Aug. 20, 2015); *see also* Robert Ambrogi, *Washington State Moves Around UPL, Using Legal Technicians To Help Close the Justice Gap*, ABA J. (Jan. 1, 2015, 5:50 AM), http://www.abajournal.com/magazine/article/washington_state_moves_around_upl_using_legal_technicians_to_help_close_the.

None of those exceptions can apply to third-party funders, however, according to the way in which those rules and exceptions are currently worded. To modify these rules to allow third-party funders to participate in firm ownership, profit sharing, and client advising might be justified for several reasons. First, the vast majority of third-party funders either were founded by attorneys, have attorneys within their partnership structures, or have attorneys on their advisory boards evaluating potential case investments and giving the funder guidance regarding which cases to accept and which to reject.[307] In fact, third-party funders actively recruit the most talented lawyers away from law firms and dispute resolution institutions.[308] Many of those attorneys-turned-funders keep their bar licenses active, although they are not directly practicing law.[309] In essence, lawyering and legal services are part of the ownership and management structure of third-party funders already.[310]

Second, some funders advise potential funding clients regarding why their cases were rejected, which helps better inform those clients should they choose to pursue their cases using other financial means.[311] In light of this, one could argue that funders are already giving some form of legal advice within the narrow context of the funder informing a rejected potential funding client regarding the reasons for the rejection.[312]

Third, practicing attorneys can already legally do the job of a funder—namely, provide dispute financing to their clients in a variety

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307. For example, a majority of the members of Gerchen Keller Capital's management and operations teams are well-trained lawyers. *See Team*, GERCHEN KELLER, http://www.gerchenkeller.com/who-we-are/team/ (last visited Aug. 24, 2016) ("Gerchen Keller's team offers a unique blend of backgrounds in law and finance, including former commercial litigators and transactional attorneys, Supreme Court law clerks, investment bankers and portfolio managers, and in-house counsel at Fortune 500 companies."). Similarly, the former Chairman of the International Court of Arbitration (ICA), who had previously spent 30 years litigating at the international law firm Clifford Chance, joined the investment advisory panel of Woodsford Litigation Funding, a London-based litigation funder. *See* Leo Szolnoki, *Beechey To Advise Third-Party Funder*, GLOBAL ARB. REV. (Nov. 5. 2013), http://globalarbitrationreview.com/news/article/32028/.

308. *See supra* note 307.

309. *See generally* Michele DeStefano, *Compliance and Claim Funding: Testing the Borders of Lawyers' Monopoly and the Unauthorized Practice of Law*, 82 FORDHAM L. REV. 2961 (2014) (analyzing unauthorized practice of law statutes and concluding that "claim funders" could be viewed as practicing law).

310. *Id.*

311. *See* Shannon, *Impact*, *supra* note 225.

312. *Id.*

of forms, beyond the contingency fee.[313] However, law firms could benefit from the extra infusion of cash and business expertise that an active partner, like a third-party funder, could offer.[314]

Fourth, the one type of dispute-related financing that an attorney is not allowed to provide to his or her client is living expenses while the case is pending, which is prohibited by ABA Model Rule 1.8(e), although it is allowed in a small minority of states.[315] Funders are already filling that gap by providing living expenses to clients who cannot afford to wait until the case ends and the judgment is collected.[316]

Fifth, the ABA Commission on Ethics 20/20 issued an informational report to the House of Delegates in 2012 about "alternative litigation finance," which stated that lawyers have a duty to become knowledgeable about third-party funding enough to advise their clients or to "associate with experienced counsel when advising clients who are entering into these transactions."[317] If the third-party

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313. *See* MODEL RULES OF PROF'L CONDUCT r. 1.5 (AM. BAR ASS'N 2016); Mark A. Robertson, *Marketing Alternative Fee Arrangements*, ABA (Sept./Oct. 2011), http://www.americanbar.org/publications/law_practice_magazine/2011/september_october/alternative_fee_arrangements.html.

314. See *supra* subpart IV.B.2, for a discussion of the reasons why law firms need an infusion of cash and business expertise.

