Testimony to the Senate Committee on the Judiciary

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on behalf of the
U.S. Chamber Institute for Legal Reform

Senate Bill Number 94: Making Third-Party Litigation Funding Transparent and Protecting Ohio Consumers and Businesses

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Good afternoon Chairman Manning, Vice Chairman McColley, Ranking Member Thomas, Members of the Committee, Ladies and Gentlemen:

Thank you for inviting me to speak today on behalf of the U.S. Chamber Institute for Legal Reform ("ILR") regarding third-party litigation funding ("TPLF") and proposed Senate Bill Number 94 ("S.B. No. 94") to address that practice.[1] ILR applauds the Committee for addressing this issue, and is overall supportive of the proposed legislation, which would make TPLF more transparent, create much-needed oversight of a largely unregulated industry, and enact statutory safeguards for consumers and businesses alike.

ILR is a program of the U.S. Chamber of Commerce ("the Chamber") dedicated to championing a fair legal system that promotes economic growth and opportunity. The Chamber is the world's largest business federation, representing the interests of more than three million businesses of all sizes, sectors and regions, as well as state and local chambers and industry associations, and it is dedicated to promoting, protecting and defending America's free enterprise system.

As part of its core mission, ILR has been studying the effects of TPLF for more than a decade. It has sponsored a number of nonpartisan symposia and conferences, as well as the publication of articles on the effects of TPLF in the United States. ILR also has engaged in public advocacy with multiple state legislatures, the U.S. Congress and federal and state courts. In short: TPLF is very much on ILR's mind, and I welcome and am grateful for the opportunity to testify about TPLF, the dangers it poses to Ohio's civil justice system, and why S.B. No. 94 is necessary to mitigate those problems.

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I. BACKGROUND

TPLF is the practice of providing money to a party in connection with the party's pursuit of a potential or pending lawsuit.[2] Most TPLF contracts resemble non-recourse loans: the borrower who is or may become a party to a civil action obtains money from a TPLF lender and is only required to repay the loan if he or she obtains a damages award at trial or receives money in a settlement.[3] The amount of the repayment, which is generally calculated either as a percentage of the borrower's recovery or as a percentage of the loan amount itself, turns on several factors, including the amount of money advanced, the length of time until recovery, the potential value of the borrower's case and whether the case settles or goes to trial.[4] The key feature of TPLF, which distinguishes it from other forms of credit, is that its repayment is tied to the outcome of a particular lawsuit or portfolio of litigation. If the lawsuit that is the source of the lender's recovery is not successful, the lender receives nothing. But the more money the plaintiff wins or settles for, the higher the lender's recovery.

TPLF first emerged in Australia and some European countries as a supposed means of making courts more accessible to potential litigants who could not afford to finance their own lawsuits.[5] But that justification is dubious in the United States because our legal system already makes it virtually free for someone to file a lawsuit, regardless of real merit. The U.S. judicial system has long allowed plaintiffs who cannot (or do not want to) self-finance a suit to enter into contingency-fee arrangements with their attorneys. That approach – which is not permitted in most other legal systems – encourages the filing of many lawsuits that would never be brought in other countries. As long as some lawyer thinks a case is worth the investment of his or her time, a plaintiff in the United States can file a lawsuit without having to shoulder the litigation costs. There is no evidence that we have a problem in this country of large numbers of people with meritorious claims who are unable to have their day in court.

"Lawsuit finance is no longer in its infancy in the United States."[6] "TPLF has grown by leaps and bounds in the past decade; according to a recent survey, 'private funders active in the [United States] have a whopping $9.52 billion under management for commercial case investments.'"[7] Moreover, apart from the dramatic growth of the industry in the United States, the practice has become increasingly diversified, with funders coming up with new and

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[2] *See* Robert Huffman & Robert Salcido, *Blowing the Whistle on* Qui Tam *Suits and Third-Party Litigation Funding: The Case for Disclosure to the Department of Justice*, 50 Pub. Cont. L.J. 343, 344, 350 (2021).

[3] *See* Ronen Avraham & Anthony Sebok, *An Empirical Investigation of Third Party Consumer Litigant Funding*, 104 Cornell L. Rev. 1133, 1133-34 (2019).

[4] *See* William J. Harrington, *Feature, Champerty, Usury, and Third-Party Litigation Funding*, 49 The Brief 54, 56 (Winter 2020).

[5] *See* John Beisner, Jessica Miller & Gary Rubin, *Selling Lawsuits, Buying Trouble: Third-Party Litigation Funding in the United States*, U.S. Chamber Institute for Legal Reform, Oct. 2009.

[6] Ralph Sutton, *Five Predictions for Litigation Finance in 2019*, Am. Law (Nov. 27, 2018), https://www.law.com/americanlawyer/2018/11/27/five-predictions-for-litigation-finance-in-2019/.

[7] Huffman & Salcido, *supra* note 2, at 348 (quoting Andrew Strickler, *Awash in Cash, Litigation Funders Eager to Strike Deals*, Law360 (Nov. 19, 2019), https://www.law360.com/articles/1220829).

sophisticated models to invest in litigation.[8] "They include portfolio financing, which 'gathers multiple litigation or arbitration matters in a single funding vehicle.'"[9] "An example is a 'deal[] in which an outside funder invests in a group of related plaintiff-side cases in exchange for a cut of any award or settlement.'"[10]

Broadly speaking, two general types of TPLF have emerged. The first type of TPLF is what I will call "consumer lawsuit lending." The second type of TPLF involves investments by highly sophisticated companies in potential high-stakes lawsuits, such as business-to-business litigation and even mass tort litigation or class actions.[11]

Consumer lawsuit lending generally involves loans to individual plaintiffs to finance small claims or provide living expenses. In this variant of litigation funding, the plaintiff sells his or her claim to the funding company in exchange for an up-front cash payment.[12] If the plaintiff's claim is successful, the plaintiff repays the funding provider the money advanced, plus interest. However, if the case is resolved on terms that do not provide enough funds to cover the plaintiff's loan, the plaintiff still owes the full amount of the loan – in essence, the plaintiff can end up in a worse position than if he or she had not filed the lawsuit and obtained the loan to begin with. As one scholarly article observed, "[i]t is a lousy deal."[13] While the interest rates charged by consumer lawsuit funders vary, "it is not atypical for a[] [funder] to charge 80% interest in the first year of a loan and ***up to 280% of the total loan amount***."[14]

The second type of TPLF has fewer direct consequences for consumers but is just as harmful both to the integrity of our legal system and to the economy. In this type of TPLF, large investment companies or consortiums provide substantial sums of money to a law firm to finance the conduct of litigation. The commercial funding industry initially focused on "the funding of business disputes, such as disputes relating to intellectual property, antitrust, business contracts, and international commercial and investment arbitration-brought by sophisticated parties and involving larger stakes."[15] However, this variant of TPLF has expanded well beyond business-to-business disputes, increasingly playing a role in large-scale mass-tort litigation as well.[16] Sometimes, the money is provided before the suit is even brought – indeed, the investment

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8 *See* John H. Beisner, Jessica Miller & Jordan Schwartz, *Selling More Lawsuits, Buying More Trouble: Third Party Litigation Funding A Decade Later*, U.S. Chamber Institute for Legal Reform, p. 9, Jan. 2020.

9 Huffman & Salcido, *supra* note 2, at 348 (quoting *5 Minutes on . . . Portfolio Finance*, Burford Capital (Apr. 17, 2019), https://www.burfordcapital.com/insights/insights-container/5-minutes-on-portfolio-finance).

10 *Id.* (quoting Strickler, *supra* note 7).

11 *See* Avraham & Sebok, *supra* note 3, at 1135.

12 *Id.*

13 Jenna Wims Hashway, *Litigation Loansharks: A History of Litigation Lending and a Proposal to Bring Litigation Advances Within the Protection of Usury Laws*, 17 Roger Williams U. L. Rev. 750, 751 (2012).

14 Terrence Cain, *Symposium: Fringe Economy Lending – The Problem, Its Demographics, and Proposals for Change: Third Party Funding of Personal Injury Tort Claims: Keep the Baby and Change the Bathwater*, 89 Chi.-Kent L. Rev. 11, 12 (2014) (emphasis added).

