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A CANADIAN LENS ON THIRD PARTY LITIGATION FUNDING IN THE AMERICAN BANKRUPTCY CONTEXT

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I. INTRODUCTION

Third party litigation funding (“TPLF”) has been described as “the process through which the inherent value of a legal claim is used to secure financing.”¹ In more practical terms, TPLF is the phrase used to describe the financing of litigation by specialized parties (“litigation funders”) who are not party to the litigation being funded. The five common characteristics of litigation funding agreements are as follows: (1) a cash advance, (2) made by a non-party to the litigation, (3) in exchange for a share of the litigation proceedings, (4) whether in settlement, judgment or award, and (5) payable at the time of recovery if, and only if, recovery by the funded litigant occurs.² The fifth criteria listed above is a key feature of TPLF; the non-recourse nature of TPLF distinguishes it from other forms of financing where the litigant may be required to repay the advanced funds whether it is successful in its litigation proceedings or not.

While TPLF may be most commonly known for its use in the class action contexts, it has become increasingly prominent in Australia and, more recently, in Canada in the commercial litigation context where contingency arrangements are far less common and available.³ In Australia, where contingency fee arrangements are not permitted, the use of TPLF has become

* Professor of Law, Osgoode Hall Law School. The authors gratefully acknowledge the excellent research assistance provided by Katrina Brazzell and Sayjon Ariyaratnam. We are also grateful for comments from Christoph Henkel and the other participants at the Chicago-Kent Law Review Comparative and Cross-Border Issues in Bankruptcy and Insolvency Law Symposium.

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1. David R. Glickman, *Embracing Third-Party Litigation Finance*, 43 FLA. ST. U. L. REV. 1043, 1043 (2016).

2. Bernardo M. Cremades, Jr, *Usury and Other Defenses in U.S. Litigation Finance*, 23 KAN. J.L. & PUB. POL’Y 151, 152 (2013).

3. Yamri Taddese, *Aussie Litigation Funding Company Comes to Canada*, LAW TIMES, Mar. 14, 2016, at 9.

quite prevalent over the last fifteen years as a general matter and, particularly, in the insolvency context.⁴ The most common use for TPLF in the insolvency context is for avoidance actions as well as other claims held by the estate that are too costly to pursue, for example: commercial and intellectual property claims, breach of fiduciary duty claims, theft of corporate opportunities, equitable subordination type claims, and tax refunds. TPLF holds the potential to increase the size of the estate of an insolvent debtor and thereby offers the opportunity for a larger, or any return, to unsecured and other lower-ranked creditors.

Despite TPLF's growing popularity in other common law jurisdictions, TPLF has not become as popular in the United States. This Article will explore TPLF's lack of adoption in the United States and examine the rationale for the absence of this funding model with a particular focus on the insolvency context. Part II of this Article first provides a discussion of the legal barriers to the adoption of TPLF in the United States, as well as a discussion of the recent origins of TPLF in the United States, including a discussion of its current place in the American legal landscape and the bankruptcy context. Part III then discusses the benefits of TPLF, while Part IV addresses some of the legal and ethical concerns with TPLF which may be driving the American market's slow adoption of TPLF. Finally, Part V provides a discussion of some of the options for regulation of the TPLF industry in an American context.

II. LEGAL BARRIERS TO AND ORIGINS OF TPLF IN THE UNITED STATES

A. *Doctrines of Maintenance and Champerty*

A variety of factors impact TPLF's limited use in the United States until now, but the historical origins provide the first insight into its limited adoption. The TPLF industry has been impacted by the common law legal doctrines of maintenance and champerty. Generally speaking, maintenance is the helping of another to prosecute a suit, while champerty is the maintaining of a suit in return for the financial interest in the outcome.⁵ Today, these doctrines are used nearly synonymously.⁶

TPLF falls squarely within these doctrines; a litigation funder helps a litigant prosecute a suit (through the provision of funds) in return for a financial interest in the outcome of such suit (a portion of the award or settlement).

4. *Id.*

5. *Rancman v. Interim Settlement Funding Corp.*, 789 N.E.2d 217, 219 (Ohio 2003).