315. *See* MODEL RULES OF PROF'L CONDUCT r. 1.8(e) (AM. BAR ASS'N 2016). The jurisdictions that allow attorneys to loan their clients living or medical expenses with varying levels of restrictions and limitations include Alabama, Arizona, California, the District of Columbia, Iowa, Louisiana, Minnesota, Mississippi, Montana, New Jersey, North Dakota, Texas, Utah, Virginia, and possibly Georgia. *See, e.g.*, Cristina D. Lockwood, *Adhering to Professional Obligations: Amending ABA Model Rule of Professional Conduct 1.8(e) to Allow for Humanitarian Loans to Existing Clients*, 48 U.S.F. L. REV. 457, 494-98 (2014); Susan Michmerhuizen, *Ethics Tip: Financial Assistance to Clients*, ABA (Sept. 2015), http://www.americanbar.org/groups/professional_responsibility/services/ethicsearch/ethicstipseptember2015.html (describing the variations in Rule 1.8 among various state bars); ABA CPR Policy Implementation Comm., *Variations of the ABA Model Rules of Professional Conduct: Rule 1.8: Conflict of Interest: Current Clients: Specific Rules*, ABA, http://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/mrpc_1_8.authcheckdam.pdf (last updated May 13, 2015) (describing the variations in Rule 1.8 among various state bars).

316. *See, e.g.*, Tina Burns, *Wreck Victim: Consumer Legal Funding Needs Protection from Alabama Legislature*, ARC LEGAL FUNDING (May 24, 2015), http://arclegalfunding.org/wreck-victim-consumer-legal-funding-needs-protection-from-alabama-legislature/.

> I finally got some relief when I contacted a legal funding company and was able to get the money I needed to keep the power on and to put food on the table for my children. It was a huge relief to know there was someone out there who could help me.

Id.

317. *See ABA White Paper*, *supra* note 32, at 4.

funder is allowed to partner directly with the law firm or become a partial owner of the law firm, ensuring competent advising of the client would be easier.[318] Of course, there would be the potential for self-serving advice from the third-party funder, so it would be a best practice for the funder-law firm joint venture to advise the client to obtain independent legal advice regarding the transaction.[319] However, if states adopt a formulation of Rule 5.4 that is similar to the D.C. Rule 5.4, then a nonlawyer—such as a third-party funder—who becomes a partial owner in a law firm is required to agree to abide by the Rules of Professional Conduct, which mandate a duty of loyalty to the client, and the law firm—and therefore the funder as a partner of that law firm—could be sanctioned for violating that duty.[320]

In light of the foregoing, it would be reasonable for states to consider allowing third-party funders that have lawyers among their principal partners to combine with law firms to form a multidisciplinary practice that provides joint legal representation and dispute financing services to clients or to become partial owners of law firms. The United Kingdom and the District of Columbia have somewhat relaxed their prohibitions on nonlawyers sharing fees and partially owning law firms, and a handful of states in the United States have expressly allowed the limited practice of law by nonlawyers in order to increase access to legal services for low-income or indigent clients.[321] Thus state legislatures should feel

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> Lawyers who are not experienced in dealing with these funding transactions must become fully informed about the legal risks and benefits of these transactions, in order to provide competent advice to clients. Because this is a new and highly specialized area of finance, it may be necessary for a lawyer to undertake additional study or associate with experienced counsel when advising clients who are entering into these transactions.

Id.

318. *Cf.* Shannon, *Impact*, *supra* note 225 and accompanying text (discussing the current practice of some funders to give reasons to clients that they decline to finance).

319. *See* MODEL RULES OF PROF'L CONDUCT r. 1.8 (AM. BAR ASS'N 2016) (requiring attorneys to advise clients to seek independent legal advice before entering into business transactions with attorneys); *ABA White Paper*, *supra* note 32, at 18.

320. *See supra* notes 235-237, 242 and accompanying text.

