AGGREGATE RISK, AGGREGATE REWARD: REGULATORY PROPOSALS AND GUIDANCE FOR MANAGING THIRD PARTY FUNDERS IN CLASS ACTIONS

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I.
INTRODUCTION

The past two decades have seen the rise of a new investment vehicle whose popularity shows no signs of slowing down: Third Party Litigation Financing (TPLF). TPLF describes "an arrangement where a funder that is not a party to a lawsuit agrees to provide funding to a litigant . . . or law firm in exchange for an interest in the potential recovery in a lawsuit."[1] Financial institutions, like hedge funds and investment banks, have come to view the court system as a new financial battleground filled with low-risk, high-return investment opportunities. By investing in claims, these institutions have amassed portfolios of lawsuits, which they hope will generate returns for their investors.

While the benefits to financial institutions are obvious, this practice also can provide real benefits to plaintiffs, who most often receive funding.[2] However, regulators, legislators, and courts have been slow to respond to the industry's growth. This lack of action raises tremendous concerns and can leave plaintiffs vulnerable. It poses questions about who is in control of the claim, whether funded parties are being sufficiently protected from bad actors, and whether funding contracts leave plaintiffs with sufficient compensation. These concerns are heightened in the class action context. Because absentee plaintiffs do not pursue their claims directly, they place their trust in class counsel and perform little oversight as their claim is pursued. Funders can take advantage of this arrangement by directing litigation strategy, insisting on control over settlement decisions, and otherwise influencing class counsel to act in their interests rather than that of the class. Absentee plaintiffs, who may not even be aware of the presence of a funder, are placed at risk of great harm.

Considering the rapid growth of the TPLF industry, the practice should be treated seriously. But lawmakers have, so far, left TPLF almost entirely unregulated at the national level. Judges have similarly been slow to respond to the industry's rise. This paper proposes procedural, legislative, and regulatory reforms to address the industry and its associated risks. These reforms will specifically focus on funding in class actions, as this practice poses the greatest risk. The reforms aim to reign in the behavior of funders and protect absentee class members, all while preserving plaintiffs' ability to enter into funding agreements with TPLF entities.

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1. U.S. Gov't Accountability Off., GAO-23-105210, Third-Party Litigation Financing: Market Characteristics, Data, and Trends, at intro. (2022).

2. *Id.*

First, and most importantly, the Advisory Committee on Civil Rules should amend Rule 23 of the Federal Rules of Civil Procedure to require notice of TPLF to class members and require judges to consider TPLF arrangements during the settlement and certification stages. Second, additional data should be gathered on the TPLF industry either by judges or federal regulators. Finally, Congress should impose a duty of loyalty upon funders, place funders under the authority of a regulatory agency, and mandate disclosure of all funding arrangements to the judge overseeing the funded matter. In the absence of these reforms, this Note will also provide guidance to judges on how to assess the Rule 23(a)(4) adequacy requirement in light of the presence of a funder.

II.
CLASS ACTIONS AND THIRD PARTY LITIGATION FINANCING

A. Class Actions and the Adequacy Requirement

A class action is an aggregate form of litigation in which a multi-member plaintiff class is represented by a single plaintiff representative and class counsel. Class actions in the federal judicial system are governed by the requirements of Rule 23 of the Federal Rules of Civil Procedure.[3] They are designed to achieve many aims, including efficiency and the preservation of judicial resources, but one of their most vital functions is increasing a plaintiff class's access to justice.[4] This is especially true for class actions certified under Rule 23(b)(3), which allows a plaintiff class to recover monetary damages.[5] Often, a (b)(3) class action is made up of small claims which are economically unviable to assert on an individual basis, primarily because the anticipated recovery is too small to justify protracted, expensive litigation.[6] Class actions certified under (b)(3) are especially popular in antitrust and securities-fraud cases, where individual damages can be very small.[7] By providing for the aggregation of these small claims, class actions allow large groups of plaintiffs to vindicate rights they would otherwise be unable to assert.

A class action is also a representative action, a deviation from the gold standard of a one-on-one claim. Unlike traditional litigation,

3. Fed. R. Civ. P. 23.

4. *See* 7A Charles Alan Wright & Arthur R. Miller, Federal Practice and Procedure § 1753, Westlaw FPP (database updated Apr. 2025).

5. *See id.* § 1777.

6. *See* Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 616–17 (1997).

7. *See* 20 Charles Alan Wright & Mary Kay Kane, Federal Practice Deskbook § 77, Westlaw FPP DESKBOOK (database updated Apr. 2023).

not every plaintiff is present throughout the prosecution of their claim. Rather, the interests of absentee plaintiffs are advanced by a named plaintiff representative and class counsel, which raises unique concerns.[8] Absentee plaintiffs do not get their traditional day in court, do not control litigation strategy, and are often entirely unaware of the day-to-day developments of their case.[9] To ensure that the due process rights of these absentee plaintiffs are respected, Rule 23 imposes requirements for the certification of a class and the appointment of class counsel.[10]

The most important of these certification requirements, for the purpose of this Note, is the Rule 23(a)(4) requirement of adequacy.[11] Because absentee plaintiffs are bound by the settlement or judgment obtained by the lead plaintiff, "basic notions of fairness and justice demand that the representation they receive be adequate."[12] Adequacy demands both the lead plaintiff and class counsel meet certain standards. To determine whether a lead plaintiff is adequate, the court considers the plaintiff's knowledge of the litigation, their financial stake in the litigation, and any potential conflicts of interest.[13] In order to ensure the rights of absentee plaintiffs are protected and their claims are vigorously pursued, Rule 23 requires class counsel to be capable of handling complex litigation and free from any conflicts of interest.[14] Critics of class action practice have long pointed to the risk of so-called "lawyer-driven" litigation, in which enterprising lawyers manufacture a class, "rush[] to the courthouse to get named lead counsel, [run] the action without consulting the lead plaintiffs . . . , and then obtain[] a quick settlement for a gargantuan fee."[15] The adequacy requirement seeks to protect against this risk by uncovering any conflicts of interest between lead plaintiffs, class counsel, and the class members at large before the merits stage.[16]

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8. *See* 7A Wright & Miller, *supra* note 4, § 1753 (discussing the reasons behind the 1966 revision of Rule 23 of the Federal Rules of Civil Procedure, including the need to assure procedural fairness and properly notify members of a class).

9. *See* John Bronsteen & Owen Fiss, *The Class Action Rule*, 78 Notre Dame L. Rev. 1419, 1420 (2003).

10. Fed. R. Civ. P. 23.

11. Fed. R. Civ. P. 23(a)(4).

12. 7A Wright & Miller, *supra* note 4, § 1765.

13. *See id.* §§ 1766–68.

14. *See* Fed. R. Civ. P. 23(g).

15. Edward R. Becker et al., Panel Discussion, *The Private Securities Law Reform Act: Is It Working?*, 71 Fordham L. Rev. 2363, 2363 (2003) (quoting a remark by Professor Daniel J. Capra in a lecture series discussion).

16. *See* 7A Wright & Miller, *supra* note 4, § 1768.

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Additionally, Rule 23(e)(2) requires any settlement reached by the parties be approved by the judge, who must be satisfied that the terms are "fair, reasonable, and adequate."[17] In conducting this inquiry, judges look to the quality of representation, the negotiation process that led to settlement, and the amount of relief afforded to the plaintiff class.[18] As part of this consideration, judges may also review the proposed attorney fee structure.[19] If a judge believes class counsel has demanded an unreasonable fee, either because their work on the case was minimal or the remainder would undercompensate the plaintiff class members, they can adjust the fee or impose a lodestar calculation in which the attorneys are paid an hourly rate.[20] In reviewing fee arrangements, judges ensure attorneys are paid for their work and plaintiff class members receive adequate compensation for their injuries.[21]

B. Third Party Litigation Financing: History and Practice

Although Third Party Litigation Financing (TPLF) has existed in some form since the early 2000s, its development into a full-fledged industry was kickstarted by the 2008 Global Financial Crisis.[22] Financial institutions, stung by their exposure to mortgage-backed securities, sought out new, less-risky investment vehicles.[23] At the same time, law firms saw their resources dwindle and looked to hedge funds, banks, and other financial institutions for new sources of financing.[24] This happy marriage of post-recession convenience proved lasting, as TPLF has only continued to grow. Most passive observers first heard about the concept of litigation finance in 2016, when it was revealed that venture capitalist, Peter Thiel, had funded the wrestler Hulk Hogan's defamation lawsuit against Gawker Media.[25] Between the salacious details revealed at trial and the combined celebrity power of Hogan, Thiel, and star

17. Fed. R. Civ. P. 23(e)(2).

18. *Id.*

19. Fed. R. Civ. P. 23(e)(2)(C)(iii).

20. *See, e.g.*, Bell v. DuPont Dow Elastomers, LLC, 640 F. Supp. 2d 890, 901 (W.D. Ky. 2009).