6. Glickman, *supra* note 1, at 1052.

Another concept that falls directly within these doctrines is contingency fee arrangements; a lawyer helps his or her client litigate a case (through the provision of legal services on a fee and cost-free basis) in return for a financial interest in the outcome of such case (a portion of the award or settlement).⁷ Contingency fee arrangements are permitted in all states. However, the treatment of the doctrines of maintenance and champerty have not been universal across the states, causing uncertainty in the TPLF industry.⁸ The District of Columbia and twenty-seven states explicitly permit champerty with varying exceptions; sixteen of those states explicitly allow the investment by contract into a stranger's litigation proceedings as a permissible form of maintenance.⁹ In other states, however, the doctrine of champerty still continues to have an impact; at least three state courts of appeals cited or suggested it as a viable defence in 2016–2017, with a U.S. bankruptcy court finding an agreement to be champertous as recently as January 2017.¹⁰

In a 2016 New York Court of Appeals decision,¹¹ the court affirmed the relevance of the doctrine of champerty in New York. The court broadly defined champerty as “the purchase of notes, securities, or other instruments or claims with the intent . . . for the primary purpose of bringing a lawsuit.”¹² While this appears threatening to litigation funders, the court confirmed that New York legislation creates a safe harbour from the champerty prohibition where the purchaser has a binding and bona fide obligation to pay at least \$500,000.¹³ The purchaser in *Justinian* was found not to qualify for the safe harbour because it intended to pay off its \$1 million obligation from the proceeds of the litigation.¹⁴ However, TPLF in the traditional sense would have qualified for the safe harbour, provided the litigation funder was funding in excess of \$500,000.

7. Jasminka Kalajdzic et al., *Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding*, 61 AM. J. COMP. L. 93, 135 (2013).

8. *Id.*

9. Karen Rubin, *Bring Third-Party Funders out of “The Shadows,” U.S. Chamber Asks Federal Rules Committee*, THOMPSON HINE LLP: THE LAW FOR LAWYERS TODAY (June 15, 2017), <http://www.thelawforlawyerstoday.com/2017/06/3347/> [<https://perma.cc/8JGT-SCHE>].

10. *Id.*; see also *In re DesignLine Corp.*, 565 B.R. 341 (Bankr. W.D.N.C. 2017).

11. *Justinian Capital SPC v WestLB AG*, 65 N.E.3d 1253 (N.Y. 2016).

12. *Id.* at 163; see also Alison Frankel, *New York's Top Court Clamps Down on Shoestring Litigation Funders*, REUTERS (Oct. 28, 2016, 3:50 PM), <http://www.reuters.com/article/us-frankel-litigation-idUSKCN12S2M3> [<https://perma.cc/TYS2-UAQN>].

13. *Justinian*, 65 N.E.3d at 1257–59; see also Frankel, *supra* note 12.

14. *Justinian*, 65 N.E.3d at 1259; see also Frankel, *supra* note 12.

The Delaware Superior Court has also considered the doctrines of maintenance and champerty in the litigation funding context. In *Charge Injection v. DuPont*,¹⁵ the defendant moved to dismiss the plaintiff's action on the basis that the plaintiff's litigation funding arrangement violated Delaware's prohibition against maintenance and champerty.¹⁶ More specifically, the defendant argued that the litigation funding arrangement was champertous because the litigation funder, a disinterested third party, had de facto control over the litigation. However, the court noted that the litigation funding agreement expressly noted that the litigation funder lacks "any rights as to the direction, control, settlement, or other conduct" of the litigation.¹⁷ With respect to the defendant's argument that the litigation funding arrangement violated the doctrine of maintenance, the court held that the litigation funder did not "stir up" the litigation or control or force the plaintiff to pursue the litigation, but rather, the litigation funder provided the plaintiff with funds to pursue a claim which the plaintiff was already committed to litigate.¹⁸ The court cited several facts to support this decision:

- the plaintiff pursued the litigation despite previously being unable to procure TPLF in 2008;
- the plaintiff sought TPLF because it did not believe it had the capital to pursue long litigation against a defendant with billions of dollars at its disposal; and
- the litigation funding agreement was freely negotiated and it did not give the litigation funder any control over the litigation.¹⁹

It is encouraging to see that two states in which commercial activity is heavily focused, Delaware and New York, have adopted favourable stances on the application of the doctrines of maintenance and champerty that allow for the existence of TPLF under the proper circumstances. However, the patchwork of application of these doctrines across various states makes navigating the American legal landscape as a litigation funder challenging and uncertain.

15. *Charge Injection Techs. v. E.I. Dupont De Nemours & Co.*, No. N07C-12-134-JRJ, 2016 Del. Super. LEXIS 118 (Mar. 9, 2016).