321. *See supra* note 159 (identifying the U.K. approach of allowing nonlawyer ownership of law firms through "alternative business structures" under the Legal Service Act of 2007); *supra* note 160 (identifying the District of Columbia approach of allowing nonlawyer ownership of law firms and allowing nonlawyers to share fees in limited circumstances under Rule 5.4 of the Rules of Professional Conduct); *supra* note 306 (identifying Washington State's approach to allow nonlawyers to practice law in a limited way as "Limited License Legal Technicians (LLLTs)").

justified if they choose to adopt a rule similar to the District of Columbia to allow nonlawyers to serve as internal partners within law firms.[322] In turn, by authorizing funders to share fees, share ownership, make business decisions, and advise clients in partnership with law firms, the existing regulatory regime that applies to law firms would be extended to funders as quasi-law firm participants in the legal system.[323] In addition, allowing third-party funders to take an equity stake in law firms or form multidisciplinary partnerships with law firms will make third-party funding accessible to more types of cases, including class actions and pro bono cases.[324]

3. Drawbacks to the Proposed Structure

There are several troubling drawbacks to this proposed structure. The most important drawback to this structure is that it does not solve the problem of collusion between the attorney and the funder to the detriment of the client—in fact, multidisciplinary practice or nonlawyer ownership of law firms may even exacerbate this problem.[325] This problem could be mitigated by extending the Rules

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322. *See* D.C. RULES OF PROF'L CONDUCT r. 5.4 (D.C. BAR 2007).

323. *Id.*

324. *Cf.* John C. Coffee, Jr., *Litigation Governance: Taking Accountability Seriously*, 110 COLUM. L. REV. 288, 342-43 (2010).

> A structure in which the class has both a class counsel and a separate litigation funder is inherently one in which "agents are watching agents." This has advantages, as the litigation funder would be in a position to monitor the attorney, while both the representative plaintiff (often a nonprofit organization in Europe) and class counsel could negotiate the financial arrangement with the third-party funding firm.

Id. (internal footnote omitted)*; see also supra* note 19; *cf.* Deborah R. Hensler, *Third-Party Financing of Class Action Litigation in the United States: Will the Sky Fall?*, 63 DEPAUL L. REV. 499, 525 (2014) ("Neither anecdotal evidence of third-party litigation investors' strategies in the United States, nor contemporary U.S. class action jurisprudence, nor empirical data on trends in Australian class actions, suggest that the sky will fall any time soon should third-party litigation financing migrate to the class action domain in the United States."); Samuel Issacharoff, *Litigation Funding and the Problem of Agency Cost in Representative Actions*, 63 DEPAUL L. REV. 561, 585 (2014) ("On this view, third-party litigation funding may reduce the agency risk in representative litigation not so much by opening the pool of capital available for the prosecution of class claims, but by introducing a genuinely motivated monitor of class counsel performance with interests that align, albeit imperfectly, with those of the represented class. The approach clearly differs from the PSLRA [1995 Private Securities Litigation Reform Act], CAFA [Class Action Fairness Act of 2005], or the 2003 amendments to Rule 23 in inviting a market actor to serve as an intermediary agent.").

325. *See* Corinne N. Lalli, Comment, *Multidisciplinary Practices: The Ultimate Department Store for Professionals*, 17 ST. JOHN'S J. LEGAL COMMENT. 283, 299-300 (2003).

of Professional Conduct to the funder via its multidisciplinary practice with the law firm and by explicitly stating that the funder could be sanctioned under the Rules of Professional Conduct for not putting the client's interests first.[326] Alternatively, new Professional Conduct rules specifically for funders could be developed.[327] Either option may prove to be a workable solution to this drawback if accompanied by an appropriate enforcement mechanism for funders, similar to bar disciplinary actions and court-imposed sanctions on attorneys.[328]

> A primary reason for the Bar Association's vehement stance against a fully integrated MDP [multidisciplinary practice] is the fear that it would violate the three core legal values: professional independence of judgment; protection of confidential client information; and loyalty to clients through the avoidance of conflicts of interest. Non-lawyers, in their interpretation of Lawyer's Code for Professional Responsibility, are more likely to be influenced by economic considerations and are less inclined to uphold the integrity of the legal system.

Id. (internal footnotes omitted).

