REPORT TO THE PRESIDENT
BY
THE NEW YORK CITY BAR ASSOCIATION
WORKING GROUP ON LITIGATION FUNDING

NEW YORK CITY BAR ASSOCIATION
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APPENDIX: Formal Opinion 2018-5: Litigation Funders' Contingent Interest in Legal Fees

EXECUTIVE SUMMARY

In July 2018, the Professional Ethics Committee of the New York City Bar Association ("City Bar") issued Formal Ethics Opinion 2018-5: Litigation Funders' Contingent Interest in Legal Fees ("Opinion 2018-5").[1] That opinion generated a significant amount of attention and commentary.[2] In October 2018, the City Bar's President, Roger Juan Maldonado, formed the Litigation Funding Working Group (the "Working Group") to study third-party litigation funding and to provide a report on observations and recommendations regarding the practices utilized in connection with litigation funding.

The Working Group is comprised of a range of interested professionals, including private practitioners, ethics professors and specialists, litigation funding executives, a former federal judge, in-house counsel, ADR specialists, and representatives from several of the City Bar's standing committees. The Working Group's Mission Statement specifies in pertinent part:

> The Litigation Funding Working Group is studying the issues and practices surrounding litigation funding. Specifically, the Working Group is addressing the following topics: (a) the ethics rules and framework relating to the City Bar's Ethics Opinion 2018-5, (b) current practices in litigation funding and best practices for the future, (c) issues of disclosure regarding litigation funding, (d) litigation funding in the consumer and civil rights arenas and (e) recent litigation funding developments in New York and in certain jurisdictions outside New York. The Working Group will not be revisiting Opinion 2018-5, but is open to exploring potential revisions to the ethics rules and/or legislation.[3]

Over the course of the last year, the Working Group met as a whole ten times and convened numerous subcommittee meetings and teleconferences. During these meetings, the Working Group heard from a range of guest speakers, including practitioners, scholars, and experts in the fields of commercial and consumer finance.[4]

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[1] *See* Appendix A (Formal Opinion 2018-5).

[2] *See, e.g.*, Paul B. Haskel & James Q. Walker, *New York City Bar Opinion Stuns the Litigation Finance Markets*, LEXOLOGY (Aug. 31, 2018), https://www.lexology.com/library/detail.aspx?g=eed0a03b-ae12-4157-917f-00bdad2b2dfc.

[3] *Litigation Funding Working Group*, NEW YORK CITY BAR, https://www.nycbar.org/member-and-career-services/committees/litigation-funding-working-group (last visited Oct. 28, 2019).

[4] Among those speakers were Ina C. Popova (Partner, Debevoise & Plimpton), Eric Schuller (President, Alliance for Responsible Consumer Legal Funding), Philippe Selendy (Partner, Selendy & Gay), Maya Steinitz (Professor, University of Iowa College of Law), and Aviva Will (Senior Managing Director, Burford), who offered a range of views on litigation funding grounded in their diverse experiences.

In addition, the Working Group for a five-month period sought and received comments from the public on the issues and practices surrounding litigation funding. We received eleven written submissions provided by private practitioners, retired judges, mediators, litigation funders, and lobbying groups. These commentators provided diverse views both supportive and critical of litigation funding and supplied additional resources for study. To obtain further comments, the Working Group released a draft of this Report in December 2019 to multiple City Bar committees and received comments through February 2020.

The Working Group formed four subcommittees to analyze particular issues surrounding litigation funding: (i) Ethics Rules, (ii) Best Practices, (iii) Disclosure, and (iv) Consumer Litigation. The Report that follows contains the findings and recommendations of each of these Subcommittees as reviewed and vetted by the Working Group.

In Section I, we provide a brief overview of the history of litigation funding in the United States and other countries; the current legal landscape with respect to case law on disclosure and discovery-related issues; and current legislative proposals in Congress and New York to regulate litigation funding.

In Section II, we address whether Rule 5.4 of the New York Rules of Professional Conduct, as interpreted in Opinion 2018-5, should be revised to reflect contemporary commercial and professional needs and realities. We conclude that lawyers and the clients they serve would benefit if lawyers have less restricted access to funding and offer two alternative proposals for a revised Rule 5.4.

In Section III, we present guidelines for representing a client seeking litigation funding, which encompass both the specific steps and the process to follow when obtaining and utilizing litigation funding to carry out clients' objectives. We focus on the necessary steps a lawyer should take to best protect the client's interest and to comply with his or her professional obligations.

In Section IV, we provide an overview of the policies, statutes, rules, regulations, and case law governing disclosure in federal and state courts; present arguments commonly made in support of and against disclosure in federal and state courts, including a discussion of the special considerations in the class action, multi-district litigation and arbitration contexts; and present the Working Group's recommendations regarding disclosure. We conclude that there should not be a mandatory disclosure requirement in federal and state courts with respect to the funding of commercial litigation at this time, but that the details of funding arrangements may be discoverable in special circumstances. We recognize that different considerations may apply regarding disclosure in class and derivative actions and in arbitrations.

In Section V, we review the industry that provides to consumers funding secured by recoveries from civil litigation, and focus on the way in which the industry is regulated. In particular, we analyze the bill introduced in New York during the last legislative session and offer our views on changes that could be made to the current bill, including removal of the fee cap and changes in the annual reporting requirement designed to gather sufficient financial information to evaluate the industry.[5]

[5] The Working Group recognizes that its Mission Statement includes a reference to examining the role of litigation funding in the realm of civil rights. We found that there are funders who have dedicated a portion of their portfolio to funding civil rights litigation, such as Legalist, Inc. and USClaims. In addition, impact litigation has frequently been funded by third parties, such as public interest organizations (albeit with no pecuniary investment return). While we believe that litigation funding earmarked toward civil rights cases could have a salutary effect in vindicating unpursued civil rights violations, we did not study this subject further and invite additional exploration by others. This Report also does not specifically or separately address litigation funding directed at mass torts or matrimonial proceedings.

I. BACKGROUND

A. History of Litigation Funding

Litigation funding, also known as litigation finance, involves an entity other than the parties to a litigation or their counsel that provides financing, usually as some or all of a party's legal fees, in exchange for a share of the final judgment or settlement.[6] Litigation funding takes multiple forms. Single-case litigation finance typically involves funding that can be used to pay for legal fees or expenses associated with pursuing a single case or arbitration.[7] Portfolio finance, by contrast, provides financial support for multiple cases or arbitrations.[8]

A range of individuals and entities engage in litigation funding, including private individuals,[9] private firms that may have an affiliation with institutional investors,[10] and publicly traded companies.[11] Litigation funders typically provide non-recourse funding, meaning that if the plaintiff does not recover in the lawsuit, the plaintiff is not obligated to repay the funder.[12] The non-recourse nature of litigation funding distinguishes it from traditional loans, which require repayment of the principal and interest, regardless of the outcome in a case.

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[6] *See* ABA COMM'N ON ETHICS 20/20, INFORMATIONAL REPORT TO THE HOUSE OF DELEGATES 1 (2012); INT'L COUNCIL FOR COMMERCIAL ARBITRATION, REPORT OF THE ICCA-QUEEN MARY TASK FORCE ON THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION 18 (2018); Verity Jackson-Grant, *Litigation Funding: What You Need to Know About This Fast-Growing Business*, LEGAL WEEK (April 17, 2018, 6:37 AM), https://www.law.com/legal-week/2018/04/17/litigation-funding-what-you-need-to-know-about-this-fast-growing-business/.

[7] *See Research Insight: The Enduring Value of Single-Case Litigation Finance*, BURFORD CAPITAL (Oct. 2, 2017), https://www.burfordcapital.com/blog/research-insight-enduring-value-single-case-litigation-finance/ (describing how single-case litigation finance works).

[8] *See 5 Minutes on . . . Portfolio Finance*, BURFORD CAPITAL (Apr. 17, 2019), https://www.burfordcapital.com/blog/5-minutes-on-portfolio-finance/ ("Portfolio finance gathers multiple litigation or arbitration matters in a single funding vehicle.").

[9] *See* Derek Thompson, *The Most Expensive Comment in Internet History?*, ATLANTIC (Feb. 23, 2018), https://www.theatlantic.com/business/archive/2018/02/hogan-thiel-gawker-trial/554132/ (discussing Peter Thiel's litigation funding efforts to drive Gawker into bankruptcy).

[10] *See* Matthew Mallon, *The Top-Performing Alternative Investments: Litigation Funding*, MINYANVILLE (Feb. 17, 2011, 5:16 PM), http://www.minyanville.com/special-features/articles/alternative-investments-litigation-funding-lawsuit-lawsuit/2/17/2011/id/32425?refresh=1 (referencing Citigroup-backed litigation funding firm Counsel Financial).

[11] Publicly traded litigation funders include Burford Capital LLC and IMF Bentham Limited. Brian Baker, *In Low-Yield Environment, Litigation Finance Booms*, MARKETWATCH (Aug. 21, 2018, 10:59 AM), https://www.marketwatch.com/story/in-low-yield-environment-litigation-finance-booms-2018-08-17.

[12] ABA REPORT, *supra* note 6, at 7.

In its current form, litigation funding treats litigation as an alternative asset class in which funders, institutional investors, and others can invest.[13] This form of litigation funding is a fairly recent, though burgeoning, phenomenon in the United States. Courts and regulators still are adapting to the emerging litigation funding market.[14]

A large number of bar association opinions and other publications discuss the ethical framework implicated by litigation funding. For the most part, they address funding provided to clients – principally plaintiffs – in civil litigation. Among the other relevant opinions are: ABA Op. 484 (2018); NYC Op. 2011-2 (2011); NYSBA Op. 1145 (2018); NYSBA Op. 1108 (2016); NYSBA Op. 1051 (2015); NYSBA Op. 769 (2003); and COPRAC Formal Opinion Interim 14-002. Other relevant publications include: the American Bar Association Commission on Ethics 20/20, Informational Report to the House of Delegates; Civil Justice and the Need for Transparency, DRI Center for Law and Public Policy, Third Party Litigation Funding Working Group; and Report of the ICCA-Queen Mary Task Force on Third-Party Funding In International Arbitration, The ICCA Reports No. 4, International Council for Commercial Arbitration, April 2018. There are also numerous news articles and opinion pieces that offer a variety of perspectives.[15]

The next few sections provide a brief history of litigation funding and discuss its growth across the globe and modern legal issues regarding its practices.

1. The Evolution of Maintenance and Champerty

Although they currently have little bearing on the modern form of commercial litigation finance, forms of litigation funding date back to ancient Rome and Greece.[16] At common law,

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[13] *See What Are Alternative Investments?*, YIELDSTREET, https://www.yieldstreet.com/resources/article/the-investment-landscape-and-alternative-investments (last visited Oct. 25, 2019).

[14] *See* Matthew Fechik & Amy G. Pasacreta, *Litigation Finance: A Brief History of a Growing Industry*, LEXOLOGY (Mar. 24, 2016), https://www.lexology.com/library/detail.aspx?g=0cd484ee-76fb-41d4-acd2-5b85972beab9.

[15] *See e.g.*, Mary Ellen Egan, *Other People's Money*: *Rise of Litigation Finance Companies Raises Legal and Ethical Concerns*, ABA JOURNAL (Dec. 1, 2018 12: 05 AM) http://www.abajournal.com/magazine/article/litigation_finance_legal_ethical_concerns (explaining difficulties and potential benefits presented by litigation finance); Roomy Khan, *Institutionalize Litigation Funding: Ethics Rules Need to Be Reviewed, Clarified and Legislated*, FORBES (Aug. 2, 2019, 2:24 PM), https://www.forbes.com/sites/roomykhan/2019/08/02/institutionalize-litigation-funding-ethics-rules-need-to-be-reviewed-clarified-and-legislated/#3a1d9157d797 (calling for legislation to address "existing murky environment" of litigation finance); Anthony J. Sebok, *Selling Attorneys' Fees*, 2018 U. ILL. L. REV. 1207 (2018).

[16] *See* Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV 1269, 1286–87 (2011) (describing "historical antecedents" of litigation finance).

aspects of these practices came to be described as maintenance and champerty.[17] Maintenance is defined as "helping another prosecute a suit,"[18] and champerty is defined as "maintaining a suit in return for a financial interest in the outcome."[19] Prohibitions against maintenance and champerty arose in medieval England.[20] During that era, wealthy English landowners funded third-party litigation to drive down the cost of land so that they could acquire it at below-market prices.[21] Looking to curb this practice, England's law evolved to prohibit maintenance and champerty.[22]

The extent to which the United States has adopted and has continued to enforce similar prohibitions varies by jurisdiction.[23] Some jurisdictions refused to adopt restrictions on maintenance and champerty.[24] Others developed common law or statutory prohibitions against maintenance and champerty,[25] often driven by a desire to limit excessive or unnecessary litigation that sought profit, rather than recompense.[26] Over time, some courts in the United States began to question whether the doctrines prohibiting maintenance and champerty served any useful purpose.[27] Some states that had adopted English common law restrictions against maintenance and champerty, such as Colorado and South Carolina, began to abandon these doctrines

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[17] *See id. See also* Ari Dobner, Comment, *Litigation for Sale*, 144 U. PA. L. REV. 1529, 1543–46 (1996) (discussing history of champerty and maintenance).

[18] *In re Primus*, 436 U.S. 412, 424 n. 15 (1978).

[19] *Id.*

[20] *See* Max Radin, *Maintenance by Champerty*, 24 CALIF. L. REV. 48, 57–62 (1935) (rooting feudal prohibitions on champerty in popular concern about "vexatious law suits for profit" and "general complaint against the delay and expensiveness of justice").

[21] 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, 1082 (2013) (citing VICKI WAYE, TRADING IN LEGAL CLAIMS: LAW, POLICY AND FUTURE DIRECTIONS IN AUSTRALIA, UK AND US 12–13 (2008)).

[22] *Id.*

[23] *See* R. D. Cox, *Champerty as We Know It*, 13 MEMPHIS ST. U.L. REV. 139, 141–151 (1983) (describing how early states in the Union differed in their adoption of champerty); Anusheh Khoshsima, *Malice Maintenance Is "Runnin' Wild": A Demand for Disclosure of Third-Party Litigation Funding*, 83 BROOK, L. REV. 1029, 1034–40 (2018) (providing overview of U.S. maintenance law).

[24] *See, e.g., Grant v. Stecker & Huff, Inc.*, 1 N.W.2d 500 (Mich. 1942) ("[T]he defense of champerty does not exist in Michigan.").

[25] *See* Jason Lyon, *Revolution in Progress: Third-Party Funding of American Litigation*, 58 UCLA L. REV. 571, 584–87 (2010).

[26] *See, e.g., Saladini v. Righellis*, 687 N.E.2d 1224, 1226 (Mass. 1997) ("[T]he doctrine has been viewed as a check on frivolous or unnecessary litigation, or a mechanism to encourage the settlement of disputes without recourse to litigation.").

[27] *Id.* ("We have long abandoned the view that litigation is suspect, and have recognized that agreements to purchase an interest in an action may actually foster resolution of a dispute.").

altogether.[28] States such as Florida found that third-party litigation funding could give rise to a claim of champerty only if the third-party funder "officiously intermeddles" in the litigation being funded.[29] Further, some states with maintenance and champerty laws do not enforce these restrictions.[30]

Many U.S. states are beginning to relax prohibitions on maintenance and champerty. Twenty-eight jurisdictions permit maintenance with varying limitations,[31] and sixteen explicitly allow champerty.[32] However, other states have refused to "abandon the champerty doctrine simply because a few states have chosen to do so."[33]

New York's prohibition of champerty remains in force, although its breadth is uncertain. Judiciary Law § 489 restricts individuals and companies from taking an assignment of notes or other securities "with the intent and for the purpose of bringing an action or proceeding thereon."[34] Notably, Judiciary Law § 489 contains a safe harbor for certain transactions "having an aggregate purchase price of at least five hundred thousand dollars."[35] In 2009, the New York Court of Appeals limited the champerty doctrine with its decision in *Love Funding*.[36] The court held that Judiciary Law § 489 prohibits "the purchase of claims with the intent and for the purpose of

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[28] *See, e.g.*, *Fastenau v. Engel*, 240 P.2d 1173, 1174 (Colo. 1952) ("Common-law maintenance and champerty no longer exist in Colorado."); *Osprey, Inc. v. Cabana Ltd. P'ship*, 532 S.E.2d 269, 279 (S.C. 2000) ("We abolish champerty as a defense because we believe it no longer is required to prevent the evils traditionally associated with the doctrine as it developed in medieval times.").

[29] *Kraft v. Mason*, 668 So. 2d 679, 682 (Fla. Dist. Ct. App. 1996). A party officiously intermeddles if it offers "unnecessary and unwanted advice or services" or are "meddlesome, esp. in a highhanded or overbearing way." *Id.* Thus, litigation funding that is desired by a party to the litigation arguably does not violate Florida's champerty restrictions.

[30] *See* Paul Bond, Comment, *Making Champerty Work: An Invitation to State Action*, 150 U. PA. L. REV. 1297, 1301–16 (2002). *See also Gowen v. Helly Nahmad Gallery, Inc.*, 77 N.Y.S.3d 605, 630 (N.Y. Sup. Ct. 2018), *aff'd* 95 N.Y.S.3d 62 (N.Y. App. Div. 2019) (holding that New York's champerty statute did not apply to litigation funding agreement to recover artwork that was taken by Nazis because statute "is to be applied narrowly, and does not apply when the purpose of an assignment is the collection of a legitimate claim").

[31] *See* Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61, 98–99 (2011) (listing states).

[32] *Id.* at 107 (noting that "the remaining [twelve] states probably permit champerty—it is just that they do not explicitly cite the investment by contract into a stranger's suit as a permissible form of maintenance").

[33] *Johnson v. Wright*, 682 N.W.2d 671, 678 (Minn. Ct. App. 2004). Other states, including Delaware, similarly apply the champerty doctrine strictly. *See, e.g.*, *Hall v. State*, 655 A.2d 827 (Del. Super. Ct. 1994).

[34] NY CLS Jud § 489.

[35] NY CLS Jud § 489(2).

[36] *Trust for the Certificate Holders of the Merrill Lynch Mortgage Investors Mortgages Pss-Through Certificates, Series 1999-CI v. Love Funding*, 13 N.Y.3d 190 (2009).

bringing an action that the purchaser may involve parties in costs and annoyance."[37] This decision led many commentators to believe that champerty was confined to claims purchased for the sole purpose of bringing frivolous lawsuits.[38] The New York Court of Appeals, however, recently reaffirmed elements of champerty in interpreting Judiciary Law § 489. In *Justinian Capital*, the court held that for an agreement to "constitute the offense of champerty the *primary purpose* of the purchase must be to enable one to bring a suit, and the intent to bring a suit must not be merely incidental and contingent."[39]

2. Usury Restrictions on Litigation Funding

Usury is "the lending of money at exorbitant interest rates."[40] While historically usury was prohibited, including in early English law,[41] usury laws in the United States have had a mixed reception.[42] The colonies and early states enacted laws against usury, yet a number of states repealed such legislation in the mid-to-late nineteenth century and expressed the belief that such laws inhibited economic growth.[43] Over time, states again passed usury laws, and today most states have statutes prohibiting usury with certain limited exceptions.[44] In the majority of states, the elements of usury are: (1) an agreement to lend money; (2) the borrower's absolute obligation to repay with repayment not contingent on any other event or circumstance; (3) a greater compensation for making the loan than is allowed under a usury statute or the State Constitution; and (4) an intention to take more for the loan of the money than the law allows.[45]

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[37] *Id.* at 210.

[38] *See* Thomas T. Janover & David E. Blabey Jr., *Recent Court of Appeals Case Sheds Light on Scope of Champerty Doctrine*, 257 N.Y. L. J. 70 (Apr. 13, 2017) (discussing recent developments in New York's champerty doctrine).

[39] *Justinian Capital SPC v WestLB AG, N.Y. Branch*, 28 N.Y.3d 160, 167 (N.Y. 2016).

[40] MERRIAM-WEBSTER, https://www.merriam-webster.com/dictionary/usury (last visited Oct. 25, 2019).

[41] *See* Paul G. Hayeck, *An Economic Analysis of the Justifications for Usury Laws*, 15 ANN. REV. BANKING L. 253, 255–56 (1996) (providing a history of usury prohibitions and limitations).

[42] Susan Lorde Martin, *Financing Litigation On-Line: Usury and Other Obstacles,* 1 DEPAUL BUS. & COM. L.J. 85, 89 (2002).

[43] *See id*. at 89–90. For example, Massachusetts was the first state to repeal its usury statute, deploring the "absurdity of arbitrary legislative attempts to fix the market rate of interest." Hayeck, *supra* note 41, at 253–56.

[44] *See* Martin, *supra* note 42, at 90.

[45] *Id.* at 90–91.

The second element—the borrower's absolute obligation to repay with repayment not contingent on any other event or circumstance—often allows litigation funders to avoid running afoul of state usury laws. Because most litigation funding is non-recourse, the recipient of litigation funding ordinarily does not have an absolute obligation to repay, but instead must repay only if the litigation is successful. Thus, while some courts have classified litigation funding agreements as loans subject to state usury laws,[46] the majority view is that usury laws do not restrict litigation funding.[47]

For example, New York courts originally held that litigation finance agreements were subject to usury laws, but have adopted a more permissive view of these financing arrangements.[48] *Compare Echeverria v. Estate of Lindner*, 801 N.Y.S.2d 233 (Sup. Ct. N.Y. Mar. 2, 2005) (classifying litigation funder as lender subject to usury laws because payout was "sure thing" as plaintiff's case was based on strict liability) *with Lynx Strategies v. Ferreira*, 28 Misc. 3d 1205(A), *2 (Sup. Ct. N.Y. July 6, 2010) (holding that usury laws did not apply to litigation funder because it did not advance loan but took "an ownership interest in proceeds for a claim, contingent on the actual existence of any proceeds").[49] To date, no New York appellate court has ruled on the applicability of usury laws to litigation funding.

[46] Some courts have found that certain litigation funding agreements resemble loans closely enough to be subject to, and be found invalid under, state usury laws. *See, e.g., Oasis Legal Fin. Grp., LLC v. Coffman*, 361 P.3d 400, 410 (Colo. 2015) (holding that litigation funding agreements are loans subject to state usury laws because they create debt from an obligation to repay and that obligation increases with the passage of time); *Boling v. Prospect Funding Holdings, LLC*, No. 1:14-CV-00081-GNS-HBB, 2017 WL 1193064, *5 (W.D. Ky. 2017).

[47] *See* Justin M. Daniel, *INSIGHT: A 10-Minute Primer on Litigation Finance*, BLOOMBERG LAW (Sept. 4, 2018, 2:08 PM), https://news.bloomberglaw.com/us-law-week/insight-a-10-minute-primer-on-litigation-finance, ("Courts have also thus far generally agreed with the parties' characterizations of the agreements as something other than loans.") *See also, e.g., Obermayer, Rebmann, Maxwell & Hippel v. West*, 725 F. App'x 153, 155–56 (3d Cir. 2018) (holding that, because litigation funding agreement was contingent on outcome of case and not secured in any way, agreement was not a loan and was not subject to state usury laws); *Cash4Cases, Inc. v. Brunetti*, 167 A.D.3d 448, 449 (1st Dep't N.Y. 2018) (holding that usury laws did not apply to litigation funder "because the repayment of principal is entirely contingent on the success of the underlying lawsuit").

[48] New York prohibits persons or corporations from "directly, or indirectly, charg[ing], tak[ing], or receiv[ing] any money, goods or things in action as interest on the loan or forbearance of any money, goods or things in action at a rate" exceeding "six per centum per annum" unless otherwise prescribed. N.Y. Gen. Oblig. L. § 5-501 (2012).

[49] *See also Lawsuit Funding, LLC v. Lessoff*, 2013 WL 6409971, 2013 Slip Op. 33066 (U) (N.Y. Sup. Ct. Dec. 4, 2013) (finding that litigation financing arrangement constituted contingent investment, not loan).