16. *Id.* at *1.

17. Benjamin P. Chapple et al., *Delaware Court Approves Litigation Funding Agreement*, REED SMITH LLP (Mar. 21, 2016), <https://www.reedsmith.com/en/perspectives/2016/03/delaware-court-approves-litigation-funding-agreeme> [<https://perma.cc/YXP3-FPE3>]; see also *Charge Injection*, 2016 Del. Super. LEXIS 118, at *12.

18. *Charge Injection*, 2016 Del. Super. LEXIS 118, at *13.

19. *Id.* at *13–16.

B. Privilege and Confidentiality

The adoption of TPLF in the United States is also impacted by uncertainty regarding the maintenance of privilege. Before a litigation funder invests in a claim, it will generally require the potential litigant and the litigant's counsel to share details of the case so that the litigation funder can conduct a due diligence process and evaluate the merits of the litigant's claim.²⁰ However, the loss of privilege can be catastrophic to a litigant's case and thus the litigant and its legal team must ensure that privilege is maintained. Unfortunately, while there appear to have been trends towards the protection of the information disclosed to litigation funders through attorney work privilege, there is still uncertainty; when it comes to maintaining privilege in high stakes litigation, nothing but certainty is acceptable.

This issue has been considered by courts in Delaware. In *Leader*,²¹ the U.S. District Court for the District of Delaware upheld an earlier order requiring that the common interest doctrine did not apply to information shared by Leader pursuant to TPLF arrangements and that privileged documents should be disclosed. The court noted that for a communication to be protected, the interests must be "identical, not similar, and be legal, not solely commercial."²² The judge who rendered the order conducted a survey of cases suggesting differing views on the issue, factored in that Leader had the burden of establishing the existence of privilege, considered the numerous policy considerations, including the need for litigation funding companies and the truth-seeking function of litigation, and noted that the case at hand presented a close question.²³ However, the court in *Leader* found no grounds to overturn the order.

The same issue was considered by the Delaware Court of Chancery five years later in *Carlyle*.²⁴ This time, the result was different; the court found in favour of maintaining work product privilege. The court noted that a litigation funder's decision to fund a case is based on the merits of the case. Thus, the litigation funder's communications with the litigant and the litigant's legal team are likely to contain the "lawyer's mental impressions, theories and strategies about' the case, which 'were only prepared 'because

20. See Ranjan K. Agarwal & Doug Fenton, *Beyond Access to Justice: Litigation Funding Agreements Outside the Class Actions Context*, 59 CAN. BUS. L.J. 65 (2017).

21. *Leader Techs., Inc. v. Facebook, Inc.*, 719 F. Supp. 2d 373 (D. Del. 2010).

22. *Id.* at 376 (quoting *In re Regents of Univ. of Cal.*, 101 F.3d 1386, 1390 (Fed. Cir. 1996)).

23. *Id.*

24. *Carlyle Inv. Mgmt. L.L.C. v. Moonmouth Co. S.A.*, No. 7841-VCP, 2015 Del. Ch. LEXIS 42 (Feb. 24, 2015).

of the litigation.”²⁵ In addition, the court stated that it saw no persuasive reason “why litigants should lose work product protection simply because they lack the financial means to press their claims on their own dime.”²⁶ This appears to be an acknowledgement by the court of the access to justice benefits of TPLF.

The same result was true in *Miller*,²⁷ a U.S. District Court for the Northern District of Illinois decision. Upon determining that the litigation funding agreement did not violate the doctrines of maintenance and champerty because it did not constitute “officious meddling,” the court ruled that, while disclosure to litigation funders waived attorney–client privilege, work product privilege was not waived so long as the litigant had a reasonable expectation of confidentiality with the litigation funder.²⁸ A non-disclosure agreement between the litigant and the funder created a reasonable expectation of confidentiality, although the court did note, but did not discuss, that a reasonable expectation of confidentiality may exist even in the absence of a non-disclosure agreement.²⁹ This case suggests that litigants and litigation funders ought to enter into non-disclosure agreements to further protect against attacks on work product privilege.