21. *See* Fed. R. Civ. P. 23(e).

22. *See* Maya Steinitz, *Whose Claim Is This Anyway? Third Party Litigation Funding*, 95 Minn. L. Rev. 1268, 1283–84 (2011).

23. *See id.* at 1283–84.

24. *See id.* at 1283–85.

25. *See* Andrew Ross Sorkin, *Peter Thiel, Tech Billionaire, Reveals Secret War With Gawker*, N.Y. Times (May 25, 2016), https://www.nytimes.com/2016/05/26/business/dealbook/peter-thiel-tech-billionaire-reveals-secret-war-with-gawker.html [https://perma.cc/QY7S-V2FB].

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witness Bubba the Love Sponge, funding arrangements were introduced to the public as part of a media circus.[26]

Despite this introduction, TPLF is no sideshow. Its growth has been rapid, particularly over the past ten years. To provide a sense of scale, from 2000 to 2002, an early TPLF entity named LawCash reported that it advanced a total of $10 million in loans to litigants.[27] In 2017, today's largest outfit, Burford Capital, reported a war chest totaling $3.1 billion in both active investments and available capital.[28] While Burford is undoubtedly the largest funder in the industry, it is far from the only large player in the field.[29] The industry as a whole managed $16.1 billion in assets in 2024.[30] This growth has attracted the attention of institutional players, signaling the industry's continued capacity for expansion.[31] In 2021, the New York-based law firm Willkie Farr & Gallagher entered a $50 million litigation funding arrangement with Longford Capital Management, one of the industry's largest firms.[32] Even elite lawyers are getting in on the action. Over the past decade, multiple Supreme Court clerks, who presumably have their pick of prestigious legal positions, have started or taken jobs at litigation funding outlets following their tenure on the Court.[33] Funders are no longer marginal figures; they have become institutional players in the court system.

Litigation funding can take many forms including an advance to a party, ongoing funding to a law firm, or a loan given to an individual

26. *See* Ravi Somaiya, *Hulk Hogan v. Gawker: A Guide to the Trial for the Perplexed*, N.Y. Times (Mar. 17, 2016), https://www.nytimes.com/2016/03/18/business/media/hulk-hogan-v-gawker-a-guide-to-the-trial-for-the-perplexed.html [https://perma.cc/HYH4-6EBP].

27. Ronen Avraham & Anthony Sebok, *An Empirical Investigation of Third Party Consumer Litigant Funding*, 104 Cornell L. Rev. 1133, 1136 (2019).

28. *Id.* at 1134.

29. Other major players include Parabellum Capital (approximately $1.5 billion in assets under management) and Longford Capital Management (over $1.2 billion in assets under management). *Parabellum Capital*, Chambers & Partners, https://chambers.com/law-firm/parabellum-capital-litigation-support-58:22609837 [https://perma.cc/BLY7-ZSV2]; *Longford Capital Management*, Chambers & Partners, https://chambers.com/law-firm/longford-capital-management-litigation-support-58:22868386 [https://perma.cc/37DF-GM5T].

30. Westfleet Advisors, The Westfleet Insider: 2024 Litigation Finance Market Report 3 (2025).

31. *See* 1 Michael Dore, Law of Toxic Torts § 10:4, Westlaw LTOXICT (database updated Oct. 2024).

32. *Id.*

33. Jimmy Hoover, *Ex-Supreme Court Clerks Find Big Money Opportunities in Litigation Finance*, Law.com (Oct. 23, 2023, 8:18 PM), https://www.law.com/2023/10/23/ex-supreme-court-clerks-find-big-money-opportunities-in-litigation-finance/ [https://perma.cc/N74Q-Y6F3].

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who has not yet brought a claim. The typical funding arrangement takes the form of a nonrecourse loan. Under these terms, the funder receives either a percentage of recovery or a multiple of the initial loan upon a successful judgment or settlement, and they receive nothing in the event the lawsuit is dismissed or the funded party loses.[34] These loans often involve a "waterfall provision," which allows funders to be paid before the claimant or their attorney.[35] Although defendants can certainly make use of TPLF, this Note focuses only on the relationship between funders and plaintiffs, as they receive the lion's share of available funding.

C. Third Party Funding: Benefits and Risks

Proponents of TPLF argue the practice is justified by the benefits it provides to plaintiffs.[36] They correctly point out that TPLF enhances the access to justice aims of class actions. The typical class action funding structure, which relies on plaintiffs' attorneys fronting the cost of a lawsuit in exchange for a contingency fee, can be a very risky proposition for plaintiff-side firms.[37] Because of this structure, plaintiffs may not be able to find a representative willing to take on the risk of bringing their claims.[38] TPLF, then, acts as a form of insurance for plaintiffs' attorneys; they can bring meritorious cases that they may have thought too uncertain to fund on their own without facing the downside risk.[39] While there is very little data available in the U.S. context, Australian jurisdictions that allow for TPLF have seen an increase in litigation, indicating the practice increases plaintiffs' opportunity to bring claims.[40] However, this increase in litigation may be limited only to high-value claims.[41] Funders may

34. *See* Avraham & Sebok, *supra* note 27, at 1134–35.

35. W. Bradley Wendel & Joshua P. Davis, *Complex Litigation Funding: Ethical Problem or Ethical Solution?*, 74 HASTINGS L.J. 1459, 1466 (2023).

36. *See id.* at 1471.

37. Tyler W. Hill, Note, *Financing the Class: Strengthening the Class Action Through Third-Party Investment*, 125 YALE L.J. 484, 487 (2015).

38. *See id.*

39. *See* U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 1, at 19.

40. *See* Jason Lyon, Comment, *Revolution in Progress: Third-Party Funding of American Litigation*, 58 UCLA L. REV. 571, 590–91 (2010) (citing 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, 1075, 1102–03 (2013)).

41. *See* Samuel Issacharoff & Thad Eagles, *The Australian Alternative: A View from Abroad of Recent Developments in Securities Class Actions*, 38 U. NEW S. WALES L.J. 179, 201 (2015) (noting that funders consider both the merits and the value of prospective claims, generally requiring an expected return on investment of at least 300 percent).

choose to ignore meritorious low-value claims unless the class is large enough to make their investment economically rational.[42]

Opponents of TPLF argue the increase in litigation represents a more sinister phenomenon. Because TPLF allows plaintiffs' attorneys to eliminate any downside risk, they argue, plaintiffs are better able to bring frivolous claims in hopes of pressuring defendants into settlement: the so-called "extortionist lawsuit."[43] This argument mischaracterizes the aims and practice of funders. Because they view litigation as an investment vehicle, funders are incentivized to only extend financing to those cases they believe will succeed.[44] The low chance of substantial recovery from an extortionist lawsuit is outweighed by the risks of a lost investment. For that reason, funders employ teams of lawyers and analysts who seek out meritorious, high-value claims they deem worthy of investment.[45] The available evidence suggests this "robust underwriting process" is both rigorous and successful.[46] One study found that funders reject 52% of the applications they receive, and they enjoy an average return on investment of 91%.[47] These statistics suggest the risk of frivolous claims is minimal. Moreover, in the class action context, there already exists a filter designed to weed out meritless claims: the certification stage.[48]

Beyond its access to justice benefits, TPLF also allows plaintiffs to level the playing field against well-funded defendants. Because class

42. *See id.* ("Chief among these meritorious actions that are rarely brought are consumer class actions. In order for funders to make a profit, they would need to find and contract with a huge number of plaintiffs *ex ante*, all of whom were subjected to relatively small losses in value.").

43. *See* William W. Large, U.S. Chamber of Com. Inst. for Legal Reform, Selling Out: The Dangers of Allowing Nonattorney Investment in Law Firms 42 (2023), https://instituteforlegalreform.com/wp-content/uploads/2023/01/Selling-Out-The-Dangers-of-Allowing-Nonattorney-Investment-in-Law-Firms-final-digital.pdf [https://perma.cc/W6CE-AB57].

44. *See* Lyon, *supra* note 40, at 591–92 ("[T]hird-party lenders will only select those cases most likely to yield a return on their investment . . . .").

45. *See, e.g.*, *Adding Value Beyond Capital: During Case Review*, Burford Cap., https://www.burfordcapital.com/insights-news-events/insights-research/adding-value-beyond-capital-during-case-review/ [https://perma.cc/R48C-TL32].

46. Jim Sams, *Push for Litigation Funding Disclosure Grows*, Carrier Mgmt. (Oct. 5, 2021) (citing Avraham & Sebok, *supra* note 27), https://www.carriermanagement.com/features/2021/10/05/226996.htm [https://perma.cc/5TWL-FLBD].