3. Forms of Litigation Funding

As litigation funding has gained increasing acceptance in the United States, new markets for third-party litigation funding have developed. While some wealthy individuals still engage in the practice of funding third-party litigation for personal gain,[50] more modern third-party litigation funders have come to see litigation as a new asset class ripe for investment.[51] The ability to invest in this new asset class has led to the rise of a niche industry of litigation-funding companies.[52] This industry has grown rapidly in the United States, with many consumer litigation funders coming together to form their own membership organization, the American Legal Finance Association (ALFA), that lobbies for the consumer litigation funding industry.[53]

As the litigation-funding industry has expanded, so too have the types of third-party litigation funders. Initially, the litigation-funding industry was dominated by funds that had the backing of established banks and hedge funds.[54] Over time, however, the industry has grown to include various other private funds, as well as publicly-traded firms such as Burford Capital and IMF Bentham.[55] Moreover, the litigation-funding market recently has grown to include companies that use crowdfunding to fund pre-selected lawsuits.[56] These crowdfunding companies vet legal claims and post a request for funding on their company websites so that individuals can become litigation funders by giving small amounts until the necessary amount is raised to fund a lawsuit.[57]

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[50] *See* Thompson, *supra* note 9.

[51] YIELDSTREET, *supra* note 13.

[52] *See* ALFA MEMBER COMPANIES, AMERICAN LEGAL FINANCE ASSOCIATION, https://americanlegalfin.com/alfa-membership/alfa-member-companies/ (last visited Oct. 25, 2019) (listing thirty-two member companies).

[53] AMERICAN LEGAL FINANCE ASSOCIATION, https://americanlegalfin.com/ (last visited Oct. 25, 2019).

[54] *See, e.g.*, Kevin M. LaCroix, *Why Are Investors Seeking Litigation Funding Opportunities? Because Litigation Funding Is Profitable*, THE D&O DIARY (Mar. 20, 2015), https://www.dandodiary.com/2015/03/articles/litigation-financing-2/why-are-investors-seeking-litigation-funding-opportunities-because-litigation-funding-is-profitable/ (discussing hedge fund EJF Capital LLC's deployment of new litigation finance arm).

[55] *See id. See also* Barney Thompson, *Litigation Finance Industry Opens up to Private Investors*, FINANCIAL TIMES (Aug. 23, 2018), https://www.ft.com/content/03921f5e-a49a-11e8-926a-7342fe5e173f (describing litigation finance market).

[56] *See* Thompson, *supra* note 55 (noting that "[t]he crowdfunding approach [to litigation funding] was pioneered by LexShares, a US-Based platform launched in 2014"). *See also* LEXSHARES, https://www.lexshares.com/ (last visited Oct. 25, 2019).

[57] *Id.* Litigation funding may also evolve into "monetization," which is the investment of money in legal claims, often in the form of working capital for a plaintiff entity, which we do not address in this Report. *See* Dai Wai Chin Feman and Sean Thompson, *Claim Monetization: A Lesser Known Use of Litigation Finance*, CORPORATE COUNSEL (Feb.

There are also 501(c)(3) nonprofit litigation funders who use contributions from donors to provide non-recourse funding to plaintiffs whose cases align with the nonprofit's mission.[58]

4. Litigation Funding in Other Countries

While litigation funding is an emerging market in the United States, other jurisdictions, such as Australia and England and Wales, have allowed litigation funding for decades.[59]

a) Australia

Early Australian law mirrored early England's limitations on third-party litigation funding.[60] In the late twentieth century, however, Australian courts began to question if laws against third-party litigation funding had become "obsolete."[61] In line with this thinking, Australian states began passing legislation that removed the barriers to third-party litigation funding,[62] although Australian courts maintained the power to disallow litigation funding agreements based on public-policy concerns.[63] However, in 2006, the Australian High Court decided *Campbells Cash & Carry v. Fostif*, which effectively eliminated this limitation on third-party litigation funding.[64]

The *Fostif* decision came at a time of growing demand for litigation funding in Australia where third-party litigation funding had become a way to give greater access to courts.[65] Against

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14, 2019), https://www.law.com/corpcounsel/2019/02/14/claim-monetization-a-lesser-known-use-of-litigation-finance/.

[58] For example, the "Bairs Foundation is a 501(c)(3) nonprofit organization [providing] . . . funds to people who need help covering immediate living or medical expenses during litigation." BAIRS FOUNDATION, http://www.bairsfoundation.org/ (last visited Oct. 25, 2019). These organizations seek to draw a distinction between their "funding with low, simple interest" and other funders' "non-recourse advances at high interest rates." *Id*.

[59] Steinitz, *supra* note 16, at 1278–79.

[60] *See id.* (providing overview on Australian litigation finance law). *See also* Australian Courts Act 1828 (ACT) § 24 ("all Laws and Statutes in force within the Realm of England at the Time of passing of this Act . . . shall be applied in the Administration of Justice in the courts of New South Wales Van Diemen's land").

[61] *Clyne v. NSW Bar Assoc.* (1960) 104 CLR 186 (Austl.) ("it may be necessary some day to consider whether maintenance as a crime at common law ought not now to be regarded as 'obsolete'").

[62] *See* Abolition of Obsolete Offences Act 1969 (Vic) (Austl.); Criminal Law Consolidation Act 1935 (SA) sch 11 (Austl.) (schedule 11 was added in 1992); Maintenance, Champerty and Barratry Abolition Act 1993 (NSW) (Austl.).

[63] *Roux v. Austl. Broad. Comm'n* (1992) 2 VR 577 (Austl.) ("The illegality [of maintenance and champerty], therefore, to the extent that it exists, must again depend upon public policy.").

[64] *Campbells Cash & Carry Pty. Ltd. v. Fostif Pty. Ltd.* (2006) 229 CLR 386 (Austl.).

[65] *See* Abrams & Chen, *supra* note 21, at 1085.

this backdrop, the Australian High Court in *Fostif* made clear that Australian law had "abolished the crimes, and the torts, of maintenance and champerty," and that, "[b]y abolishing those crimes, and those torts, any wider rule of public policy . . . lost whatever narrow and insecure footing remained for such a rule."[66] The *Fostif* decision opened the door for third-party litigation funders to take an active role in litigation, including choosing the attorney for the funded party and settling with the defendants.[67] Other Australian courts interpreted *Fostif* as disallowing any general rules prohibiting litigation funding.[68] The only limit on litigation-funding agreements was that parties entering into such agreements must be of "full age and capacity . . . untainted by infirmity."[69]

A few years later, in *Brookfield Multiplex Funds Management v. International Litigation Funding Partners*, the Australian High Court ruled that litigation funding agreements in funded class actions constituted managed investment schemes.[70] As a result, such agreements would have to be managed by an entity holding an Australian Financial Services License (AFSL).[71] The Australian Securities and Investment Commission (ASIC) intervened, however, and exempted litigation funders from the requirement of being managed by an entity holding an AFSL.[72]

Today, there are no licensing requirements imposed on litigation funders in Australia, and the market is continually growing, with almost half of all Australian class actions supported by litigation funders.[73] Australian litigation funders, however, are subject to the consumer provisions of the ASIC Act of 2001 that protects consumers against unfair contract terms and unreasonable conduct.[74] Additionally, in 2013, ASIC released a regulatory guide detailing how litigation funders should manage conflicts of interest.[75] The involvement of funders for a party in a class action must also be disclosed to the court as long as the disclosure does not give the other party a

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[66] *Fostif*, 229 CLR at 433.

[67] *Id.* at 413.

[68] *See Jeffery & Katauskas Pty. Ltd. v. SST Consulting Pty. Ltd.* (2009) 239 CLR 75, 92 (Austl.).

[69] *Fostif*, 229 CLR at 434–35.

[70] *Brookfield Multiplex Funds Mgmt. Pty. Ltd. v. Int'l Litig. Funding Partners Pty. Ltd.* (2009) 180 FCR 11 (Austl.).

[71] LESLIE PERRIN, THE THIRD PARTY LITIGATION FUNDING LAW REVIEW 4 (Leslie Perrin ed., 2018).

[72] *Id.*

[73] *Id.* at 1, 4.

[74] *Id.* at 4.

[75] ASIC REGULATORY GUIDE 248, LITIGATION SCHEMES AND PROOF OF DEBT SCHEMES: MANAGING CONFLICTS OF INTEREST (2013).

tactical advantage.[76] Due in part to this permissive regulatory environment, there are approximately 25 active litigation funders in the Australian market.[77]

b) England and Wales

England and Wales similarly have accommodated third-party litigation funding. Although they historically had a more restrictive champerty law than the U.S.—barring contingency fee agreements entirely[78]—England and Wales sought to increase access to the courts through two pieces of legislation. In 1967, England and Wales passed the Criminal Law Act, which both decriminalized maintenance and champerty and removed the practices from tort liability.[79] Then, in 1990, England and Wales passed the Courts and Legal Services Act, which legalized conditional fee arrangements.[80]

Together, these acts created a favorable landscape for the modern litigation funding market in England and Wales. In *Arkin v. Borchard Lines, Ltd*, a plaintiff received litigation funding and subsequently lost his case, leading to his bankruptcy.[81] Normally, England follows a "loser pays" system for legal fees,[82] but, because the plaintiff in *Arkin* was bankrupt, the defendants requested the fees from the litigation funder.[83] The trial court refused the defendants' request and noted that litigation funding furthered public policy by providing access to justice.[84] The defendants appealed, and the appellate court ruled that litigation funders would have to pay the opposing parties' costs only to the extent of the funding contractually agreed upon with the losing party.[85]

[76] FEDERAL COURT OF AUSTRALIA, CLASS ACTION PRACTICE NOTE (GPN-CA)-GENERAL PRACTICE NOTE (Oct. 25, 2016).

[77] Australian Law Reform Comm'n, *Inquiry Into Class Action Proceedings And Third-Party Litigation Funders* 16 (Discussion Paper No. 85, 2018). The report notes that from September 2013 to September 2016, 49% of all class actions were funded by third-party litigation funders. *Id*.

[78] Nicholas Dietsch, *Litigation Financing in the U.S., the U.K., and Australia: How the Industry Has Evolved in Three Countries*, 38 N. KY. L. REV. 687, 698 (2011) (describing litigation finance in the UK).

[79] Criminal Law Act, 1967, c. 58, §§ 13, 14 (U.K.).

[80] Dietsch, *supra* note 78. *See also* Susan Dunn, *Paying For Personal Injury Claims - What Are the Options for Clients and Their Representatives?*, J. PERS. INJ. L. 218, 220 (2009).

[81] *Arkin v. Borchard Lines, Ltd.*, (2005) 1 W.L.R. 3055, 3059.

[82] Dietsch, *supra* note 78, at 699.

[83] *Arkin*, 1 W.L.R. at 3060.

[84] *Id.* at 3062.

[85] *Id.* at 3069.

The court reasoned that requiring a portion, but not all, of the winning party's fees to be paid by a litigation funder would allow the litigation funding market to grow while imposing some necessary regulation.[86]

While the requirement to pay a portion of the winning party's costs is a judicially imposed regulation on litigation funding, that market is still growing in England and Wales. Funders are apparently responding to this court-imposed regulation by factoring in the cost of this additional risk when they make funding decisions.[87] This form of regulation has also created a lucrative practice in England and Wales for the funding of arbitration, where the losing party is not automatically required to pay the winning party's fees.[88] Instead, the winning party must apply for security for costs, which is a mechanism for the winning party to collect some or all of its fees from the losing party if approved by the arbitrator(s).[89]

As the litigation funding market has grown in England and Wales, the market has used voluntary regulation to self-police. Under this arrangement, industry professionals, with sponsorship from government entities, have developed their own regulatory regime and follow the regulations that are issued.[90] In 2011, the Association of Litigation Funders (ALF) was founded with the approval of the Civil Justice Counsel of England and Wales, an advisory public body that advises the government and the judiciary on civil justice in England and Wales.[91] Along with endorsing the ALF, the Civil Justice Counsel published a Code of Conduct for Litigation Funders.[92] The ALF administers the Code of Conduct and works to regulate the litigation funding market on a voluntary basis.[93] With a supportive legal system and a framework for self-regulation, the litigation funding market in England and Wales appears poised for further expansion.

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[86] *Id.* at 3069–70 ("Professional funders will also have to consider with even greater care whether the prospects of litigation are sufficiently good to justify the support that they are asked to give. This also will be in the public interest.").

[87] PERRIN, *supra* note 71, at 49.

[88] *Id.* at 55.

[89] *Id.* at 55–56.

[90] *Id.* at 50–51.

[91] ASSOCIATION OF LITIGATION FUNDERS, OUR FOUNDING, http://associationoflitigationfunders.com/about-us/our-founding/ (last visited Oct. 29, 2019).

[92] ASSOCIATION OF LITIGATION FUNDERS, CODE OF CONDUCT, http://associationoflitigationfunders.com/code-of-conduct/ (last visited Oct. 29, 2019).

[93] *Id.*

c) Other Foreign Jurisdictions

Although viewed as having the most established international litigation funding markets, Australia and England and Wales are not the only jurisdictions with a growing field of capable funders.[94] For instance, in Germany, third-party funders have existed since 1998.[95] The German legal framework for litigation funding is relatively non-restrictive, which has led to growth in the industry.[96] Germany does not require disclosure of the involvement of a litigation funder in either state court litigation or arbitration.[97] While the German market for litigation funding continues to evolve, there is still debate and uncertainty surrounding the rules and regulations governing third-party funding agreements.[98] Litigation funding also has attracted significant attention in Canada.[99] Recent decisions by Canadian courts have confirmed the viability of litigation funding in both the class action and single-party commercial litigation contexts, subject to certain requirements.[100] As a result, international litigation funders have increasingly entered the Canadian market.[101] As with Germany, there is an opportunity for Canadian courts and/or legislators to provide additional guidance on third-party funding agreements and the relationship between funders and plaintiffs.[102]

Recent entrants to the litigation funding market include Singapore and Hong Kong. Both Singapore and Hong Kong passed legislation in 2017 allowing for third-party funding of international arbitration, which is prevalent in each jurisdiction.[103] In addition, Singapore abolished maintenance and champerty torts and declared that litigation funding contracts would

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[94] PERRIN, *supra* note 71, at iii–iv. Over twenty jurisdictions outside the U.S. allow some form of litigation funding. These countries include: Australia, Austria, Brazil, Canada, England and Wales, Germany, Hong Kong, Italy, the Netherlands, New Zealand, Nigeria, Norway, Poland, Portugal, Singapore, Spain, Sweden, Switzerland, Ukraine, and the United Arab Emirates. *Id.*

[95] *Id.* at 59.

[96] *Id.*

[97] *Id.* at 69.

[98] *Id.* at 74.

[99] *Id.* at 35.

[100] *Id.*

[101] *Id.* For example, Bentham IMF entered the Canadian market in January 2016 and by October 2017 had received over 300 applications for funding. *See id.*

[102] *Id.* at 47.

[103] *The Modern Evolution of Litigation Funding*, BENTHAM IMF (Oct. 11, 2017), https://www.benthamimf.com/blog/blog-full-post/bentham-imf-blog/2017/10/11/the-modern-evolution-of-litigation-funding.

be enforceable in Singapore courts.[104] While Hong Kong paved the way for litigation funding in arbitration, it still has strict maintenance and champerty laws applicable to litigation.[105] As litigation funding continues to grow, however, Hong Kong may follow other countries in eliminating laws against maintenance and champerty.

The developments in Hong Kong and Singapore are representative of the growing desire for litigation funding around the world. As litigation funding expands, foreign jurisdictions will have to confront the question of how to regulate this emerging market.

B. The Current Legal Landscape of Litigation Funding

1. Recent Court Decisions

U.S. courts have grappled with aspects of litigation funding for decades in the context of champerty, maintenance, and usury. Recently, courts have considered additional issues regarding litigation funding—including a growing body of case law on disclosure, discovery, and privilege.

a) Disclosure

As discussed more fully in Section IV of this report, courts across the country have addressed the scope of disclosure of commercial litigation funding. For example, United States District Judge Dan Polster of the Northern District of Ohio issued an order in a multidistrict opioid litigation to any attorney who has received third-party litigation funding. The Court required the attorneys to disclose that funding to the Court and provide information, for *in camera* review, confirming that the funder was not controlling the litigation, influencing counsel's judgment, or creating a conflict of interest.[106] The Northern District of California has a standing order requiring that, in any class or collective action, parties disclose entities that are "funding the prosecution of any claim or counterclaim."[107] One court, in the consumer litigation context, has gone further by requiring disclosure of litigation funding to a jury.[108]

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[104] *Id.*

[105] PERRIN, *supra* note 71, at 76.

[106] *See In re Nat'l Prescription Opiate Litig.*, No. 1:17-MD-2804, 2018 WL 2127807, at *1 (N.D. Ohio, May 7, 2018).

[107] N.D. Cal. Standing Order on the Contents of Joint Case Management System (effective Nov. 1, 2018).

[108] *See, e.g., ML Healthcare Servs., LLC v. Publix Super Markets, Inc.*, 881 F.3d 1293, 1302–03 (11th Cir. 2018) (upholding required disclosure of litigation funding to jury so that defendant could probe potential bias).

While some courts require disclosure of litigation funding, others have been hesitant to do so. For example, in January 2019, a judge in the Northern District of California did not allow discovery of a plaintiff's litigation funding agreement because the party seeking discovery could not show that the information sought was relevant.[109] In line with this reasoning, other courts have required a showing of relevance before information about litigation funders is required to be produced. [110]

b) Attorney-Client Privilege and the Common Interest Exception

Some courts have disallowed discovery of documents shared with litigation funders on the basis of attorney-client privilege. Normally, attorney-client privilege is waived for information shared with third parties, which would include litigation funders.[111] However, the common interest exception allows parties to maintain the attorney-client privilege for documents shared with a third party who has a common legal interest.[112]

Courts are split over whether the common interest exception should apply to documents shared with litigation funders. Some courts hold that funders and litigants have a common legal interest because communications with funders are necessary for some litigants to receive legal advice and because funders have an interest in the successful litigation of a claim.[113] Other courts hold that a mere commercial interest does not rise to the level of a common legal interest, so the

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[109] *MLC Intellectual Property LLC v. Micron Technology, Inc.*, No. 14-cv-03657-SI, 2019 WL 118595, at *2 (N.D. Cal. Jan. 7, 2019).

[110] *See, e.g.*, *Miller UK Ltd. V. Caterpillar, Inc.*, 17 F. Supp. 3d 711, 723–24 (N.D. Ill. 2014) (holding that defendant seeking discovery of information about litigation funder must show that information is relevant); *Space Data Corp. v. Google LLC*, No. 16-cv-03260 BLF, 2018 WL 3054797, at *1 (N.D. Cal. June 11, 2018) (denying motion to compel discovery because defendants failed to show that discovery of litigation funding information was relevant).

[111] Bruce Kelly, *What To Know About The Common Interest Privilege*, LAW360 (June 25, 2013, 12:02 PM), https://www.law360.com/articles/451580/what-to-know-about-the-common-interest-privilege.

[112] *Id.* In New York, the common interest doctrine is narrowly construed. *See Ambac Assur. Corp. v. Countrywide Home Loans, Inc.*, 27 N.Y.3d 616, 632 (2016) (holding that common interest doctrine applies only where litigation is pending or reasonably anticipated).

[113] *See, e.g.*, *In re Int'l Oil Trading Co., LLC*, 548 B.R. 825, 833 (Bankr. S.D. Fla. 2016) (holding that attorney-client privilege was not waived for documents shared with litigation funder because litigant and funder had common legal interest).

common interest exception should not apply to documents shared with litigation funders.[114] This split will be explored in more detail in Section IV of this Report.

c) The Work Product Doctrine

Under New York, law, "[t]he work product of an attorney shall not be obtainable."[115] As further discussed in Section IV, courts have limited discovery of documents surrounding litigation funding agreements by holding that these documents fall under the work product doctrine.[116] Because litigation funding agreements are prepared in anticipation of litigation and often contain information about attorney impressions and litigation strategies, some courts find that documents regarding these agreements are protected work product.[117]

The work-product protections for litigation funding agreements are not unlimited. Some courts hold that documents sent to potential litigation funders receive work product protections only if the funded party expected the disclosures to remain confidential, such as documents shared pursuant to a nondisclosure agreement.[118] At least one court has allowed discovery of the underlying facts conveyed to litigation funders.[119]

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[114] *See, e.g.*, *Miller UK*, 17 F. Supp. 3d at 733 (holding that because there was no legal planning with funders to ensure compliance with the law, litigation was already underway, and plaintiff was looking for money, not legal advice, common interest exception did not apply to documents shared with litigation funders).

[115] N.Y. C.P.L.R. 3101(c) (McKinney).

[116] *See, e.g.*, *Lambeth Magnetic Structures, LLC v. Seagate Tech. (US) Holdings, Inc*., Nos. 16-538, 16-541, 2018 WL 466045, at *5 (W.D. Pa. Jan. 18, 2018) (holding that communications with litigation funders were protected work product because they were "undisputedly prepared in anticipation of the instant litigation and for the purpose of pursuing the litigation"); Grace M. Giesel, *Alternative Litigation Finance and the Work-Product Doctrine*, 47 WAKE FOREST L. REV. 1083 (2012).

[117] *See, e.g., Charge Injection Techs., Inc. v. E.I. DuPont De Nemours & Co.*, No. 07C–12–134–JRJ, 2015 WL 1540520, at *5 (Del. Super. Ct. Mar. 31, 2015) (holding that, because agreement was "prepared in anticipation of litigation and reflect[s] the type of attorney mental impressions and litigation strategies," litigation funding agreement was protected work product). Additional case law will be discussed in Section IV *infra*.

[118] *See, e.g.*, *United States v. Homeward Residential, Inc.*, No. 4:12-CV-461, 2016 WL 1031154, at *6 (E.D. Tex. Mar. 15, 2016) (holding that work product protection was not waived for agreements with potential litigation funders because documents were subject to nondisclosure agreements); *Odyssey Wireless, Inc. v. Samsung Elecs. Co., Ltd*, No. 15-01735, 2016 WL 7665898, at *6 (S.D. Cal. Sept. 20, 2016) (holding that documents sent to litigation funders were protected by work product doctrine because they were subject to confidentiality agreements and expectation of confidentiality).

[119] *See, e.g., Morley v. Square, Inc.*, 2015 WL 7273318, at *2–3 (E.D. Mo. Nov. 18, 2015) (holding that, although work product doctrine protected documents shared with litigation funders, defendants were still entitled to redacted documents sufficient to reveal underlying facts conveyed to funders).

2. Federal Regulation of Litigation Funding

Over the last decade, several states have enacted or are in the process of proposing legislation to regulate consumer litigation finance.[120] There also has been a recent effort to subject litigation funding to federal oversight. On February 13, 2019, the Litigation Funding Transparency Act of 2019 (the "Act") was referred to the Senate Committee on the Judiciary.[121] The Act would require disclosure of any agreement between (a) a party in any class action lawsuit filed in federal court or in any claim that is aggregated into a federal multi-district litigation proceeding and (b) any third-party commercial enterprise that has a contingent interest in the outcome of the case.[122] While the Act would signal Congress's first foray into the regulation of litigation funding, other countries have had laws allowing for and regulating the litigation funding market for years.[123]

3. New York Proposal Regarding Consumer Litigation Funding

New York State does not currently have legislation to regulate litigation funding. On May 13, 2019, the NY Senate's Consumer Protection Committee voted 7-0 to approve Senate Bill Number S04555, sponsored by Senator Anna Kaplan (D-7) ("Kaplan's Bill") for consideration by the full Senate. Kaplan's Bill is discussed in detail in Section V.C of this Report. It would enact the "Consumer Litigation Funding Act" and has a stated goal of promoting consumer protections in consumer funding transactions by mandating certain contractual terms and registration requirements.

Kaplan's Bill is co-sponsored by Senators Robert Ortt (R-62) and James Skoufis (D-39). The companion bill in the Assembly is Bill Number A6764, sponsored by William Magnarelli (D-129). This bill was referred to the Assembly's Consumer Affairs and Protection Committee on March 19, 2019; no action was taken to move it forward before the session ended in June 2019.[124]

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[120] *See infra* Section V.

[121] S.471-LITIGATION FUNDING TRANSPARENCY ACT OF 2019, CONGRESS.GOV, https://www.congress.gov/bill/116th-congress/senate-bill/471/text (last visited Oct. 25, 2019).

[122] *Id.*

[123] *See* Abrams & Chen, *supra* note 21, at 1083–84.

[124] *See* MP McQueen, *Inside the Battle Over Litigation Funding Regulation*, LAW.COM (July 12, 2019, 2:43 PM), https://www.law.com/newyorklawjournal/2019/07/12/inside-the-battle-over-litigation-funding-regulation/ ("New York legislators considered a bill this year that would require more detailed explanations of fee structures and impose registration but the measure failed to make it out of committee.").