C. Current Use of TPLF in the United States

The bulk of TPLF in the United States has been focused in the areas of patent infringement and price fixing/antitrust. It is no surprise that these are the arenas in which litigation funders tend to operate as these are the types of cases that typically favour plaintiffs.³⁰ In the intellectual property context, the use of TPLF has developed as an alternative to the use of patent “trolls” or non-practicing entities (“NPEs”). NPEs purchase patents for the purpose of litigating potential infringements of the patent.³¹ However, through the use of TPLF, the owner of a patent can partially monetize the patent by agreeing to give away a portion of the award or settlement in exchange for funding instead of having to fully monetize and lose its rights to the patent.³² There

25. *Id.* at *28 (quoting *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711, 735 (N.D. Ill. 2014)).

26. *Id.* at *30–31.

27. *Miller*, 17 F. Supp. 3d 711.

28. *Id.* at 735–38.

29. *Id.* at 738.

30. Joanna M. Shepherd, *Ideal Versus Reality in Third-Party Litigation Financing*, 8 J.L. ECON. & POL’Y 593, 595 (2012).

31. STEVEN GARBER, ALTERNATIVE LITIGATION FINANCE IN THE UNITED STATES: ISSUES, KNOWN, AND UNKNOWN 37 (RAND Corp., Occasional Paper Ser. No. OP-306-LFCMP, 2010), http://www.rand.org/pubs/occasional_papers/OP306.html [https://perma.cc/GFP8-DZZ2].

32. *Id.*

are also two major reasons why patent infringement cases are attractive to funders. Firstly, such cases are very costly to defend and the majority of costs are borne by the defendant, who has higher discovery burdens;³³ this means that a lower percentage of the award or settlement than is typical goes toward the payment of costs. Secondly, patent infringement cases can have significant award or settlement amounts as defendants often have to pay reasonable royalties or treble damages for wilful infringement.³⁴ Together, these factors mean that patent infringement cases are particularly attractive to litigation funders as they create the potential for a higher award than the average case and give the plaintiff a large amount of bargaining power.³⁵

Price fixing and antitrust is another legal landscape in which litigation funders are operating in the United States. There are a number of factors that make the use of TPLF in price fixing and antitrust litigation not just attractive for litigation funders but also practical for plaintiffs:

- there is potential for a high damages award, including automatic treble damages under section 4 of the Clayton Antitrust Act, and reasonable attorneys' fees;³⁶
- the defendants are jointly and severally liable and do not have the right to contribution from co-conspirators;³⁷
- there is the potential for an extended limitations period;³⁸
- due to the complexity of the cases, the plaintiffs tend to be well-represented by sophisticated legal teams;³⁹
- the cases generally settle;⁴⁰
- there are significant up-front costs which increases the need for funding; and⁴¹
- the defendants are typically credit-worthy,⁴² thus reducing the plaintiff's and litigation funder's credit risk.

33. Shepherd, *supra* note 30, at 602, 605.

34. *Id.*

35. *Id.* at 602–03.

36. *Id.* at 605.

37. *Id.* at 605–06.

38. *Id.* at 606.

39. Anne Rodgers et al., *Emerging Issues in Third-Party Litigation Funding: What Antitrust Lawyers Need to Know*, ANTITRUST SOURCE, Dec. 2016, art. 2, at 1, https://www.americanbar.org/content/dam/aba/publishing/antitrust_source/dec16_full_source.authcheckdam.pdf [<https://perma.cc/ZH3A-Z6JK>].

40. *Id.* at 2.

41. *Id.*

42. *Id.*

In the American bankruptcy context, however, TPLF has not attracted significant attention.⁴³ Instead, distressed debt financing has provided the necessary liquidity to distressed estates. Distressed debt financing occurs when an investor purchases the debt of a distressed corporation rather than just an interest in the outcome of the litigation.⁴⁴ However, the benefits of TPLF were exemplified in the recent bankruptcy proceedings of Magnesium Corporation of America (“MagCorp”), rumoured to be the first time a bankruptcy trustee has auctioned off a piece of a litigation judgment via an open proceeding overseen by a federal bankruptcy judge.⁴⁵ The basic facts of the MagCorp case are as follows: MagCorp filed for bankruptcy and its bankruptcy trustee commenced a lengthy legal battle against billionaire Ira Rennert and The Renco Group (who almost wholly owned MagCorp’s parent company) for their involvement in the diversion of MagCorp’s value.⁴⁶ The trustee obtained a favourable judgment of \$213 million, but that judgment was appealed by Rennert. A favourable judgment, and thus a successful result in the appeal, was the only hope of recovery for MagCorp’s unsecured creditors.⁴⁷ However, while the trustee was confident that the judgment would stand on appeal, it was concerned about the liquidity of the estate and its ability to pay for the costs of the appeal.