15 Maya Steinitz, *The Litigation Finance Contract*, 54 Wm. & Mary L. Rev. 455, 460-61 (2012).

16 *See* Beisner et al., *supra* note 8, at 5, 8, 13.

company may come up with the idea for the lawsuit in the first place. Rather than imposing a monthly or annual interest fee, these investors typically seek a return "expressed as a percentage of case proceeds, a multiple of the funder's investment, or an accruing interest on the funding amount, with the return typically escalating over time."[17] Needless to say, these returns are substantial: in its 2019 annual report, Burford Capital – one of the largest funders in the world and a publicly traded company in the United States – reported an internal rate of return of approximately 30% over the past years, with a net return on invested capital in the range of 60-90%.[18]

TPLF has penetrated all aspects of our nation's civil justice system, including Ohio's. In 2003, in a case called *Rancman v. Interim Settlement Funding Corp.*, the Ohio Supreme Court recognized the problems posed by TPLF and invalidated the practice as an illegal form of champerty and maintenance, which are two centuries-old legal prohibitions against outsiders buying an interest in another's lawsuit.[19] In that case, the consumer, who had been seriously injured as a passenger in a collision, commenced a lawsuit against an insurance company and sought an advance of funds secured by her pending claims from two third parties, Interim Settlement Funding Corp. ("Interim") and Future Settle Funding Corporation ("FSF").[20] Interim, on behalf of FSF, initially provided the plaintiff with $6,000 in exchange for the first $16,800 recovered from the suit if resolved within 12 months, $22,200 if resolved within 18 months, or $27,600 if resolved within 24 months, yielding an aggregate interest rate ***exceeding 180% per year***.[21] Interim subsequently advanced an additional $1,000, which was secured by the next $2,800 the consumer expected to collect on her lawsuit.[22] The consumer ultimately settled her case with the insurance company for $100,000 within 12 months of entering the initial agreement, but refused payment on the ground that the TPLF contract was void under Ohio law.[23]

The Ohio Supreme Court held that the arrangements "constitute[d] champerty because FSF and Interim sought to profit from [the consumer's] case" and qualified as maintenance because "each purchased a share of a suit to which [it] did not have an independent interest; and because the agreements provided [the consumer] with a ***disincentive*** to settle her case."[24] As the Supreme Court explained, assuming that the consumer's attorney charged a 30-percent contingency fee, the consumer would not have received ***any*** funds from a settlement of $28,000 or less entered into within 12 months.[25] "Suppose [the consumer] decide[d] that she w[ould]

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17 Suneal Bedi & William C. Marra, *The Shadows of Litigation Finance*, 74 Vand. L. Rev. 563, 575 (2021).

18 *Id.* (citing Burford Capital, Annual Report 2019, at 20 (2020), https://www.burfordcapital.com/media/1734/fy-2019-report.pdf).

19 *See Rancman v. Interim Settlement Funding Corp.*, 789 N.E.2d 217, 218 (Ohio 2003).

20 *Id.* at 218-19.

21 *Id.* at 217-19.

22 *Id.* at 219.

23 *Id.*

24 *Id.* at 220 (emphasis added).

25 *Id.* at 220-21.

settle for nothing less than $80,000 minus attorney fees. Because of the obligation to repay the advances, she would refuse to settle until [the insurance company] offer[ed] $98,000."[26] In other words, the Court reasoned, TPLF agreements have the propensity to "prolong litigation and reduce settlement incentives – an evil that prohibitions against maintenance seek to eliminate."[27] And "[e]qually troubling," the Court lamented, was a "champertor's earning a handsome profit by ***speculating*** in a lawsuit and by potentially manipulating a party to the suit" – a reality laid bare by one of the funding agreements itself, which expressly provided that FSF "SHOULD MAKE A SUBSTANTIAL PROFIT ON THIS AGREEMENT."[28]

In 2008, the Ohio General Assembly effectively overturned the Supreme Court's judicial ban on TPLF and legalized the practice.[29] In so doing, the General Assembly imposed "fairly minimal requirements" on TPLF[30] – namely, the disclosure of the total dollar amount advanced, an itemization of one-time costs, disclosure of the annual percentage of return and the right to revocation within five business days of entering into a TPLF agreement.[31] These disclosures are fewer than those required in certain other states, such as Maine and Nebraska.[32] Moreover, the Ohio legislation did ***not*** require TPLF agreements to be disclosed to the court (much less to the other side), did not impose any limits on the amount of interest charged and otherwise left TPLF largely immune from any regulation.

Against this regulatory black hole, Ohio has become one of the "most attractive states for investing in litigation."[33] This dynamic threatens to harm consumers, increase litigation costs, encourage the filing of meritless lawsuits, create all kinds of ethical problems and otherwise impede the administration of justice. The remainder of this written testimony explains in more detail why TPLF is such a troubling practice, and what can be done to mitigate its negative impact on Ohio's civil justice system.

II. PROBLEMS INHERENT IN THIRD-PARTY LITIGATION FINANCING

TPLF raises serious public-policy and ethical concerns. Most notably, TPLF has the potential to exploit consumers and siphon money away from plaintiffs with bona fide claims. In addition, TPLF makes litigation more expansive by encouraging the filing of even more lawsuits, including many that would be considered too weak to file otherwise, putting a drain on our economic growth and opportunity. TPLF also discourages reasonable settlements and slows down the progress of litigation. And finally, TPLF compromises the integrity of the U.S. judicial

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26 *Id.* at 221.

27 *Id.*

28 *Id.* (emphasis added).

29 *See* Ohio Rev. Code Ann. § 1349.55 (enacted in 2008).

30 Michael McDonald, *The Best and Worst States for Litigation Finance (Part II)*, Above the Law (July 11, 2017), https://abovethelaw.com/2017/07/the-best-and-worst-states-for-litigation-finance-part-ii/?rf=1.

31 *See* Ohio Rev. Code Ann. § 1349.55.

32 *See* Cain, *supra* note 14, at 34.

33 *See* McDonald, *supra* note 30.

system by undermining a litigant's control over her lawsuit, spurring unethical fee-sharing between lawyers and non-lawyer TPLF companies and generating potential conflicts of interest.

A. TPLF Benefits Funders, Not Consumers

One of the most troubling consequences of TPLF is that it reduces litigation recoveries for purportedly aggrieved consumers, while increasing the cost of litigation. This reality is the direct result of both the excessive rates charged by lawsuit lenders and the relatively unsophisticated nature of the consumers who are lured into accepting the one-sided terms of the arrangements. As one prominent law professor put it, "[i]t's almost the Wild West of consumer credit products, like payday loans in the 1990s."[34]

Typically, the financing arrangement is structured as a non-recourse loan, with monthly interest accruing on the principal amount of the loan at rates that generally range from 3-5% per month. That "per month" dimension is extremely important to understanding the economics of such transactions. If the litigation lasts a year and the interest is compounded monthly, the total amount of interest due can be ***80 percent*** of the original loan amount; if the litigation lasts two years, the interest due can top ***220 percent*** of the principal. Moreover, such "excessive financing charges" are rarely adequately disclosed to consumers, who "do not possess the same level of negotiating power as do larger commercial entities or law firms."[35]

For example, according to court papers, LawCash – which boasts about providing "thousands of clients with lawsuit funding advances" – has allegedly charged its clients interest rates as high as ***124 percent***.[36] That is nearly ***five times*** the 25% ceiling imposed on financial institutions in Ohio.[37] In one recent case, an inmate at a New York prison received a paltry $350 advance from LawCash for a lawsuit alleging that he was abused by prison guards. After obtaining a $10,000 settlement from New York City, he had to repay LawCash ***$4,200***, or ***42%*** of the award.[38] And in another case, "[a] client alleged that his lawyer failed to competently negotiate with two [consumer third-party finance] providers, leaving him with a net recovery of ***$111 out of a $150,000 settlement*** in a personal injury claim."[39]

Other examples of TPLF leaving purportedly aggrieved consumers with little (if any) recovery abound, though some of them have been thwarted by vigilant judges. In the federal

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34 Brandon Lowrey, *How Litigation Funding Can Save, and Doom, Poor Plaintiffs*, Law360 (May 13, 2019), https://www.law360.com/articles/1157455/how-litigation-funding-can-save-and-doom-poor-plaintiffs (quoting Vanderbilt Law Professor Paige Marta Skirba).

35 ABA Comm'n on Ethics 20/20, Informational Report to the House of Delegates, at 7 (2012), https://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.pdf; Austin T. Popp, *Federal Regulation of Third-Party Litigation Finance*, 72 Vand. L. Rev. 727, 737 (2019).