Since these bills or similar ones have been introduced for several sessions in a row, it is likely that a similar bill will be introduced this session.

II. PROPOSAL TO AMEND RULE 5.4 OF THE NEW YORK RULES OF PROFESSIONAL CONDUCT TO ALLOW FOR AND ADDRESS LITIGATION FUNDING

A. Overarching Ethical Framework

Various New York Rules of Professional Conduct ("Rules") are implicated when any third party finances a lawsuit. We list a number of the relevant Rules below. The application of the Rules to funding of litigants, as distinguished from their lawyers, has not occasioned significant controversy.[125] In contrast, the application of the Rules to the expanding practice of funding lawyers and law firms where the funder has an interest in the client's recovery has been controversial. Rule 5.4, governing if, when and how attorneys may share fees with nonlawyers, has recently received the most attention.[126] While we recognize that other Rules that may be relevant to litigation funding also could be the subject of lengthy discussion, we therefore focused on Rule 5.4.

The Rules, modeled on the ABA Model Rules, were adopted into law by the state judiciary and constitute part of the law governing New York lawyers, who may be disbarred, suspended or otherwise disciplined for violating a Rule.[127] Beyond that, the Rules provide a framework for the ethical practice of law in New York and may affect civil liability, although that is not their principal purpose. The Preamble adopted by the New York State Bar Association explains:

> Violation of a Rule shall not itself give rise to a cause of action against a lawyer nor should it create any presumption in such a case that a legal duty has been breached. In addition, violation of a Rule does not necessarily warrant any other nondisciplinary remedy . . . . The Rules are designed to provide guidance to lawyers and to provide a structure for regulating conduct through disciplinary agencies. They are not designed to be a basis for civil liability . . . . Nevertheless, because the

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[125] This Report does not address the situation of a lawyer with an interest in the litigation funder. *See, e.g.*, N.Y. STATE BAR ASSOC. COMM. ON PROF'L ETHICS, Ethics Op. 1145 (2018).

[126] Other states have begun to consider whether amendments to Rule 5.4 should address litigation funding or broader issues, such as non-lawyer ownership of law firms. *See, e.g.*, Dan Packel, *ABA Could Encourage States to Allow Outside Ownership of Law Firms*, LAW.COM (Dec. 03, 2019) (discussing various approaches to litigation finance regulation proposed by Utah, California, Arizona, and the ABA Center for Innovation). These proposals are beyond of the scope of this Report.

[127] N.Y. RULES OF PROF'L CONDUCT, PREAMBLE 4 (2018) ("Failure to comply with an obligation or prohibition imposed by a Rule is a basis for invoking the disciplinary process."); *see also N.Y. Comp. Codes R. & Regs. tit. 22*, § 1240.

> Rules do establish standards of conduct by lawyers, a lawyer's violation of a Rule may be evidence of breach of the applicable standard of conduct.[128]

Preamble, [12], at 4-5.

The following Rules are relevant to the ethical framework surrounding commercial or direct-to-consumer litigation funding:[129]

- Rule 1.1 – Competence; this may relate to ethical considerations for lawyers contemplating business arrangements with non-legal organizations and crowdfunding
- Rule 1.2 – Scope of representation and allocation of authority
- Rule 1.4 – Communication
- Rule 1.5 – Fees and division of fees
- Rule 1.6 – Confidentiality
- Rule 1.7 – Conflicts of interest
- Rule 1.8 – Duties to current clients
- Rule 1.9 – Duties to former clients
- Rule 1.10 – Imputation of conflicts of interest
- Rule 1.13 – Organization as client
- Rule 3.1 – Non-meritorious claims and contentions
- Rule 5.4 – Professional independence of a lawyer
- Rule 5.5 – Unauthorized practice of law
- Rule 7.2 – Payment for referrals

As mentioned above, Rule 5.4 has received significant attention in the litigation funding area with respect to funding lawyers and law firms.[130] The Rule provides in part as follows:

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[128] N.Y. RULES OF PROF'L CONDUCT, PREAMBLE 4–5 (2018).

[129] These Rules apply to circumstances where funding is provided both directly to the party and to the lawyer or law firm.

[130] For example, in anticipation of the American Bar Association's mid-year meeting earlier this month, the ABA's Center for Innovation proposed a resolution that would encourage U.S. jurisdictions to consider regulatory innovations to, among other things, increase the accessibility, affordability and quality of civil legal services. The Center for Innovation explored issues such as the use of non-lawyer legal service providers, alternative business structures for law firms (including non-lawyer co-ownership), and unauthorized practice of law approaches. The final resolution, as passed by the ABA House of Delegates on February 17, 2020, largely adopted the original resolution, with additional language meant to clarify that the resolution should not be construed as recommending any changes to any of the ABA Model Rules of Professional Conduct, including Rule 5.4. *See* ABA CTR. INNOVATION et al., REVISED RESOLUTION AND REPORT TO THE HOUSE OF DELEGATES (Feb. 2020), https://www.americanbar.org/content/dam/aba/images/centerforinnovation/r115final.pdf.

(a) A lawyer or law firm shall not share legal fees with a nonlawyer, except that:

(1) an agreement by a lawyer with the lawyer's firm or another lawyer associated in the firm may provide for the payment of money, over a reasonable period of time after the lawyer's death, to the lawyer's estate or to one or more specified persons;

(2) a lawyer who undertakes to complete unfinished legal business of a deceased lawyer may pay to the estate of the deceased lawyer that portion of the total compensation that fairly represents the services rendered by the deceased lawyer; and

(3) a lawyer or law firm may compensate a nonlawyer employee or include a nonlawyer employee in a retirement plan based in whole or in part on a profitsharing arrangement.

(b) A lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law;

(c) Unless authorized by law, a lawyer shall not permit a person who recommends, employs or pays the lawyer to render legal service for another to direct or regulate the lawyer's professional judgment in rendering such legal services or to cause the lawyer to compromise the lawyer's duty to maintain the confidential information of the client under Rule 1.6.

The accompanying Comments to this Rule provide:

[1] The provisions of this Rule express traditional limitations on sharing fees. These limitations are to protect the lawyer's professional independence of judgment . . . .

[2] This Rule also expresses traditional limitations on permitting a third party to direct or regulate the lawyer's professional judgment in rendering legal services to another . . . .[131]

B. Formal Opinion 2018-5: Litigation Funders' Contingent Interest in Legal Fees

The City Bar's Opinion 2018-5 interpreted Rule 5.4 in the context of litigation funding and reflects the City Bar Association's formal view of how the Rule applies. As an opinion, it is neither

[131] New York courts infrequently have addressed the relationship between litigation funding and Rule 5.4. The courts that have addressed the relationship have held that the litigation funding arrangements at issue did not violate Rule 5.4. *See Hamilton Capital VII LLC vs Khamani*, 22 N.Y.S.3d 137 (N.Y. Sup. Ct. 2015); *Lawsuit Funding LLC v. Lessoff*, No. 650757/2012, 2013 WL 6409971, at *6 (N.Y. Sup. Ct. Dec. 4, 2013).

binding precedent nor a required rule of practice; it is advisory. In this opinion, the City Bar's Committee on Professional Ethics addressed the following question:

> May a lawyer enter into a financing agreement with a litigation funder, a non-lawyer, under which the lawyer's future payments to the funder are contingent on the lawyer's receipt of legal fees or on the amount of legal fees received in one or more specific matters?

The City Bar stated that for a number of reasons, "we conclude that such an arrangement violates Rule 5.4's prohibition on fee sharing with non-lawyers."[132] The opinion began by explaining that Rule 5.4. has "generally been interpreted to forbid business arrangements in which lawyers agree to make payments based on the receipt of legal fees or the amount of legal fees in particular matters."[133] The Opinion states:

> [W]e see no meaningful difference between payments for financing, on the one hand, and payments for goods and services, on the other, that would call for a different interpretation of "fee sharing" when a lawyer's payments to a provider of funding, rather than a provider of goods or services, are contingent on the lawyer's receipt of fees in a particular matter. Rule 5.4(a) must therefore be read to foreclose a financing arrangement whereby payments to the funder are contingent on the lawyer's receipt of legal fees. A non-recourse financing agreement secured by legal fees in a matter – i.e., an arrangement in which it is contemplated that the lawyer will make future payments only if the lawyer recovers fees – constitutes an impermissible fee-sharing arrangement regardless of how the lawyer's payments are calculated. Likewise, a financing arrangement constitutes impermissible fee sharing if the amount of the lawyer's payment is contingent on the amount of legal fees earned or recovered.[134]

As part of the mandate of this Working Group, we considered whether Rule 5.4, as interpreted in Opinion 2018-5, well serves the professional community and the public, or whether the Rule should be revised to reflect contemporary commercial and professional needs and realities.[135] We find that it would be beneficial for the Rule to be revised. The consensus of the Working Group is that lawyers and the clients they serve will benefit if lawyers have less restricted access to funding.

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[132] N.Y. CITY BAR ASSOC. COMM. ON PROF'L ETHICS, Formal Op. 2018-5 (2018). The Committee made clear that its opinion did not address the ethical implications of litigation funding directly to clients. *See id.* at 2.

[133] *Id.* at 3.

[134] *Id.*

[135] For a discussion of the pros and cons of litigation funding, see MP McQueen, *Inside the Battle Over Litigation Funding*, N.Y. L. J. (July 12, 2019).

C. Two Alternative Proposals

The Subcommittee on Ethics Rules spent significant time debating the pros and cons of a proposed revision to Rule 5.4. The Subcommittee ultimately generated two alternative proposals for an amendment. The Subcommittee members did not agree on which proposed language was preferable, and not all Subcommittee members would be willing to support both proposals. The full Working Group considered the merits of each proposed amendment and made further revisions to the suggested language. Ultimately, the Working Group members voted on the proposals, and the support was evenly divided between the two. The Working Group thus decided to present both proposals in full as part of this Report so that others have the benefit of seeing each suggestion and can weigh the different attributes themselves. Our aim in presenting both proposals is to further the debate and provide some inspiration to the relevant Committees of the City Bar and to those in the judiciary or legislature who may endeavor to undertake a change in the Rules or the law. A chart showing the differences between the two proposals follows the discussion.

1. Proposal A

A lawyer or law firm shall not share legal fees with a nonlawyer, except that:

* * *

(4) a lawyer or law firm may share legal fees with an entity in exchange for the entity's providing financial assistance to the lawyer specifically for use with respect to a legal representation of one or more clients, provided that:

- (i) the entity and its representatives do not participate, directly or indirectly, in the decision-making regarding the representation;
- (ii) the lawyer or law firm maintains professional independence;
- (iii) the client provides written informed consent to the financial arrangement; and
- (iv) the lawyer or law firm complies with all other applicable Rules, including Rule 1.6 and Rule 1.7.

a) Proposed Comment[136]

Commercial funding of lawyers and law firms, particularly in connection with their representation of claimants in litigation and arbitrations, has become more prevalent. Clients as

[136] This language is suggested for inclusion in the Comments section of Rule 5.4

well as lawyers and law firms may benefit. Paragraph (a)(4) recognizes that, assuming a litigation or arbitration funding arrangement would otherwise constitute impermissible fee sharing under Paragraph (a), any risks that funders will improperly influence lawyers' exercise of professional judgment may be addressed by other measures, and the benefits generally outweigh these risks.

The lawyer must disclose the essential terms of a proposed funding arrangement to the client to enable the client to make an informed decision whether to authorize the lawyer to enter into the arrangement, *see* Rule 1.4(b), and this necessitates disclosure of the risks and reasonably available alternatives. *See* Rule 1.0(j). Among other things, the lawyer must explain to the client whether the existence of the funding may have to be disclosed to the court or other parties and, if so, what the potential impact of the disclosure might be on the representation. At the same time, Paragraph (a)(4) recognizes that the lawyer or law firm must comply with all other applicable Rules. A lawyer or law firm may not allow the funder to interfere with the lawyer's independent professional judgment, see Rule 1.8(f)(2), and may not share the client's confidential information with the funder without the client's informed consent. See Rules 1.6 and 1.8(f)(3). The lawyer may not enter into the arrangement if, as a consequence, the lawyer's fee would thereby become excessive or illegal, see Rule 1.5(a), or if there is a significant risk that the lawyer's professional judgment will be adversely affected by either the funder or the lawyer's financial interest in the funding arrangement or the lawyer does not reasonably believe that the lawyer will be able to provide competent and diligent representation to each affected client. *See* Rule 1.7(a)(2) & (b).

To ensure that the funder does not improperly influence the legal representation, Paragraph (a)(4) forbids the funding entity from participating in the decision-making regarding the representation. "Participate" includes being entitled to, or attempting to, direct or otherwise control the conduct of the representation either directly or indirectly or to decide how the funding, once provided, is spent. It, however, is not intended to preclude the funder from keeping track of the representation (within the bounds permitted by Rule 1.6) and making suggestions to the lawyer and the lawyer's client with regard to tactical issues. Funders may have valuable insights and experience that they can share that will be of assistance. However, the funder may not require that its suggestions be followed. And to ensure that the client as well as the lawyer or law firm benefits from the financing arrangement, this paragraph applies only when financial assistance is provided specifically for use in the client's representation, *i.e.*, for legal fees and expenses. Thus, for example, the funds may be used to pay a portion of the fees that the lawyer would have charged the client if the matter were being handled purely on an hourly basis. Paragraph (a)(4) is not, however, intended to permit a law firm generally to finance its operations by permitting nonlawyers to share a portion of the law firm's fees or a law firm to sell an interest in its fees to investors.

b) Remarks by the Proponents of Proposal A

Proposal A imposes certain restrictions with the goal of ensuring the professional independence of lawyers. It does so to accommodate potentially beneficial funding arrangements specifically for use with respect to a legal representation of one or more clients that might otherwise constitute impermissible fee sharing with nonlawyers under subsection (a) of Rule 5.4. (Rule 1.5(g) separately restricts a lawyer from dividing a legal fee with another lawyer outside the first lawyer's firm.) The amendment is not limited in its application just to the funding of commercial litigation or just to sophisticated parties. We do not think that there is a justification for doing so or a ready way to define commercial litigation or commercial litigation funders. The amendment is not intended to allow a law firm to finance generally its operations by sharing a portion of its fees with a lender or by selling an interest in the firm to nonlawyers.

The proposed exception to Rule 5.4(a) in Proposal A is not meant to be a confirmation that any particular type of current funding arrangement is impermissible. It does, however, assume that some potential funding arrangements that lawyers and lenders may wish to contemplate would otherwise constitute the sharing of legal fees with a nonlawyer.

Proposal A provides an exception to the no-fee-sharing rule, subject to conditions, for litigation funding arrangements. The justification for such arrangements is threefold. Allowing funders to share lawyers' legal fees is potentially useful to clients as well as to lawyers. In addition, lawyers' independence can be protected less restrictively than by a complete ban on fee sharing with litigation funders. Finally, funders and lawyers are agreeing to funding structures to avoid being considered fee sharing, but those arrangements do little to benefit any of the parties involved, including clients, while distorting the economics of the funding. For example, because a funder cannot agree to accept a percentage of the fee earned by the lawyer, even if both lawyer and funder might prefer such an arrangement, lawyers are agreeing to pay a very high interest rate.

Proposal A allows for commercial financing arrangements, subject to several conditions, as follows:

First, Rule 5.4(a)(4) provides that financial assistance provided to the lawyer by a commercial funder must be "specifically [intended] for use with respect to a legal representation of one or more clients." This limitation does not appear in Proposal B. The funder may be any entity that is permitted to provide such funding in New York. There are currently no registration or filing requirements for entities providing litigation funding to lawyers in New York, but should such requirements be adopted, lawyers should only participate in funding transactions with entities that comply with these requirements. As noted, the justification for allowing lawyers to share legal fees from specific client matters with nonlawyers is, in substantial part, that clients benefit from these financing arrangements. Where the funding is to support legal work in a particular representation, a client may benefit by securing access to legal services that might otherwise be unavailable. This would not be true where, for example, the funding is intended for the law firm's purchase of a building or its provision of bonuses to its associates or is otherwise unrelated to the relevant representation. The restriction that the funds be used with respect to a legal representation is designed to ensure the client receives the benefit from these arrangements. Moreover, the exception is not intended to allow nonlawyers to have financial ownership of law firms.

Second, Rule 5.4(a)(4)(i) requires that "the [funding] entity and its representatives do not participate, directly or indirectly, in the decision-making regarding the representation." This is a prophylactic measure to protect the lawyers' professional independence. Absent this proviso, the risk is that nonlawyer funders would use their financial leverage (e.g., the express or implied threat to withhold future payments in the particular matter or to deny funding in future matters) to impose the funder's views on the lawyers and cause lawyers to conduct the representation in a manner that promotes the funder's interests, but that is inconsistent with the lawyers' best professional judgment. This provision is consistent with Rule 1.8(f)(2), which permits lawyers to receive compensation from a third party for representing a client provided, among other things, that "there is no interference with the lawyer's independent professional judgment or with the client-lawyer relationship."

Third, Rule 5.4(a)(4)(ii) requires that "the lawyer or law firm maintains professional independence." This is essentially a restatement of lawyers' obligation in all cases and, in particular, when they receive funding from a third party to conduct a representation.

Fourth, Rule 5.4(a)(4)(iii) requires that "the client provides written informed consent to the financial arrangement." This allows the client to decide whether the funding arrangement is to the client's benefit or whether its risks outweigh its benefit to the client. (Rule 1.5(g) requires client consent to fee sharing with a lawyer in another firm, essentially for the same reason, and it would be anomalous to require consent when a lawyer shares a fee with another lawyer but not with a nonlawyer.) The provision recognizes that when a law firm proposes to pledge a percentage of its fees in a matter to a commercial funder for funding for a specific representation, there are risks posed, including to the lawyer's exercise of independent professional judgment, that should not be undertaken without the client's informed consent.

Presumably, the client's informed consent would be necessary under other rules even if Rule 5.4(a)(4) did not specifically so provide. For example, the confidentiality rule, Rule 1.6, requires the client's informed consent before a lawyer discloses client confidential information (not limited to attorney-client privileged information) to a third party. Rule 1.7(a) requires a client's informed consent to a lawyer's personal-interest conflict. Rule 1.8(f) requires the client's consent when a lawyer is compensated by a third party for representing a client. All of these rules may apply to an arrangement involving fee sharing with a commercial funder.

Finally, Rule 5.4(a)(4)(iv) requires compliance with "all other applicable rules." This is axiomatic, but here, as in various other rules, it serves a useful reminder that the arrangement creates ethical complexities that may implicate other rules. Rules 1.6 (confidentiality) and 1.7 (conflicts) are specifically mentioned because they are likely to be of concern in most cases where a lawyer is going to share fees with a funder.

The proposal answers the following questions in situations that might otherwise constitute impermissible fee sharing with a nonlawyer:

- What may a lawyer receive in exchange? ["financial assistance," not goods or services]
- From whom may a lawyer or law firm receive funding? [an entity that is permitted to provide funding in New York]
- For what purposes may the lawyer receive the funding? ["specifically for use with respect to a legal representation of one or more clients"]
- What conditions govern the lawyer's relationship with the funder? [(1) those established by "other rules" and (2) the funder may "not participate in the representation"]
- What are the preconditions to entering into the funding arrangement or entering into an attorney-client representation subject to a preexisting funding arrangement? [(1) those established by "other rules" and (2) the client must give "informed consent"]

2. Proposal B

The Working Group's alternative proposal is as follows:

A lawyer or law firm shall not share legal fees with a nonlawyer, except that:

* * *

(4) a lawyer or law firm may share legal fees with an entity in exchange for the entity's providing financing for the lawyer's or law firm's practice provided that:

(i) the lawyer and law firm do not permit the entity to participate directly or indirectly in a matter except for the benefit of the client;

(ii) the lawyer and law firm do not disclose confidential client information except as Rule 1.6 may permit;

(iii) the lawyer and law firm comply with Rule 1.7; and

(iv) the lawyer or law firm informs the client in writing that they are sharing or may share fees with an entity in exchange for the entity's providing financing for the lawyer's or law firm's practice.

a) Remarks by the Proponents of Proposal B

Registration. A registration requirement was discussed. It was suggested that having such a requirement would make a Rule change more attractive if a proposal is considered by the New York Courts or New York legislature for adoption. The proponents of Proposal B believe, however, that the registration requirement could make passage more difficult because of what may be a prolonged debate about the purposes and requirements of registration.

Use of Funding. The proponents of Proposal B considered requiring that the funds be provided "specifically for use in a legal representation of one or more clients," but decided not to include such a requirement. Instead, Proposal B states that the funding must be used "for the lawyer's or law firm's practice," which still prohibits the funds from being used for purpose unrelated to client representation, but allows for funds to support generally a firm's legal infrastructure, such as new lawyers, paralegals, and investment in information technology. The rationale for this revision is that dollars are fungible so the requirement is not necessary, requiring that funds be used for certain cases may generate uncertainty and confusion, and funding is often sought for work that has already been completed. Furthermore, the funder, as the investor, has the paramount interest in how the money is spent (e.g., for the case, not office art) and can restrict its use accordingly.

Direct or Indirect Participation. The revision permits participation "for the benefit of the client." As a practical matter, Proposal B will enable funders to provide insight into case developments in ways that could enhance the likelihood of positive outcomes for the firm's clients. The word "participation" is carefully chosen to emphasize that funders may not exercise control. Under all circumstances, no participation by the funder will occur unless the lawyer believes that it is a reasonable means by which the lawyer will promote the ends of the representation.

Rules 1.6 and 1.7. Cross-references are both explicitly made to ensure that lawyers are aware of the relevant rules. The reference to Rule 1.7 ensures compliance with the conflicts rules, yet does not presume there is an inherent conflict in a lawyer or law firm receiving financing.

Client Notice. A written requirement is maintained, which may be satisfied on a prospective basis. This is not the same as informed consent, and this requirement is similar, but not identical, to the obligation imposed by Rule 1.17(c), which relates to the sale of a law practice.

b) Additional Comments Regarding Proposal B

Proposal B provides that a financing arrangement that makes a payment to a nonlawyer contingent on a lawyer successfully receiving payment for legal services is not a violation of Rule 5.4. While a number of lawyers and funders believe that such a statement is unnecessary under the current Rules of Professional Conduct, Proposal B clarifies an ambiguity in the language of Rule 5.4 identified by certain statements by ethics committees in New York and a handful of other jurisdictions.

Proposal B expressly allows a nonlawyer to share in the prospect of a success or failure of a lawyer in a matter, thus reducing ambiguity in Rule 5.4 and providing clarity to the bar. The financial arrangements permitted by Proposal B are diverse. They include (1) fixed interest recourse loans secured by all of a lawyer's assets, when the lawyer has insufficient assets to cover payment with fees generated by the lawyer's practice; (2) fixed interest non-recourse capital secured only by a lawyer's prospect of a success or failure of a lawyer in a matter or matters; and (3) the sale of a percentage share of a prospective fee earned in the event of a success by the lawyer in a matter or matters. Some of these financial arrangements, such as (2), have been deemed to be in violation of Rule 5.4 by some ethics committees but expressly permitted by Rule 5.4 by others. Some, such as (3), have been deemed to be in violation of Rule 5.4 by some ethics committees. Proposal B establishes that no difference exists among these various financial arrangements as a matter of interpretation of the revised Rule 5.4

The financial arrangements explicitly permitted by Proposal B allow lawyers to secure financing depending on the individual needs and circumstances of the lawyer. Some lawyers may prefer to forgo all forms of debt, and fund legal representation entirely from accumulated capital or demand advances from clients. Some may prefer recourse debt. Some may prefer non-recourse debt or the sale of anticipated fees.

Rule 5.4 is entitled “Professional Independence of a Lawyer”. The interpretation of the words used by the authors of the rule must be guided by reference to its purpose. As the title of Rule 5.4 reflects, the fee-sharing restriction is intended “to protect the lawyer’s professional independence of judgment.” Rule 5.4 Cmnt. [1]. Current Rule 5.4 does not prohibit all financial arrangements that may create an incentive for nonlawyers to interfere with the professional judgment of lawyers in legal matters, such as recourse loans secured by partners’ assets or liability insurance indemnification agreements, nor does the current Rule 5.4 prohibit all financial arrangements that may otherwise create an incentive for nonlawyers to engage in other objectionable conduct. The same considerations that lead to the conclusion that lawyers possess the ability to resist pressure from nonlawyers and to maintain professional independence in the face of nonlawyers incentivized to interfere with their professional judgment also lead to the conclusion that the financial arrangements permitted by Proposal B can be harmonized with the purpose of Rule 5.4.