47. *Id.* (citing Avraham & Sebok, *supra* note 27, at 1145, 1158). *See generally* Lesley Stahl, *60 Minutes: Litigation Funding; A Multibillion Dollar Industry for Investments in Lawsuits with Little Oversight*, CBS News (July 23, 2023), https://www.cbsnews.com/news/litigation-funding-60-minutes-2022-12-18/ [https://perma.cc/REU8-8EBL].

48. *See* 7A Wright & Miller, *supra* note 4, § 1753 (explaining the procedural aspects of class-action proceedings established by Rule 23(c), including the court's determination of whether the action should be certified as a class action).

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action defendants are often corporations rather than individuals, plaintiffs are typically at a resource and bargaining disadvantage.[49] This creates perverse incentives for plaintiffs and their attorneys, who face pressure to settle for less than the true value of their claims to guard against the risk of walking away empty-handed.[50] For small firms funding their own litigation, this pressure can be immense as protracted litigation could lead to insolvency absent a settlement. The pressure faced by plaintiffs' attorneys, in turn, allows defendants to settle for less than the true value of the claim or escape culpability altogether.[51] By relieving plaintiffs' attorneys of this pressure, TPLF can give a plaintiff class greater bargaining power and can allow them to pursue their claims more vigorously.

These benefits are meaningful, but they may be outweighed by serious risks. The primary concern is that TPLF could place control over litigation in the hands of a funder, rather than the plaintiff to whom the claim rightfully belongs.[52] This danger is especially acute in class actions, where class counsel often controls litigation strategy, and absentee plaintiffs are uninvolved in the day-to-day management of their claim.[53] In fact, absentee plaintiffs may not even know whether class counsel has secured outside funding, as disclosure of a funding relationship to class members is not mandated by Rule 23. Absentee plaintiffs may believe their claims are being pursued by trustworthy class counsel and named plaintiffs, when decision-making power truly rests in the hands of an unknown third party.[54] Without the monitoring benefits of active plaintiff oversight, there is an inevitable risk that the attorney receiving funding will act in the interests of someone other than the client to whom they owe a duty of loyalty.[55] This would allow funders to control the maintenance of a claim that properly belongs to the plaintiff class members.

Funders' ability to direct litigation can take two forms: direct control over litigation decisions and informal influence over class counsel. Funders can directly control litigation through contractual provisions in the funding agreement that give them the ability to

49. *Cf.* Steinitz, *supra* note 22, at 1302–06.

50. *See* Hill, *supra* note 37, at 500.

51. *See id.*

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

53. *Id.* at 222.

54. *See* Lyon, *supra* note 40, at 600 (citing John Beisner et al., U.S. Chamber Inst. for Legal Reform, Selling Lawsuits, Buying Trouble: Third-Party Litigation Funding in the United States 8–9 (2009)).

55. Jonathan D. Petrus, *Legal and Ethical Issues Regarding Third-Party Litigation Funding*, L.A. Law., Nov. 2009, at 16, 17.

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select counsel, approve or reject settlement offers, and dictate litigation strategy.[56] This direct influence has been permitted by Australian courts since 2006,[57] but its per se validity has never been decided by American courts. Many funders insist their standard agreements contain no such provisions, and the pursuit of a claim is entirely under the control of the plaintiff.[58] But other American funders have, in fact, secured direct control arrangements, including in large class actions.[59] These arrangements are theoretically easy for a court to review. The details are spelled out explicitly in the contract signed by the funder and class counsel. But because disclosure of funding is not required under the existing Federal Rules of Civil Procedure, direct influence will only be rooted out if the judge decides to request disclosure of the funding agreement.

On the other hand, a funder's indirect influence is much harder for a court to detect. Funders may hold informal influence over the attorneys they contract with via threats to withdraw funding during litigation, a general sense of gratitude, or an attorney's desire to secure additional funding contracts in the future.[60] If attorneys make decisions that run counter to a funder's interests, they place themselves at risk of losing a valuable source of funds for future litigation. Funders may also exert influence by selecting the attorney appointed to represent a class of plaintiffs. Even without express contractual guarantees, these forms of informal influence may allow funders, rather than plaintiffs, to control litigation strategy and decision-making. Given the informality, even the most careful, well-intended judge may not be able to detect the full extent of control a funder has over the litigation at hand.

Proponents argue that even if funders control litigation strategy, they only do so in pursuit of the plaintiff class's best interest.[61] Because a funder shares the same goal as a plaintiff, a judgment or settlement for the full value of the claim, a funder will not cause a

56. *See, e.g.*, Lisa Rickard, *Why Are Hedge Funds Allowed to Invest in Litigation?*, THE ATL. (July 3, 2012), https://www.theatlantic.com/national/archive/2012/07/why-are-hedge-funds-allowed-to-invest-in-litigation/259345/ [https://perma.cc/TFH4-GX8E] ("[A leading TPLF] firm's contract stipulated that it would have veto power over the choice of attorneys and also receive precedence over the plaintiffs in the disbursement of any settlement or judgment funds.").

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

58. U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 1, at 10–11.

59. *See* Rickard, *supra* note 56 ("[W]hen it comes to class actions and other multi-plaintiff lawsuits, it is the investment firms, not the plaintiffs, that often appear to be in control.").

60. *See* Polavarapu, *supra* note 52, at 221.

61. *Id.* at 224.

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plaintiff any harm. Although the interests of the funders and plaintiffs may appear to be aligned, funders' profit incentive may lead them to act against the interests of plaintiffs. While TPLF entities initially focused only on commercial litigation, they have increasingly branched out to personal injury and mass tort cases.[62] In this context, funders may solicit plaintiffs to participate in a class action to increase the potential recovery. In some cases, funders have convinced plaintiffs to engage in risky medical procedures that serve as a prerequisite to a products liability claim.[63] In exchange for funding the procedure and resulting litigation, funders receive a share of any payout the plaintiff receives.[64]

In one particularly egregious example, women were convinced by a small TPLF outfit to have dangerous pelvic mesh removal surgeries, which resulted in long-term health complications for several plaintiff patients.[65] Many of these plaintiffs had no prior symptoms, but "felt rushed into getting surgery" by the funders.[66] In this case, the funders charged "double-digit interest rates," and after paying the funders and their attorneys, plaintiffs were vastly undercompensated compared to the true cost of their injuries.[67] Far from having consistently aligned interests, funders seeking to build a large, profitable portfolio may not adequately consider the interests and safety of the plaintiffs with whom they work. In the class action context, this problem is magnified as funders are incentivized to create as large of a class as possible to maximize the return on their investment.

While funders may increase the bargaining power of a plaintiff class, allowing for a settlement closer to the claim's true value, they can also take a very substantial portion of a given recovery.[68] Under Rule 23, a plaintiffs' attorney's contingency fee is subject to the court's review.[69] Judges can mandate a percentage or, if the case calls for it, impose a lodestar calculation in which attorneys are paid a fixed rate for their time.[70] They take this step to ensure the

62. *See, e.g.*, 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 [https://perma.cc/B9L7-LM7U].

63. *See id.*

64. *See id.*

65. *Id.*

66. *Id.*

67. *See id.*

68. *See* Rickard, *supra* note 56.

69. Fed. R. Civ. P. 23(e)(2)(C)(iii); *see, e.g.*, Bell v. DuPont Dow Elastomers, LLC, 640 F. Supp. 2d 890, 901 (W.D. Ky. 2009).

70. *Bell*, 640 F. Supp. 2d at 899–90.

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plaintiff class walks away with the bulk of any settlement. Because the Federal Rules do not require review or approval of funding arrangements, funders can extract an enormous cut of the plaintiff's recovery, leaving the plaintiff class with only a small fraction of the settlement value. In one individual lawsuit, a plaintiff agreed to a $25 million settlement, but walked away with less than $800,000 after the funder and attorney received their shares of the settlement.[71] Such arrangements are highly problematic as they undercompensate the parties who suffered from the harmful behavior. Without expressly requiring review of funding arrangements, it is unlikely these considerations will be discovered, and plaintiffs will continue to be undercompensated for their injuries.

Given the dangers associated with TPLF in class actions, namely the risks that funders will improperly guide litigation, plaintiffs will be injured by bad actors, and classes will be undercompensated, the industry needs regulation. Surprisingly, the industry remains unregulated at the national level, and state-level regulation suffers from a lack of clarity and uniformity.

III.
PROPOSALS FOR REGULATION OF THIRD PARTY LITIGATION FINANCING

A. Current State of Regulation

Currently, the TPLF industry is not regulated by the federal government. At the state level, only a handful of states have acted, while others have remained silent on the validity of third-party funding. Across those states that have acted on TPLF, there exists a patchwork system of regulation created by state laws and rulings by state-level courts. Broadly speaking, there are two kinds of state regulatory statutes. The first requires disclosure of funding arrangements and certain contractual measures, like "standardized . . . language, minimum cancellation periods[,] and [a] prohibition against attorney referral fees."[72] The second caps the interest rates which TPLF outfits can charge their clients.[73] While the imposition of required contractual language represents a minor annoyance to the industry, a law imposing a cap on interest rates could spell its doom. If a law capped the statutory maximum at a particularly low level, TPLF may be economically unviable, driving funders out of the state entirely.