326. This may be a potential solution because the most prominent litigation funders around the world were founded or cofounded by lawyers or have lawyers serving as principals. *See, e.g.*, Rebecca Lowe, *Speculate and Arbitrate To Accumulate*, INT'L B. ASS'N (Apr. 4, 2013), http://www.ibanet.org/Article/Detail.aspx?ArticleUid=804e46e3-dfc0-4966-b16e-31627803970c ("Burford Capital, the world's biggest litigation funder, was founded by former Time Warner General Counsel Chris Bogart and former Latham & Watkins partner Selvyn Seidel in 2009."). Thus, to the extent that any principals at litigation funding companies are licensed attorneys or give legal advice as part of their work at litigation funding companies, the Model Rules of Professional Conduct could potentially apply to their conduct.

327. *See Third Party Funding: Code for Conduct for Litigation Funders*, CTS. & TRIBUNALS JUDICIARY, https://www.judiciary.gov.uk/related-offices-and-bodies/advisory-bodies/cjc/third-party-funding/ (last visited Aug. 24, 2016) (setting out the code for conduct for litigation funders in the United Kingdom); *cf. Code of Conduct for Litigation Funders*, ASS'N LIT. FUNDERS ENG. & WALES (Nov. 2011), https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/CJC/Publications/CJC+papers/Code+of+Conduct+for+Litigation+Funders+(November+2011).pdf (illustrating a code of conduct for litigation funders in the United Kingdom, which authorizes U.K. funders to govern themselves). This Author has proposed elsewhere that a similar code should be developed for funders in the United States. *See* Victoria Shannon Sahani, *Governing Third-Party Funders* [hereinafter Sahani, *Governing*] (forthcoming) (on file with author). Rather than self-governance, however, there would need to be an external enforcement mechanism—similar to attorney disciplinary mechanisms—in order to combat third-party funders colluding with attorneys. *Id.*

328. *See* Sahani, *Governing*, *supra* note 327 (setting out the code for conduct for litigation funders in the United Kingdom); *cf.* Cydney Batchelor, *Disciplinary Actions: When Bad Things Happen to Good Lawyers*, ABA (Oct./Nov. 2006), http://www.americanbar.org/content/newsletter/publications/gp_solo_magazine_home/gp_solo_magazine_index/disciplinaryactions.html (advising lawyers regarding responding to a complaint notice from the state bar or disciplinary agency).

A second drawback is that this structure does not solve the question of who would pay security for costs or adverse costs awards on behalf of the client.[329] Currently, third-party funders may agree to pay security for costs or adverse costs awards when operating in jurisdictions or arbitrations that apply the "loser pays" rule to cost allocation.[330] Law firms, however, typically do not pay cost awards on behalf of their clients.[331] Perhaps in a multidisciplinary practice, the funder might still agree to pay costs, as is common in traditional third-party funding transactions where the underlying case will be pursued in a jurisdiction or forum that follows the "loser pays" rule of cost allocation.

From the funder's perspective, a third drawback relates to the funder's potential liability for sanctions due to violations made by the law firm.[332] For example, if the funder enters into a partnership or multidisciplinary practice arrangement with a law firm, then the funder could be partly liable if the law firm is sanctioned for violating Federal Rules of Civil Procedure 11 or 37 while conducting a funded case.[333] Federal Rules 11 and 37 do contemplate sanctioning party representatives or attorneys, and the funder may fall into this category

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329. *See supra* note 176 (citing sources discussing in what contexts a third-party funder may pay costs orders if the funded party loses the case).

330. *See* Sahani, *Judging Third-Party Funding*, *supra* note 27, at 439-40 (discussing how arbitral tribunals handle the issue of security for costs and adverse costs awards when applying a "loser pays" rule in cases involving third-party funders). *See generally* NIEUWVELD & SHANNON, *supra* note 35 (discussing how arbitral tribunals handle the issue of security for costs and adverse costs awards when applying a "loser pays" rule in cases involving third-party funders in various jurisdictions around the world).