Likewise, Proposal B implicitly acknowledges that money is fungible and that providing financing to a law firm benefits clients (whether that funding is recourse or non-recourse and whether repayment is contingent or not). The proponents of Proposal B view Proposal A’s requirement that financing be limited to “specifically for use in a legal representation” as creating unnecessary restrictions, as well as ambiguity with respect to work that has already been completed.

The proponents of Proposal B assert that it reaffirms the principle that the client’s interests are paramount. To the extent that a financial arrangement permitted by Proposal B creates an incentive for a nonlawyer to communicate with a lawyer about a client’s case, the proposal reaffirms client control by reference to Rule 1.6.

Finally, while there is no reason to presume that the financial arrangements permitted by Proposal B are in conflict with the interests of the client, Proposal B requires the lawyer to inform the client of the possibility that the lawyer may seek financial arrangements permitted by the proposal. This notice requirement allows the client the opportunity to specify, as part of the scope of representation, whether a lawyer's decision to pursue a financial arrangement permitted by Proposal B touches and concerns the representation, and if it does, whether the client wants to communicate with the lawyer about the lawyer's decision to pursue a financial arrangement, to the extent that it relates to the representation. Proposal B does not require the client to provide informed consent each and every time the lawyer secures a financial arrangement permitted by the proposal (in contrast to Proposal A). Proposal B is intended to provide that all financial arrangements permitted by the proposal should be treated equally by Rule 5.4. Since informed consent is not required when a lawyer secures a recourse loan with anticipated proceeds from a matter, the proponents of Proposal B see no reason why informed consent should be required when a lawyer secures a non-recourse loan with anticipated proceeds from a matter or sells anticipated proceeds in a matter to a nonlawyer.

The following chart sets forth the key differences in language between Proposal A and Proposal B:

Condition	Proposal A	Proposal B
Use of Funding	Funding "specifically for use with respect to a legal representation."	Funding generally "for the lawyer's or law firm's practice."
Direct or Indirect Participation of Funding Entity	No participation by entity or representative "directly or indirectly, in the decision-making regarding the representation."	No participation by entity "directly or indirectly in a matter <u>except for the benefit of the client</u>."
Client Notice	Written informed consent required: "the client provides written informed consent to the financial arrangement."	Written informed consent <u>not</u> required: "the lawyer or law firm informs the client in writing that they are sharing or may share fees with an entity in exchange for the entity's providing financing for the lawyer's or law firm's practice."
Incorporation of Other Rules	"[T]he lawyer or law firm complies with all other applicable Rules, including Rule 1.6 and Rule 1.7."	The lawyer and law firm comply with Rules 1.6 and 1.7: "the lawyer and law firm do not disclose confidential client information except as Rule 1.6 may permit" and

Condition	Proposal A	Proposal B
		"the lawyer and law firm comply with Rule 1.7."
Registration Requirement	Should New York adopt a registration or filing requirement, lawyers should borrow funds only from entities that comply with those requirements.	Not addressed at this time.

III. GUIDELINES FOR NEW YORK LAWYERS WHEN DEALING WITH LITIGATION FUNDING

A. Introduction

The Working Group examined the practices and emerging customs of the litigation funding market. The Subcommittee on Best Practices undertook a review of these issues and developed these guidelines for representing clients in the context of litigation funding, which address both the specific steps and the process to follow while engaged in a particular activity.[137] As it relates to third-party litigation funding, the focus in this section of the Report is on the necessary steps a lawyer acting as counsel to a client should take to best protect the client's interest and comply with his or her professional obligations—that is, obtaining and utilizing litigation funding to carry out the client's objectives while adhering to both the ethical and legal standards of professional conduct. Several key ethics rules are typically implicated when representing a client who receives or seeks litigation funding, including New York Rules of Professional Conduct 1.1 (Competence), 1.3 (Diligence), 1.4 (Communication), 1.6 (Confidentiality of Information), 1.7 and 1.8 (Conflicts), and 2.1 (Advisor). In addition, lawyers representing such a client must make sure to discharge their fiduciary duties and responsibilities, including those set out under applicable agency law.

The role of the lawyer or law firm may be any of the following: counsel to the client seeking funding; counsel to a law firm seeking funding; counsel to the client in the underlying litigation; counsel to the client in the underlying litigation and counsel for the client in obtaining litigation funding; or any of the aforementioned roles on behalf of multiple clients.[138] Depending on the lawyer's role, these guidelines require that the lawyer should (1) possess the required competence—understanding the varying structures of the agreement and other areas of law affecting the litigation funding agreements; (2) act with diligence and perform the required inquiries to represent the client effectively—*i.e.*, understanding the terms of the agreements; (3) communicate relevant information and alternatives to the client before and during the litigation and protect the client's confidence; and (4) as the fiduciary, act to protect the client's best interest and property. Following these steps will help ensure compliance with the lawyer's ethical and

[137] The Working Group extends its appreciation to Brian Hooven, associate at Proskauer Rose LLP, for his assistance to the Subcommittee on Best Practices.

[138] These guidelines do not purport to address situations where a lawyer is acting as counsel to a litigation funder.

legal professional obligations and is the best way for participants to avoid or minimize undesirable surprises in litigation financing.

Counsel are reminded to check the applicable rules relating to the relevant jurisdiction(s) in which they practice to ensure the guidelines are consistent with those rules. This Report does not purport to interpret or provide definitive guidance on the application of specific ethics rules to particular attorney conduct. In addition, this Report does not reflect the formal view of the City Bar as to whether any specific scenario discussed below complies with or violates the Rules of Professional Conduct.

B. Competence

A lawyer whose client seeks third party litigation funding should determine at the outset whether he or she has the transactional experience and sophistication required to negotiate a beneficial agreement with the funder or whether a specialist in the field should be involved. If the lawyer acts as counsel to the client regarding the funding relationship, the lawyer should ensure that he or she is adequately familiar with litigation financing transactions in general so as to provide competent representation as required under Rule 1.1 of the New York Rules of Professional Conduct. This competence includes familiarity with New York law surrounding champerty, maintenance, barratry, usury, professional responsibilities, privileges against disclosure and the work product doctrine, and Article 9 of the Uniform Commercial Code. Additionally, familiarity with various litigation financing structures may be necessary to develop competence in litigation financing, depending on the engagement for which the attorney is retained. For example, structures may depend on the type of collateral, such as:

a. single case financing—the litigant enters into a litigation funding agreement with the litigation funder regarding a lawsuit, in which the litigant may be either the plaintiff or defendant;

b. multi-case financing—the litigant enters into a litigation funding agreement with the litigation funder on a portfolio basis for multiple cases, in which the litigant may be either plaintiff, defendant, or both;

c. appellate financing—the litigant enters into a litigation funding agreement with the litigation funder after a judgment or verdict has been reached for purposes of pursuing the appeal, where the litigant may be either the appellant, appellee, or both; and

d. post-judgment financing—the litigation funder purchases a portion of an uncollected judgment.

In addition, structures may involve different means of financing legal fees, such as:

a. full-case financing—the litigation funder advances the full amount of legal costs and the lawyer is compensated on a fixed or hourly basis;

b. hybrid-contingency financing—the litigation funder advances a partial amount of the legal costs, and the lawyer is compensated partially on a fixed or hourly basis and partially on a contingency basis;

c. disbursement and expense financing—the litigation funder advances only costs and disbursements, and the lawyer is compensated on a full contingency basis; and

d. monetization/working capital financing—the litigation funder advances capital to the litigant for a use other than the payment of legal fees.

The manner in which funding is disbursed may also vary, such as:

a. drip financing—the funded amount is disbursed as needed or in tranches to cover specified costs or expenses; and

b. up-front financing—the funded amount is disbursed as a lump sum payment to cover specified costs or expenses.

Finally, the return structure of the financing may vary, such as:

a. fixed-return financing—the litigation funder receives a fixed multiple of its investment in the event of a successful outcome, after repayment of the funded amount;

b. variable-return financing—the litigation funder receives a fixed percentage of any judgment, typically after repayment of the funded amount;

c. scaled-return financing—the multiple or percentage used to calculate the litigation funder's return depends upon either the amount that has been funded or the duration of the investment; and

d. hybrid-return financing—the litigation funder receives either the greater of, or lesser of, a fixed-return, variable return, scaled return, or other return metric.

C. Diligence

In addition to the requirement to act with reasonable diligence in accordance with Rule 1.3, a lawyer considering a litigation funding agreement may also need to conduct a reasonable inquiry into the funder and the terms being offered. Unlike commodity transactions driven solely by price, litigation financing sources and terms are critically important factors that must be considered carefully. The lawyer should have clarity with the client as to whether the lawyer will perform duties related to this due diligence.

As the popularity of litigation funding has expanded,[139] the number of players in the market has proliferated, and some have even failed.[140] No national regulatory body ensures a financed party that a given litigation funder will meet its obligations to a financed party, either through insurance or other means.[141] Given the lack of a comprehensive and consistent regulatory framework, the best means for a financed party to protect himself or herself is through choosing with whom to do business and under what contractual terms.

1. Selecting a Funder

If the lawyer and client have agreed that the lawyer will assist with due diligence on the funder, key factors to consider relating to the funder include the general financial stability of the funder; how much capital the funder has and how much is dedicated to litigation funding; the funder's history and reputation; and the financial and contractual terms the funder is offering.

A useful checklist of diligence items can be found in a report prepared by a Task Force of the International Council for Commercial Arbitration and Queen Mary University relating to Litigation Finance in International Arbitration (the "Queen Mary Report").[142] The Queen Mary Report checklist includes inquiring as to whether the funder is publicly listed, how it is regulated, how it is set up, how it manages conflicts and what are its compliance policies and procedures. Other important considerations are whether the funder has experience with matters in the relevant

[139] *See, e.g.*, Paul Barrett, *The Business of Litigation Finance Is Booming*, BLOOMBERG BUSINESSWEEK (May 30, 2017, 4:00 AM), https://www.bloomberg.com/news/articles/2017-05-30/the-business-of-litigation-finance- is-booming; Elizabeth Olson, *Lack of Capital to Lead Law Firms to Seek Help*, *Survey Finds*, N.Y. TIMES (May 3, 2016), https://www.nytimes.com/2016/05/04/business/dealbook/lack-of-capital-to-lead-law-firms-to-seek-help-survey-finds.html.

[140] *See, e.g.*, Jennifer Smith, *Litigation Finance Firm Black Robe Shuts Down*, WALL STREET J. (May 14, 2013), https://www.wsj.com/articles/SB10001424127887324031404578483492868041194.

[141] *See Third-Party Litigation Funding in U.S. Enters Mainstream, Leading to Calls for Reform*, FINANCIER WORLDWIDE (Nov. 2016), https://www.financierworldwide.com/third-party-litigation-funding-in-us-enters-mainstream-leading-to-calls-for-reform#.XbhjJehKi70; Victoria Sahani, *Harmonizing Third-Party Litigation Funding Regulation*, 36 CARDOZO L.R. 861 (2015). *See also* Jasminka Kalajdzic et al., *Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding*, 61 AM. J. COMP. L. 93, 109 (2013).

[142] INT'L COUNCIL FOR COMMERCIAL ARBITRATION, REPORT OF THE ICCA-QUEEN MARY TASK FORCE ON THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION 196 (2018). The Queen Mary Report is the project of an international group of arbitration lawyers working under the auspices of an English institution.

area(s) of law and whether the funder is providing the capital itself or acting as a broker on behalf of others.

In a jurisdiction where discovery may be permitted into the existence of the funding arrangement, and the adversary may find out who is funding the opposition's case, the reputation of the funder may be important. A litigation opponent seeking to establish what the case is "worth" for settlement purposes, for example, may seek the identity of a funder of the other party, though disclosure of the identity of the funder alone may not be very meaningful and may simply reflect which funder offered the terms most favorable to the borrower.

2. Contract Terms

The terms of the litigation funding agreement should be carefully reviewed and fully understood by the lawyer and client before execution. The litigation funding agreement should be written in clear, concise, and plain English, be structured as a non-recourse transaction, and should specify:

- how the litigation funder's and law firm's remuneration is to be calculated;
- the funded amount;
- how the funded amount will be disbursed;
- what restrictions, if any, will be placed on the use of the disbursed funds;
- the allocation of costs and expenses;
- what is to be done if the litigation costs exceed the funded amount before resolution;
- the circumstances under which each party can terminate the agreement, and the consequences of termination;
- the role of the litigation funder in the decision-making process;
- under what circumstances the financing becomes recourse (such as breach of representations and warranties);
- how litigation proceeds are received, allocated, and distributed;
- the rights that the litigation funder has to be consulted regarding settlement decisions or otherwise; and
- a procedure for resolving any disputes that may arise during the course of the funding relationship.

The Queen Mary Report provides helpful guidance on these items, including looking at the specifics of the funding contract, such as the extent of the funding, the rigidity of the budget, how money can be spent, how confidentiality and control over the litigation are addressed, exactly what costs the funder will bear and how disputes are to be resolved.[143] It is also important to consider how recoveries (and in particular outsized recoveries) are to be distributed, how interests between the funder and the financed party are aligned (*e.g.*, where the funder's return is on a priority basis, certain settlement paths may become untenable), who controls the ability to change counsel, and how access to confidential information and substantive communications are handled.

In the United States, because each state may approach litigation funding differently, the lawyer should also determine how the controlling jurisdiction deals with common litigation funding issues. Complex questions, including those relating to disclosure, champerty, fee-splitting, and the protection of attorney-client privilege, may require significant research of jurisdiction-specific law. A lawyer providing advice on these issues may also need to consider the tax implications and tax treatment of litigation funding.

D. Communication and Confidentiality

A lawyer who is representing a client for the purposes of the client obtaining funding has an obligation to communicate with his or her client in accordance with Rule 1.4. The lawyer should inform the client of the benefits, risks, and possible alternatives to the contemplated litigation funding agreement.

A lawyer representing a client in a funded litigation should communicate with the funder in a manner that will maintain the attorney-client privilege and/or work product protections, comport with the lawyer's confidentiality duties under Rule 1.6 and under agency law, and comply with protective orders. There should be a clear agreement between the funder and the lawyer regarding the manner and extent of communication. A non-disclosure agreement should be executed at the outset of the negotiations and before any non-public information is shared. There also should be careful consideration of the risks of any information sharing after the non-disclosure agreement is signed, including whether sharing information protected by the work product doctrine is appropriate, and whether there are any protective orders or other applicable considerations. An attorney should carefully consider whether he or she can share attorney-client communications with the litigation funder and discuss the issue with the client, including whether such communication could be deemed a waiver of the attorney-client privilege.

[143] *Id.*

E. Fiduciary Duties and Conflicts

Typically, a litigation funder does not have fiduciary duties to a financed party. Accordingly, the profit motive of the funder may trump the interest of a particular financed party in a particular situation.[144] Nonetheless, a lawyer representing a client should not allow his or her interest, or that of the funder, to override the interest of the client. The lawyer is the client's fiduciary and agent who owes his or her client undivided loyalty and is forbidden from putting her interest or that of another above the interest of the client. Further, a New York lawyer has a duty to "exercise independent professional judgment and render candid advice."[145] These duties, along with other professional obligations to the client, such as those stemming from agency law principles, demand freedom from interference with the attorney-client relationship by the funder. These principles similarly require limitations on the rights of the funder so that the attorney can guard against the funder having control over litigation strategy or settlement decisions.

A lawyer representing a litigant who either has entered into a litigation funding agreement or is seeking to enter into one should clearly delineate the scope of the lawyer's retention to clarify the limitations of the representation, if any.

1. Client's Best Interest and Lawyer Independence

A lawyer who agrees with a client to assist with due diligence in obtaining funding must always act in the best interest of the client. How a putative litigation funding agreement would compare to what others in the market might provide (as well as relative to other types of funding potentially available, such as recourse lending) is an essential factor in determining whether to proceed with a particular funder. It is imperative, however, that counsel also ensure that the financed party understands the non-price terms and conditions of a contemplated financing arrangement. With respect to both price and non-price terms, it can be difficult for counsel to determine what "market" terms are because of the opacity of most litigation financing arrangements and the infrequency with which disputes between funders and financed parties are

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[144] *See* Carol Langford, *Betting on the Client: Alternative Litigation Funding is an Ethically Risky Proposition for Attorneys and Clients*, 49 U.S.F. L. REV. 237, 245 (2015) ("In order to maximize its return, a third-party litigation funder may object to steps that would benefit the client if it would either reduce the potential award or settlement amount, or increase litigation costs and diminish the available profit margin."); *see also* A.B.A COMM'N ON ETHICS 20/20 INFORMAL REPORT TO THE HOUSE OF DELEGATES, White Paper on Alternative Litigation Finance, 22 (Feb. 2002).

[145] N.Y. RULES OF PROF'L CONDUCT R. 2.1.

litigated, rather than arbitrated.[146] Getting competitive quotes and contemplated terms from more than one funder may be the best way to assess what is "market." Accordingly, a lawyer should think carefully about whether to abide by a funder's request to have an "exclusive" opportunity with respect to a potential deal before the element of competition can be introduced. However, a lawyer should also balance a desire to make competitive comparisons with a client's desire to close a transaction quickly, or reduce transaction costs associated with legal representation beyond the actual negotiation of the contract.

The lawyer in this situation must also take care to have the client's best interests as the guidepost. Ethics committees have commented on the lawyer's obligation not to pursue his or her own self-interests or the funder's interests when assisting with the negotiation of and operating under a litigation funding contract.[147]

2. Protecting the Client's Property

If a dispute arises between the client and the funder and the client objects to the disbursement of any portion of the proceeds claimed by the funder, the lawyer should withhold payment to the funder and retain that portion of the funds in his or her dedicated client escrow account. Alternatively, the parties may elect to use a third-party escrow account at the inception of a litigation funding transaction. That portion of the funds should not be disbursed in the absence of written informed consent of the client or a final order of a competent court. The lawyer must at all times act in accordance with that lawyer's obligations under N.Y. Rules of Prof'l Conduct R. 1.15. In a proceeding before a tribunal to resolve a dispute, neither the lawyer nor his firm should represent the client if the lawyer is to be called as a witness on a significant issue on behalf of the

[146] *See, e.g.*, Maya Steinitz & Abigail C. Field, *A Model Litigation Finance Contract*, 99 IOWA L. REV. 711, 719 (2014) ("[L]itigation financing contracts are confidential, and only in litigation have a few come to light.").

[147] "Litigation Financing; Conflicts of Interest," New York State Bar Association Committee on Professional Ethics, Op. 1145 (Mar. 7, 2018); "Financing Legal Fees in Litigation, Third-Party Funding," State of New York State Ethics Commission, Op. No. 1108 (Nov. 15, 2016); "Third-Party Litigation Financing," The Association of the Bar of the City of New York Committee on Professional and Judicial Ethics, No. 2011-2 (June 15, 2011); "Representing Client in Transaction with Entity Proposing to Lend Against Litigation Proceeds," New York State Bar Association Committee on Professional Ethics, Op. 769 (Nov. 4, 2003); "Conflict of Interest; Maintenance; Referring Client to Institution That Will Lend Money for Living Expenses Contingent on Resolution of Personal Injury Claim," New York State Bar Association Committee on Professional Ethics, Op. 666 (Mar. 6, 1994).

client, and it is apparent that the testimony may be prejudicial to the client contrary to Rule 3.7(b)[148] or otherwise if the lawyer is precluded from doing so by Rules 1.7[149] or 1.9.[150]

Finally, when any of proceeds from the matter are paid to the funder, the lawyer should ensure that a written acknowledgment of receipt of funds is given by the funder.

3. Conflicts of Interest

A lawyer must also be aware of the potential for conflicts of interest when advising a client who has, or is seeking litigation financing.[151] For instance, conflicts may arise where the lawyer is advising a client who would not otherwise be able to commence, or continue, litigation absent a third party advancing the lawyer's fees. In this instance, the lawyer should ensure to comply with his or her responsibilities under Rules 1.7 and 1.8.[152] Lawyers must also remain apprised of whether they, or any attorney in their firm, has a financial interest in a funder that is advancing money to the lawyer's client. Such investments may prohibit that lawyer from continuing to represent that particular client.[153] Furthermore, depending on the structure of the lawyer's compensation agreement, the lawyer must be sure to abide by the requirements of Rule 1.8(a).[154] These are only several examples of potential conflicts that may arise when advising clients seeking or employing litigation financing, and lawyers representing such clients must stay apprised of current developments.[155]

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[148] "A lawyer may not act as advocate before a tribunal in a matter if . . . another lawyer in the lawyer's firm is likely to be called as a witness on a significant issue other than on behalf of the client, and it is apparent that the testimony may be prejudicial." N.Y. RULES OF PROF'L CONDUCT R. 3.7(b).

[149] "Except as provided in paragraph (b), a lawyer shall not represent a client if a reasonable lawyer would conclude that either: (1) the representation will involve the lawyer in representing differing interests; or (2) there is a significant risk that the lawyer's professional judgment . . . will be adversely affected by the lawyer's own financial . . . interests." *Id*. at R. 1.7.

[150] "A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent." *Id*. at R. 1.9.

[151] A lawyer must also consider the potential for conflicts if he or she is representing a client who is seeking financing and is also representing that client in the underlying litigation. *See, e.g.*, NYSBA Op. 769 (2003).

[152] *See, e.g.,* NYC Op. 2011-2 (2011); NYSBA Op. 1108 (2016).

[153] *See, e.g.,* NYSBA Op. 1145 (2018).

[154] *See, e.g.,* NYSBA Op. 1051 (2015).

[155] *See e.g.*, Mary Ellen Egan, *Other People's Money*: *Rise of Litigation Finance Companies Raises Legal and Ethical Concerns*, ABA JOURNAL (Dec. 1, 2018 12: 05 AM)

F. Conclusion

Third-party litigation funding can serve to advance the objectives of clients, facilitate the smooth operations of law firms, and offer an attractive investment option for funders. Lawyers following the guidelines outlined above will be more informed and better prepared when utilizing third-party litigation funding, protecting their clients' interests and complying with their professional obligations.

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http://www.abajournal.com/magazine/article/litigation_finance_legal_ethical_concerns (explaining difficulties and potential benefits presented by litigation finance); Roomy Khan, *Institutionalize Litigation Funding: Ethics Rules Need to Be Reviewed, Clarified and Legislated*, FORBES (Aug. 2, 2019, 2:24 PM), https://www.forbes.com/sites/roomykhan/2019/08/02/institutionalize-litigation-funding-ethics-rules-need-to-be-reviewed-clarified-and-legislated/#3a1d9157d797 (calling for legislation to address "existing murky environment" of litigation finance).

IV. DISCLOSURE OF COMMERCIAL LITIGATION FUNDING

A. Introduction

The disclosure of commercial litigation funding has been a well-publicized topic of debate in recent years. The debate specifically concerns whether, and to what extent, a party's receipt of litigation funding must be disclosed to courts, arbitrators, and adversaries.

As commercial litigation funding has become more mainstream, a body of rules, regulations, and case law has developed governing disclosure. Nevertheless, the framework is far from settled, leaving significant gray areas open for discussion by parties, special interests, and industry commentators.

The Subcommittee on Disclosure studied various facets of the disclosure debate and developed this discussion and analysis. *First*, we provide an overview of the policies, statutes, rules, regulations, and case law governing disclosure in federal and state courts. *Second*, we present arguments commonly made in support of and against disclosure in federal and state courts. *Third*, we discuss special considerations in the class action and multi-district litigation ("MDL") context. *Fourth*, we discuss special considerations in the international arbitration context. *Finally*, in light of the developing state of the law, we present the Working Group's recommendations regarding disclosure.[156]

B. Legal framework

1. Overview

The legal framework concerning disclosure has developed through federal and state policymaking, requirements set by the judiciary and case law.

From a policy-making perspective, disclosure rules are still nascent and have been adopted only to a limited degree or in response to specifically-identified needs, such as to inform judicial recusal and disqualification decisions. While there have been proposals and calls for increased disclosure—with many states adopting rules and guidance for litigation funding in other contexts—mandatory disclosure has yet to gain traction outside of the only state to adopt such rules, Wisconsin.