71. Rickard, *supra* note 56.
72. Sams, *supra* note 46 (citing Avraham & Sebok, *supra* note 27, at 1139).
73. *Id.*

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State courts have also stepped into the regulatory fray by issuing opinions on the validity of TPLF. Several states have found the practice invalid under state law, relying on different bases of support. Alabama courts have found that the practice constitutes gambling, which is illegal in the state.[74] Pennsylvania courts have pointed to the doctrines of "maintenance" and "champerty," which prevent a lawyer from sharing the proceeds of a suit with non-attorneys, to invalidate the practice.[75] And the Colorado Supreme Court has found that TPLF contracts, while theoretically permissible, fall under the state's usury laws, which limit the interest rates that funders can charge.[76] Curiously, other state courts have reached precisely the opposite conclusions when considering TPLF's validity. For example, a Texas court of appeals also considered the question of whether TPLF contracts fell under the authority of the state's usury laws. In *Anglo-Dutch Petroleum International, Inc. v. Haskell*, the court held they do not.[77] And Florida courts have repeatedly found that the contracts do not violate the principles of maintenance and champerty, which are still recognized in the state.[78]

To put it bluntly, the current regulatory framework is a mess. The lack of nationwide uniformity hurts claimants and funders. Consumers in some states are left vulnerable to exorbitant interest rates and different degrees of control over their claims. Claimants in other states are left without access to a potentially vital source of funding that could allow them to assert their legal rights. To improve the regulatory framework, the same levels of protection and freedom to contract should be provided across the entire legal system. This goal can be most effectively accomplished through some combination of amendments to the Federal Rules of Civil Procedure, federal regulation, and judicial action.

B. Amendments to the Federal Rules of Civil Procedure

Amendments to the Federal Rules would provide the most effective means of protecting class plaintiffs against the risks posed by TPLF. To start, Rule 23, which governs class actions, should be amended to require disclosure of any funding arrangements

74. Wilson v. Harris, 688 So. 2d 265, 269–70 (Ala. Civ. App. 1996).

75. WFIC, LLC v. Labarre, 148 A.3d 812, 818–19, 818 n.13 (Pa. Super. Ct. 2016).

76. Oasis Legal Fin. Grp., LLC v. Coffman, 361 P.3d 400, 410 (Colo. 2015); Austin T. Popp, Note, *Federal Regulation of Third-Party Litigation Finance*, 72 VAND. L. REV. 727, 746 (2019).

77. Anglo-Dutch Petrol. Int'l, Inc. v. Haskell, 193 S.W.3d 87, 95–101 (Tex. App. 2006); Popp, *supra* note 76, at 747–48.

78. *See, e.g.*, Kraft v. Mason, 668 So. 2d 679, 683–84 (Fla. Dist. Ct. App. 1996).

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entered by the parties. This amendment should specifically require judges to consider TPLF contracts when ruling on certification and adequacy of settlement. Some have argued that an amendment requiring disclosure and consideration is unnecessary; judges already have the power to request disclosure of funding arrangements, and there is nothing preventing them from considering funding when ruling on certification and settlement.[79] While true, those who suggest giving discretion to judges in this arena ignore the realities of a federal judge's caseload. A judge's docket imposes tremendous time and resource constraints. The number of cases commenced, per authorized district court judge, per year has held steady at around 500 since 1995.[80] This pressure creates an incentive for judges to quickly dispose of the cases before them and move on to other important matters.[81] Accordingly, judges are unlikely to spend precious time and resources reviewing funding arrangements, and they face a strong incentive to approve class action settlements. This is especially true of "small claimant" class actions, where judges may consider an inadequate (yet less consequential) settlement a necessary evil in managing their docket.[82] If we want to ensure judges will monitor funding relationships for conflicts of interest and incorporate these relationships into their adequacy and settlement determination, only a binding obligation to do so will suffice.

The Advisory Committee has already considered proposed amendments that would target the TPLF industry.[83] Citing the lack of available data, the Committee has so far declined to amend the rules to address TPLF.[84] However, the Committee has established a dedicated litigation finance subcommittee to research the issue, sending a signal that they believe an amendment may be warranted in the near future.[85] Apart from the Committee's work, legal scholars

79. *Cf.* Laws. for Civ. Just. & U.S. Chamber of Com. Inst. for Legal Reform, An Important but Rarely Asked Question: Amending Rule 16(c)(2) to Prompt Judges to Consider Inquiring About Financial Interests Created by Third-Party Litigation Funding 7 (2022), https://www.uscourts.gov/sites/default/files/22-cv-m_suggestion_from_lcj_and_ilr_-_rule_16c2_0.pdf [https://perma.cc/CD6H-AVPM] (discussing the existent mechanisms for judges to inquire into TPLF agreements in the class action context).

80. Barry Friedman et al., Judicial Decision-Making 365 fig. 5.2 (2020).

81. *See* John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 Colum. L. Rev. 1343, 1369 (1995).

82. *See id.*

83. *See* Maya Steinitz, *Follow the Money? A Proposed Approach for Disclosure of Litigation Finance Agreements*, 53 U.C. Davis L. Rev. 1073, 1079 (2019).

84. *Id.*

85. *See id.*; Robert Freedman, *Court Advisory Committee OKs Look at Third-Party Funding Disclosure*, Legal Dive (Oct. 30, 2024), https://www.legaldive.com/news/

have proposed draft amendments. One proposed amendment reads, "[A] party must, without awaiting a discovery request, provide to the other parties . . . for inspection and copying as under Rule 34, any agreement under which any person, other than an attorney permitted to charge a contingent 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."[86] This rule would require disclosure of funding relationships to the court, eliminating the need for a judge to use their discretionary power to discover funding arrangements. In turn, this disclosure would help judges act as more effective monitors of conflict and would allow them to collect relevant data on TPLF.

Amendments to Rules 23(a)(4) and 23(e) can provide the strongest protection for absentee plaintiffs. Judges should be required to incorporate the disclosed terms of TPLF relationships when determining whether class counsel and the proposed settlement are adequate. This may sound like an extreme step, but judges already conduct a very similar inquiry. As discussed above, judges closely inspect the relationship between attorney and client when assessing whether class counsel is "adequate" under Rule 23(a)(4).[87] Under Rule 23(e), judges assess whether a proposed attorney's fee is reasonable, and they have the power to reduce the fee if it is excessive.[88] Amending Rule 23 would entail only an extension of these pre-existing duties and powers to guard against the dangers of funder-driven litigation. Similarly, if a judge believes a funding arrangement would leave plaintiff class members grossly undercompensated, they should have the authority to reject the settlement or adjust the percentage of the settlement going to the funder. These proposals should be particularly effective because of their binding effect on the court. This mandatory inquiry will ensure that funding relationships do not slip through the cracks without due consideration.

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advisory-committee-civil-rules-third-party-funding-disclosure-litigation-financing-2024/731526/ [https://perma.cc/8P3R-67DB].

86. Anthony J. Sebok, *White Paper on Mandatory Disclosure in Third-Party Litigation Finance*, *in* Mandatory Disclosure Rules for Dispute Financing 5, 11 (David Siffert ed., 2023) (quoting Letter from U.S. Chamber Inst. for Legal Reform et al. to Rebecca A. Womeldorf, Sec'y of the Comm. on Rules of Prac. & Proc. of the Admin. Off. of the U.S. Cts. app. B (June 1, 2017), https://www.uscourts.gov/sites/default/files/17-cv-o-suggestion_ilr_et_al_0.pdf [https://perma.cc/R62M-K7DF]).

87. *See* Kim v. Allison, 87 F.4th 994, 1000 (9th Cir. 2023).

88. *See, e.g.*, Bell v. DuPont Dow Elastomers, LLC, 640 F. Supp. 2d 890, 899–901 (W.D. Ky. 2009).

Finally, Rule 23 should be amended to require an opt-out notice to all plaintiffs whose class actions are funded by third parties.[89] Rule 23(c)(2)(B) already requires an opt-out notice be sent to all plaintiff class members in a damages class action.[90] Because (b)(3) class actions involve monetary damages, the mandatory opt-out notice gives plaintiffs a chance to pursue claims on their own if they believe they can secure higher recovery by pursuing the litigation on an individual basis. The purpose of the notice requirement is "to enable class members to make informed decisions about whether to opt out."[91] Disclosure of a funding source to plaintiffs is not required under the current notice regime, and many plaintiff class members may not even be aware that their attorney has entered into a third-party funding agreement.[92] To give absentee plaintiffs sufficient power to make an informed choice about whether to opt out, funding arrangements must be disclosed in the opt-out notice. Otherwise, the presence of a funder may subject absentee plaintiffs to inflated attorneys' fees without their knowledge, leaving them without the complete information necessary to reach an informed decision on whether to opt-out. Because they do not know the fees have been inflated by the participation of a funder, they may erroneously believe the class claim will be worth more than an individual claim.