36 *See* Shawn Cohen et al., *Inside the Cottage Industry That's Fleecing NYC Taxpayer*s, N.Y. Post (Jan. 2, 2018), https://nypost.com/2018/01/02/how-firms-are-getting-rich-on-the-surest-money-grab-in-nyc/.

37 Ohio Rev. Code Ann. § 1109.20.

38 Cohen et al., *supra* note 36.

39 Avraham & Sebok, *supra* note 3, at 1176 n.140 (citing *Francis v. Mirman, Markovits, & Landau P.C.*, No. 29993/10 (N.Y. Sup. Ct. Jan. 3, 2013).

litigation involving the prescription medication Vioxx, a number of individuals who were eligible for the settlement program established by Merck obtained loans from a lawsuit lender called Oasis Legal Finance. When they received their money from the program and proceeded to "settle up" with the lender, some were surprised to receive demands for amounts that equaled – and in some cases even exceeded – their recovery. The lender sought to enforce liens on the borrowers' settlement distributions, but the judge noted that such loan arrangements were barred by the terms of the resolution program.[40] In the end, the lender recovered little more than the amounts advanced, but solely because the judge not only was made aware of these arrangements, but was also actively involved in the settlement distributions.

TPLF has also threatened to cut into recoveries in litigation on behalf of 9/11 Ground Zero workers, including former New York police officer Elmer Santiago.[41] Santiago had been living out of his Jeep for years before RD Legal Capital LLC gave him three advances totaling $355,000 – all of which were extended ***after*** Santiago had already reached a $3.9 million settlement with the 9/11 victim compensation fund, meaning that there was virtually no risk to the lawsuit lender. When Santiago finally received the proceeds from his settlement in 2016, the TPLF firm told Santiago that he owed $863,000 – ***more than $500,000 of which was interest, constituting a nearly 150% rate on the original advancement less than two years prior***.[42] According to Santiago and his attorney, they had been duped into believing that the applicable interest rate was set at 19% annually, when in fact it was 19% compounded monthly.[43]

In short, the main justification for TPLF is that the practice is "pro-consumer," but the reality is that TPLF benefits only one group of people – the investors. Excessive interest rates that are compounded monthly, coupled with exorbitant annual fees (which are rarely adequately disclosed to consumers), render the consumer variant of TPLF highly predatory and ripe for meaningful reform.

B. <u>TPLF Encourages Meritless And Sometimes Even Vexatious Litigation.</u>

TPLF increases the filing of questionable claims. TPLF companies are mere investors, and they base their funding decisions on the present value of their expected return. As such, even if a lawsuit has little or no merit, it may be a worthwhile investment if there is a potential (however small) to recover a very large sum of money.[44] In addition, TPLF providers can mitigate their downside risk by spreading the risk of any particular case over their entire portfolio of cases and by spreading the risk among their investors – a phenomenon that has

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40 *See* Minute Entry, *In re Vioxx Prods. Liab. Litig.*, MDL No. 1657, ECF No. 31326 (E.D. La. Jan. 7, 2010).

41 Lowrey, *supra* note 34.

42 *Id.*

43 *Id.*

44 *See* Jeremy Kidd, *Modeling the Likely Effects of Litigation Financing*, 47 Loy. U. Chi. L.J. 1239, 1259 (2016) ("If the potential damages award is high enough, the expected value of the case will be high enough to warrant filing, even if the probability of winning is low.").

become increasingly ubiquitous in the TPLF industry.[45] For these reasons, TPLF providers have higher risk appetites than most contingency-fee attorneys and will be more willing to back claims of questionable merit.[46]

One of the most notorious examples of TPLF playing a role in fueling meritless litigation occurred in the case of *Chevron Corp. v. Donziger*.[47] In *Donziger*, Burford Capital – one of the largest funders – helped sustain a lawsuit against Chevron filed in an Ecuadorian court, alleging environmental contamination in Lago Agrio, Ecuador. Burford invested $4 million with the plaintiffs' lawyers in the Lago Agrio suit in October/November 2010 in exchange for a percentage of any award to the plaintiffs. In February 2011, the Ecuadorian trial court awarded the plaintiffs an $18 billion judgment against Chevron. In March 2011, Judge Lewis Kaplan of the U.S. District Court for the Southern District of New York issued an injunction barring the plaintiffs from trying to collect on their judgment because of what he called "ample evidence of fraud" on the part of the plaintiffs' lawyers, including the plaintiffs' lead attorney, Steven Donziger.[48] In particular, Donziger "forged expert reports";[49] he attempted to improperly influence the presiding judge in Ecuador by "attack[ing] the judge through legal, institutional channels and through any other channel [he could] think of";[50] and he even fabricated evidence against Chevron.[51]

Importantly, long before Burford had made its investment in the case, Chevron had conducted discovery into the conduct of the plaintiffs' lawyers under a federal statute that authorizes district courts to compel U.S.-based discovery in connection with foreign proceedings, and at least four U.S. courts throughout the country had found that the Ecuadorian proceedings were tainted by fraud.[52] Sometime in 2011, Burford decided not to provide any additional funding in the Lago Agrio case.[53] Nevertheless, its willingness to invest $4 million in a lawsuit despite allegations of fraud illustrates that TPLF investors have high risk appetites and are

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45 *See* Maya Steinitz, *Follow the Money? A Proposed Approach for Disclosure of Litigation Finance Agreements*, 53 U.C. Davis L. Rev. 1073, 1085-86 (2019) (noting that "portfolio funding" "is changing the competitive landscape of law firms").

46 *See generally* Paul H. Rubin, *On the Efficiency of Increasing Litigation*, paper presented to the Public Policy Roundtable on Third Party Financing of Litigation, Northwestern University Searle Center on Law, Regulation, and Economic Growth (Sept. 2009).

47 768 F. Supp. 2d 581 (S.D.N.Y. 2011)

48 *Id.* at 636. The Second Circuit later vacated Judge Kaplan's injunction on jurisdictional and procedural grounds, but his factual findings stand. *See Chevron Corp. v. Naranjo*, 667 F.3d 232 (2d Cir. 2012).

49 768 F. Supp. 2d at 636.

50 *Id.* at 612 (citation omitted).

51 *See id.* at 608 ("Upon hearing from his consultants "that there was no evidence that contamination" "had spread into the surrounding groundwater[,] Donziger responded . . . [:] 'You can say whatever you want.'") (citation omitted).

52 On the Lago Agrio suit, *see generally* Roger Parloff, *Have you got a piece of this lawsuit? The bitter environmental suit against Chevron in Ecuador opens a window on a troubling new business: speculating in court cases*, Fortune (June 28, 2011), https://fortune.com/2011/06/28/have-you-got-a-piece-of-this-lawsuit-2/.

53 *See* Roger Parloff, *Investment fund: We were defrauded in suit against Chevron*, Fortune (Jan. 10, 2013), http://fortune.com/2013/01/10/investment-fund-we-were-defrauded-in-suit-against-chevron/.

willing to back claims of questionable merit. Chevron ultimately sued Donziger for civil racketeering arising out of the Ecuador litigation, and in 2014, Judge Kaplan found that the "decision in the Lago Agrio case was obtained by corrupt means."[54] Judge Kaplan also lamented the plaintiffs' lawyers' "romancing of Burford," which the court found led the plaintiffs' counsel to adopt a litigation strategy designed to maximize the plaintiffs' ability to collect on any judgment – rather than focus on securing a judgment ethically and honestly.[55] Donziger was not only disbarred, but he was also recently found guilty of criminal contempt in connection with his fraudulent litigation scheme.[56]

TPLF has also made its way into the mass tort arena in the United States as part of a "sophisticated new tort machine that leverages Wall Street litigation funding, third-party brokers to collect and commoditize claims, and sweeping online marketing that recruits and coaches claimants."[57] Essentially, this paradigm allows lawyers to amass as many "faceless clients as possible" without adequately investigating the merit of the claims.[58] A lawsuit brought by a former employee of plaintiffs' law firm AkinMears in connection with the use of TPLF in litigation involving allegedly defective pelvic mesh products summarized the business model employed by the law firm as follows:

> (i) borrow as much money as possible; (ii) buy as many television ads and/or faceless clients as possible; (iii) wait on real lawyers somewhere to establish liability against somebody for something; (iv) use those faceless clients to borrow even more money or buy even more cases; (v) hire attorneys to settle the cases for whatever they can get; (vi) take a plump 40% of the settlement from the thousands and thousands of people its lawyers never met or had any interest in meeting; and (vii) lather, rinse, and repeat.[59]

This lawsuit, which had been reported on in the press, ultimately settled. However, the allegations in the petition are consistent with more recent reports in the media that TPLF is not only fueling dubious claims in the mass tort arena, but also potentially putting the health and safety of consumers at risk.