331. Under the terms of a contingency fee agreement or pro bono retainer, an attorney may finance a client's litigation expenses and costs up front. *See* MODEL RULES OF PROF'L CONDUCT r. 1.8(e) (AM. BAR ASS'N 2016). Otherwise, an attorney does not normally pay the client's litigation expenses and costs without the promise of reimbursement. *Id.*

> [There is no] prohibition on a lawyer lending a client court costs and litigation expenses, including the expenses of medical examination and the costs of obtaining and presenting evidence, because these advances are virtually indistinguishable from contingent fees and help ensure access to the courts. Similarly, an exception allowing lawyers representing indigent clients to pay court costs and litigation expenses regardless of whether these funds will be repaid is warranted.

Id. r. 1.8(e) cmt. 10.

332. *See* Sahani, *Judging Third-Party Funding*, *supra* note 27, at 433-36 (explaining that funders are typically not liable under Federal Rules of Civil Procedure 11 or 37 because funders are not explicitly mentioned in those rules and do not present papers to the court, appear in court, or participate in discovery).

333. *See id.* at 433-36.

under a partnership or multidisciplinary practice arrangement with a law firm.[334] As a potential solution, the law firm and the funder can stipulate in their agreement that the funder will not present papers or make representations to the court or arbitrator and that the law firm alone would be liable to cover the amount of any sanctions ordered by a court or arbitrator. It is possible that this will somewhat insulate the funder from paying sanctions while still enabling the coadvisor structure for third-party funding arrangements. However, a court or arbitrator still has the power to order sanctions against an attorney or law firm directly under the current rules, so the agreement may not be completely effective at insulating the funder acting as an internal partner of the law firm.[335] To provide for this possibility, the funder and law firm can stipulate in their agreement that the law firm will reimburse the funder for any sanctions levied directly against the funder if the law firm was solely responsible for the offending conduct. This would serve the purpose of effectively insulating the funder from paying sanctions for any conduct for which it was not responsible.

A fourth drawback is that since attorney ethics rules and statutes defining the practice of law are implemented on a state-by-state basis, it would be extremely difficult to convince states to adopt uniform revisions.[336] The first logical step would be to revise Model Rule of Professional Conduct 5.4 regarding law firm ownership and fee sharing as well as state laws defining the practice of law, none of which seem likely.[337] The ABA Ethics 20/20 Commission recently

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334. *See id.*

335. *See* FED. R. CIV. P. 11 (authorizing sanctions and parties and their legal counsel relating to signed pleadings, motions, and other papers presented the court or representations made to the court); *id.* R. 37 (authorizing sanctions for failure to comply with discovery requests or orders).

336. *Cf. States Making Amendments to the Model Rules of Professional Conduct: Dates of Adoption*, ABA, http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/chrono_list_state_adopting_model_rules.html (last visited Aug. 28, 2016) (showing dates of states adopting amendments to the Model Rules ranging from 1988 to 2010 suggesting that it is difficult to get states to uniformly adopt new changes promulgated by the ABA). In addition, California—one of the largest legal markets in the United States—has not adopted the Model Rules at all. *See Model Rules of Professional Conduct*, *supra* note 283 ("To date, California is the only state that does not have professional conduct rules that follow the format of the ABA Model Rules of Professional Conduct."). Puerto Rico has also declined to adopt the ABA Model Rules of Professional Conduct. *See* Bernabe, *supra* note 283.

337. *See* ABA Memo, *supra* note 221. *See generally* Marc N. Biamonte, Note, *Multidisciplinary Practices: Must A Change to Model Rule 5.4 Apply to All Law Firms*

explored whether to allow multidisciplinary practice or nonlawyer ownership of law firms and decided not to modify the Model Rules regarding either issue.[338] As mentioned above, current law prohibits this structure in all U.S. jurisdictions, except the District of Columbia.[339] Thus third-party funders are not likely to become internal partners of law firms in the vast majority of states anytime soon.[340]

Despite these drawbacks, however, the D.C. Rule 5.4 might allow for law firms and third-party funders in the District of Columbia to experiment with some restricted variation of this T-structure, so perhaps the District of Columbia could serve as a laboratory for other states to observe.[341] In addition, the United Kingdom is already serving as a laboratory for nonlawyer ownership of law firms and multidisciplinary practices.[342] As mentioned above,

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Uniformly?, 42 B.C. L. REV. 1161 (2001) (analyzing proponents' and opponents' views regarding allowing multidisciplinary legal practices by amending Model Rule 5.4).