C. Data Collection

Because TPLF carries a high risk of abuse by funders, regulators must step in to protect vulnerable plaintiffs. To start, there is one step that nearly everyone agrees on: there must be more research on the TPLF industry and its effect on litigants.[93] Given the relatively recent rise of TPLF in the United States, it is not surprising that there is a lack of available data. However, regulators lack answers to even basic questions. In 2022, the Government Accountability Office commissioned a study on TPLF, in which funders and critics alike pointed to the lack of available data on basic facts like "funders' rates of return, the number of funders operating in the U.S., and the total amount of funding provided."[94] While considering a proposed amendment to the Federal Rules, the Advisory Committee reached

89. Lyon, *supra* note 40, at 601.
90. Fed. R. Civ. P. 23(c)(2)(B).
91. Fed. R. Civ. P. 23 advisory committee's note to 2018 amendment.
92. *See* Lyon, *supra* note 40, at 600–01.
93. *See* U.S. Gov't Accountability Off., *supra* note 1, at 15–18; Steinitz, *supra* note 84, at 1079.
94. U.S. Gov't Accountability Off., *supra* note 1, at 15.

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a similar conclusion about the lack of available data on TPLF.[95] The Committee has not yet issued any amendments related to TPLF in part because of this information gap.[96]

The data collection process could be led by either the court system or federal regulators, but neither party seems particularly well suited to performing this data gathering under the current system.[97] Additional regulation will likely be necessary to gather sufficient data about the industry. Because funding arrangements are not always disclosed to the courts, important data points may fall through the cracks if judges are left to collect information on the TPLF industry on their own, leading to an underestimation of its scale. This problem could be fixed by moving to a mandatory disclosure regime in which all TPLF contracts are reviewed by the court. Under such a system, judges would be particularly well suited to collect data about the industry based on the contracts before them.

Federal regulators suffer from a similar problem. The TPLF industry, as such, is not specifically regulated by the federal government.[98] Funders are not required to provide data on their investments to the government and are not required to release any data publicly. Some have suggested Congress give the Federal Trade Commission (FTC) the authority to regulate TPLF entities, in part, as a means of closing the information gap.[99] Given the agency's purview to regulate "unfair or deceptive" business practices, it seems well suited to the task.[100] Other scholars have suggested the Consumer Financial Protection Bureau (CFPB) be delegated the power to regulate the TPLF industry.[101] Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the agency is tasked with "enforc[ing] Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive."[102] The goal of federal regulation of TPLF entities aligns very well with the general goals of the CFPB; regulators should strive to ensure funding

95. *See* Steinitz, *supra* note 84, at 1079.
96. *Id.*
97. *See* U.S. Gov't Accountability Off., *supra* note 1, at 16–17.
98. *See id.*
99. John H. Beisner & Gary A. Rubin, U.S. Chamber Inst. for Legal Reform, Stopping the Sale on Lawsuits: A Proposal to Regulate Third-Party Investments in Litigation 10 (2012).
100. *Id.*
101. Popp, *supra* note 76, at 751.
102. *Id.* (quoting 12 U.S.C. § 5511(a)).

arrangements are "fair, transparent, and competitive."[103] If placed under the authority of a federal agency, regulators would also be capable of collecting necessary data about the industry.

D. Regulation by Administrative Agencies

Regardless of which agency is given authority over the TPLF industry, federal regulation can take a few forms. First, regulators can create a licensing scheme, which would require funders to apply for and receive licenses before entering into funding agreements with parties.[104] TPLF licensing requirements are already in place at the state level. In 2013, Oklahoma passed a statute requiring funders to secure a license from the state's Department of Consumer Credit before entering into litigation funding agreements.[105] This type of regulation accomplishes two objectives simultaneously. By requiring applications and periodic disclosures to regulators, an agency can collect valuable information about the industry, allowing judges and policymakers to make better, informed decisions about the industry. These parties can also tackle overly exploitative funding arrangements and bad actors by denying or revoking licenses from unscrupulous entities.

Regulators can also deter bad actors through enforcement actions. The CFPB has already asserted some authority over the industry by bringing sporadic enforcement actions against funders. For example, in 2017, the agency, along with the New York State Attorney General, brought an enforcement action against a funder, RD Legal, "for allegedly scamming 9/11 heroes out of money intended to cover medical costs, lost income, and other critical needs."[106] The matter was settled five years after it was brought, and RD Legal agreed to pay only a $1 fine and to refrain from collecting outstanding debts.[107]

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103. *Id.*

104. *See* Beisner & Rubin, *supra* note 99, at 10.

105. Act of May 29, 2013, § 9, 2013 Okla. Sess. Law Serv. ch. 386 (West) (codified as amended at Okla. Stat. Ann. tit. 14A, § 3-809 (West 2024)).

106. Press Release, Consumer Fin. Prot. Bureau, CFPB and New York Attorney General Sue RD Legal for Scamming 9/11 Heroes Out of Millions of Dollars in Compensation Funds (Feb. 7, 2017), https://www.consumerfinance.gov/about-us/newsroom/cfpb-and-new-york-attorney-general-sue-rd-legal-scamming-911-heroes-out-millions-dollars-compensation-funds [https://perma.cc/2RQ9-8GQG].

107. Press Release, Consumer Fin. Prot. Bureau, CFPB and New York Attorney General Take Action Against Companies that Cheated 9/11 Victims (Nov. 23, 2022), https://www.consumerfinance.gov/about-us/newsroom/cfpb-and-new-york-attorney-general-take-action-against-companies-that-cheated-9-11-victims [https://perma.cc/78PJ-T4TD]; Jody Godoy, *Litigation Funder to Pay $1 to Settle CFPB, N.Y. Lawsuit over 9/11 Fund*, Reuters (Nov. 23, 2022, 5:28 PM), https://www.

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Aside from these infrequent actions, the CFPB has generally shied away from regulating the industry and has certainly not engaged in the broad regulation that is needed to provide adequate consumer protection.

To protect consumers through consistent, close oversight, Congress should specifically delegate authority over the TPLF industry to an administrative agency. This clear mandate will give agencies more freedom to bring enforcement actions designed to weed out bad actors. If this delegation of power was combined with a federalization of the Oklahoma licensing model, regulators would be better able to police industry players and ensure funded parties are not exploited or harmed.

E. Legislative Action

Some commentators have suggested Congress take the extreme step of banning TPLF altogether.[108] This proposal is most often pushed by business interest groups, like the U.S. Chamber of Commerce, who are overwhelmingly pro-defendant.[109] While these critics are guided by self-interest, their stated concerns for plaintiffs are often meritorious. But while they are correct that TPLF poses risks to plaintiffs, outlawing the practice is too extreme a step. Plaintiffs can derive real benefits from the presence of a funder, and not all relationships are problematic. As part of a 60 Minutes interview about the TPLF industry, one plaintiff described the role played by the funder of his suit in glowing terms, saying, "They basically rescued us."[110] Instead of a wholesale ban, reform should be targeted to preserve these beneficial relationships while mitigating the harmful externalities created by TPLF.

On the other end of the spectrum, TPLF advocates have suggested legislators take a hands-off approach and allow the industry to regulate itself.[111] This is the approach taken in England and Wales, where funders are subject only to a voluntary code of conduct

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reuters.com/legal/litigation/litigation-funder-pay-1-settle-cfpb-ny-lawsuit-over-911-fund-2022-11-23/ [https://perma.cc/DDZ9-5SP6].

108. *See* John H. Beisner et al., U.S. Chamber Inst. for Legal Reform, Selling More Lawsuits, Buying More Trouble: Third Party Litigation Funding a Decade Later 26 (2020).

109. *See id.* at ii (noting that the Institute for Legal Reform is "[a]n [a]ffiliate of the U.S. Chamber of Commerce"); U.S. Chamber of Com., *Class Actions and Mass Actions*, https://www.uschamber.com/cases/class-actions-and-mass-actions [https://perma.cc/J8BE-QUWV] (exhibiting an anti-plaintiff tone).