In April 2018, for example, the *New York Times* chronicled reports of litigation funders pushing plaintiff law firms to encourage women to undergo unnecessary surgeries in order to

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54 *Chevron Corp. v. Donziger*, 974 F. Supp. 2d 362, 644 (S.D.N.Y. 2014).

55 *Id.* at 479.

56 *See* Bob Van Voris, *Chevron Foe Donziger Is Found Guilty of Criminal Contempt*, Bloomberg (July 26, 2021), https://www.bloomberg.com/news/articles/2021-07-26/chevron-challenger-donziger-is-found-guilty-of-criminal-contempt.

57 Editorial Board, *Looting the Boy Scouts: The mass tort industry gins up thousands of dubious claims*, Wall St. J. (Mar. 2, 2021), https://www.wsj.com/articles/looting-the-boy-scouts-11614728612.

58 David Yates, *"Mass tort warehouse" fires fund officer to avoid paying him millions for acquiring 14,000 mesh claims, suit alleges*, Se. Tex. Rec. (Oct. 10, 2015), http://setexasrecord.com/stories/510642299-mass-tort-warehouse-fires-fund-officer-to-avoid-paying-him-millions-for-acquiring-14-000-mesh-claims-suit-alleges.

59 Orig. Pet. ¶ 76, *Shenaq v. Akin*, No. 2015-57942 (Tex. Dist. Ct. Harris Cnty. filed Sept. 29, 2015).

drive up the value of their claims.[60] The article describes the story of a woman receiving a phone call from a stranger who tells the woman that she has a defective mesh implant and that she needed surgery to remove it. "Just like that, she had stumbled into a growing industry that makes money by coaxing women into having surgery – sometimes unnecessarily – so that they are more lucrative plaintiffs in lawsuits against medical device manufacturers."[61] "While studies have shown that up to 15 percent of women with mesh implants will encounter problems" and that "removing the mesh is not always recommended," some TPLF companies will apparently do anything necessary to increase the potential recovery in cases they invest in, including pushing women to undergo unnecessary and dangerous surgeries.[62] Approximately one year after the *New York Times* reported these allegations, an indictment in the U.S. District Court for the Eastern District of New York alleged that a litigation funder bankrolling pelvic mesh litigation "facilitated the coordination of removal surgeries and purchases and resold [the plaintiffs'] medical debts for profit."[63]

As these examples reveal, if TPLF continues to operate without any meaningful limits, Ohio businesses will have to divert more of their resources from job-creation efforts to defending and/or resolving questionable claims. Ohio consumers will ultimately pay the price for such meritless – and even abusive – litigation, as businesses are forced to pass on the increased litigation costs to consumers and spend money defending against litigation instead of investing in new jobs.

C. TPLF Deters Reasonable Settlements And Prolongs Litigation.

TPLF also prolongs litigation by deterring plaintiffs from settling unless the defendant's offer is sufficiently generous to provide them a recovery after paying off both their attorneys and their TPLF lender. As the Ohio Supreme Court recognized in *Rancman*, a plaintiff who must pay a finance company out of the proceeds of any recovery has an "***absolute disincentive***" to accept what may otherwise be a fair settlement offer, hoping for a larger sum of money.[64] Notably, an executive of a prominent TPLF company previously acknowledged as much, confirming that litigation funding "make[s] ***it harder and more expensive to settle cases***."[65] This is so because the party may seek extra money to make up at least some of the amount (likely substantial) that will have to be paid to the TPLF entity.[66]

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60 Matthew Goldstein & Jessica Silver-Greenberg, *How Profiteers Lure Women Into Often-Unneeded Surgery*, N.Y. Times (Apr. 14, 2018), https://www.nytimes.com/2018/04/14/business/vaginal-mesh-surgery-lawsuits-financing.html.

61 *Id.*

62 *Id.*

63 Indictment ¶ 2, *United States v. Barber*, No. 1:19-cr-00239-RJD (E.D.N.Y. filed May 23, 2019).

64 *Rancman*, 789 N.E.2d at 220-21 (emphasis added).

65 Jacob Gershman, *Lawsuit Funding, Long Hidden in the Shadows, Faces Calls for More Sunlight*, Wall St. J. (Mar. 21, 2018), https://www.wsj.com/articles/lawsuit-funding-long-hidden-in-the-shadows-faces-calls-for-more-sunlight-1521633600 (emphasis added).

66 *See* Joshua G. Richey, *Tilted Scales of Justice? The Consequences of Third-Party Financing of American Litigation*, 63 Emory L.J. 489, 492-93 (2013) ("Plaintiffs may be less likely to settle disputes if they can off-load much of the risk that usually accompanies a trial onto third-party litigation funders.").

Some TPLF agreements that have become public also reveal that TPLF entities often structure their agreements to maximize their take of the first dollars of any recovery, thereby further deterring reasonable settlements. For example, in the Chevron Ecuador litigation previously discussed, the funding agreement included a "waterfall" repayment provision, which provided for a heightened percentage of recovery on the first dollars of any award.[67] Under the agreement, Burford would receive approximately 5.5% of any award, or about $55 million, on any amount starting at $1 billion. However, if the plaintiffs settled for less than $1 billion, the investor's percentage would actually go up. Thus, "the agreement effectively 'penalize[d] the claimants if they settle[d] for less than $1 billion.'"[68]

An empirical analysis of medical malpractice cases suggests that TPLF may be having precisely such an adverse effect in Ohio.[69] According to that analysis, after the Ohio Supreme Court's invalidation of TPLF in *Rancman* in 2008 (but before the 2008 legislative authorization of the practice), claim payments decreased by approximately 38% and claims were resolved 2.4 times faster than before the ruling.[70] The analysis also found evidence that "relative to the pre-ban period, the Ohio legislative legalization ***increased*** claim payment and claim duration."[71] In particular, the study found that the General Assembly's legalization of TPLF increased claim payment by approximately 13%.[72] "The claim payment and claim duration results are consistent with the theory that nonrecourse loans benefit plaintiffs by decreasing their discount rates and risk premiums so that they can ***hold out for higher settlements***."[73] Notably, these data are consistent with data reported outside the United States, which found that increased litigation funding in Australia (where TPLF originated and is also prevalent) was associated with "slower case processing, larger backlogs, and increased spending by the courts."[74]

In sum, both anecdotal and empirical evidence demonstrate that TPLF has a natural tendency to impede resolution of litigation, further driving up litigation costs. This is another reason why TPLF threatens to burden Ohio's litigation system and undermine the fair administration of justice.

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67 *See* Funding Agreement Between Treca Financial Solutions and Claimants, *Chevron Corp. v. Donziger*, No. 1:11-cv-00691-LAK-RWL, ECF No. 356-2 (Ex. B) (S.D.N.Y. filed Nov. 29, 2011).

68 Huffman & Salcido, *supra* note 2, at 358 (citation omitted).

69 Jean Xiao, *Consumer Litigation Funding and Medical Malpractice Litigation: Examining the Effect of* Rancman v. Interim Settlement Funding Corporation, at 4, 25, J. of Empirical Legal Stud. (2017), https://ssrn.com/abstract=3012180.

70 *Id.* at 25.

71 *Id.* at 5 (emphasis added).

72 *Id.* at 25.

73 *Id.* (emphasis added).

74 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, 1103 (2013).

D. <u>TPLF Raises A Host Of Ethical Issues.</u>

TPLF also poses a number of ethical challenges by: (1) undermining a party's control over his or her claims; (2) encouraging unethical fee-sharing between lawyers and non-lawyers; and (3) creating potential conflicts of interest.