338. *See* ABA Memo, *supra* note 221.

339. *Cf.* Sean T. Carnathan, *Is Prohibition of Non-Lawyer Ownership of Firms Antiquated?*, LITIG. NEWS, http://apps.americanbar.org/litigation/litigationnews/Articles-print/071012-non-lawyer-ownership-summer12.html (last visited Aug. 24, 2016) (comparing the Legal Services Act in the United Kingdom that allows nonlawyer ownership of law firms with the Rule 5.4 prohibition on fee sharing in New York and the District of Columbia Rule 5.4 that also allow such nonlawyer fee sharing and ownership).

340. *Cf.* James Podgers, *ABA Ethics Opinion Sparks Renewed Debate over Nonlawyer Ownership of Law Firms*, ABA J. (Dec. 1, 2013, 9:30 AM), http://www.abajournal.com/magazine/Article/aba_ethics_opinion_sparks_renewed_debate_over_nonlawyer_ownership_of_law_fi/ ("[Opponents'] concern is that any step in the direction of giving nonlawyers some form of ownership involvement in law firms threatens the professional independence that is one of the core principles of lawyering.").

341. *See supra* notes 287, 339 and accompanying text (discussing the Rule 5.4 in the District of Columbia that diverges from the traditional prohibitions by allowing nonlawyers to become partial owners of law firms).

342. *See, e.g.*, Steinitz, *Pricing Legal Claims*, *supra* note 17, at 1891; *supra* notes 10-15 and accompanying text (discussing third-party funder Burford's creation of a law firm called "Burford Law").

> Moreover, experimentations with creative business structures that de facto allow non-lawyers to (indirectly) profit from law firms are already underway in the United States. One example is Clearspire, which describes itself as having "reimagined everything a law firm can be [a]nd brought it to life with highly innovative business practices." Specifically, Clearspire is structured as three separate legal entities: a law firm, a service company (owned by nonlawyers), and an IT company. Such indirect or direct investors in law firms that do any measure of contingency work would, one imagines, be intensely interested in placing a value on the legal claims in which the firm has a contingent stake.

Steinitz, *Pricing Legal Claims*, *supra* note 17, at 1891 (internal footnotes omitted); *see also* Caroline Binham, *UK's Legal Services Act Leads to the Creation of New Business Models*, FIN. TIMES, (Oct. 9, 2014, 12:05 AM), http://www.ft.com (answer survey questions or sign

under the Legal Services Act 2007, the United Kingdom allows nonlawyer investment in law firms, a provision that took effect in 2013.[343] Thus, several major common law jurisdictions, including the District of Columbia, as well as the Kutak Commission that wrote the original ABA Model Rules of Professional Conduct, provide support for the argument that nonlawyer partners of law firms are not completely an outrageous idea.[344] Perhaps this structure should be allowed on an experimental basis in whichever states might be willing to modify their rules to allow it.

V. CONCLUSION: RESHAPING DISPUTE RESOLUTION

Based on the foregoing discussion, the two T-shaped structures examined in this Article present novel yet controversial solutions to the problem of how to manage the growing practice of third-party funding from the practical, business, and legislative perspectives.[345] These two new structures would allow the funder to partner with either the party to the case or the law firm to provide business savvy, advice, and mentorship—not just money—just like the "sharks" of ABC's *Shark Tank* television show.[346]

In relation to the larger market for legal services, experimenting with reshaping the third-party funding transaction in the ways proposed in this Article would likely increase access to third-party funding for both consumer and commercial clients and give parties and law firms more choices regarding what kinds of expertise and

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into a FINANCIAL TIMES account to access article); *EY Granted Alternative Business Structure Licence*, NEW L.J. (Dec. 4, 2014), http://www.newlawjournal.co.uk/nlj/content/ey-granted-alternative-business-structure-licence.