[156] While this Section focuses on disclosure of commercial litigation funding, we note that many of the principles discussed here also are relevant to consumer litigation funding.

Within the judiciary, disclosure rules vary. Under their respective local rules or pursuant to other similar limitations, approximately six federal appellate courts and twenty-four district courts currently mandate some form of disclosure that may require revealing the identity of the litigation funder (in the context of disclosing interested parties for judicial conflict-of-interest purposes). Based upon our review, it does not appear, however, that the civil or local rules of any state court require such disclosures. And no court appears to require disclosure of the litigation funding agreement itself. Indeed, courts generally do not require disclosure of litigation funding agreements (or even other litigation funding information in jurisdictions that do not have such local rules). Courts have generally justified withholding this information as irrelevant or protected by the work product doctrine.

As a point of comparison from the international perspective, common law jurisdictions like Australia and England and Wales generally do not require disclosure of litigation funding, subject to limited exceptions, such as in the class action context (Australia) or where special circumstances warrant.

2. Policy-Making at the Federal and State Levels

Congress has considered but has not, as of this time, adopted legislation that would require disclosure in federal court of third-party funding arrangements. While several states have considered funding disclosure rules, only Wisconsin has adopted such rules.

a) Federal Proposals Regarding Disclosure

No mandatory disclosure rules have been adopted at the federal level. Led primarily by the U.S. Chamber of Commerce and several members of Congress, there is a push in Congress to adopt such rules. The rationale advanced for disclosure is transparency and fairness.

On February 13, 2019, several senators reintroduced a bill, initially proposed in 2018, titled the "Litigation Funding Transparency Act of 2019."[157] The proposal is backed by the U.S. Chamber of Commerce, large companies who are more typically defendants than plaintiffs, and others.[158] If passed, the law would require automatic disclosure of third-party litigation funding

[157] S. 471, 116th Cong. (2019). *See also* discussion, *supra* at 19.

[158] *See* Emma Cueto, *Sens. Reintroduce Litigation Funding Transparency Bill*, LAW360 (Feb. 14, 2019, 5:52 PM), https://www.law360.com/articles/1129037/sens-reintroduce-litigation-funding-transparency-bill (describing the litigation funding transparency bill and its supporters).

agreements, and any third parties that have "a right to receive payment that is contingent on the receipt of monetary relief," in any class or multi-district litigations unless otherwise ordered by the court.[159] The law would give courts discretion to order partial disclosure, including the redaction of sensitive, proprietary, or privileged information, or even to block disclosure entirely. The bill remains in committee.

In addition, since June 1, 2017, the Advisory Committee on Federal Civil Rules has been considering a proposal to amend Fed. R. Civ. P. 26(a)(1)(A) to require disclosure of all litigation funding agreements.[160] This proposal has been supported by a group of major companies, including AT&T, Chevron, Verizon, Google, Merck, and Comcast.[161] The group analogizes plaintiff-side litigation funding to defense-side insurance agreements that must be disclosed under Fed. R. Civ. P. 26(a)(1)(A).[162] The group also argues that funders become real parties in interest and, moreover, that litigation funding arrangements inform the relative resources of the parties, which has relevance to the proportionality of discovery. One district court has rejected these purported justifications for discovery of funding arrangements, concluding that such agreements do not resemble insurance or indemnity contracts.[163] Most recently, in June of 2019, the Advisory Committee proposed various amendments to federal civil disclosure requirements, but deferred, pending further consideration, making any proposals regarding litigation funding.[164] The Committee stated:

> The MDL Subcommittee continues to study third-party litigation funding (TPLF), including various proposals for disclosure. All that is clear at the moment is that the underlying phenomena that might be characterized as third-party funding are highly variable and often complex. They continue to evolve at a rapid pace as large third-party funders expand dramatically. It seems clear that more study will be required to determine whether a useful disclosure rule could be developed. Nor does it seem likely that the several advisory committees will soon be in a position

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[159] S. 471, 116th Cong. (2019).

[160] Letter from Lisa A. Rickard et al., President, U.S. Chamber Institute for Legal Reform, to Rebecca A. Womeldorf, Secretary of the Committee on Rules of Practice and Procedure of the Administrative Offices of the United States Courts, (June 1, 2017), available at https://www.uscourts.gov/sites/default/files/17-cv-o-suggestion_ilr_et_al_0.pdf.

[161] Letter from Brackett B. Denniston et al., to Rebecca A. Womeldorf, Secretary of the Committee on Rules of Practice and Procedure of the Administrative Offices of the United States Courts, (January 31, 2019), available at https://www.instituteforlegalreform.com/uploads/sites/1/TPLF_letter_1.31.19.pdf.

[162] *Id.*

[163] *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711, 728-30 (N.D. Ill. 2014).

[164] *See* US Orders 2019-46.

to frame possible expansions of disclosure requirements designed to support better-informed recusal decisions.[165]

b) State Policy-Making Approaches

As at the federal level, policy-making at the state level is still at an early stage. In 2018, Wisconsin became the first state to enact mandatory disclosure rules.[166] The law requires the disclosure of litigation funding agreements in any civil action, "unless otherwise stipulated or ordered by the court."[167] The law includes a carveout for contingency-fee arrangements with lawyers, which need not be disclosed.[168]

Other states have not followed Wisconsin, although legislation remains pending in some jurisdictions. Illinois, for example, considered disclosure rules, but thus far has yet to adopt any.[169] In addition, an attempt to mandate disclosure in Texas recently failed.[170] Although litigation funding has received recent media coverage, that attention has not translated to rules regulating disclosure. Indeed, although around half of the State bars in the country have issued ethics opinions related to litigation funding, none has squarely addressed disclosure.[171]

(1) Local Court Rules, Orders, and Procedures

Approximately half of federal circuit courts[172] and one-quarter of federal district courts[173] require the disclosure of outside parties with a financial interest in the outcome of a litigation.

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[165] *Id.*

[166] *See* 2017 Wisconsin Act 235.

[167] *Id.* at § 12.

[168] *Id.*

[169] *See* John Sammon, *Illinois Unlikely to Copy Wisconsin on Third-Party Litigation Financing Disclosure Law, Observers Say*, COOK CTY. RECORD (Apr. 26, 2018), https://cookcountyrecord.com/stories/511396249-illinois-unlikely-to-copy-wisconsin-on-third-party-litigation-financing-disclosure-law-observers-say (noting that "[t]here have been numerous attempts to enact reforms in litigation financing in Illinois . . . [which] rarely get[] a hearing, let alone a vote").

[170] *See Texas Legislature Online History*, TEXAS LEGISLATURE, https://capitol.texas.gov/BillLookup/History.aspx?LegSess=86R&Bill=SB1567 (last visited Oct. 30, 2019) (showing that bill has remained in committee for over seven months).

[171] *See e.g.*, N.Y. CITY BAR ASSOC. COMM. ON PROF'L ETHICS, Formal Op. 2018-5 (2018).

[172] *See* 3d Cir. L. R. 26.1.1(b); 4th Cir. L. R. 26.1(2)(B); 5th Cir. L. R. 28.2.1; 6th Cir. L. R. 26.1(b)(2); 10th Cir. L. R. 46.1(D); 11th Cir. L. R. 26.1-1(a)(1); 11th Cir. L. R. 26.1-2(a).

[173] *See* Ariz. Form - Corporate Disclosure Statement; C.D. Cal. L. R. 7.1-1; N.D. Cal. L. R. 3-15, Standing Order for All Judges of the N.D. Cal.; M.D. Fla. Interested Persons Order for Civil Cases (does not apply to all judges); N.D. Ga. L.R. 3.3; S.D. Ga. L. R. 7.1; N.D. Iowa L. R. 7.1; S.D. Iowa L. R. 7.1; Md. L. R. 103.3(b); E.D. Mich. L. R. 83.4; W.D. Mich. Form – Corporate Disclosure Statement; Neb. Form – Corporate Disclosure Statement; Nev. L. R. 7.1-1;

Specifically, approximately thirty federal courts—six appellate courts and twenty-four district courts—have adopted such local rules. Because litigation funding involves a non-party's financial interest in the outcome of litigation, such rules may contemplate disclosure of litigation funding. The proffered justification for the disclosure is to enable judges to assess conflicts that bear on recusal and disqualification.[174] The rules do not generally target litigation funding specifically; instead, the rules—which typically expand upon Rule 7.1 of the Federal Rules of Civil Procedure ("FRCP")—generally require disclosures of information regarding non-party financial interests in litigation. Accordingly, while certain courts (and individual judge's rules) may mandate disclosure of the identity of a litigation funder, disclosure of details concerning funding arrangements is not required. With the exception of Wisconsin, the Working Group is not aware of any state court that has adopted rules that would require disclosure of litigation funding.

The six federal appellate courts that may require disclosure do so under supplemental local rules to Federal Rule of Appellate Procedure 26.1, which governs corporate disclosure statements. For example, the Fifth Circuit generally requires identification of "all persons" or "other legal entities" that "are financially interested in the outcome of the litigation."[175] The Third Circuit goes a step further than the simple identification required by courts like the Fifth Circuit; it requires in addition "a description of the financial interest."[176] But the Third Circuit mandates that such disclosures be made only where a publicly-traded corporation has the financial interest. This limitation reflects that the local rule is designed to identify a judge's conflicts of interest.

Required disclosures in the district courts that have adopted such rules or procedures are similar: to the extent they require disclosure, the disclosure is limited to identifying information about the third-party funder. The most comprehensive disclosure requirement appears to be that of the Northern District of California, which directs in its local rules disclosure of any person or

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E.D. N.C. L. R. 7.3; M.D. N.C. Form – Disclosure of Corporate Affiliations; W.D. N.C. Form – Entities with a Direct Financial Interest in Litigation; N.D. Ohio L. Civ. R. 3.13(b); S.D. Ohio L. R. 7.1.1; E.D. Okla. Form – Corporate Disclosure Statement; N.D. Okla. Form – Corporate Disclosure Statement; N.D. Tex. L. R. 3.1.(c), 3.2(e), 7.4; W.D. Va. (Form – Disclosure of Corporate Affiliations and Other Entities with a Direct Financial Interest in Litigation); W.D. Wis. (Form – Disclosure of Corporate Affiliations and Financial Interest).

[174] *See, e.g.,* C.D. Cal. L.R. 7.1-1 (instituting disclosure requirements "[t]o enable the Court to evaluate possible disqualification or recusal"); 5th Cir. L. R. 28.2.1 ("The certificate of interested persons provides the court with additional information concerning parties whose participation in a case may raise a recusal issue.").

[175] 5th Cir. L. R. 28.2.1

[176] 3rd Cir. L. R. 26.1.1

entity that has “a financial interest of any kind in the subject matter in controversy or in a party to the proceeding.”[177] The Northern District of California considered adopting local rules that specifically referenced “litigation funders,” but ultimately decided against doing so after one litigation funder argued express reference to litigation funders was unnecessary because the local rule as written already required litigation funding disclosures. Other courts contemplate disclosure by interrogatory,[178] within a corporate disclosure statement form,[179] by standing order,[180] or in individual judicial rules and practices.[181]

(2) Case Law

The majority of courts that have considered disclosure have concluded that production of identifying information (in jurisdictions that do not have local rules or procedures otherwise requiring disclosure) is not warranted because the information is irrelevant or protected by a privilege. A significant number of courts have similarly concluded that the underlying litigation funding agreement need not be produced in the ordinary course for the same reasons. Indeed, disclosure has generally been required only upon a showing of exceptional circumstances or that the litigation funding agreement is material to the dispute. Notably, New York courts have had little occasion to decide issues of disclosure, and accordingly, the vast majority of guidance is federal in origin.

c) Relevance

Numerous courts have concluded that absent a showing of special circumstances, the existence of litigation funding, the identity of the funder, and details of the underlying arrangement

[177] N.D. Cal. L. R. 3-15.

[178] W.D. Tex. L. R. CV-33 (providing that court will not consider objection to following interrogatory except in “exceptional circumstances”: “If there is a publicly owned corporation or a holding company not a party to the case that has a financial interest in the outcome, list the identity of such corporation and the nature of the financial interest.”).

[179] U.S. District Court for the District of Arizona, Corporate Disclosure Statement Form (requiring party to list identity of any “[p]ublicly held corporation, not a party to the case, with a financial interest in the outcome” and “the nature of the financial interest”).

[180] N.D. Cal. Standing Order on the Contents of Joint Case Management System (effective Nov. 1, 2018).

[181] *See, e.g.*, N.D. Ga. L. R. 3.3 (requiring disclosure of “a financial interest in or other interest which could be substantially affected by the outcome of this particular case”).

are irrelevant and not discoverable.[182] At least one case has extended this reasoning to the class action context, where the assertion of relevance relates to purported bias, ability to prosecute the litigation, or some collateral matter. *Kaplan v. S.A.C. Capital Advisors, L.P.*,[183] a case that arose in the class action context, is illustrative. There, defendants moved to compel litigation funding disclosures, including of the underlying agreement, to discover potential conflicts, to ensure that plaintiff would be an adequate class representative under FRCP 23(a)(4), and to ensure that counsel would have adequate financial resources to prosecute the case under FRCP 23(g).[184] The court rejected the request for discovery as purely speculative and irrelevant to class certification because class counsel was "advancing the costs of the litigation"—meaning the adequacy of the underlying plaintiffs to fund the litigation was irrelevant—and there was no basis to conclude that counsel could not prosecute the litigation in light of the representation that it had "sufficient resources to see the case through to trial and appeal, if need be."[185]

In *Miller UK Ltd. v. Caterpillar, Inc.*[186]—a non-class action case—the court, following a comprehensive analysis, also denied a motion to compel production of the litigation funding agreement as irrelevant. First, the court found that the agreement was not relevant to any defense, such as champerty.[187] Second, the court rejected the argument that a funding agreement is analogous to an insurance agreement because the funder is not a real party in interest and, in

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[182] *See, e.g.*, *Pipkin v. Acumen*, No. 1:18-cv-00113-HCN-PMW, 2019 WL 6324633, at *1 (D. Utah Nov. 26, 2019); *In re Valsartan N-Nitrosodimethylamine (NDMA) Contamination Prods. Liab. Litig.*, No. 19-2875 (RBK/JS), 2019 WL 4485702 (D.N.J. Sep. 18, 2019); *Hybrid Athletics, LLC v. Hylete, LLC*, No. 3:17-cv-1767 (VAB), 2019 WL 4127377, *11 (D. Conn. Aug. 30, 2019); *MLC Intellectual Property, LLC v. Micron Technology, Inc.*, No. 14-cv-03657-SI, 2019 WL 118595 (N.D. Cal. Jan. 7, 2019); *Benitez v. Lopez*, 2019 WL 1578167, 17-CV-3827-SJ-SJB (E.D.N.Y. March 14, 2019); *Mackenzie Architects PC v. VLG Real Estate Developers LLC*, No. 1:15-cv-1105, 2017 WL 4898743, at *3 (N.D.N.Y. March 3, 2017); *VHT, Inc. v. Zillow Group, Inc.*, No. C15-1096JLR, 2016 WL 7077235, at *1 (W.D. Wash. Sept. 8, 2016); *Ashghari-Kamrani v. United Services Automobile Assn.*, No. 2:15-CV-478, 2016 WL 11642670, at *14–15 (E.D. Va. May 31, 2016); *Kaplan v. S.A.C. Capital Advisors, L.P.*, No. 12-CV-9350, 2015 WL 5730101 (S.D.N.Y. 2015); *Yousefi v. Delta Elec. Motors, Inc.*, No. 13-CV-1632, 2015 WL 11217257, at *2 (W.D. Wash. May 11, 2015); *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711, 721 (N.D. Ill. 2014).

[183] No. 12-cv-9350 VM KNF, 2015 WL 5730101 (S.D.N.Y. Sept. 10, 2015).

[184] *Id.* at *3.

[185] *Id.* at *3-5; *cf. Piazza v. First Am. Title Ins. Co.*, No. 3:06CV765AWT, 2007 WL 4287469, at *1 (D. Conn. Dec. 5, 2007) ("[F]ee arrangements between a plaintiff and her counsel are not relevant to certification issues."). *But see Gbarabe v. Chevron Corp.*, No. 14-cv-00173-IS, Dkt. No. 159, 2016 WL 4154849, at *3 (N.D. Cal. Aug. 5, 2016) (concluding production warranted for adequacy purposes where counsel consisted of solo practitioners that conceded relevance to class certification and did not assert privilege).

[186] 17 F. Supp. 3d 711, 724 (N.D. Ill. 2014).

[187] *Id.* at 724–28.

contrast to an insurer, has no right of subrogation, meaning the funder cannot satisfy a claim or take control of a litigation.[188] Other courts have rejected disclosure for similar reasons.[189]

Recent instances of courts addressing disclosure are *Hybrid Athletics, LLC v. Hylete, LLC*[190] and *Benitez v. Lopez*.[191] In *Hybrid Athletics*, the United States District Court for the District of Connecticut granted in part a motion to quash a subpoena seeking litigation funding information, stating that "the Court fails to see what meaningful purpose litigation financing or fee related discovery would reveal at this time that would be relevant or proportional to the claims in this case."[192] In *Benitez*, the United States District Court for the Eastern District of New York denied the defendants' motion to compel documents concerning the plaintiff's litigation funding.[193] The court held that the defendants failed to establish the relevance of the documents, despite defendants' arguments that they could bear on credibility or motives. The court also rejected the defendants' argument that the possibility of funder control was relevant.[194]

Courts where local rules or procedures require disclosure of identifying litigation funding information have, as a general matter, not required disclosure of the underlying agreement, also finding it to be irrelevant.[195]

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[188] *Id.* at 728–30.

[189] *Harper v. Everson*, No. 3:15-CV-00575-JHM, 2016 WL 8201785, at *6 (W.D. Ky. June 27, 2016) (rejecting bias, recoverability of attorney's fees, and standing as reasons for compelling discovery); *VHT, Inc. v. Zillow Grp., Inc*, No. C15-1096JLR, 2016 WL 7077235, at *1 (W.D. Wash. Sept. 8, 2016) ("Although Zillow poses several imaginable hypotheticals in which VHT's litigation funding scenario becomes relevant, the dearth of evidence on the record supporting Zillow's position renders that information negligibly relevant, minimally important in resolving the issues, and unduly burdensome.").

[190] No. 3:17-cv-1767 (VAB), 2019 WL 4127377, *11 (D. Conn. Aug. 30, 2019).

[191] No. 17-CV-3827-SJ-SJB, 2019 WL 1578167 (E.D.N.Y. March 14, 2019).

[192] 2019 WL 4127377, at *13.

[193] 2019 WL 1578167, at *1.

[194] "Defendants' argument that they are entitled to understand the litigation funder's 'ability to intervene' and 'dictate the legal strategies or settlement decisions' is just a series of conclusory and irrelevant assertions. A defendant is not entitled to learn any of these things in any case, absent some special need or showing. One party to litigation is not entitled—absent some contractual or other relationship like an indemnification agreement—to know why the adverse party chooses to make certain strategic decisions in a case or avoid settlement. Many such considerations are privileged; and if they are not, they are irrelevant and outside the scope of what a party needs to defend or prosecute its case. If a court were to accept Defendants' premise, all defendants would be permitted to conduct discovery of all individuals who have spoken to the plaintiff to ask them if they counseled plaintiff to reject a settlement offer or if plaintiff ever expressed doubts or uncertainties in his case. Those matters certainly involve the case; they are, after all, discussions about the matter at hand. That, however, does not make them discoverable." *Id.* at *2.

[195] *See, e.g.*, *MLC Intellectual Prop., LLC v. Micron Tech., Inc.*, No. 14-CV-03657-SI, 2019 WL 118595, at *2 (N.D. Cal. Jan. 7, 2019) (denying discovery because "assertions of potential bias and conflicts of interest are speculative").

By contrast, litigation funding agreements may be found to be relevant, for example, where the agreement is material to an issue in the dispute itself, such as to establish the bias of specific witnesses that have a plausible relationship to the funder[196] or to a specific damages issue, such as valuation of a patent-in-suit.[197]

d) Work Product Doctrine

Beyond relevance, parties have successfully invoked the work product doctrine to protect litigation funding agreements from disclosure.[198] Subject to limited exceptions, the federal work product doctrine, as well as state analogues, generally protects from disclosure information prepared by or for a party in anticipation of litigation.[199] A party may discover a document otherwise protected as work product if it can demonstrate a substantial need.[200]

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[196] *Yousefi v. Delta Elec. Motors*, No. C13-1632 RSL, 2015 WL 11217257, at *2 (W.D. Wash. May 11, 2015) ("Whether plaintiff is funding this litigation through savings, insurance proceeds, a kickstarter campaign, or contributions from the union is not relevant to any claim or defense at issue. If, however, Local 46 has not merely donated funds or expertise to pursue these claims but has an expectation of payment if and only if plaintiff prevails, evidence of that financial interest may be relevant to determining the credibility and potential bias of Local 46 witnesses."); *Nelson v. Millennium Labs*, No. 2:12-cv-01301-SLG, 2013 WL 11687684, at *5–6 (D. Ariz. May 17, 2013) (ordering production of plaintiff's fee agreements because defendant asserted that market competitor was funding plaintiff's litigation); *Berger v. Seyfarth Shaw LLP*, No. C07-05279JSWMEJ, 2008 WL 4681834, at *3 (N.D. Cal. Oct. 22, 2008) (ordering disclosure of litigation funding contract where funder was potential witness in case).

[197] *Cont'l Circuits LLC v. Intel Corp.*, No. 16-cv-02026-PHX-DGC, 2020 WL 416109 (D. Ariz. Jan. 27, 2020); *Odyssey Wireless, Inc. v. Samsung Elecs. Co., Ltd*, No. 315CV01735HRBB, 2016 WL 7665898, at *7 (S.D. Cal. Sept. 20, 2016); *see also Fulton v. Foley*, No. 17-CV-8696, 2019 WL 6609298, at *4 (N.D. Ill. Dec. 5, 2019) (ordering plaintiff to produce "all non-mental impressions, fact-based information and documents including any statements provided by Plaintiff directly, if any, that was provided to [the litigation funder]").

[198] *See, e.g.*, *Cont'l Circuits LLC*, 2020 WL 416109; *Securitypoint Holdings, Inc. v. United States*, No. 11-268C, 2019 WL 1751194 (Fed. Cl. Apr. 16, 2019); *In re Nat'l Prescription Opiate Litig.*, No. 1:17-MD-2804, 2018 WL 2127807 (N.D. Ohio May 2018); *Space Data Corp. v. Google LLC*, No. 16-cv-03260 BLF, 2018 WL 3054797 (N.D. Cal. June 11, 2018); *Lambeth Magnetic Structures, LLC v. Seagate Technology (US) Holdings, Inc.*, Nos. 16-538, 16-541, 2018 WL 466045 (W.D. Pa. Jan. 18, 2018); *Viamedia, Inc. v. Comcast Corporation*, No. 16-5486, 2017 WL 2834535 (N.D. Ill. June 30, 2017); *Eidos Display, LLC v. Chi Mei Innolux Corp.*, No. 6:11-CV-00201-JRG, 2017 WL 2773944 (E.D. Tex. 5 26, 2017); *Odyssey Wireless, Inc. v. Samsung Elecs. Co., Ltd.*, No. 15-01735, 2016 WL 7665898 (S.D. Cal. Sept. 20, 2016); *United States v. Homeward Residential, Inc.*, No. 12-461, 2016 WL 1031154 (E.D. Tex. Mar. 15, 2016); *United States v. Ocwen Loan Serv., LLC*, No. 12-543, 2016 WL 1031157 (E.D. Tex. Mar. 15, 2016); *In re Int'l Oil Trading Co.*, 548 B.R. 825, 835 (Bankr. S.D. Fla. Apr. 28, 2016); *Charge Injection Techs., Inc. v. E.I. Dupont De Nemours & Co.*, No. 07C-12-134-JRJ, 2015 WL 1540520 (Del. Super. Ct. Mar. 31, 2015); *Doe v. Soc'y of Missionaries of Sacred Heart*, No. 11-02518, 2014 WL 1715376 (N.D. Ill. May 1, 2014); *Mondis Tech., Ltd. v. LG Elecs., Inc.*, Nos. 07-565, 08-478, 2011 WL 1714304, (E.D. Tex. May 4, 2011). *But see Acceleration Bay LLC v. Activision Blizzard, Inc.*, Nos. 16-453, 16-454, 16-455, 2018 WL 798731 (D. Del. Feb. 9, 2018); *Leader Techs., Inc. v. Facebook, Inc.*, 719 F. Supp. 2d 373, 376 (D. Del. June 24, 2010).