1. Party Control Over Litigation.

TPLF undercuts a plaintiff's control over litigation because funders generally seek to protect their investment by exerting control over the plaintiff's strategic decisions. In some sense, the plaintiff becomes a bystander in his or her own case, particularly where the investor and lawyer have a relationship involving multiple cases. The Supreme Court's decision in *Rancman* is once again instructive. As previously discussed, the agreement in that case expressly provided that the consumer "ACKNOWLEDGES AND FULLY UNDERSTANDS THAT [THE FUNDER] MAY, WILL, AND SHOULD MAKE A SUBSTANTIAL PROFIT ON THIS AGREEMENT."[75] The clear import of that provision, the Supreme Court recognized, was that the funder would "potentially manipulat[e] [the] party to the suit."[76] While TPLF companies frequently assert that they do not engage in such conduct, the few TPLF agreements that have come to light demonstrate that, unsurprisingly, TPLF entities actually do exercise various forms of control and influence over the litigation matters in which they invest.

A recent example is *Boling v. Prospect Funding Holdings, LLC*, in which the U.S. Court of Appeals for the Sixth Circuit – the federal appeals court that hears cases originating in Ohio and several other states – concluded that the terms of the funding agreements involved in that personal injury matter "effectively g[a]ve [the TPLF entity] substantial control over the litigation."[77] For example, two of the agreements permitted the funder to require the plaintiff to execute documents or pay filing fees to protect the funder's interest. Another agreement provided that "[i]f the Proceeds [from settlement] are insufficient to pay the Prospect Ownership Amount in full, [Prospect] shall receive all of the Proceeds."[78] Such a provision undoubtedly influenced the plaintiff's ability to settle his case since he was required to accommodate the funder's flat fee, which accrued with interest.[79] And "[a]ll four Agreements limited [the plaintiff's] right to change attorneys without [the funder's] consent, otherwise [the plaintiff] would be required to repay [the funder] immediately."[80]

Similarly, in *White Lilly, LLC v. Balestriere PLLC*, a TPLF company affirmatively asserted that it had the right to exercise control over litigation in which it had acquired an

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75 *Rancman*, 789 N.E.2d at 221.

76 *Id.*

77 771 F. App'x 562, 579 (6th Cir. 2019).

78 Purchase Agreement ("*Boling* Purchase Agreement") § 6.1, *Boling v. Prospect Funding Holdings, LLC*, No. 1:14-cv-00081-GNS-HBB, ECF No. 1-3 (Ex. C to Compl.) (W.D. Ky. filed June 19, 2014); *see generally Boling v. Prospect Funding Holdings, LLC*, No. 1:14-CV-00081-GNS-HBB, 2017 U.S. Dist. LEXIS 48098 (W.D. Ky. Mar. 30, 2017).

79 *Boling* Purchase Agreement at 1.

80 *Boling*, 771 F. App'x at 580.

interest.[81] In its complaint, the TPLF company alleged that its TPLF agreement required that specified counsel, who had an existing relationship with the TPLF company, serve as one of the plaintiff's counsel in the funded lawsuit. Indeed, the TPLF entity alleged that its counsel breached her obligation to serve as the funder's "'ombudsman' to oversee the cases it ultimately invested in, and to ***ensure*** that the . . . [lawsuits] asserted viable claims and were litigated properly and efficiently."[82] Further evidencing control, the TPLF entity asserted that it had been assured that the "proposed litigation" would settle "quickly."[83] The funding agreement also required that "[d]efendants obtain prior approval for expenses in excess of $5,000.00."[84] The thrust of these provisions is that the TPLF entity had – and was supposed to use – various means to control or influence the course of the litigation in which it invested.

A recently released report by the American Bar Association's House of Delegates repeatedly recognizes and emphasizes the inherent risk of funder control, warning against such control over the litigation itself and even over expenses associated with the lawsuit.[85] In truth, even when a funder's efforts to control a plaintiff's case are not overt, the existence of TPLF funding may subordinate the plaintiff's own interests in the resolution of the litigation to the interests of the TPLF investor. Accordingly, TPLF undermines the bedrock principle that a party to a lawsuit has the ultimate decision-making authority in the litigation.

2. Improper Fee-Sharing

Ohio Rule of Professional Conduct 5.4(a) "prohibits lawyers from sharing legal fees with nonlawyers."[86] That rule is designed to safeguard the professional independence of attorneys – i.e., ensure that a lawyer's fidelity is to his or her client rather than to an outsider whose primary interest is maximizing its interest in the underlying litigation. However, funders are increasingly entering into arrangements directly with lawyers rather than the actual party litigant[87] – a recurring practice that threatens to violate the prohibition against fee sharing.

For example, in *Gbarabe v. Chevron Corp.*,[88] the plaintiffs commenced a putative class action arising out of an explosion on an oil drilling rig off the coast of Nigeria. Under the agreement entered into by the plaintiffs' counsel and the funder, counsel agreed that the funder would be repaid its $1.7 million investment in the case by way of a "success fee" of six times that amount ($10.2 million), to be paid from attorneys' fees – plus 2% of the total amount

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81 Compl. ¶ 35, No. 1:18-cv-12404-ALC (S.D.N.Y. filed Dec. 31, 2018).

82 *Id.* (emphasis added).

83 *Id.* ¶ 45.

84 *Id.* ¶ 124.

85 *See* ABA, *Best Practices for Third-Party Litigation Funding*, at 11, 12, 13, 15 (Aug. 2020), https://www.americanbar.org/content/dam/aba/directories/policy/annual-2020/111a-annual-2020.pdf.

86 *Cincinnati Bar Ass'n v. Mullaney*, 894 N.E.2d 1210, 1216 (Ohio 2008) (per curiam) (construing Ohio Code Prof. Resp. DR 3-102(A) (now Ohio Prof. Cond. Rule 5.4(a))).

87 *See* Bedi & Marra, *supra* note 17, at 573-74 ("[A]n increasing number are agreements between a funder and a *law firm*.").

88 *Gbarabe v. Chevron Corp.*, No. 14-cv-00173-SI, 2016 U.S. Dist. LEXIS 103594, at *6 (N.D. Cal. Aug. 5, 2016).

recovered by the putative class members.[89] The fact that the funder was to be paid as a "success fee" after the collection of attorneys' fees (i.e., on a contingency basis) means that this agreement was seeking to authorize the sharing of attorneys' fees with non-lawyer funders.

In August 2018, the New York City Bar Association issued an interpretation of New York's version of Rule 5.4(a), which mirrors the Ohio rule in relevant material respects. The New York City Bar Association found that New York's analogous rule explicitly prohibits fee-sharing with a litigation funder where "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."[90] As that opinion explains, Rule 5.4(a) "presupposes that when nonlawyers have a stake in legal fees from particular matters, they have an incentive or ability to improperly influence the lawyer."[91] In so explaining, the City Bar noted that the bar associations of Maine, Nevada, Utah and Virginia reached a similar conclusion.[92]

In short, provisions purporting to commingle attorney and funder fees blur the line separating lawyers from non-lawyers and undermine the attorney-client relationship that is at the core of our civil justice system.

3. Conflicts Of Interest

Another potential ethical concern is the possibility of conflicts of interest. According to Canon 1 of the Ohio Code of Judicial Conduct, judges must avoid even the appearance of impropriety in all activities.[93] In particular, "[a] judge shall not permit . . . financial . . . or other interests or relationships to influence the judge's judicial conduct or judgment."[94] Attorneys likewise have an ethical obligation to avoid "even the appearance" of conflicts of interest.[95] It is presently difficult (if not impossible) to determine whether TPLF arrangements violate these principles because the very existence of TPLF (let alone the identity of a funder) is generally not disclosed in a particular case. The presence of TPLF in a given lawsuit can generate potential conflicts of interest because certain funders are publicly traded, which means that a judge or even the opposing counsel may have a pecuniary interest in that company that is adverse to his or her position in the underlying litigation. "And for privately held [funding] entities, the web of

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89 Litigation Funding Agreement ("*Gbarabe* Litigation Funding Agreement") § 1.1, *Gbarabe v. Chevron Corp.*, No. 3:14-cv-00173-SI, ECF No. 186-4 (Ex. 13) (N.D. Cal. filed Sept. 16, 2016).

90 N.Y. City Bar, Formal Opinion 2018-5: Litigation Funders' Contingent Interest in Legal Fees at 1.

91 *Id.* at 6. In the face of pressure from the funding industry, the New York City Bar Association subsequently issued a recommendation that the state abrogate the well-established bar against sharing of fees between lawyers and non-lawyers.