110. Stahl, *60 Minutes*, *supra* note 47.

111. *See* Lyon, *supra* note 40, at 603.

which does not have the binding force of law.[112] The code specifies that funders are not to dictate litigation strategy and to "take reasonable steps to ensure" plaintiffs receive independent legal advice before retaining their services.[113] These rules are meant to "keep[] the roles of funders, litigants[,] and their lawyers separate."[114] Under a self-regulating system, courts can engage in discretionary review of funding arrangements, but are not required to do so. While the UK code system may be instructive, its lack of enforceability and required court approval limit its corrective potential. Moreover, the scale of the class action industry in the United States warrants more serious protections. Given the unique due process requirements of the class action, and the potential harm of TPLF in the class action context, remedial steps should not be discretionary, but binding.

If self-regulation and an outright ban are too extreme, what intermediate steps can legislators take? First, Congress could pass a bill imposing a duty of loyalty upon funders to the plaintiffs involved in the litigation.[115] Currently, funders have no such duty, and they are free to consider only their interests and the success of their investment. Such legislation would impose a similar duty upon funders as that currently carried by attorneys to their clients. The goal would be to eliminate any potential conflicts of interest between the funders and the plaintiffs; funders would have a legal duty to act in the plaintiff's interest when making decisions.[116] This statute could be even more effective if coupled with a statute outlawing direct funder control over litigation. The combined effect of these statutes would represent a powerful statement affirming the rights of plaintiffs to control their claims.

Congress can also pass legislation requiring the terms of all funding agreements be disclosed to the court. Bills have been proposed in both houses of Congress to mandate disclosure.[117] The Litigation

112. *See* Ass'n of Litig. Funders of Eng. & Wales, Code of Conduct for Litigation Funders (2018), https://associationoflitigationfunders.com/wp-content/uploads/2018/03/Code-Of-Conduct-for-Litigation-Funders-at-Jan-2018-FINAL.pdf [https://perma.cc/6G2J-5TSS]; Emily O'Neill, *Litigation Funding Overview—United Kingdom*, Deminor Litig. Funding, https://www.deminor.com/en/litigation-funding/global-landscape/united-kingdom/ [https://perma.cc/DQ58-GBNP].

113. Ass'n of Litig. Funders of Eng. & Wales, *supra* note 112, at 2.

114. *Code of Conduct*, Ass'n of Litig. Funders of Eng. & Wales, https://associationoflitigationfunders.com/code-of-conduct/ [https://perma.cc/EBL7-C76L].

115. *See* Lyon, *supra* note 40, at 602.

116. *See id.*

117. *See* Litigation Funding Transparency Act of 2018, S. 2815, 115th Cong. (2018); Litigation Funding Transparency Act of 2021, H.R. 2025, 117th Cong. (2021) [collectively hereinafter LFTAs].

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Funding Transparency Acts of 2018 and 2021 would require class counsel to disclose funding arrangements both to the court and any other named parties.[118] Both bills would also mandate disclosure in the Multidistrict Litigation (MDL) context.[119] Sponsors point to the ameliorative effect of transparency, suggesting disclosure alone can mitigate any conflicts of interest between funders, lawyers, and the parties.[120] The bills themselves are short and impose no additional requirements on parties or judges beyond disclosure.[121] Neither bill has passed its respective house of Congress.[122] Both bills are co-sponsored solely by members of the Republican Party, suggesting little bipartisan support.[123]

IV.
JUDICIAL OVERSIGHT OF THIRD PARTY LITIGATION FINANCING

A. Judicial Powers Under the Current System

As we have seen, disclosure of TPLF arrangements allows judges to better protect absentee plaintiffs and make more considered decisions on certification and settlement approval. But without additional regulation, judges can still use their existing powers to provide functional oversight of TPLF practice in their courtrooms. While they are not subject to binding rules relating to TPLF, they have discretionary powers which can be used to protect plaintiff classes. Specifically, judges can require plaintiffs to disclose the presence of funders and incorporate funding information into their consideration of adequacy and settlement value.[124] In exercising these

118. *Id.*

119. *Id.*

120. *See* Press Release, Chuck Grassley, Sen., U.S. Senate, Lawmakers Reintroduce Litigation Funding Transparency Bill (Mar. 19, 2021), https://www.grassley.senate.gov/news/news-releases/lawmakers-reintroduce-litigation-funding-transparency-bill [https://perma.cc/9KWU-VMKB].

121. *See* LFTAs, *supra* note 117.

122. *S.2815 - A Bill to Amend Title 28, United States Code, to Increase Transparency and Oversight of Third-Party Litigation Funding in Certain Actions, and for Other Purposes*, CONGRESS.GOV, https://www.congress.gov/bill/115th-congress/senate-bill/2815/all-actions [https://perma.cc/FX2Y-BW57]; *H.R. 2025 - Litigation Funding Transparency Act of 2021*, CONGRESS.GOV, https://www.congress.gov/bill/117th-congress/house-bill/2025/all-actions [https://perma.cc/J9EC-EC3A].

123. *See* LFTAs, *supra* note 117.

124. *See* FED. R. CIV. P. 23(e)(2)(C)(iv); *see also* 7B WRIGHT & MILLER, *supra* note 4, § 1797.5.

discretionary powers, judges must consider important questions and balance interests between plaintiffs, defendants, and funders. These questions include whether TPLF arrangements should be discoverable, how much information should be disclosed, and whether a funding relationship constitutes a conflict of interest.

Although disclosure is not mandatory, judges can request the parties before them reveal the terms of any existing funding arrangements. Judges overseeing a class action have authority to require disclosure of funding arrangements under Rule 23(g)(1)(C), which gives them broad power to demand class counsel disclose "information on any subject pertinent to the appointment."[125] Judges can incorporate this information into their assessment of adequacy under Rule 23(a)(4) or their evaluation of the fairness of settlement under Rule 23(e). If judges felt the terms of funding arrangements impaired class counsel's ability to adequately represent class members, they could deny certification under Rule 23(a)(4) or require the selection of different class counsel. This additional judicial work should not be overly burdensome, as judges already conduct a similar inquiry when reviewing the fairness of a contingency fee arrangement under Rule 23(h).[126]

Similarly, judges could reject any proposed settlement under Rule 23(e) if they felt the terms of a funding agreement prevented the plaintiff class members from securing adequate compensation for their injuries. When considering a proposed settlement, judges have only three options: approve the settlement, deny it, or "approve the settlement but then award only very modest attorneys' fees, thereby signaling [their] lack of confidence in the outcome."[127] Under their existing powers, there is nothing preventing judges from requesting information about a funding agreement and incorporating its terms into their determination of a settlement's adequacy.[128] If judges felt funders were taking too large a share, leaving plaintiff classes with an unreasonably low settlement value, they have the power to reject the settlement and send the parties back to the bargaining table.[129] Australian judges have provided such a model in funded class actions by refusing to approve a settlement with excessive funder's fees and even directly reducing the percentage of the settlement going to

125. Fed. R. Civ. P. 23(g)(1)(C).
126. *See* Fed. R. Civ. P. 23(e)(1) advisory committee's note to 2018 amendment.
127. Coffee, *supra* note 81, at 1369.
128. *See supra* note 124 and accompanying text.
129. *See generally* Fed. R. Civ. P. 23(e).

the funder.[130] While American judges have not yet used these tools, they should follow the lead of their Australian counterparts.

B. Discovery and Disclosure

Although some states have mandated disclosure, either via statute or local rule, federal judges who have decided questions of funder disclosure have, by and large, ruled that funding contracts are not discoverable by the opposing party. Rather, they have found these contracts are protected from discovery under the work product doctrine.[131] In handing down this rule, the Court sought to create a carve-out to the disclosure-friendly Federal Rules in order to "safeguard the adversarial process by providing a 'zone of privacy' within which attorneys could develop their cases."[132]

While the jurisprudence is limited, courts that have considered the discoverability of funding arrangements have often found that they are protected by the work product doctrine. In *Devon IT, Inc. v. IBM Corp.*, defendants sought access to a large cache of information related to the funding relationship, including a request for "all communications between [funder] and [plaintiff], including all communications with any in-house or outside counsel of [plaintiff]."[133] The court emphasized this broad request necessarily included materials that would reveal litigation strategy and plaintiff counsel's mental impressions about the case.[134] Accordingly, the motion was denied under both the work product doctrine and the doctrine of attorney-client privilege.[135]

In the class action context, defendants in *Kaplan v. S.A.C. Capital Advisors, L.P.* requested access to the plaintiffs' funding materials to argue the plaintiffs' class counsel was inadequate under Rule 23(a)

130. John Emmerig & Michael Legg, *Australian Federal Court Has Power to Reduce Litigation Funder's Commission Payable in a Class Action*, Jones Day (Jan. 31, 2017), https://www.jonesday.com/en/insights/2017/01/australian-federal-court-has-power-to-reduce-litigation-funders-commission-payable-in-a-class-action [https://perma.cc/A4BW-5ZKZ].