[199] *See* Fed. R. Civ. P. 26(b)(3).

[200] *Id.*

Several courts have found that the work product doctrine applies to litigation funding agreements on the grounds that such documents are at "a minimum created for possible future litigation."[201]

Documents that are prepared for a business purpose are generally not protected by the work product doctrine. However, "even though the overlap between business and litigation reasons for the creation of the disputed [funding] documents is more extensive than usual," courts have concluded that the work product doctrine applies because even financial terms reflect an assessment of the "merits of the case."[202]

Judicial decisions vary as to whether documents and communications exchanged between attorneys and funders, including communications designed to seek funding, can benefit from the work product protection. However, the majority rule appears to be that such materials are subject to the work product doctrine protections so long as there is an oral or written confidentiality agreement between the funder and fundee.[203] Such an agreement provides assurance that the exchange will not increase the likelihood of disclosure of work product to third-parties, which can break the privilege.[204] In addition, several states have enacted legislation to protect

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[201] *Mondis Technology Ltd. v. LG Electronics Inc.*, No. 2:07-cv-565, 2011 WL 1714304 (E.D. Tex. May 4, 2011); *In re Nat'l Prescription Opiate Litig.*, No. 1:17-MD-2804, 2018 WL 2127807, at *1 (N.D. Ohio May 7, 2018) (multi-district litigation). *Accord Lambeth Magnetic Structures, LLC v. Seagate Tech. (US) Holdings, Inc.*, No. CV 16-538, 2018 WL 466045, at *5 (W.D. Pa. Jan. 18, 2018); *United States v. Homeward Residential, Inc.*, No. 4:12-CV-461, 2016 WL 1031154, at *6 (E.D. Tex. Mar. 15, 2016); *Morley v. Square, Inc.*, No. 4:10CV2243 SNLJ, 2015 WL 7273318, at *2 (E.D. Mo. Nov. 18, 2015); *Doe v. Soc'y of Missionaries of Sacred Heart*, No. 11-CV-02518, 2014 WL 1715376, at *4 (N.D. Ill. May 1, 2014); *Devon It, Inc. v. IBM Corp.*, No. CIV.A. 10-2899, 2012 WL 4748160, at *1 (E.D. Pa. Sept. 27, 2012). *But see Leader Techs., Inc. v. Facebook, Inc.*, 719 F. Supp. 2d 373, 376–77 (D. Del. 2010) (concluding with limited explanation work product doctrine did not apply).

[202] *Carlyle Inv. Mgmt. L.L.C. v. Moonmouth Co. S.A.*, No. CV 7841-VCP, 2015 WL 778846 (Del. Ch. Feb. 24, 2015).

[203] *Miller UK Ltd.*, 17 F. Supp. 3d at 738.

[204] *Id. Accord United States v. Homeward Residential, Inc.*, No. 4:12-CV-461, 2016 WL 1031154, at *6 (E.D. Tex. Mar. 15, 2016) ("Litigation funders have an inherent interest in maintaining the confidentiality of potential clients' information, therefore, [plaintiffs] had an expectation that the information disclosed to the litigation funders would be treated as confidential."). Notably, disclosure of documents treated as work product does not automatically waive the protection. *Miller*, 17 F. Supp. 3d at 735. As such, the work product protection survives exchange even though most courts have found the "common interest doctrine"—another doctrine that maintains the privilege in the event of document exchange—inapplicable to funding agreements because "[a] shared rooting interest in the 'successful outcome of a case' . . . is not a common *legal* interest," in contrast to a risk that both parties will be sued in the same case. *Id.* at 732. Accordingly, the majority of courts have found the common interest doctrine inapplicable to funders/fundees. *Id. But see Devon It, Inc. v. IBM Corp.*, No. CIV.A. 10-2899, 2012 WL 4748160, at *1 (E.D. Pa. Sept. 27, 2012); *In re Int'l Oil Trading Co., LLC*, 548 B.R. 825, 833 (Bankr. S.D. Fla. 2016).

communications between an attorney and funder with respect to the work product doctrine and other privileges.[205]

Where a substantial need was demonstrated, courts have occasionally ordered production of redacted litigation funding agreements notwithstanding that they are work product.[206]

The minority position appears to be that documents created for funding purposes are not subject to the work product protection because the primary purpose of the documents was to obtain funding, as opposed to aiding in possible future litigation.[207]

3. Comparative Perspectives

a) England and Wales

The law in England and Wales also continues to develop. At least one court has ruled that disclosure of the identity of the funder is not required absent unusual circumstances. In *In the Matter of Edwardian Group Limited,*[208] the court rejected an application for an order disclosing the identity of the litigation funder, holding that it was irrelevant to the merits of the dispute. However, in *Wall v. The Royal Bank of Scotland Plc,*[209] the claimant was ordered to reveal the identity of third-party funders so the defendant could seek an application for security for costs against the funder. Nevertheless, the court explicitly warned against "fishing expeditions" to identify third party funders.

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[205] *See, e.g.*, Neb. Rev. Stat. § 25-3306 ("No communication between the attorney and the civil litigation funding company as it pertains to the nonrecourse civil litigation funding contract shall limit, waive, or abrogate the scope or nature of any statutory or common-law privilege, including the work-product doctrine and the attorney-client privilege."); *see also* Ind. Code Ann. § 24-12-8-1; Vt. Stat. tit. 8, § 2255.

[206] *See Odyssey Wireless, Inc. v. Samsung Elecs. Co., Ltd*, No. 15-01735, 2016 WL 7665898, at *7 (S.D. Cal. Sept. 20, 2016) (ordering production where funding agreement was only indication of value of patent-in-suit, a substantial factor in calculating patent damages).

[207] *Acceleration Bay LLC v. Activision Blizzard, Inc.*, No. CV 16-453-RGA, 2018 WL 798731, at *2 (D. Del. Feb. 9, 2018).

[208] (2017) EWHC 2805 (Ch).

[209] (2016) EWHC 2460 (Comm).

b) Australia

In Australia, litigation funding agreements need not be disclosed except in class actions.[210] However, limited redactions may be appropriate to protect privileged or confidential information, such as specific deal terms.[211]

c) France

In France, while disclosure of funding arrangements is not required by law, attorneys are encouraged to do so where a failure to do so may result in impediments to enforcing the judgment—particularly in arbitrations.

C. Arguments Regarding Disclosure of Commercial Litigation Funding

As discussed above, judicial decisions, court rules and statutes requiring disclosure of funding are currently limited in number and scope. Nevertheless, commercial litigation funding still remains a relatively new phenomenon. Thus, while policy efforts and litigation attempting to mandate disclosure have had only limited success, there remain numerous bodies, tribunals, and jurisdictions that have not yet considered the issue of disclosure. In light of this, the disclosure debate continues to persist in multiple forums—ranging from legislatures, to courts, to bar associations.

In general, the defense bar is in favor of disclosure, whereas the plaintiffs' bar resists disclosure. The extent of disclosure is an important issue that is less frequently discussed because the current debate centers around disclosure of the mere presence of litigation funding—something that defendants have predominantly failed to obtain. It is important to keep the extent of disclosure in mind because if a pro-disclosure argument prevails, disclosure should logically be limited to accomplish the purpose of such argument.

Arguments commonly raised in the disclosure debate are summarized below, followed by counterpoints made in opposition. While the summary is not comprehensive, it includes the most prevalent arguments made in the commercial litigation arena. Arguments that relate principally to the consumer funding space are not discussed. In addition, issues related to arbitration and class and derivative litigation are discussed in Sections (D) and (E) below. Members of the Working

[210] *See* Paragraph 3.6 of Practice Note CM 17 ("At or prior to the initial case management conference each party will be expected to disclose any agreement by which a litigation funder is to pay or contribute the costs of the proceeding.").

[211] *Coffs Harbour City Council v. Australia and New Zealand Banking Group Ltd.*, (2016) FCA 306.

Group do not necessarily agree with any of the arguments below, but recognize that these are the arguments most commonly made for or against disclosure.

1. Pro-Disclosure Arguments

The following arguments in favor of disclosure have been made in various court submissions, as well as in lobbying efforts by the United States Chamber of Commerce's Institute for Legal Reform and other lobbies of the defense bar.

a) Bias and Conflicts of Interest

Rationale. It is possible that judges, jurors, and/or witnesses have relationships with litigation funders and would therefore be inclined to side with the party receiving litigation funding. Such relationships could be in the form of investment in the litigation funder or a relationship with a law firm that has an ongoing portfolio relationship with the litigation funder. Although it is sometimes argued that absent disclosure, no judge, juror, or witness would have any basis to know that the litigation funder may stand to gain, it is always possible that the identity of the funder could be revealed at some later point in the litigation, which could result in recusal or substantial delay; therefore it is preferable to air any such potential conflicts at the outset of the proceedings.

Moreover, most conflict rules do not contain a state of mind requirement and it is possible that a judge or lawyer could be in breach of a disclosure or recusal obligation without having knowledge of the underlying facts. In addition, although public investment in litigation funders is limited, certain litigation funders (*e.g.*, Burford Capital and IMF Bentham) are publicly traded. Further, a judge, juror, or witness may potentially be influenced by the fact that a spouse or relative works for a funder with an interest in the litigation. Even if disclosure were expanded to litigation funders under a modified version of FRCP 7.1, that change would not suggest that other creditors (*e.g.*, banks with lines of credit to law firms) should be similarly disclosed, as such bank creditors would have a more attenuated relationship to the specific litigation matter, as compared to many litigation funders.

Counter-Argument. Absent disclosure, no judge, juror, or witness would have any basis to know the litigation funder that may stand to gain. To the extent litigation funding would give rise to a conflict of interest because of a financial interest in the outcome, a special disclosure rule for litigation funding would not be complete; disclosure should technically be expanded to parties beyond those identified in FRCP 7.1 to creditors, lenders, affiliates, and other party stakeholders (including venture capital and private equity backing)—which would be a significant shift in existing law. Further, absent a connection between the case at bar and a law firm's relationship with a litigation funder, no mutuality of interest exists. In addition, litigation funders are typically bound by confidentiality, and therefore do not disclose the matters they fund even to their investors. Finally, public investment in litigation funders is extremely limited, and judges should not invest in litigation funders. In the event disclosure is required, *in camera* review should suffice.

b) Control/Party in Interest

Rationale. To the extent litigation funders exercise control over the matters they fund, their identity should be revealed as the true party in interest. A defendant may also seek to determine if a funding arrangement impermissibly constitutes champerty, maintenance, usury, fee-splitting, or is otherwise prohibited by law or public policy. Even if a funder disclaims that it will exercise control over a litigation, not all funders in practice observe such admonitions. Moreover, control mechanisms may be subtle or indirect, including pressures regarding the decision to release additional funds in a matter at particular times or to renew or extend funding arrangements on either an individual case or portfolio basis.

Counter-Argument. The attempt to exercise control by a commercial litigation funder is the exception, not the rule, and would not be permitted in a funding contract with attorneys. Control is normally disclaimed, and funders receive returns based on the purchase of claim proceeds, rather than assignment of the claims themselves. If a funding arrangement were champertous or otherwise impermissible, only the funder's counterparty (*i.e.*, the party receiving funding) would typically have standing to challenge the arrangement. Attorneys are subject to professional obligations that protect clients beyond the economic arrangement negotiated with a funder, and non-recourse funding arrangements in practice have less of an effect on attorney independence than traditional recourse debt financing. Finally, a defendant's liability for a legal claim exists and must be resolved or adjudged regardless of whether the named plaintiff, or another party, is arguably the true "party in interest." In the event disclosure is warranted, *in camera* review should initially suffice, followed by additional discovery if it is determined that control exists or an assignment has occurred.

c) Proportionality

Rationale. Funded parties may seek to narrow discovery on the ground that expenses are disproportionate to the party's resources. Where this is the case, funded parties have put their resources, and therefore any litigation funding received, at issue in the litigation.

Counter-Argument. The proportionality inquiry is broader than a party's resources. Although a party's resources are a factor considered by courts in determining the scope of discovery, litigation funding should be extrinsic to a court's analysis due to the cost of capital. In the event disclosure is warranted, it should occur only after party resources are put at issue. In that case, production of redacted litigation funding transaction documents, and potentially information regarding amounts of remaining funding, should suffice.

d) Fee-Shifting and Security for Costs

Rationale. Where costs and/or fees are shifted to a prevailing party and the adverse party lacks the means to pay amounts due, litigation funding should be disclosed, and the litigation funder should be liable. While fee awards are rare under the American Rule, legal cost awards can be substantial and may be awarded to the prevailing party in the United States. As a matter of simple fairness, the party who has funded the litigation should be liable for costs incurred as a result to the extent a court has seen fit to award them.

Counter-Argument. Costs and fee-shifting are rare under the American Rule and may impede access to justice. Even rarer are circumstances in which litigation funders have a direct contract obligation to the funded party to indemnify it for adverse costs and fee awards. Funders' lack of control and their investment in litigation proceeds, rather than the purchase of claims, do not warrant guarantor liability. Funders may also invest in litigation through provision of pure monetization of working capital rather than the financing of attorneys' fees. Although a litigation funder may have backed a losing litigation, the client and attorneys had professional and legal obligations to bring a non-frivolous action and prosecute it in a non-vexatious manner and were in ultimate control of the litigation. In the event disclosure is warranted, it should occur only after costs or fee-shifting is imposed. In that case, production of redacted litigation funding transaction documents, and potentially information regarding amounts of remaining funding, should suffice.

e) Insurance

Rationale. Parties in federal court are required by Fed. R. Civ. P. 26(a)(1)(A)(iv) to produce "any insurance agreement under which an insurance business may be liable to satisfy all or part of a possible judgment in the action or to indemnify or reimburse for payments made to satisfy the judgment."[212] At the time this rule was adopted, the Advisory Committee Notes stated that the rationale was to "enable counsel on both sides to make the same realistic appraisal of the case."[213] That same baseline reasoning applies to litigation funding.

The purpose of this insurance disclosure requirement also is to enable the realistic appraisal of the case and inform settlement and litigation strategy, notwithstanding that the insurance agreements themselves may not be admissible as evidence. Similarly, even if litigation funding agreements and/or the identity of the funder are not admissible as evidence, there is little doubt that the presence of litigation funding will have an impact on the case, including with respect to the likelihood of settlement and the terms and form of any settlement. For example, if a litigation funder must receive a certain recovery before the client recovers anything, a client will likely not agree to a settlement that does not satisfy that hurdle amount and may in fact seek to litigate even a weak case up to the funded amount. The disclosure of such information to the defendant would be relevant and useful in permitting the parties to negotiate successfully any settlement, including in those instances in which the funder is being asked by the client to renegotiate its lien on the proceeds from any recovery. Any disclosure beyond the fact of funding and identity of the funder could be held to a higher standard that would require a showing of need for more detailed disclosure.

Counter-Argument. The federal requirement to disclose insurance coverage has roots in an insurer's right to control litigation, which is typically not present in commercial litigation funding arrangements. In addition, insurance coverage is relevant to a defendant's ability to satisfy a judgment, which is not relevant to plaintiffs unless a counterclaim exists, in which case plaintiffs are also required to comply with the disclosure requirement. Furthermore, there is a well-established legal privilege between insurers and insureds that is less developed in the litigation funding context, which may lead to abuse. Moreover, disclosure of litigation funding as a means

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[212] FED. R. CIV. P. 26(a)(1)(A)(iv).

[213] Fed. R. Civ. P. 26(a)(1)(A)(iv) cmnts. on 1970 Amendments.

to discover party resources would result in an imbalance. While defendants are required to disclose insurance policies, the duty to defend is broader than the duty to indemnify, and defendants are not required to disclose all resources that may be available to satisfy a judgment. Likewise, disclosure of litigation funding may provide an incomplete picture of a plaintiff's settlement incentives to the extent the plaintiff—like many that receive litigation funding—has other creditors.

Furthermore, disclosure of policy limits, which typically exceed the cost of litigation, do not provide information to plaintiff attorneys of how much the insurer is prepared to spend in fees to litigate the case. Additionally, the requirement to disclose insurance exists by virtue of statute and court rules. No similar statute or court rule yet exists specifically relating to litigation funding. Finally, any aid to settlement that could be gained via disclosure could easily be eclipsed by the prejudice associated with such disclosure. To aid settlement meaningfully, sensitive details of the funding arrangement would likely need to be disclosed—such as the funder's investment commitment, investment to date, and investment budget. Once disclosed, defendants could use such information to the plaintiff's detriment in the event the parties are unable to reach a settlement. Absent such information, the mere fact of funding and identity of funding would provide very little to no aid to assisting settlement. To the extent disclosure would be helpful to achieve a settlement, funded parties are free to disclose supplemental information as they choose.

2. Anti-Disclosure Arguments

In addition to the counter-arguments noted above, the following arguments against disclosure have been made in various court submissions, as well as by litigation funders in response to lobbying efforts.

a) Irrelevance/Voyeurism

Argument. A party's receipt of litigation funding has no relevance to any party's claims or defenses. A defendant's voyeuristic desires do not render litigation funding discoverable. Accordingly, no legal basis exists for disclosure from parties or litigation funders.

Counter-Argument. Litigation funding may be legally relevant to the extent a litigation funder possesses control or funding is otherwise put at issue. In addition, the federal requirement to disclose insurance policies requires legally irrelevant information to be produced, yet insurance must still be disclosed because of, among other things, its importance to settlement discussions.

b) Definition/Discrimination

Argument. Commercial litigation funding may take many different forms. Defining what types of disclosure require production presents a definitional challenge, the results of which may discriminate against certain types of funding. While traditional non-recourse single-case investment in litigation expenses may be straightforward, questions of disclosure are more difficult when funding is more attenuated or bespoke. Financing can take many forms, such as law firm single-case funding, law firm portfolio funding, claimant portfolio funding, brokered cases, non-funded cases as collateral, recourse funding, traditional bank lending and credit lines, family and friends investment, hedging, monetization, secondary investing, securitization, syndication, and amicus curiae briefs. Certain types of investment, such as traditional bank lending, recourse lending, and family and friends investment, have existed for years without any push for disclosure. If those investments are carved out from disclosure requirements, that distinction would discriminate against other types of funding. Finally, litigation funding arrangements can be highly complex, and there is significant risk they can be misinterpreted by factfinders or adverse parties.

Counter-Argument. A requirement to disclose "agreements under which any person, other than an attorney permitted to charge a contingency fee representing a party, has a right to receive compensation that is contingent on, and sourced from, any proceeds of the civil action, by settlement, judgment or otherwise" carefully limits the disclosure requirement to arrangements in which an investor buys an interest in the outcome of a lawsuit. By focusing on those who have thus "invested" in litigation, the requirement is tailored to cover circumstances in which third parties will benefit directly from the outcome of the action and may be exercising some level of control.

c) Prejudice

Argument. Disclosure of details of litigation funding arrangements could prejudice funded parties. Disclosure is likely to spawn unnecessary and irrelevant discovery and associated satellite litigation that, absent special circumstances, does not serve a legitimate purpose. The result is added expense and delay to litigation, as well as increasing the burden on judicial resources. Also, litigation funding rarely involves an unconditional obligation to fund litigation. Instead, funding arrangements often involve limitations on investment commitments (in the aggregate and tied to phases or milestones), and other conditions that could result in prejudice if disclosed (such as triggers for the termination of funding). If an adverse party has access to a funded party's litigation budget, it could employ tactics designed to exhaust that budget and leverage an uneven playing field through litigation and settlement strategy. This risk of prejudice is much more attenuated for defendants in the case of insurance agreements, as the policy limits often exceed the cost of litigating the case. By contrast, the close nexus between the funding agreement and the cost of litigating the case creates greater possibilities for abuse if disclosure of funding terms is mandated.

Counter-Argument. As with insurance, disclosure of the particulars of funding arrangements could incentivize settlement. In addition, disclosure is warranted regardless of prejudice if control rights exist. There is little prejudice or burden from the disclosure of the existence of funding and identity of the funder. Any additional disclosure could be held to a standard requiring a showing of need and tailoring the disclosure to such a showing.

d) Efficiency/Prematurity

Argument. Disclosure could open the door to unnecessary, lengthy, and costly motion practice and sideshow litigation concerning the details of litigation funding arrangements and communications between funded parties and funding sources. This would be inimical to judicial economy, and the costs would outweigh whatever marginal benefits are associated with disclosure. Unless and until the law is clear – by statute, rule, or otherwise – that litigation funding does not provide a basis for discovery beyond that which is necessary, it is premature to require disclosure.

Counter-Argument. If a legal basis exists to seek further disclosure, defendants have the right to seek such disclosure.

e) Passivity

Argument. Commercial litigation funding arrangements are typically passive in nature. Requiring disclosure on the basis that control may exist would be overbroad and lead to the inefficiencies described above. If the existence of control does warrant disclosure, then funded parties should disclose relevant information if and only if control rights exist. Parties and their attorneys are required to produce relevant information, and litigation funding should be no exception.

Counter-Argument. Production of litigation funding transaction documents is necessary to determine if control exists. In addition, not all funders are mere passive investors, especially where they contract directly with the litigant, who is not protected by the ethics rules covering attorneys.

f) Privilege

Argument. Details regarding litigation funding arrangements (including terms of the agreements themselves), as well as communications between funders and funded parties, have been held to be protected from disclosure by the work product doctrine and sometimes by common interest privilege. Internal documents maintained by litigation funders may also be privileged for various reasons.

Counter-Argument. While certain aspects of litigation funding arrangements and related communications may be privileged, it does not justify a blanket prohibition on disclosure.

g) Lack of Reciprocity

Argument. To the extent disclosure is required from plaintiffs regarding litigation funding (whether to fund affirmative costs or defensive counter-claim costs), such disclosure should be reciprocal. Thus, requiring a plaintiff to disclose funding to incentivize settlement should be accompanied by a defensive disclosure obligation regarding assets available to satisfy a judgment (and insurance policies for cases in state court).

Counter-Argument. Disclosure is sought for reasons beyond resources, such as control. In those instances, disclosure need not be reciprocal, as defendants have not elected to participate in litigation.

D. Special Considerations for Class and Derivative Actions

1. Overview

Disclosure obligations arguably differ with respect to class actions. Those who support that distinction contend that a judge in a class action is not merely an “umpire,” nor does he or she have the detached role envisioned by the adversary system for traditional litigation. Class representatives are appointed to monitor class counsel and assist in making case decisions, but the judge also assists in overseeing the class proceedings. This gives the judge a heightened obligation to ensure that a fee award that comes out of any class recovery is fair and reasonable. The court’s rules allowed for the class action and any ultimate recovery, underscoring the court's responsibility to ensure fairness for the class.[214]

Consequently, some would argue that the judge in a class action may have a greater interest in knowing whether a litigation financer has an interest in any fee the court awards and under what terms, including the amount.

To put it another way, the fund that a class action may produce through settlement or trial belongs to the client—the class—unless and until a portion of it is awarded as counsel fees. Some may therefore contend that the judge must be fully informed of the identities of the recipients and the basis on which they will be compensated. There is no counsel fee until the court says so. Accordingly, in deciding on the amount of any such fee, a judge may need to know who is getting it and why.

Arguments exist to the contrary. Indeed, whether a non-recourse funder ultimately receives a portion of a class fee award is arguably no different from a recourse lender—or any other creditor of a law firm, be it a copier lessor, e-discovery vendor, landlord, or the Internal Revenue Service—receiving the same funds. In other words, whether or not a financier has recourse to a firm's furniture and the assets of its partners, or merely the firm's receivables or a subset thereof, is of no moment if the main point of disclosure is to determine the ultimate recipients of class funds. While the current debate is in the context of the phenomenon of non-recourse funding, to date there has emerged no proponent of disclosure of all third-party recipients of class fee awards.

Moreover, courts routinely grant lead counsel the authority and discretion to distribute fee awards among other class counsel. Such delegation divests courts of significant oversight that is arguably more relevant to the court's supervisory role than any firm's decision to distribute its receivables to a non-recourse funder.