92 *Id.* at 5 (citing Prof'l Ethics Comm'n Me. Bd. of Overseers of the Bar, Op. 193 (2007); State Bar of Nevada Op. 36 (2007); Utah Bar Ass'n Adv. Op. 97-11 (1997); Va. Bar Standing Comm. on Legal Ethics, Advisory Op. 1764 (2002)).

93 Canon 1 of Ohio Code of Judicial Conduct.

94 Rule 2.4(B) of Ohio Code of Judicial Conduct.

95 *Carnegie Cos. v. Summit Props., Inc.*, 918 N.E.2d 1052, 1065 (Ohio Ct. App. 2009) (citation omitted).

personal relationships judges [or other judicial officers] have could be impacted as well, leading to unintentional appearances of impropriety."[96]

This problem was once again on display in the Chevron Lago Agrio case mentioned above.[97] During a deposition in that proceeding, lead plaintiffs' lawyer Steven Donziger was asked to identify the company that had helped finance the underlying suit against Chevron.[98] Only after being ordered to answer the question by the special master presiding over the case did Donziger disclose that the funder was Burford.[99] The special master then disclosed that he was former co-counsel with the founder of Burford, and that he had received marketing materials from that same individual aimed at litigation funding.[100] The special master also disclosed that he was friends with Burford's former general counsel.[101] The special master did not recuse himself from the racketeering litigation, and the parties did not insist that he do so.[102] Nonetheless, as the special master recognized, the deposition "prove[d] . . . that it is ***imperative for lawyers to insist that clients disclose who the investors are***."[103]

4. TPLF In Class Actions

Once reserved for individual business-to-business or consumer litigation, TPLF is now increasingly being used in class action lawsuits.[104] For example, one prominent hedge fund, EJF Capital, specifically targets "class-action injury lawsuits" at "hefty interest rates," with the loans to be repaid by law firms "as they earn fees from settlements and judgments."[105] "[C]lass actions [also] make up a significant portion of the cases that" Law Finance Group invests in.[106] The increasing prevalence of TPLF arrangements in class actions raises serious ethical questions, as well as concerns about the named plaintiffs' adequacy of representation, as funders seek to maximize their own pecuniary interest in the litigation. The funding agreement in the *Gbarabe* case (previously discussed) demonstrates this point, containing several key provisions that

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96 Tripp Haston, *The Missing Key to 3rd-Party Litigation Funding*, Law360 (Feb. 7, 2017), https://www.law360.com/articles/888716/the-missing-key-to-3rd-party-litigation-funding.

97 Jennifer A. Trusz, *Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration*, 101 Geo. L.J. 1649, 1658 (2013).

98 *Id.* at 1650.

99 *Id.*

100 *Id.*

101 *Id.*

102 *Id.*

103 *Id.* (emphasis added) (citation omitted).

104 *See Third-Party Litigation Funding: A Review of Recent Industry Developments*, IADC Defense Counsel Journal (Jan. 30, 2020), https://www.bradley.com/insights/publications/2020/01/third-party-litigation-funding-a-review-of-recent-industry-developments.

105 Rob Copeland, *Hedge-Fund Manager's Next Frontier: Lawsuits*, Wall St. J. (Mar. 9, 2015), http://www.wsj.com/articles/hedge-fund-managers-next-frontier-lawsuits-1425940706.

106 Ben Hancock, *New Litigation Funding Rule Seen as "Harbinger" for Shadowy Industry*, The Recorder (Jan. 25, 2017), https://www.law.com/therecorder/almID/1202777609784/New-Litigation-Funding-Rule-Seen-as-Harbinger-for-Shadowy-Industry/?slreturn=20190902111717.

suggest the funder's desire to influence the course of the litigation without regard for the interests of the purportedly injured class members.

Perhaps most starkly, the attorneys were bound by the agreement to seek the ***maximum possible contingency fee***, despite the fact that such a requirement could easily become a barrier to resolving the suit by way of settlement with the defendant.[107] Citing this provision, Chevron argued that the limitations imposed on fees showed that the plaintiffs' counsel could not adequately represent the class because it was plausible that the class's interest would be better served by a different fee arrangement.[108] In addition, the funding agreement contained a number of provisions allowing the TPLF entity to exercise control over the litigation, including a "Project Plan" that apparently outlined litigation strategies and provisions that restricted counsel from hiring experts "without [the funder's] prior written consent"[109] and required that counsel "give reasonable notice of and permit [the funder] where reasonably practicable, to attend as an observer at internal meetings, which include meetings with experts, and send an observer to any mediation or hearing relating to the Claim."[110]

"Although the concern that third-party funders come to control litigation is present in almost any case involving third-party funding agreements, the concern is more pronounced in the class action context."[111] This is so because "[i]n the class action context, class counsel 'exercise[s] nearly plenary control over all important decisions in the lawsuit,' incentivized by the potential of obtaining a portion of any successful recovery by the class."[112] In *Gbarabe*, for example, the proposed class representative knew nothing about the details of the funding agreement. Under these circumstances, it is difficult to see how the plaintiff could be expected to protect the putative class's interests regarding an agreement between the attorneys and a third-party funder. Ultimately, the district court denied certification in *Gbarabe* on several grounds, including adequacy of representation.[113] But it did not address any of these important issues presented by the agreement in the case, leaving them for further development by future cases.[114]

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107 *Gbarabe* Litigation Funding Agreement § 3.1.3.

108 Chevron Corporation's Memorandum in Opposition to Motion for Class Certification, 2016 WL 5596113, at *34 (N.D. Cal. Sept. 16, 2016), *Gbarabe v. Chevron Corp.*, No. 14-cv-00173-SI (N.D. Cal.).

109 *Gbarabe* Litigation Funding Agreement § 10.1.

110 *Id.* § 10.2.4.

111 Aaseesh P. Polavarapu, *Discovering Third-Party Funding in Class Actions: A Proposal for in Camera Review*, 165 U. Pa. L. Rev. Online 215, 221 (2017).

112 *Id.* (footnotes omitted); *see also* Steinitz, *Follow the Money*, *supra* note 45, at 1105 ("[T]he lawyers rather than the clients drive and control the case . . . .").

113 *Gbarabe v. Chevron Corp.*, No. 14-cv-00173-SI, 2017 WL 956628, at *35-37 (N.D. Cal. Mar. 13, 2017).

114 *Gbarabe* is just one recent example of TPLF in the class action context, and is not even the first one involving Chevron. For example, the Chevron Ecuador litigation (which is discussed *supra*) was also a class action, and the funding agreement at issue in that case "provide[d] control to the Funders" through "installment of 'Nominated Lawyers'" – lawyers "selected by the Claimants with the ***Funder's approval***." Steinitz, *The Litigation Finance Contract*, *supra* note 15, at 472 (emphasis added) (footnote omitted).

At bottom, class actions already raise significant adequacy-of-representation and other ethical challenges because the named plaintiffs usually have no desire – much less ability – to control the litigation. Because class counsel run the show, adding a funder to the equation would only "exacerbate" these problems and increase the risk that litigation decisions are not driven by the interests of the absent class members, whom the class device is designed to protect.[115]

III. PROPOSALS FOR REFORM

As the prior discussion demonstrates, TPLF can be harmful to the fair and ethical functioning of our civil justice system. So what should be done about the problems posed by this largely unregulated practice in Ohio? S.B. No. 94 contains a number of sensible solutions that ILR strongly supports, including: (1) appointing the Superintendent of the Division of Financial Institutions to oversee TPLF investors and requiring their registration as a precondition of doing business in the State; (2) enactment of statutory safeguards to avoid TPLF-related abuses and protect consumers; and (3) requiring the disclosure of TPLF arrangements in civil litigation. In addition to these proposed reforms – which are reflected in the proposed legislation – the General Assembly should also consider prohibiting the use of TPLF in class actions.

A. Registration Regime

First, ILR supports the proposed registration regime outlined in S.B. No. 94, which would create meaningful oversight of a presently-unregulated industry.

Funders "should be regulated just like banks, credit card issuers, payday lenders, and lenders in the fringe credit industry. A reasonable regulatory regime strikes the proper balance between the abolition of the [TPLF] industry, which is unlikely to happen, and the 'Wild, Wild, West,' which is what exists now."[116] Multiple states, including Indiana, Maine, Nebraska, Oklahoma, Tennessee, Vermont, West Virginia and most recently Utah, have recognized as much by requiring TPLF investors to register as a perquisite to doing business in those jurisdictions.[117] The proposed legislation would align Ohio with these other states by requiring funders to register with the Superintendent of Financial Institutions – an arm of the Department of Commerce – on an annual basis. "Mandatory registration w[ould] help identify just how many" funders "there are"; "provide a means to identify those [investors]" that may be engaging in the abuses previously discussed; and ultimately permit meaningful oversight of TPLF investors,[118] who have been able to evade scrutiny by Ohio regulators ever since the General Assembly legalized third-party litigation funding in 2008.