131. The work product doctrine, established by *Hickman v. Taylor*, protects from discovery, materials created in anticipation of litigation. *See* Hickman v. Taylor, 329 U.S. 495, 508, 510–11 (1947); *see also* J. Maria Glover, *Alternative Litigation Finance and the Limits of the Work-Product Doctrine*, 12 N.Y.U. J.L. & Bus. (Special Issue) 911, 920 (2016).

132. Glover, *supra* note 131, at 919 (quoting Jeff A. Anderson et al., *The Work Product Doctrine*, 68 Cornell L. Rev. 760, 785 (1983)).

133. Devon IT, Inc. v. IBM Corp., No. 10-2899, 2012 WL 4748160, at *1 n.1 (E.D. Pa. Sept. 27, 2012), *dismissed*, No. 13-4827, 2015 WL 13927026 (3d Cir. Feb. 6, 2015).

134. *Id.*

135. *Id.*

(4) and Rule 23(g), which looks at whether the attorneys have adequate resources to maintain the class action.[136] There, the court ruled that the funding materials "were not even relevant to the adequacy issue."[137] The court relied largely on the attorneys' experience in litigating class actions, determining that they have proven themselves over time to be adequate representatives of large plaintiff classes.[138] The defendants' attempts to gain access to the funding arrangement were characterized as a fishing expedition.[139] Regardless of the defendants' motivations, the court in *Kaplan* was too quick to dismiss their concerns. The magistrate judge's memorandum on the funding issue suggested the defendants had no basis for believing a conflict of interest existed.[140] But asking defendants to provide a basis without information related to the funder is asking them to prove the impossible. Without access to the funding agreement, defendants will always be working on a hunch and will never be able to argue the presence of a conflict of interest between funder and counsel. The agreement is the only document that can prove the presence of a conflict of interest. Accordingly, judges should not dismiss these requests as mere fishing expeditions. They should take the concern seriously and, at a minimum, require disclosure to the court, if not to opposing counsel.

Some scholars have argued this trend is not motivated by a sincere application of the work product doctrine but by policy concerns.[141] Judges are wary of increasing the cost of litigation and the potential disclosure of a funding arrangement can certainly create a costly discovery fight.[142] This can be especially harmful for plaintiffs who engage with TPLF entities, as the increased discovery costs can function as a tax on their use of a funder. Judges may be wary to allow disclosure in hopes of avoiding what they see as an unnecessary, expensive fight between the parties. When it comes to class actions, however, there are countervailing policy rationales that cannot be ignored. Defendants and judges must have all relevant information available to them to assess the adequacy of class counsel. Judges should not rely solely on an attorney's prior experience; they

136. Kaplan v. S.A.C. Cap. Advisors, L.P., No. 12-CV-9350, 2015 WL 5730101, at *3 (S.D.N.Y. Sept. 10, 2015), *aff'd*, 2015 WL 5547263 (S.D.N.Y. Sept. 15), *reaff'd*, 141 F. Supp. 3d 246 (S.D.N.Y).

137. Glover, *supra* note 131, at 935.

138. *Kaplan*, 2015 WL 5730101, at *5.

139. *Cf. id.*

140. *See id.*

141. *E.g.*, Glover, *supra* note 131, at 927.

142. *Id.* at 930.

must consider the presence of current conflicts.[143] Because absentee plaintiffs do not affect litigation strategy, do not approve funding relationships, and do not select class counsel, they need the protection afforded by the adequacy determination at the certification stage.[144] Without a thorough consideration of all relevant information, judges cannot be certain that the interests of these out-of-court parties are sufficiently protected.

Defendants seeking disclosure of funding arrangements should not consider the privileged nature of funding arrangements a settled issue. The work product doctrine contains an exception for "substantial need."[145] Under Rule 26(b)(3)(A)(ii), parties seeking discovery may pierce the work product privilege if they can show a "substantial need for the materials to prepare [their] case and cannot, without undue hardship, obtain their substantial equivalent by other means."[146] If defendants are to make an informed, comprehensive argument that class counsel lacks adequacy due to some conflict of interest, they must have access to information about the relationship that potentially creates such a conflict. Clearly the details of the arrangement between counsel and funder are relevant to the preparation of their case. Furthermore, defendants would not only suffer "undue hardship" in trying to find alternative evidence of the conflict, but the details of the funding arrangement are also the *only* means of making such an argument. There exist no alternative materials that would describe the level of control a funder has over litigation.

While this may seem like an overly defendant-friendly rule, it must be recalled that adequacy is no frivolous matter. A determination of adequacy at the certification stage is a requirement under Rule 23, and it should be taken seriously.[147] Because class actions are representative actions, exceptions to the usual one-on-one form of litigation, they provide absentee plaintiffs with procedural protections to ensure their interests are being represented.[148] In individual litigation, there is no equivalent policy rationale that would support making funding arrangements discoverable, meaning the rule can be limited exclusively to class actions. While allowing discov-

143. *See* 7A Wright & Miller, *supra* note 4, § 1769.1.

144. *See* Bronsteen & Fiss, *supra* note 9, at 1425. The adequacy requirement directs the court "to search for conflicts within the class that might exist even if the requirements of commonality and typicality are applied rigorously." *Id.*

145. Fed. R. Civ. P. 26(b)(3)(A)(ii).

146. *Id.*

147. Fed. R. Civ. P. 23(a)(4).

148. Bronsteen & Fiss, *supra* note 9, at 1423.

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ery of funding agreements would almost certainly increase litigation costs, which would be passed on to plaintiffs in the form of slightly increased attorneys' fees, the additional protection provided to the absentee class members would be worth the tradeoff.

Some believe disclosure to defendants is unnecessary, because it grants the opposition an advantage by giving them "a free look at plaintiffs' financial affairs."[149] Instead, in camera review may be more appropriate.[150] Under an in camera review system, the court could review funding arrangements without revealing the particulars of the plaintiff's war chest to a defendant. Some jurisdictions have already imposed a requirement that funding arrangements be disclosed to the court in any class or collective action.[151] In fact, "about [a] third of the federal district courts have adopted rules regarding disclosure of litigation funding agreements," although the rules vary by district.[152] The Northern District of California was the first to adopt a disclosure rule, doing so in 2018. This rule required parties to disclose only the identity of any funder assisting with the lawsuit. The District of New Jersey followed suit in 2021 with a broader rule which required not only disclosure of the funder's identity, but also a description of their financial interest in the case and their power to dictate litigation strategy and settlement.[153]

Disclosure regimes like these can be made even more effective if coupled with additional judicial action. For example, judges could follow the approach of Judge Dan Polster in the Northern District of Ohio, who recently required attorneys in nationwide opioid litigation to disclose TPLF arrangements and sign an affidavit "affirming that any financing agreements did not create a conflict under a number of specified criteria, including with respect to the funders' ability to control or dictate the direction of the litigation."[154] This example arises out of the MDL context, but the same principle applies to class actions. Of course, an affidavit does not eliminate the possibility

149. Steinitz, *supra* note 83, at 1077 (quoting *Burford Capital Comments on The Litigation Funding Transparency Act of 2018*, Burford Cap. (Oct. 11, 2019), https://www.burfordcapital.com/insights-news-events/insights-research/burford-capital-comments-on-the-litigation-funding-transparency-act-of-2018/ [https://perma.cc/E4D7-47KK]).

150. *See id.* at 1078–79; Polavarapu, *supra* note 52, at 233–34.

151. U.S. Gov't Accountability Off., *supra* note 1, at 27–28.

152. Sams, *supra* note 46.

153. U.S. Gov't Accountability Off., *supra* note 1, at 28.

154. Anne Gruner et al., *Why Reformers Want Disclosure of 3rd-Party MDL Funding*, Law360 (Jan. 13, 2020, 5:56 PM), https://www.law360.com/ip/articles/1232667/why-reformers-want-disclosure-of-3rd-party-mdl-funding [https://perma.cc/M66Z-NV2J].

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of informal influence over litigation, but it represents an important step in ensuring plaintiffs retain ownership over their claim.

C. Boundaries of Disclosure

Although funding agreements should fall within the substantial need exception to the work product doctrine, judges should not allow defendants to discover anything and everything related to a funding relationship. Once they are approached by attorneys, funders typically conduct a rigorous due diligence process. In their 2019 study of the TPLF industry, Profs. Ronen Avraham and Anthony Sebok described the massive amount of information collected by funding entities, including:

> [T]he name and address of the party seeking funding, the name of the lawyer representing them, where the applicant's suit has been filed, a brief description of the case, and the amount requested by the applicant. . . . [T]he company may obtain police, hospital, and insurance reports on the incident at the center of the claim, it may conduct independent legal research to determine the likelihood of success and the potential damage award, and the company may also seek details concerning any liens on an award the plaintiff might receive or historical data concerning, for example, whether the plaintiff has ever filed for bankruptcy.[155]

Defendants do not need access to this seemingly endless stream of information about the plaintiff and their claim. To allow for limitless discovery would amount to a fishing expedition. Instead, discovery of funding arrangements should be limited in such a way that will allow the funded party to bring their claim, preserve TPLF's goal of equalizing resources, and ensure absentee plaintiffs are protected from conflicts of interests. A court should only require disclosure of those details which go to the question of adequacy and conflicts. Clearly, insurance reports, bankruptcy records, and independent legal research have no bearing on the relationship between an attorney and a funder. However, details like waterfall provisions, settlement thresholds, and contractual terms which allow funders to withdraw funding or control litigation strategy are highly probative. They should be disclosed to the court and, if requested during discovery, to opposing counsel.