In light of the countervailing arguments, and open questions concerning the timing and extent of disclosure, we do not make a recommendation at this time regarding a model form of disclosure in class actions.

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[214] For example, the Local Rules of the United States District Courts for the Southern and Eastern Districts of New York specifically require that "The notice [in class action and shareholder derivative actions] shall include a statement of the names and addresses of the applicants for such fees and the amounts requested respectively and *shall disclose any fee sharing agreements with anyone*." Local Civil Rule 23.1 (emphasis added).

2. Arguments

The following arguments exist for a heightened disclosure obligation in class actions.

a) Pro-Disclosure Arguments

In *In re "Agent Orange" Product Liability Litigation*,[215] the court described one of the appellate issues in the case this way:

> This portion of the *Agent Orange* appeal concerns the district court's approval of a fee sharing agreement entered into by the nine-member Plaintiffs' Management Committee ("PMC") in December of 1983. Under the agreement, each PMC member who had advanced funds to the class for general litigation expenses was to receive a threefold return on his investment prior to the distribution of other fees awarded to individual PMC members by the district court. In result, the agreement dramatically increased the fees awarded to those PMC members who had advanced funds to the class for expenses, and concurrently decreased the fees awarded to non-investing PMC members, who only performed legal services for the class.

The court rejected the lawyers' agreement, writing:

> There is authority for a court, under certain circumstances, to award a lump sum fee to class counsel in an equitable fund action under the lodestar approach and then to permit counsel to divide this lodestar-based fee among themselves under the terms of a private fee sharing agreement. . . . We reject this authority, however, to the extent it allows counsel to divide the award among themselves in *any* manner they deem satisfactory under a private fee sharing agreement. Such a division overlooks the district court's role as protector of class interests under Fed. R. Civ. P. 23(e) and its role of assuring reasonableness in the awarding of fees in equitable fund cases. . . . *cf. Jones v. Amalgamated Warbasse Houses, Inc.*, 721 F.2d 881, 884 (2d Cir. 1983) ("if the court finds good reason to do so, it may reject an agreement as to attorneys' fees just as it may reject an agreement as to the substantive claims"), *cert. denied*, 466 U.S. 944 (1984). In addition, this approach overlooks the class attorneys' "duty . . . to be sure that the court, in passing on [the] fee application, has all the facts" as well as their "fiduciary duty to the . . . class not to overreach." *Lewis v. Teleprompter Corp.*, 88 F.R.D. 11, 18 (S.D.N.Y. 1980).

The court added:

> We do agree with the district court's ruling that in all future class actions counsel must inform the court of the existence of a fee sharing agreement at the time it is formulated. This holding may well diminish many of the dangers posed to the rights of the class. Only by reviewing the agreement prospectively will the district courts be able to prevent potential conflicts from arising, either by disapproving improper agreements or by reshaping them with the assistance of counsel to conform more

[215] 818 F.2d 216, 223 (2d Cir. 1987).

> closely with the principles of *Grinnell I* and *Grinnell II.*[216] In the present case, however, where the district court was not made aware of the agreement, and the potential for a conflict of interest arising was substantial, the adoption of a rule for future cases in no way alleviates the fatal flaws of this agreement and does not offset the need for its invalidation."

Disclosure in class actions may also be necessary to prove a firm's ability to afford the costs of the litigation. Rule 23(g)(1)(A)(iv) directs the court, in appointing class counsel, to consider "(iv) the resources that counsel will commit to representing the class." N.D. Cal. L. R. 3-15.

In *Zwegat v. Board of Trustees,* the court stated:[217]

> "Courts examine such third-party financing arrangements to attempt to assure they impose no limitation on counsel's strategy, or independent professional judgment." *E.g., In re Nat'l Prescription Opiate Litig.*, N.D. Ohio Case No. 1:17-MD-2804, 2018 U.S. Dist. LEXIS 84819, *45, 2018 WL 2127807. In a class action, the impact of any third-party involvement must also be considered from the standpoint of the named plaintiffs, and their ability to be active representatives of the class.

Finally, in considering a fee application, a court may examine the amount of risk taken by class counsel to justify a lodestar enhancement. In such circumstances, the fact that a firm was de-risked by a non-recourse funder may be relevant. That information may be relevant because non-recourse funding reduces the law firm's risk of no recovery, which may be a consideration in a court's determination of the fee award.

b) Anti-Disclosure Arguments

In contrast, it can be argued that *Agent Orange* and its progeny address a different concern that is not raised by non-recourse funding: conflicts between attorneys as a result of fee-sharing agreements. In *Agent Orange*, the Second Circuit was principally concerned with the potentially perverse incentives of counsel that were guaranteed certain investment returns regardless of the amount of hourly fees contributed. While such a conflict may exist in a funded case, the existence

[216] *Grinnell I* and *Grinnell II* outlined the principles applicable to fee distribution in equitable fund actions. "The underlying rationale . . . is the belief that an attorney who creates a fund for the benefit of a class should receive reasonable compensation from the fund for his efforts." *Id.* at 222.

[217] No. 18CV-10593, 2019 Ohio Misc. LEXIS 228, at *12 (Ct. Com. Pl. July 25, 2019).

of funding would not impact the outcome under an *Agent Orange* analysis, which concerns fee allocation among the attorneys working on a case.

Class fee awards are evaluated under the *Grinnell* framework. Even though it is widely known that class action firms rarely self-fund and instead employ various types of financing, that framework does not contain any requirement to consider how a firm intends to distribute its fee award. Instead, the evaluation is focused on whether fees are fair and reasonable. Once a fee award is received, a firm is free to use that award to distribute it to its members and employees, or pay any creditor—whether a non-recourse funder, a recourse lender, or any contractual counterparty. Even in the case of a non-recourse funder, a dispute may exist between the firm and funder regarding the amount of proceeds to which the funder is entitled, which may not be resolved until after the approval of the class fee award. Moreover, "litigation risk must be measured as of when the case is filed," not at the time of a settlement.[218]

The expansion of judicial oversight specifically to non-recourse funders would also contravene the well-established practice of delegating authority to lead counsel to distribute fee awards to other class counsel pursuant to contribution. While each firm's time is used to justify an award, firms do not all receive the same multipliers for their time, and the court typically lacks oversight over how the fees are divided (and, accordingly, lacks oversight regarding the non-lead firms' intended use of fee proceeds).[219]

While spectators have observed the hypothetical potential for conflicts of interest arising from non-recourse financing arrangements, it is widely-accepted that contingency counsel—whether class or otherwise—routinely face conflicts of interest in practice. Such conflicts exist

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[218] *Kornell v. Haverhill Ret. Sys.*, No. 18-3673-CV, 2019 WL 5681336, at *1 (2d Cir. Nov. 1, 2019).

[219] *See In re Auto. Refinishing Paint Antitrust Litig*., No. 10-md-1426, 2008 WL 63269, at *7 (E.D. Pa. Jan. 3, 2008) ("Courts generally approve joint fee applications which request a single aggregate fee award with allocations to specific firms to be determined by Co-Lead Counsel, who are most familiar with the work done by each firm and each firm's overall contribution to the litigation."); *McKinney on behalf of Res. Capital Corp. v. Cohen*, No. 17-cv-1381-LLS, 2017 WL 2271541, at *3 (S.D.N.Y. May 9, 2017) (ordering co-lead counsel "to appropriately distribute any Plaintiffs' attorneys' fees that may be awarded by the Court"); *In re DDAVP Direct Purchaser Antitrust Litig*., 2011 WL 12627961, at *5 ("Co-Lead Counsel shall allocate the fees and expenses among all of the Class Counsel."); *In re U.S. Foodservice, Inc. Pricing Litig*., No. 07-md-1894, ECF No. 521, at ¶ 15 (D. Conn. 2014) ("Lead Class Counsel shall allocate the fees and expenses among all Class Counsel.") (Ex. 1); *In re Urethane Antitrust Litig. (Urethane III)*, No. 04-md-1616, ECF No. 3276, at ¶ 4 (D. Kan. Jul. 29, 2016) (Ex. 2) ("The award of attorneys' fees shall be allocated among plaintiffs' counsel by agreement among Co-Lead Counsel in a manner that, in Co-Lead Counsel's good-faith judgment, reflects each plaintiffs' counsel's contribution to the institution, prosecution and resolution of the litigation against Defendants.").

regardless of whether a firm has incentives related to its own financial goals or its obligations pursuant to whatever contracts it has, including recourse and non-recourse financing. Attorneys must comply with the Rules of Professional Conduct regarding conflicts, and it is partly because of such conflicts that the *Grinnell* factors exist.

Finally, a law firm's receipt of non-recourse funding may or may not reduce its risk in a manner that is relevant to the quantum of a fee award. For example, where the funding is received in the context of a portfolio, a loss results in the need to pay a greater amount from other portfolio collateral. In addition, although non-recourse funding constitutes a partial shifting of risk to a third-party, the risk is still borne by the third party. Reduction of fee awards due to third-party funding would be reflected in the market by rising returns to account for the fee reduction. Such returns would raise the cost of capital to law firms and could chill the availability of a capital source that benefits class members with valid claims.

Thus, recommending special disclosure rules would in effect create a special rule singling out non-recourse finance without a basis for doing so. It would also be a step beyond that recommended by the Advisory Committee on Civil Rules, which noted as recently as October 29, 2019 that "the Subcommittee has concluded that rule amendments [regarding third-party litigation funding] keyed to MDL litigation would not be justified," as "it may be that the better course given the evolving nature of this complex area is to allow the issues to develop further in the courts before rulemaking is undertaken."[220]

3. Other Issues

Even if the Working Group recommended enhanced disclosure of non-recourse funding of class actions, further issues would warrant additional discussion regarding the timing and extent of such disclosure.

For instance, should disclosure occur at the outset of a case, or should it be limited to a fee application in connection with a certification class or judgment? If the sole rationale for disclosure relates to judicial oversight of law firms' financing decisions, disclosure would likely be relevant only at the conclusion of a case when a court is making a fee award. Alternatively, if a court seeks to evaluate conflicts of interest, it may require disclosure at an earlier stage. However, the extent

[220] *See* Advisory Comm. on Civ. Rules, *Meeting of the Advisory Committee on Civil Rules*, 161 (Oct. 29, 2019), https://www.uscourts.gov/sites/default/files/2019-10_civil_rules_agenda_book.pdf.

of such disclosure may arguably be limited to *in camera*, *ex parte* review to avoid associated prejudice, as ordered in the *In Re National Prescription Opiate Litigation MDL*.[221] Or disclosure may be truncated, provided it is accompanied by an appropriate attorney affirmation that no financial conflict of interest will affect or control a settlement.

Furthermore, where non-recourse funding occurs in a portfolio consisting of numerous cases, early disclosure may be rendered irrelevant in the event that a funder has received its return from other collateral at the time the class fee is evaluated.

Accordingly, the Working Group believes further evaluation of class concepts is warranted prior to making a recommendation regarding special class action disclosure mechanisms and the extent and timing thereof.

E. Special Considerations for Arbitration

The disclosure of third-party funding in arbitration matters presents issues that differ significantly from the considerations present in commercial litigation.[222] We conclude that these issues tip the balance decidedly in favor of the routine disclosure at an early stage of arbitration of (i) the fact of funding, whether as an individual matter, by inclusion in a funded portfolio of matters, or other arrangement; and (ii) the identity of the funder. Any further disclosure (other than an ongoing duty to update in the event of material changes to the matter initially disclosed) would require a showing of need, as determined by the arbitral tribunal or institutional rule. We also note that issues of the disclosure of funding have been extensively debated within the arbitration community for more than five years and that there now appears to be a broad consensus around the recommendations we adopt here.

The need for disclosure of funding in arbitration arises primarily from the process by which arbitrators are appointed. Arbitrators have an obligation to make disclosure at the time of appointment of any fact or circumstance that may give rise to justifiable doubt about the arbitrator's impartiality or independence, including any financial or personal interest in the result

[221] *See* 1:17-md-02804-DAP, ECF No. 303, 2018 WL 2127807 (N.D. Ohio, May 07, 2018) (ordering *ex parte* submission for *in camera* review of "(A) a letter identifying and briefly describing the 3PCL financing; and (B) two sworn affirmations – one from counsel and one from the lender – that the 3PCL financing does not: (1) create any conflict of interest for counsel, (2) undermine counsel's obligation of vigorous advocacy, (3) affect counsel's independent professional judgment, (4) give to the lender any control over litigation strategy or settlement decisions, or (5) affect party control of settlement").

[222] This Report does not specifically address disclosure issues that may arise in mediation.

of the arbitration, or relationship with the parties or their representatives. The rules of virtually all arbitral institutions provide for broad disclosure of any circumstance likely to give rise to justifiable doubt as to the arbitrator's impartiality or independence, including any bias or any financial or personal interest in the result of the arbitration or any past or present relationship with the parties or their representatives.[223] Canon 1 of the AAA/ABA Code of Ethics for Arbitrators in Commercial Disputes provides that an "arbitrator has a responsibility not only to the parties, but also to the process of arbitration itself, and must observe high standards of conduct so that the integrity and fairness of the process will be preserved. Accordingly, an arbitrator should recognize a responsibility to the public, to the parties whose rights will be decided, and to all other participants in the proceeding."

The major arbitral institutions have routine processes for arbitrator disclosure prior to confirmation of appointments and regularly admonish potential arbitrators about the importance of broad disclosure. For example, the American Arbitration Association and International Centre for Dispute Resolution Notice of Appointment form reminds potential arbitrators that

> [i]t is most important that the parties have complete confidence in the arbitrator's impartiality. Therefore, please disclose any past or present relationship with the parties, their counsel, or potential witnesses, direct or indirect, whether financial, professional, social or of any other kind. This is a continuing obligation throughout your service on the case. . . . Any doubts should be resolved in favor of disclosure.

The backdrop of broad disclosure requirements strongly supports the need for potential arbitrators to have information at an early stage of the proceeding that will enable them to make a well-informed, complete disclosure. The risks of non-disclosure, or partial disclosure based on inadequate information, are substantial for the arbitrator, for the integrity and reputation of the arbitral process generally, and for individual arbitration matters. There is a significant risk of delay, or to the enforceability of an award that may be entered after years of litigation, where funding is not disclosed until later in the process and an arbitrator is found to have a conflict or to have made inadequate disclosure.[224]

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[223] *See e.g.*, AAA COMMERCIAL ARB. RULES, R-17; ICDR INT'L ARB. RULES, Article 13; INT'L CHAMBER OF COMMERCE ARB. RULES, Article 11; INT'L BAR ASSOC. GUIDELINES ON CONFLICTS OF INTEREST IN INT'L ARB., Part I: General Standards Regarding Impartiality, Independence and Disclosure.

[224] At least in part to facilitate arbitrator disclosure, some arbitral institutions have amended their rules in recent years specifically to require disclosure of third-party funding. *See e.g.*, 2018 HONG KONG INT'L ARB. CTR. (HKIAC) RULES,

The possibility of a conflict, or at least the need for disclosure, is more than theoretical in the current practice of arbitration. The need for disclosure of funding in arbitration is framed as well by the participation of arbitrators in third-party funding entities. While such participation is far from universal, it is also the case that, in recent years, a significant number of persons who regularly serve as arbitrators also have taken on roles as investors, employees or consultants in third-party funding entities. In addition, many arbitrators are partners in law firms that may have other cases or a portfolio funded by an entity that has funded the case at hand. Many arbitrators receive repeat appointments from the same law firms, some of which may have funded cases. Disclosure may be required to enable the arbitrator to determine whether prior cases have been funded by the same entity that is funding a new matter.

The foregoing considerations have led to an emerging consensus in the field of arbitration in favor of early routine disclosure solely of the fact of funding and identity of the funder. The *ICCA-Queen Mary Task Force Report on Third-Party Funding in International Arbitration* (the "Task Force") reported the result of a 2015 Queen Mary School of International Arbitration Survey in which 76% of respondents agreed that disclosure of the existence of third-party funding should be mandatory and 63% believed that the disclosure of the identity of the funder should be mandatory. Conversely, 71% of participants agreed that the full terms of the funding agreement should not be disclosed. The Task Force, which included arbitrators, attorneys from in-house and law firms, arbitral institutions, academics, third-party funders, and brokers, reported that "broad agreement existed on the Task Force that disclosure by the funded party of the existence and identity of funders is necessary so that arbitrators could make appropriate disclosures and decisions regarding potential conflicts of interest."[225]

We have considered as well the arguments that have been made against disclosure of third-party funding in arbitration. The argument that third-party litigation funding does not differ in meaningful ways from traditional bank or other finance is made more broadly than in relation to

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Article 44 (requiring a funded party to disclose the existence of any funding arrangements and the identity of the funder); INT'L CHAMBER OF COMMERCE, *ICC Guidance Note for The Disclosure Of Conflicts by Arbitrators* (2016) (recommending that that arbitrators consider, when evaluating whether to make a disclosure, "relationships with any entity having a direct economic interest in the dispute or an obligation to indemnify a party for the award"; INT'L BAR ASSOC., *IBA Guidelines on Conflicts of Interest in International Arbitration*, Standard 7(a) (2014) (same).

[225] INT'L COUNCIL FOR COMMERCIAL ARBITRATION, REPORT OF THE ICCA-QUEEN MARY TASK FORCE ON THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION 83 (2018).

arbitration. At least in the context of arbitration, the Working Group considers that the existence of non-recourse funding attached to the matter in which an arbitrator is being considered for appointment requires disclosure to enable the arbitrator appropriately to evaluate and disclose the possibility of conflicts. Similarly, while some courts have taken the view that an absence of actual knowledge about a conflict may preclude a later finding of evident partiality by the arbitrator, the better view, requiring disclosure, is driven by the prospective arbitrator's affirmative duty to investigate and report potential conflicts.

The Working Group also considered arguments that routine disclosure beyond the fact of funding and identity of the funder serves no useful purpose and may lead to a "weaponizing" of the arbitrator disclosure process, including frivolous challenges to arbitrators, unwarranted requests for security for costs, delays in proceedings, and other abuses. We conclude that most potential abuses may be avoided by limiting the disclosure to the fact of funding and identity of the funder, which are necessary to inform arbitrators' pre-appointment disclosure. We agree that any further disclosure should be based on a showing of specific need, as determined by the arbitration tribunal, once convened.

F. Recommendations Regarding Disclosure of Commercial Litigation Funding

After surveying the current legal framework governing disclosure, as well as the arguments in support of and in opposition to disclosure, the Working Group does not at this time support any mandatory disclosure requirement with respect to the funding of commercial litigation. Nor does the Working Group support discoverability of the details of funding arrangements absent special circumstances. We have also considered whether a variant of Fed. R. Civ. P. 7.1 should be adopted under the N.Y.C.P.L.R. to require disclosure of the existence and identity of funders in particular matters in order to inform recusal and disqualification decisions, but we decline to recommend adoption of such a rule at this time.

However, the arguments supporting disclosure at least under some circumstances are significant. For instance, to the extent a funded party places its resources at issue in opposing discovery on the basis of proportionality, disclosure of relevant funding details may be appropriate. Furthermore, certain types of investment in patent litigation may raise standing issues that require disclosure to resolve. The Working Group also considers that routine disclosure of the fact of funding and identity of the funder should be required in arbitration, where arbitrators must make informed conflict disclosures before their appointments are confirmed.

The rationale of providing information as relevant to recusal and disqualification decisions is both compelling and appropriately narrow such that it avoids the vast majority of problematic concerns with broader disclosure. However, in light of the limited instances of funding, requiring a blanket disclosure in all funded cases of the existence and identity of funders appears overbroad. In addition, requiring disclosure would necessitate developing a further body of law surrounding the extent of disclosure. Such law would need to address various complicated issues, including *what* constitutes litigation funding (*e.g.*, portfolios, monetizations, recourse and debt instruments), *who* has access to such disclosure (*i.e.*, factfinders or parties), *what* disclosure is appropriate (*e.g.*, the fact of funding, redacted or unredacted single-case and portfolio transaction documents, communications with funders, communications with potential funders), and *why* disclosure is appropriate (*e.g.*, relevance and privilege). It may be that over time, as legislatures and tribunals thoughtfully consider the complex issues associated with disclosure, patterns will become more apparent and disclosure rules can be promulgated that are efficient and advance legitimate needs, while avoiding unnecessary complexities and risks.

We note, however, that the analysis differs for class and derivative actions under the authorities cited in Section D above. Also, the existence of funding for a class or derivative matter, whether by itself or included in a portfolio, reduces the law firm's risk of no recovery, which may be a consideration in a court's determination of the fee award.

V. REVIEW OF LITIGATION FUNDING FOR CONSUMERS AND PROPOSED LEGISLATION

In 2007, Maine became the first state to regulate the industry that provides to consumers funding secured by recoveries from civil litigation. Today, only fourteen states in this country regulate litigation funding in the consumer space. Twelve of those states do so through either laws or regulations.[226] The other two states have had court decisions impose limits on the industry.[227]

New York is among the 36 states that do not currently have legislation or regulations in place. While New York does not yet have legislation or regulation, some guidelines do exist based on the efforts of New York's Office of the Attorney General.[228] In February 2005, the AG's office and a group of nine funders entered into an agreement pursuant to which the participating funders agreed to observe certain minimal guidelines concerning their transactions with New York residents. These guidelines generally are protective of consumers, such as requiring plain language disclosures of repayment obligations, and are discussed further below in Part A.16. For the past several sessions, legislation has been proposed in the Assembly and the Senate to have New York join the list of states with some regulation of this industry. To date, each session has ended without the proposed legislation becoming law.

The Subcommittee on Consumer Litigation reviewed the regulation of the consumer litigation funding market and developed this report on trends across the country. The analysis of the effects and any unintended consequences of the various regulations is limited to anecdotal evidence given the lack of publicly-available data. We also discussed the bill introduced in New York during the Spring 2019 legislative session. This report concludes that the proposed legislation would be improved by certain changes, including removal of the fee cap and changes in the annual reporting requirement designed to gather sufficient financial information to evaluate the industry.

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[226] The states with laws are Maine (2007), Ohio (2008), Nebraska (2010), Oklahoma (2013), Tennessee (2014), Arkansas (2015), Indiana (2016), Vermont (2016), Wisconsin (2018) and West Virginia (2019). Maryland and Kansas impose regulations at the agency level.

[227] The two states that rely on court decisions are Michigan and North Carolina. *See infra* Part A.

[228] Last year, a New York trial court offered its own guidance when it addressed the topic as part of an infant compromise order. *See S.D. v. St. Luke's Cornwall Hosp.*, 63 Misc.3d 384, 96 N.Y.S.3d 467 (N.Y. Sup. Ct. 2019) (infant compromise order voiding portion of agreement to pay funder owned by plaintiff's counsel's brother "exorbitant" assumption of risk charges for failure to disclose counsel's relationship to funder).

We note a few points at the outset. The consumer litigation funding industry can be divided into two broad categories depending on the type of litigation involved and the stage of the litigation. It appears that most entities in the consumer space advance money to individual plaintiffs pursuing individual claims (frequently personal injury claims) while their cases proceed toward resolution. These advances are made primarily to allow the consumers to pay basic living expenses. Most of the regulatory activity to date is targeted at this segment of the industry. The other distinct segment of this industry is active in the class action arena and typically advances funds once a settlement has been reached. Oftentimes, it can take several months for a class action settlement to obtain the necessary court approval and become final. It is also typical for objectors to appeal decisions approving the settlement on behalf of the class, further delaying distribution of settlement proceeds. Some of the regulatory activity is directed at this segment of the industry. This report focuses on the former portion of the industry – direct funding to consumers pursuing individual claims. While the existence of such an industry does provide a benefit to consumers, abuses do occur and thus regulation is warranted. The difficult question is the appropriate level of regulation.

A. An Analysis of Existing Regulation by Issues and Areas Regulated

1. Nomenclature

The applicable legislation and regulations use various ways to describe the industry or the participants in the industry. The nomenclature includes:

- Consumer litigation funding;
- Litigation financing / litigation financier;
- Civil proceeding advance payment provider;
- Litigation funding provider; and
- Non-recourse civil litigation advance contract.

In this section, we refer to persons or entities who provide consumer litigation funding or advances as funders.

2. Licensure

a) Requirements

Many, but not all, states require funders to register with a state agency and to pay a registration fee. Some of these states require funders to renew on a periodic basis thereafter and to pay a renewal fee. Some states simply require registration by funders while other states actually investigate potential funders before issuing licenses. Oklahoma requires that the Administrator of Consumer Credit conduct an investigation and determine whether the applicant's business "will be operated honestly and fairly in accordance with this act."