Any registration regime should incorporate various safeguards designed to prevent unscrupulous funders from engaging in TPLF in Ohio. To this end, S.B. No. 94 would require

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115 Steinitz, *Follow the Money*, *supra* note 45, at 1105.

116 Cain, *supra* note 14, at 15 (footnote omitted).

117 *See, e.g.*, W. Va. Code § 46A-6N-2(a)(1); Ind. Code Ann. § 24-12-9-1; Me. Rev. Stat. Ann. tit. 9-A, § 12-106; Neb. Rev. Stat. § 25-3307; Okla. Stat. tit. 14A, § 3-809; Tenn. Code Ann. § 47-16-103; Vt. Stat. Ann. tit. 8, § 2252; H.B. 312, 2020 Gen. Sess. (Utah 2020).

118 Cain, *supra* note 14, at 37 (espousing registration as a condition of doing business in a state).

funders to pay an annual registration fee and obtain a $50,000 surety bond as a condition for doing business in Ohio. This money should remain in an account administered by the Division of Financial Institutions, with any interest or dividends going to fund enforcement and oversight activities by the agency. The payment of a surety bond would guarantee actual "buy-in" by funders, encouraging funders to carefully vet lawsuits prior to investing in them, thereby minimizing the prospect of questionable litigation.

Finally, the Superintendent or Attorney General should have meaningful authority to enforce all laws, rules and regulations governing TPLF investments. As part of this authority, the Superintendent or Attorney General should be empowered to bring enforcement actions and obtain civil penalties for violations. The proposed legislation would appropriately authorize such action by making clear that "all powers and remedies available to the attorney general to enforce sections 1345.01 to 1345.13 of the Revised Code" (i.e., the Consumer Sales Practices Act) "are available to the attorney general" in the area of TPLF-related activities.[119]

B. Statutory Safeguards Against Abuses In TPLF Investments

ILR also strongly supports the various statutory safeguards contained within S.B. No. 94, which would protect consumers, businesses and the overall integrity of Ohio's civil justice system.

First, S.B. No. 94 would appropriately prohibit excessive fees and rates charged by TPLF companies doing business in Ohio. Ohio law generally caps interest rates at 8% per year, and imposes a 25% ceiling on annual interest rates charged by banks.[120] Anything higher is usury and illegal. The defenders of TPLF argue that the practice does not constitute usury because TPLF loans are non-recourse – i.e., repayment only occurs if the plaintiff prevails in the underlying litigation. But that should not be the only test of usury. As previously discussed, the truth is that many TPLF borrowers who "win" their cases end up owing most – if not all – of the proceeds of the lawsuit to the TPLF lenders. Notably, at least one state, Nebraska, expressly prohibits funders from requiring repayment in cases where the borrower recovers less than what she owes the funder.[121] And a number of other states (e.g., Arkansas, Indiana, Tennessee, Utah and West Virginia) prohibit excessive interest rates and/or fees by either making consumer funding agreements subject to the general usury limits or otherwise imposing reasonable caps on such rates and fees.[122] The proposed legislation would protect consumers by limiting any annual fee charged to no greater than 10% of the original amount of the loan. In addition, the legislation would ban "excess[ive]" interest rates, essentially aligning it with the federal short-term interest

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119 Draft Ohio Rev. Code § 1349.555(A).

120 *See, e.g.*, Ohio Rev. Code Ann. § 1343.01; Ohio Rev. Code Ann. § 1109.20.

121 *See* Neb. Rev. Stat. § 25-3303(1)(g).

122 *See, e.g.*, Ark. Code Ann. § 4-57-109(b) ("The maximum rate of interest provided by § 4-57-104 applies to a consumer lawsuit lending transaction."); Ind. Code Ann. § 24-12-4.5-2(a)(1) (setting a 36% cap); Tenn. Code Ann. § 47-16-110(a) (10% limit); H.B. 312, 2020 Gen. Sess. (Utah 2020) (imposing 25% interest rate limit); W. Va. Code § 46A-6N-9(a) ("A litigation financier may not charge the consumer an annual fee of more than 18 percent of the original amount of money provided to the consumer for the litigation financing transaction.").

rate, plus an additional 3%.[123] Enacting these reasonable limits on interest rates and fees would help ensure that Ohio's civil justice system fairly compensates those who recover in a lawsuit, as opposed to lining the pockets of litigation funders as a result of excessive and anti-consumer litigation funding practices.

Second, S.B. No. 94 would also expressly prohibit false or misleading information by TPLF companies and make any violation of the new law actionable under the Ohio Consumer Sales Practices Act. As an ABA Working Group on litigation funding warned years ago, litigation funding in the consumer context warrants special scrutiny because funders may engage in "misleading advertising, inadequate disclosure of financing terms, and excessive financing charges."[124] "Scholars have expressed concern" over these "abusive practices," which are particularly exploitive of "unsophisticated" consumers, who "do not possess the same level of negotiating power as do larger commercial entities or law firms."[125] Accordingly, the proposed legislation would ensure that any false or misleading advertisements or any other violation of the provisions codified in the TPLF legislation qualify as unfair or deceptive trade practices actionable by either an aggrieved consumer or the Attorney General.

Third, S.B. No. 94 also appropriately contains several provisions aimed at preserving the professional independence of attorneys and avoiding conflicts of interest with funders. As previously discussed, "[t]he principles of loyalty and independent judgment are fundamental to the attorney-client relationship."[126] Indeed, attorneys owe their clients a fiduciary duty of allegiance – mandated by the rules of ethics – which requires them to put the interests of their client above their own, and to avoid even the appearance of impropriety.[127] However, an attorney that has contracted directly with a funding company may have contractual duties to it that are separate from – and, perhaps, inconsistent with – the attorney's professional duties to his or her client.[128] Moreover, because both third-party funders and attorneys are repeat players in the litigation market, it can be expected that relationships among them will develop over time. Attorneys can be expected to "steer" clients to favored financing firms, even if the client's particular circumstances suggest a different firm may be more appropriate, and *vice versa*. The proposed legislation would help curb that self-dealing by prohibiting TPLF companies from referring a consumer to a specific attorney, accepting any fee or commission from the plaintiff's lawyer, or having any financial relationship with the lawyer representing the plaintiff in the underlying case.

Fourth, S.B. No. 94 would also appropriately ban the assignment of TPLF agreements unless the consumer consents in writing or the assignment is to a wholly owned subsidiary of the

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123 Draft Ohio Rev. Code § 1349.553(A)-(B).

124 ABA Comm'n on Ethics 20/20, *supra* note 35, at 7.

125 Popp, *supra* note 35, at 737.

126 Ohio Prof. Cond. Rule 1.7 cmt. [1].

127 *Id.*

128 *See*, *e.g.*, *id.*, Rule 1.7(a) (providing that a conflict exists where "there is a *substantial* risk that the lawyer's ability to consider, recommend, or carry out an appropriate course of action for that client will be materially limited by the lawyer's responsibilities to . . . a third person or by the lawyer's own personal interests").

TPLF company or an affiliate under the funder's control. As the Supreme Court lamented in *Rancman*, "a lawsuit is not an investment vehicle. . . . An intermeddler" should not be "permitted to gorge upon the fruits of litigation."[129] Allowing funders to assign their interests to others would only exacerbate that unseemly feature of TPLF by injecting yet another financially motivated "intermeddler" into the fray. Moreover, such a permissive approach to the assignment of TPLF agreements would also further commoditize civil litigation in Ohio. Requiring lenders to keep their investments in their own portfolio would incentivize them to analyze any claim before agreeing to fund it, thus reducing the risk that third-party funding will increase frivolous lawsuits. In short, to the extent TPLF is allowed to remain a permitted practice in Ohio, it should be limited, not unnecessarily accommodated by allowing funders to assign their pecuniary interests to other non-parties.