155. Avraham & Sebok, *supra* note 27, at 1140–41.

Determining which materials are relevant and which are not will be a task left up to individual judges. Each will have their own opinions. These differing opinions should be guided by the same principle: materials related to the merits of the case should be excluded, and materials related to the relationship and degree of control between funder and attorney should be discoverable. Of course, judges are busy and class action litigation can be a tremendous strain on their resources. Accordingly, judges should be encouraged to appoint a special master under Rule 53 to conduct this inquiry. Masters are well suited to the task, as they are frequently appointed to conduct a review of apparently privileged information.[156] And if judges are concerned the appointment of a master would increase litigation costs and serve as a tax on funded plaintiffs, they can place the costs on the defendant as the party responsible for the appointment.[157] Under this system, courts can allow defendants to make informed arguments as to the adequacy of plaintiff's counsel without taxing the plaintiff class itself.

D. Conflicts of Interest Faced by Class Counsel

Assuming judges and/or opposing counsel are given access to funding materials, what provisions would lead them to determine class counsel is inadequate? Surely provisions that provide funders with direct control over litigation strategy and give them authority to reject or accept settlement offers are a bridge too far. The claim belongs to the class members, not the funder. It is not for a third party to decide how a class should assert its claim or what amount of recovery would suitably compensate class members. However, it is more difficult to determine when other provisions cross the line into inadequacy.

Judges may want to inquire into whether the funder had any influence over the selection of class counsel. In such a case, counsel may feel more beholden to the funder who has set them up for a healthy payday than the class members to whom they owe a duty of loyalty. But having influence over counsel's appointment may not make counsel per se inadequate. Counsel may be solely responsible for making litigation decisions and place the interests of the class ahead of the funder. Rather than immediately denying certification in this scenario, judges could take more moderate steps like requiring counsel and funders submit affidavits making clear the funder

156. *See, e.g.*, 9C Wright & Miller, *supra* note 4, § 2602.1 nn.15–16 & 19.60 (listing instances in which appointing special masters is appropriate).

157. *See* Fed. R. Civ. P. 53(g)(3).

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has no control or influence over litigation.[158] This may give the judge enough confidence to allow certification to proceed.

Judges may also want to know whether the funder can withdraw or threaten to withdraw funding at any time in the litigation. If continued funding is contingent, a judge may be concerned that funders hold a veto over any litigation decisions that run counter to their interests.[159] To guard against this threat, judges should closely examine the terms of the funding contract and ensure funding will remain available throughout the litigation. Arrangements that allow funders to abandon their commitments at any time should be seen as problematic. Judges facing this scenario should, at minimum, exercise continued oversight of the arrangement throughout the litigation to ensure the funder is not in control.

On the other hand, some issues we have identified could never be sufficient to find counsel inadequate. For example, consider the informal influence generated by past relationships or an attorney's desire to secure funding arrangements in the future. These forms of influence are too speculative to serve as a basis for deeming counsel inadequate. Judges and opposing counsel could never find concrete proof that informal influence placed funders in the driver's seat. If this, alone, were sufficient, the presence of a funder would doom every potential certification. Accordingly, judges should treat decertification based on a funding relationship as a last resort. Only if they have concrete proof that a funder is inappropriately driving litigation should they deny certification under Rule 23(a)(4). Specifically, they should only do so in three situations: (1) the funder is given explicit control over litigation strategy and settlement; (2) counsel was selected by the funder and the judge has a reasonable basis for believing counsel will act in the funder's interests out of a sense of loyalty; or (3) the funder is able to withdraw funding at any time, and the judge has a reasonable basis for believing the funder will do so to influence the actions of class counsel. Certification should be denied only in these situations, and only when the judge believes additional guardrails, like an affidavit, would provide insufficient protection to the class.

Some scholars believe these steps are entirely unnecessary. They correctly point out that lawyers run up against conflicts of interests

158. *See, e.g.*, Gruner et al., *supra* note 154 (explaining Judge Polster's required disclosures relating to third-party financing arrangements).

159. *See, e.g.*, *In re* Nat'l Prescription Opiate Litig., No. 1:17-MD-2804, 2018 WL 2127807, at *1 (N.D. Ohio May 7, 2018) (requiring affirmations that third-party litigation financing does not affect litigation control, signaling judicial concern over funder influence).

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all the time.[160] Lawyers frequently deal with parties like "[i]nsurers, banks, and officers of corporate clients [who] may seek to influence the way a lawyer carries out the representation of a client."[161] In these situations, we trust the lawyer to hew to their professional duty to place their clients' interests before any others. This duty is further reinforced by the Model Rules of Professional Conduct and state ethics rules.[162] We do not impose additional hurdles upon lawyers to prove their loyalty to their clients. Why then should we approach funding relationships with suspicion and treat them differently than an insurer, bank, or corporate officer?

This argument is correct in the individual litigation context, but class actions are a different story. We do, in fact, place extra requirements on lawyers to show that they are not tainted by a conflict of interest during the certification stage: lawyers must show they are adequate under Rule 23(a)(4).[163] If class counsel was somehow beholden to an insurer, bank, or corporate officer, that would create serious doubt as to their adequacy. Extending this logic to funding relationships advances the policy goals of Rule 23 and ensures class members are protected. This does not mean that we do not trust attorneys to take seriously their ethical obligations. It merely recognizes that class actions are not like the gold standard of one-on-one litigation and, as such, require heightened care for one's ethical obligations.

V.
CONCLUSION

The risks of TPLF are too great to leave the industry to monitor itself. Conflicts of interest between funders, attorneys, and plaintiffs can remove control over the litigation from the plaintiff class to whom it rightfully belongs. They can cause direct, material harm to vulnerable plaintiff class members, and funders can take a massive cut of any settlement leaving plaintiffs with very little compensation. Regulation, legislative reform, and judicial oversight are essential to protect against these harms while preserving the access to justice and bargaining power benefits of TPLF.

160. W. Bradley Wendel, *Paying the Piper but Not Calling the Tune: Litigation Financing and Professional Independence*, 52 Akron L. Rev. 1, 21–22 (2018).

161. *Id.* at 22.

162. *See generally* Model Rules of Pro. Conduct r. 1.7 (Am. Bar Ass'n 1983) (amended 2023).

163. Fed. R. Civ. P. 23(a)(4).

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Regulators and legislators must step up to the plate. The Federal Rules of Civil Procedure should be amended to specifically instruct judges to consider TPLF during class certification and when ruling on settlement proposals, and a mandatory disclosure provision in (b)(3) class actions should be added. Absentee plaintiffs should receive an opt-out notice explaining the terms of any funding arrangements so they can make an informed decision about how best to pursue their claim. In the absence of amendments to the Federal Rules, legislators can fill the regulatory void by placing the TPLF industry under the authority of an administrative agency. They should also impose a duty of loyalty upon funders and pass a litigation transparency bill to ensure the presence of funders is disclosed in all class actions. These reforms would allow courts and regulators to collect valuable data on the TPLF industry, which can inform future decision-making and reduce the risks of TPLF to plaintiffs.

Judges should not sit on the sidelines and wait for regulation. They should use their discretionary powers to require disclosure of funding arrangements in class actions and should consider these arrangements when ruling on certification and settlement. They should also allow defendants to discover limited details about a funding arrangement to make an informed argument on counsel's adequacy during the certification stage. Judges can utilize the services of a master to assist with this discovery regime, ensuring defendants receive access to vital information while protecting the plaintiff class from unnecessary costs and excessive disclosure.

This proposed regulation and guidance is wide-ranging, and some may believe it to be unnecessary. Like the Advisory Committee, they might feel that we lack sufficient information on the TPLF industry to enact regulations. Even if they are correct that more information is needed, we can only collect that information via regulation or judicial action. Moreover, the stakes in the class action context are too high to leave the system untouched. Absentee plaintiffs are at risk of abuse. Class counsel is placed in an ethical dilemma, which may interfere with their duty to their clients. And perhaps most importantly, the integrity of the entire class action system is undermined. If we do not have confidence that the interests and rights of absentee parties are protected, the class action cannot properly function. If we take the values of the class action system seriously, it is time to act on TPLF.

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