Many statutes contain carve-out provisions that exclude certain persons from the application of the statute. These excluded persons include attorneys representing the consumer in the litigation being funded, immediate family members, and accountants providing accounting services to the consumer. Indiana's statute applies only to someone "regularly engage[d]" in the business and defines regularly engaged to mean more than 25 transactions in a calendar year.

3. Bonds

Funders are often required to post a surety bond or provide an irrevocable letter of credit at the time they register with the applicable state agency. The amount of the bond/letter of credit is usually $50,000. In Vermont, funders have to post a bond equal to the greater of $50,000 or "double the amount of the company's largest funded amount in Vermont in the prior three calendar years," *i.e.*, the largest amount funded in a single case.

4. Other Licensing Requirements

Three states – Maine, Nebraska and Vermont – require funders to file an annual report with certain data including the number of transactions, the amount of funds advanced, the number of transactions where consumers repaid advances, the amounts repaid by consumers, the annual percentage fee charged and the itemized fees charged.

5. Scope of Transactions to which Regulations Apply

a) Limitations as to the Maximum Amount Covered

As best can be determined, no current state regulation contains a limitation as to the maximum amount for a transaction to be covered.

b) Definition of Consumer

Almost all of the statutes analyzed define consumer to exclude entities. These statutes do so by utilizing terms like "natural person" or "individual" in the definition of consumer. The statutes also require that the individual (by residency or domicile) or the claim have some nexus to the state imposing the regulation. There does not appear to be any statute that addresses which state's regulatory laws would apply if a resident in one regulated state with a claim in another regulated state enters into a contract with a funder.

The Ohio statute defines consumer as follows: "a person or entity residing or domiciled in Ohio and represented by an attorney with a pending civil claim or action." This appears to be the only statute that includes an entity within the definition of consumer.

6. Contracts Terms Required/Prohibited

a) Written Contract

It appears to be a universal requirement that the consumer litigation funding contract be in writing.

b) Language of Contract

Ohio requires that for consumers who speak English, French or Spanish, the contract be in the same language as the negotiations. If the consumer does not speak one of those languages, the contract must be translated and certified under oath. Maine requires that the contract must be translated for consumers who do not speak English. Depending on the consumer's primary language, either the entire contract or its principal terms must be translated.

c) Right of Rescission

Almost all of the statutes require that the contract signed in connection with advances provide the consumer with a limited right to rescind the agreement. Most of the statutes require the funder to provide the consumer with five business days after funding provided that the consumer returns all of the funds advanced to him or her. The right of rescission has to be clearly disclosed in the funding agreement.

7. Non-Recourse Transaction

In many cases, the statutes define the applicable transactions as ones that are non-recourse. In other statutes, there is a specific requirement that the transaction must be non-recourse and that the contract disclose to the consumer that the funder cannot seek repayment from other sources.

8. Acknowledgement by Consumer's Litigation Counsel

The strictest regulations require that the consumer's litigation counsel acknowledge that he or she had an opportunity to review the agreement before it was executed by the consumer. Other states require consumers to represent that they had an opportunity to discuss the agreement with their attorneys in the underlying litigation. Some statutes do not require any acknowledgement from or about the consumer's litigation counsel.

9. Required Disclosures

The different states have different requirements as to the content of required disclosures as well as to the manner in which the disclosures are made. Tennessee requires the disclosure to be at least 14-point, bold font and conspicuous in the agreement. Vermont requires that certain disclosures be set forth on the first page of the agreement. Many states require certain material disclosures be made on the first page, especially information concerning the financial terms of the deal. These requirements mandate disclosures somewhat similar to the type of financial disclosures one would see in an automobile financing transaction. Many states require that the contract set out a schedule showing the consumer the repayment amount that will be due at the end of every six-month period. In some states the contract must advise the consumer that some or all of the funded amount may be taxable. Sometimes the contracts must also advise the consumer to seek legal advice before signing the contract.

10. Other Requirements

Most states require that there be no blanks in the funding contract when the consumer executes it. Another frequent requirement is that the consumer must initial each page of the contract.

Several states bar multiple transactions with respect to the same claim. In West Virginia, the contract must include a provision on the interaction and priority of funding contracts when a consumer has or seeks multiple funding contracts.

A couple of states – Maine and Vermont – prohibit an arbitration provision in the funding contracts.

In some statutes, if the funder's contract provides for an award of attorney's fees in the event of a breach, the right must be reciprocal.

11. Attorney's Restrictions

a) No Compensation to Consumer's Litigation Counsel from Funder

Some state statutes prohibit a consumer's attorney from receiving compensation from a funder such as a referral fee or commission.

b) No Financial Interest in Funder

Nebraska, Indiana and Vermont prohibit an attorney from having a financial interest in a funder that provides funding to the attorney's clients. It appears that no state has yet imposed an outright ban on attorneys having a financial interest in a funder.

12. Restrictions on Funders

a) Fee Caps

The states have approached the issue of fee caps in widely divergent manners. Some states do not impose any fee cap and thus allow the free market and open competition to dictate the terms of the contracts. On the other end of the spectrum are states with strict fee caps. To date, it appears that West Virginia, a state that adopted its law earlier this year, imposes one of the lowest fee caps at 18 percent. Some states have a cap that is tied to the rate allowed by the Military Lending Act – 36 percent.[229] These states typically allow the funders to charge the Military Lending Act rate plus an additional percentage rate. Another method used to cap interest is to limit how frequently interest can compound, so Maine and West Virginia allow interest to compound semiannually at most.

While Maine does not impose a cap on the interest rate, it has other limits to protect consumers. The Maine statute limits the length of time during which interest can accrue to 42 months; interest cannot compound more frequently than semiannually; and interest applies only to amounts "actually received and retained by a consumer." West Virginia has a similar restriction, including the 42-month interest accrual period. Nebraska uses a shorter period, 36 months, for a similar restriction.

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[229] The Military Lending Act provides that creditors who extend credit to members of the armed forces or their dependents "may not impose an annual percentage rate of interest greater than 36 percent with respect to the consumer credit extended to a covered member or a dependent of a covered member." 10 U.S.C. § 987(b).

Tennessee ties its restrictions to the Military Lending Act. Funders in that State can charge an annual fee of 10 percent in addition to the Military Lending Act's amount of $360 per $1,000 lent. Tennessee allows these amounts to accrue for only three years. Indiana also relies on the Military Lending Act rate plus an additional seven percent annual rate and a one-time fee of either $250 or $500 depending on the funded amount.

Arkansas treats litigation funding as a type of consumer lending and subjects it to the same restrictions, including a cap of 17 percent.[230]

b) Advertising Restrictions

As expected, the statutes prohibit funders from advertising false or misleading information about their products or services.

c) Prohibition on Paying Referral Fees

In many of the statutes, funders cannot pay or offer to pay any form of consideration to any attorney for referring a consumer. At least one state, Vermont, extends this prohibition to health care providers. The statutes work both ways and thus also prohibit funders from accepting any compensation for referrals from an attorney, law firm, medical provider, or any of their employees.

d) Requiring Use of Specific Attorney

Not only do many statutes prohibit funders from requiring the use of a specific attorney, they also prohibit funders from referring consumers to specific attorneys or law firms. Tennessee went a step further and mandated that when a consumer does not have an attorney, the funder "shall refer the consumer to a local or state bar referral service operated by a bar association."

e) Paying Costs of Litigation

Some states prohibit funders from making advances that they know will be used to pay litigations costs either during or after the resolution of the claim. Most states, however, have not addressed the issue.

[230] The Maryland Commissioner of Financial Regulation ruled in 2009 that litigation funding is a loan subject to the state's interest rate limit of 24% per year for a principal amount of more than $1000 and 33% for an amount less than $1000.

f) Obtaining Decision Making Authority

Most statutes explicitly require that the funder does not obtain any decision-making authority, which remains with the consumers and their attorneys.

g) Penalties for Violations

The most prevalent form of penalty in the various state laws is the funder's forfeiture of the right to any money above the amount provided to the consumer. In other words, the funder gets back its money and nothing more. In at least one state, if the funder violates the governing regulations, the funder forfeits its right to receive any portion of the litigation recovery, including the monies originally advanced to the consumer.[231] Arkansas considers a violation to be a deceptive and unconscionable trade practice.

13. Legal Privilege

Most states do not address legal privilege issues in their statutes or regulations. Vermont's regulation provides that "a communication between a consumer's attorney and the company shall not be discoverable or limit, waive, or abrogate the scope or nature of any statutory or common-law privilege, including the work-product doctrine and the attorney-client privilege."

14. Other Regulations

As discussed earlier, Wisconsin, which enacted its statute in 2018, became the first state to mandate that a party make disclosures about litigation funding as a component of the discovery process in the underlying lawsuit. Whenever someone other than a party to the lawsuit or the party's attorney is entitled to compensation contingent upon and sourced from proceeds of a civil action, the party must voluntarily disclose the arrangement, including the agreement itself. West Virginia subsequently included a similar provision in its new legislation.

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[231] W. Va. Code Ann. § 46A-6N-7.

15. Court Cases Imposing Restrictions

a) Michigan

In 2004, the Michigan Court of Appeals issued a ruling that governs consumer litigation funding regulation.[232] The court determined that the funder makes "nonrecourse capital advances" to the plaintiffs during the pendency of their lawsuits. The capital advances are contingent because repayment of the advance depends on the successful resolution of the case for which the advance was made.[233] For funders in Michigan, "risk" is the determining factor in whether a litigation funding transaction is considered a sound litigation funding contract or a loan. If a funder enters into a litigation funding contract with a consumer where there is risk as to whether or not the funder will be repaid, the contract will be enforceable and considered a sound litigation funding contract. If, however, the funder enters into a litigation funding contract without any risk involved – essentially having a certainty of repayment – the transaction will be viewed as a loan subject to any interest rate or usury rate laws that may apply. As a result, the funder cannot recover any interest, late fees, or attorney fees, and the borrower is entitled to recover his attorney fees from the lender.

This Michigan case addresses the difference between a proper litigation funding transaction in contrast to a loan. This case does not address licensure requirements, bonds, limitations as to the maximum amount of funding covered, contract terms, restrictions on funders or attorneys, caps on interest rates or fees, decision-making authority, privileges, or penalties for violations.

b) North Carolina

Consumer litigation funding in North Carolina is governed by *Odell v. Legal Bucks, LLC.*[234] In *Odell*, the plaintiff brought an action against a company (the defendant) that provided funds to use for expenses, asserting claims of usury, champerty, unfair and deceptive acts, and Consumer Finance Act violations.[235]

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[232] *Lawsuit Fin., L.L.C. v. Curry*, 261 Mich. App. 579, 579, 683 N.W. 2d 233 (2004), *leave denied*, 688 N.W.2d 502 (Mich. 2004).

[233] *Id.* at 581.

[234] 192 N.C. App. 298, 665 S.E.2d 767 (2008).

[235] *Id.* at 298.

In *Odell*, the plaintiff was involved in a motor-vehicle collision.[236] The plaintiff pursued a personal injury claim against the driver of the second motor vehicle in which the plaintiff expected to recover at least thirty thousand dollars from the personal injury claim.[237] The plaintiff entered into an agreement with the defendant for an advance of "money for personal expenses" in the amount of $3,000.[238] In the agreement, the plaintiff "unconditionally and irrevocably transfer[ed] and convey[ed] to [the defendant] all of [the] [p]laintiff's control, right, title and interest in the first monies paid to [the] [p]laintiff from the [p]roceeds of [the] [p]laintiff's personal injury claim."[239] Additionally, the plaintiff granted a security interest in the proceeds of the litigation and expressly provided that the agreement was not an assignment of the rights, and interest in the claim itself.[240] Notably, the agreement also provided that if there was "no recovery of [the] proceeds by [the] [p]laintiff, then [the defendant] [would receive] nothing."[241] The claim settled for $18,000.00; at the time, the plaintiff owed the defendant $9,582.00 and brought the action.[242]

The court held that the agreement was not champertous because the plaintiff did not transfer the interest in or the control over the claim itself to the defendant (the funder) but transferred only the rights and interests in the potential proceeds of the underlying claim.[243]

The court, however, held that the agreement was subject to North Carolina's usury laws as well as the Consumer Finance Act (N.C.G.S.A. § 53-166(a)), which governs loans made for $15,000 or less; the Consumer Protection Act (N.C.G.S.A. § 24), which sets the legal interest rate of 8 percent and governs loans and advances made by written contract for approximately $25,000; and the Unfair Deceptive Practices Act (N.C.G.S.A. § 75), which generally governs unfair methods of competition affecting commerce and unfair or deceptive acts or practices affecting commerce. North Carolina courts apply these statutes to consumer litigation funding agreements.

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[236] *Id.* at 301.

[237] *Id.*

[238] *Id.*

[239] *Id.* at 302.

[240] *Id.*

[241] *Id.*

[242] *Id.* at 303.

[243] *Id.*

16. Minimum Guidelines in New York Attorney General's 2005 Agreement with Certain Funders

On February 17, 2005, the Bureau of Consumer Frauds and Protection of the New York Attorney General's Office entered into a written *Assurance of Discontinuance Pursuant to Executive Law §63(15)* with nine funders. While that agreement is binding only on those nine companies, we understand that the document serves as a set of minimum guidelines for the industry in New York. The nine companies agreed to comply with the Plain Language Law, to have written contracts in English or Spanish, and to have principal terms translated for consumers who do not understand English or Spanish. Under the AG's requirements, all contracts must be completely filled in and contain certain disclosures about financial terms on the front page, including a breakdown of the total amount to be repaid at six-month intervals. The agreement provides that consumers will be given five business days to cancel the contract, consumers will be advised to consult with their lawyers before signing, the funding contracts will not have mandatory arbitration clauses, and the attorney's fees provision must be reasonable.

B. Consumer Litigation Funding Regulations in Practice

Data, even in states with reporting requirements, are fairly sparse at this time. It has proven difficult to get an unbiased perspective as to the impact, effect or unintended consequences of regulation of the consumer litigation funding industry. The website maintained by the Association for Responsible Consumer Legal Funding (ARC) says that "a few states have passed laws that have hurt everyday people–Tennessee (2014) and Arkansas (2015). ARC hopes to restore access to consumer legal funding in these states, and bring their statutes into alignment with others that benefit working families."[244] ARC suggests that the regulations have the effect of causing funders to cease doing business in these states as they cannot make enough profit for the risk involved in these non-recourse transactions. Moreover, anecdotal evidence from ARC suggests that states with low caps, such as Tennessee, Arkansas, and West Virginia, have essentially seen the industry disappear, while funders in states with regulations but no cap such as Vermont and Oklahoma seem to be operating successfully. Conversely, the Institute for Legal Reform of the U.S. Chamber of Commerce shared with the Working Group anecdotal reports of cases where it appears that the

[244] STATE LEGISLATION, ALLIANCE FOR RESPONSIBLE LEGAL FUNDING, http://arclegalfunding.org/legislative-issues/ (last visited Oct. 30, 2019).

consumers repaid excessive amounts to their funders.[245] For example, the Chamber mentioned allegations against one funder that it charged some clients interest rates as high as 124 percent.[246]

Earlier this year, the *Cornell Law Review* published an article in which the authors analyzed the consumer litigation funding industry.[247] Those authors were given access to a decade of application files from one of the country's largest funders that included more than 200,000 requests for funding. Their 50-page article contains an extremely detailed analysis of the results gleaned from the records of the funder. The authors note a discrepancy between the information they abstracted from their data and some public reports as to the percentage of cases that result in no recovery by the consumer. According to their study, the funder experienced that only 10 percent of its funded cases result in no litigation recovery whereas funders in Maine reported that between 20 and 30 percent of all cases result in no funds to the plaintiff.[248] The following chart shows what the authors determined that the funders received in the 38,318 completed cases:[249]

No money paid to funder	10%
Paid less than funded amount	2%
Paid funded amount or more but less than amount due[250]	49%
Paid amount due	34%
Paid more than amount due	5%

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[245] Letter from John H. Beisner, Esq. to the NYCBA Litigation Funding Working Group, 15–16 (May 30, 2019).

[246] In addition to receiving information from ARC and the Chamber of Commerce, the Subcommittee spoke with representatives of the Bairs Foundation of Buffalo, New York, which identifies itself as the nation's only non-profit consumer litigation finance organization, and the Maine Bureau of Consumer Credit Protection. Information from all of these sources has been utilized in preparing this report and reaching the conclusions set forth herein.

[247] R. Avraham & A. Sebok, *An Empirical Investigation of Third Party Consumer Litigant Funding*, 104 CORNELL L. REV. 1133 (2019).

[248] *Id*. at 1141–42. Elsewhere in the article, the authors noted that their calculation is "roughly consistent with some anecdotal reporting by industry actors." *Id*. at 1158, n. 56.

[249] *Id*. at 1158.

[250] The authors refer to these situations as "haircuts." *Id*. at 1143 (defining haircut); *see also id*. at 1157–60 (analyzing completed cases with haircuts).

The authors calculated that "the median actual annual return is approximately 43 percent of the amount once one takes into account defaults and haircuts."[251] The article explains some of the methods used by funders to obligate consumers to pay a greater percentage of interest than is readily apparent from advertising or from the face of the contracts. The professors "think that [their] results at minimum support reforms designed to make pricing transparent by removing complex pricing mechanisms."[252]

C. New York's Proposed Legislation

1. Status of Proposed Legislation

As discussed earlier in this Report, on May 13, 2019, the NY Senate's Consumer Protection Committee voted 7-0 to approve Senate Bill Number S04555, sponsored by Senator Anna Kaplan (D-7), ("Kaplan's Bill") for consideration by the full Senate. Kaplan's Bill is co-sponsored by Senators Robert Ortt (R-62) and James Skoufis (D-39). The companion bill in the Assembly is Bill Number A6764, sponsored by William Magnarelli (D-129). This bill was referred to the Assembly's Consumer Affairs and Protection Committee; no action was taken to move it forward before the session ended. Since similar bills have been introduced for several sessions in a row, it is likely that a similar bill will be introduced this session.

2. Analysis of Proposed Legislation

The Senate's summary of Kaplan's Bill states that it:

> Enacts the consumer litigation funding act to promote consumer protections related to consumer litigation funding transactions; provides for contract requirements, including that the contract contain a no penalty provision for the pre-payment of the funded amount prior to the settlement of his or her case; makes related provisions.

If enacted, Kaplan's Bill would:

- apply only to non-recourse transactions of $500,000 or less;
- prohibit charges exceeding the Military Lending Rate (36% annually);
- require funders to register with the Department of State, pay registration fees (renewal every 2 years), and post a bond not to exceed $50,000;

[251] *Id*. at 1142.

[252] *Id*. at 1143.

- require the Secretary of State to investigate the character and fitness of the funder and its principals;
- require that funders, before using any form of contract, file a copy with the Secretary of State;
- allow consumers 10 business days to rescind the contract and return all disbursed funds;
- require fairly typical disclosures in the contract;
- impose fairly typical restrictions on referral fees;
- impose fairly typical restrictions on attorneys' financial interest in the funder providing advances to the attorney's client;
- treat as privileged, including work product, communications about the consumer's legal claim from the consumer's attorney to the consumer's funder;
- require that the contract contain an acknowledgment by the consumer's attorney that, *inter alia*, the attorney has reviewed the mandatory disclosures provided for by the law with the consumer and that the attorney has not provided any advice as to tax, public or private benefit planning or financial matters;
- require that funders file an annual report with NYS Department of Financial Services containing certain information, which DFS must make publicly available in a manner that maintains confidentiality of the funder and the consumer;
- deem it a waiver of the right to recover the funded amount and any charges when a funder willfully violates the law in a specific case; and
- allow the Attorney General to pursue civil penalties of $5,000 for each willful violation of the statute by a funder.

Kaplan's Bill defines consumer as "a natural person who has a pending legal claim and who resides or is domiciled in New York." Thus, it appears that this law would not apply to funders who operate in New York but make advances solely to consumers in other states. Finally, the law would require that registered funders include in their annual report the number and amount in dollars of transactions funded by the funder and the annual percentage charged to each consumer where repayment was made. There is no requirement to report information concerning transactions where the consumer did not repay the advance.

D. Recommendations with Respect to Proposed Legislation

The consumer litigation funding industry does provide a benefit to the citizens of New York when such lending is conducted in a responsible manner. It is important to have some regulation in place. The executive director of ARC estimates that as many as 40 entities operate in New York providing consumer litigation funding, most of which are smaller, less formal entities. Legislation that strikes the right balance is crucial and can allow New York to protect consumers while ensuring the vitality of this industry in our State. By doing so, New York would become a national leader as other states inevitably consider similar regulation. Kaplan's Bill, with some modifications discussed below, should accomplish that goal and provide significant information to allow the Legislature, the Secretary of State and the Attorney General to reassess the regulations in a few years based on the data provided by the industry.

1. Definition of Consumer

The definition of consumer should be expanded to include non-residents who are pursuing civil claims in the courts of this State and who receive funding from a funder registered in New York. Such definition would be "a natural person who (a) has a pending legal claim and who resides or is domiciled in New York, or (b) resides and is domiciled outside New York and has a civil action pending in a New York court." This change is necessary in order to close a gap in regulatory coverage that would exist under the language of the proposed legislation.

2. Remove Cap on Fees

At this juncture, there is insufficient data to demonstrate whether New Yorkers are adversely impacted by the fact that New York does not currently have a restriction on the fees that funders can charge. Rather than risk inhibiting the industry in New York without good reason, it would be more prudent to obtain some concrete data to see if a fee cap is necessary. As discussed below, if the reporting requirements were bolstered somewhat, New York legislators and regulators would have a meaningful way to determine whether imposing a fee cap would be useful or counter-productive and, if useful, what fee cap would be reasonable.

3. Add to Reporting Requirement

In order to understand the profitability of this industry, one needs to know information about the funding transactions that are not repaid due to the non-recourse nature of the transaction. The authors of the *Cornell Law Review* article have made a valuable contribution in assisting legislatures and regulators obtain a better insight into the financial aspects of the industry. The data, however, come from the operations of only one funder. To understand, and thus appropriately regulate, this industry, it would be best to gather data from multiple funders. New York, as the state with the most robust funding industry, is uniquely situated to compel funders to provide their data. Thus, the annual report to be filed with DFS should also disclose (a) the total number of completed cases in which the funder received no payment, (b) the total amount funded in completed cases in which the funder received no payment, (c) the number of completed cases in which the funder received an amount less than or equal to the amount funded, and (d) the total amount funded in completed cases in which the funder received an amount less than or equal to the amount funded.

4. Revise Penalty Provision to Include Only Forfeiture of Fees and Charges

The forfeiture of the amount actually funded to the consumer is too harsh and would provide the consumer with an undue windfall. The forfeiture of all fees and charges and the risk of a civil penalty should be a sufficient deterrent to prevent willful misconduct by funders.

5. Restriction on Ownership by Attorney and Judges

In addition to the current restriction, Kaplan's Bill could further restrict the ability of practicing lawyers and judges to own or control a funder. The hypothetical scenario was posed where two law firms that engage primarily in representing individual plaintiffs set up their own funder entities and then refer their clients to the other firm's entity. Also, a primary reason for requiring disclosure of funding arrangements in pending lawsuits is to allow the judge to avoid a conflict of interest. Additional restrictions on lawyers and judges controlling and owning funders could eliminate or reduce issues like these.

VI. CONCLUSION

This Report is the culmination of the Working Group's comprehensive study and review of the issues and practices surrounding litigation funding. After analyzing the issues from a diverse array of perspectives, the Working Group believes that the New York Rules of Professional Conduct should be modified to accommodate the reality of litigation funding. The Working Group has proposed guidelines so that lawyers will be more informed and better prepared when utilizing third-party litigation funding, protecting their clients' interests and ensuring compliance with their professional obligations. In addition, the Working Group has conducted a comprehensive review of disclosure in federal and state courts and recommends that there should not be a mandatory disclosure requirement with respect to the funding of commercial litigation at this time, but that the details of funding arrangements may be discoverable in certain circumstances. Finally, the Working Group has reviewed the consumer litigation funding industry and offers its views on changes that could be made to improve the consumer funding bill introduced in New York during the Spring 2019 legislative session.

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