C. Disclosure Of TPLF Arrangements

ILR also strongly supports the disclosure component of S.B. No. 94, which would shine some much-needed light on TPLF (a practice that largely operates in secret). Absent such transparency, there is no way to know whether a given lawsuit is being funded pursuant to a TPLF arrangement, much less whether such an agreement poses any of the various ethical or other problems previously discussed in this testimony. Specifically:

- ***Disclosure will minimize conflicts of interest.*** As the Chevron Lago Agrio case previously discussed illustrates, TPLF raises serious conflict-of-interest questions. Such conflicts can arise based on a pecuniary, familial or other personal interest in the funder on the part of opposing counsel, or perhaps even the court itself. As a result, the court needs to know the identity of funders to assess whether it or anyone else involved in the litigation unwittingly has a conflict of interest that warrants recusal or some other remedy. Disclosure would guarantee that both the court and opposing party have that pertinent information.

- ***Disclosure will reduce the likelihood of unethical fee-sharing between lawyers and non-lawyer funders consistent with Rule 5.4.*** As reflected by the provisions at issue in the *Gbarabe* case, funders sometimes enter into arrangements directly with lawyers rather than the actual real party in interest – i.e., the plaintiff. Such agreements blur the line between lawyers and non-lawyers and threaten the professional independent judgment of attorneys. If TPLF agreements are disclosed as a matter of course at the beginning of a civil lawsuit, the parties and the court can determine whether any provisions purport to commingle lawyer and non-lawyer funds in contravention of Rule 5.4.

- ***Disclosure will help ensure that plaintiffs have control over the litigation.*** As the examples summarized in this testimony make clear, funders often seek to exercise control or influence over key strategic decisions in litigation they finance. Mandatory disclosure requirements could temper this problem by discouraging funders from insisting on inappropriate control provisions in the first instance. And if funders persist in inserting such problematic provisions into their

[129] *Rancman*, 789 N.E.2d at 221.

funding agreements, disclosure will provide the courts with the necessary information to nullify them.

- ***Disclosure will facilitate more realistic settlement negotiations.*** Courts sometimes want to hear from all parties with authority over the fundamental question of settlement. As some of the examples previously discussed in this testimony reveal, funders routinely seek to weigh in on that key strategic decision. But absent disclosure, a funder's role is completely hidden from the court and the opposing party, undermining accurate and realistic settlement negotiations between the parties.

- ***Disclosure would shine much-needed light on abusive litigation funding practices.*** For example, as already discussed, the *New York Times* recently published an exposé on litigation funders financing unnecessary surgery so women could file stronger claims in the vaginal mesh litigation – allegations that culminated in criminal indictments.[130] And in another troubling report, funders financed substantial advertising to buy control of mass tort claims.[131] These unseemly episodes would have come to light much sooner had funding disclosure been required.

Legislatures and courts across the country are increasingly recognizing that these rationales justify TPLF disclosure. Most recently, the U.S. District Court for the District of New Jersey approved a local rule requiring the disclosure of: (a) the existence of any TPLF in a given case; (b) the identity of the funder; (c) whether the funder's approval is necessary for litigation and settlement decisions (and, if so, the nature of the terms and conditions relating to that approval); and (d) a brief description of the nature of the financial interest.[132] The federal judiciary's Advisory Committee on Civil Rules is also currently considering litigation funding disclosure – specifically, a proposal by ILR and 29 other business organizations to add funding agreements to the list of required "initial disclosures" in Fed. R. Civ. P. 26(a)(1)(A).[133] In 2019, West Virginia enacted a consumer TPLF law with a number of provisions, including one requiring the disclosure of funding agreements "without awaiting a discovery request."[134] Similarly, in 2018, Wisconsin enacted a comprehensive litigation funding disclosure requirement under which "a party shall, without awaiting a discovery request, provide to the other parties any agreement under which any person . . . has a right to receive compensation that is contingent on and sourced from any proceeds of the civil action, by settlement, judgment, or otherwise."[135] Around the same time, the U.S. District Court for the Northern District of California adopted a TPLF disclosure requirement for class actions. The court added to its "Standing Order for All Judges" a provision requiring that "in any proposed class, collective, or representative action, the

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130 *See supra* notes 60-63.

131 *See supra* note 58.

132 *See* D.N.J. L.Civ.R. 7.1.1.

133 *See* Suggestion No. 17-CV-O (filed with Advisory Committee on Civil Rules, June 1, 2017).

134 W. Va. Code § 46A-6N-6.

135 2017 Wis. Act 235, https://docs.legis.wisconsin.gov/2017/related/acts/235.

required disclosure includes any person or entity that is funding the prosecution of any claim or counterclaim."[136]

S.B. No. 94 would remove the veil of secrecy surrounding TPLF in Ohio by requiring the plaintiff to "file with the court . . . and serve on the opposing party or parties a copy of the executed" funding agreement.[137] Such a requirement would ensure that all of the parties and the court overseeing the lawsuit know whether the case is being funded pursuant to a TPLF agreement and, if so, whether the nature of the arrangement implicates any of the legal, ethical or other public-policy issues discussed in this testimony.

D. Barring The Use Of TPLF In Class Actions

Finally, the General Assembly should also consider banning TPLF in class actions – a proposal that is currently not included in the proposed legislation. As previously discussed, class actions, by their nature, already raise significant concerns regarding lawsuit abuse, conflicts of interest and other ethical problems because the named plaintiffs (who are supposed to adequately protect the interests of the absent class members) are essentially bystanders to the litigation. In a large consumer class action, the average plaintiff often has "a nominal stake in the outcome of the case."[138] In addition, the "representative" plaintiffs who are empowered to speak for the class in such cases tend to be friends, neighbors or even employees of the attorney bringing the suit. As a result, "the lawyers rather than the clients drive and control the case."[139]

"Because class actions often lack a plaintiff sufficiently interested in monitoring its representatives, the class action structure increases the likelihood that a third-party funder will obtain control of the class, given the few checks on its actions."[140] The provisions in the *Gbarabe* class action – which required the attorneys to seek the maximum possible contingency fee, prohibited counsel from hiring experts without the funder's consent, and permitted the funder to attend internal strategy meetings[141] – illustrate that funders can influence class action litigation with few (if any) checks on their actions. Moreover, "unlike contingency fee lawyers, who mainly provide lawyering services and owe a duty of loyalty to their clients, funders tend to be 'financiers only' without an analogous duty."[142] As a result, the exercise of control or influence by a funder is far more likely to be motivated by its underlying pecuniary interest rather than any desire to further the interests of the absent class members.

In short, all of the concerns with TPLF diluting a plaintiff's control over his or her lawsuit and generating potential conflicts of interest apply in spades in the class action context,

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136 Standing Order for All Judges of the Northern District of California, Contents of Joint Case Management Statement, § 19 (effective Nov. 1, 2018).

137 *See* Draft Ohio Rev. Code § 1349.554(A)-(B).

138 Polavarapu, *supra* note 111, at 222.

139 Steinitz, *Follow the Money*, *supra* note 45, at 1105.

140 Polavarapu, *supra* note 111, at 222.

141 *See supra* notes 107-110.

142 Polavarapu, *supra* note 111, at 224.

where the named plaintiff has little incentive to oversee the litigation – much less to ensure that the rights and interests of the absent class members are being protected. For these reasons, TPLF should not be permitted in class actions, and ILR encourages the General Assembly to consider adding this important reform to the proposed legislation.

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In sum, as the Ohio Supreme Court recognized when it invalidated TPLF nearly two decades ago, outside investment in lawsuits raises serious ethical, normative and public policy questions. While TPLF funders have largely operated in secret due to the paucity of concrete disclosure requirements, those agreements that have seen the light of day have been rife with provisions that purport to cede control of the litigation to an outside funder, inappropriately commingle attorney and non-attorney funds and otherwise undermine the fundamental attorney-client relationship. Even assuming that these disturbing examples do not warrant the outright invalidation of TPLF, they do undoubtedly justify bringing TPLF out from the regulatory shadows and enacting commonsense reforms that are reflected in the draft legislation. In particular, S.B. No. 94 would create a straightforward registration system, prohibit excessive fees and interest rates, codify statutory safeguards that protect the independence of attorneys and client control over their lawsuits and require the disclosure of TPLF at the outset of litigation – all of which would go a long way towards minimizing the problems posed by TPLF. In addition, the General Assembly should also consider prohibiting TPLF in class actions altogether because all of the concerns regarding TPLF are magnified in those aggregate proceedings.