> Global accountancy firm EY has been granted an alternative business structure (ABS) licence enabling it to offer legal services in the UK. Its entry into the UK legal market follows that of accountancy giants PwC and KPMG, both of which were granted ABS licences earlier this year. EY's worldwide legal practice already has more than 1,000 people in 60 jurisdictions. It will provide corporate, commercial, employment and financial services legal advice. UK chair Steve Varley says: "We are offering something new."

Id.

343. *See supra* notes 159, 287, 339 and accompanying text (discussing the rules in the United Kingdom and the District of Columbia that diverge from the traditional prohibitions by allowing nonlawyers to become partial owners of law firms).

344. *See supra* note 221 and accompanying text.

345. *See supra* subparts IV.A & IV.B (presenting two new T-shaped partnerships: a partnership between funders and parties and a partnership between funders and law firms).

346. *See* discussion *supra* Part I (analogizing partnering with a "shark" to partnering with a third-party funder).

involvement they need from the funder.[347] It also would likely lead to competition and stratification in the litigation funding market, which would hopefully help reduce the price of third-party funding and give clients more bargaining power regarding the amount of their judgment, award, or settlement that would go to the funder.[348] Furthermore, reshaping the third-party funding transaction would help guide regulators' choices by better defining the funder's role and the funding relationships that the laws aim to regulate and encourage.[349] Finally, reshaping the transaction would likely give attorneys a clearer sense of their obligations regarding third-party funding under their professional ethics rules.[350]

The proposals examined in this Article are undoubtedly controversial. Moreover, neither of the two T-shaped structures discussed in the Article would replace the traditional triangular third-party funding transaction in which the funder remains a separate entity.[351] These proposals expand the menu of available transaction structures beyond structures based on the triangular paradigm. As explained earlier in this Article, however, the triangular structure has not been successful at addressing several of the potential problems that may arise in light of third-party funding, such as conflicts of interest, waiver of evidentiary privileges, and the funder's exercise of control over the process.[352] As potential solutions, the two T-shaped structures explored in this Article might address some of those potential problems; mitigate some of the attendant risks for the client, funder, and attorney; increase the alternatives available to potential clients of funding, including individual parties as well as law firms; and solve some of the regulatory challenges that accompany the

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347. *See* discussion *supra* subparts IV.A & IV.B (presenting the benefits and drawbacks of two new T-shaped partnerships: a partnership between funders and parties and a partnership between funders and law firms).

348. *See* discussion *supra* subpart IV.B.2 (discussing how diversifying the available structures for the third-party funding transaction will lead to a wider range of third-party funders).

349. *See* Shannon, *Harmonizing Regulations*, *supra* note 20, at 864-65, 867-68 (explaining why regulators need this guidance).

350. *Cf. ABA White Paper*, *supra* note 32 (discussing the attorney's existing obligations under the Rules of Professional Conduct when third-party funding is involved in the case).

351. *See supra* Diagrams A & B; *see also* discussion *supra* Part II (explaining the features and risks of the traditional triangular third-party funding transaction).

352. *See supra* Diagrams A & B; *see also* discussion *supra* Part II (explaining the features and risks of the traditional triangular third-party funding transaction).

traditional triangular third-party funding transaction.[353] Yet these two potential solutions are also fraught with potential problems of their own. Careful, limited experimentation would reveal whether these two new structures are viable, desirable additions to the menu of third-party funding transactions or whether the triangular paradigm commonly in use is the best option. Ultimately, this Article aims to start a conversation about rethinking the structure of third-party funding transactions. This Author invites other scholars or industry observers to improve upon these suggestions or make new ones.

353. *See* discussion *supra* Parts I & II (explaining the dispute resolution risks, behavioral risks, and regulatory compliance risks inherent to third-party funding and how these risks accompany third-party funding transactions in addition to the risks inherent in any financial transaction.); *supra* subparts IV.A & IV.B (explaining how two new T-shaped partnerships—a partnership between funders and parties and a partnership between funders and law firms—will solve many of the problems outlined in Parts I and II).