To fund the litigation, the MagCorp trustee sold an interest in the litigation; this was done pursuant to section 363(b) of the Bankruptcy Code which permits a trustee to sell the assets of the debtor corporation outside of the ordinary course.⁴⁸ Ultimately, a \$50 million interest in the litigation was sold for \$26.2 million at an auction split between two bidders, AEM SPV, LLC (“AEM”) and Brickell Key Investments, LP (an affiliate of litigation funder Juridica Asset Management).⁴⁹ When the appeal court affirmed the \$213 million judgment, not only did the litigation funders nearly double their investments, but the trustee was able to fulfill its duties to the creditors

43. See Stuart L. Pardau, *Alternative Litigation Financing: Perils and Opportunities*, 12 U.C. DAVIS BUS. L.J. 65, 80 (2011).

44. See Frankel, *supra* note 12.

45. See Ryan Boysen, *MagCorp Attys Insist on \$88M Legal Bill for Renco Suit Win*, Law360 (Jan. 19, 2018, 5:58 PM), <https://www.law360.com/articles/1003818/magcorp-attys-insist-on-88m-legal-bill-for-rengo-suit-win> [https://perma.cc/49UP-K9DT].

46. *Id.*

47. See *id.*

48. See *In re Magnesium Corp. of Am.*, Ch. 7 Case No. 01-14312 (MKV) (Bankr. S.D.N.Y. filed Aug. 24, 2016); see also 11 U.S.C. § 363(b) (2012).

49. *Id.*, slip op. at 4–5.

of the debtor company by monetizing some of the award to maximize recovery for the creditors.⁵⁰ Although MagCorp is not identical to litigation funding in that an interest in the litigation proceedings was purchased, the fundamental characteristics to TPLF are effectively similar: non-parties to the litigation made a cash investment in hopes that they would receive a portion of the successful award, settlement or judgment knowing that if the proceedings were unsuccessful, they would lose their investments.

III. BENEFITS OF TPLF

A persuasive argument in favour of TPLF encompasses the access to justice benefit provided those litigants who may otherwise be unable to pursue meritorious litigation. TPLF levels the playing field between litigants to ensure that a plaintiff is not discouraged from pursuing meritorious litigation as a result of the immense resources of its opponent. Although contingency fee arrangements are available to some litigants to achieve these goals, TPLF bridges the gap where a contingency fee arrangement may not be available to a litigant.

The access to justice benefit is particularly persuasive in the insolvency context where the litigants are in a unique financial position. When a company is insolvent, it has limited funds available in order to pursue claims. The company may have access to debtor-in-possession financing, but such financing is typically earmarked for the debtor's working capital requirements. However, TPLF may allow the trustee or unsecured creditors committee to move forward with a claim that it otherwise would not have been able to pursue to maximize the return on the debtor's estate, to the benefit of the debtor company, its unsecured creditors and other stakeholders who benefit from the resolution of the claim.

TPLF possesses the potential to reduce litigation costs incurred. In some situations, some litigation funders require lawyers to work on a budget or maintain supervisory rights to discourage inflated litigation costs.⁵¹ Litigation funder oversight and case management, then, is a means to mitigate excessive allocations of resources which ultimately lead to litigation costs spiralling out of control. Both the litigation funder and the successful litigant benefit in this situation as the ultimate settlement is reduced by a relatively lesser amount of costs. In the insolvency context, TPLF has the potential to

50. See Boysen, *supra* note 45.

51. Stephanie Ben-Ishai & Emily Uza, *Third-Party Litigation Funding in the Canadian Insolvency Context*, 6 J. INSOLVENCY INST. CAN. 1, 7 (2017).

be hugely beneficial as large-scale insolvency proceedings have been criticized for immense legal costs which result in a reduction of the proceeds available to be paid to the debtors' creditors. With oversight from litigation funders, scope to reduce overall legal expenses exist.

Similarly, TPLF may expedite litigation proceedings as a function of funder supervision. This is particularly important in insolvency proceedings as the passage of time increases DIP financing costs, the depreciation of the debtor's assets to be distributed to creditors, and ancillary and legal costs which deplete the debtor's estate to the detriment of creditors. The expeditious resolution of insolvency proceedings benefits vulnerable, unsecured creditors (such as, for example, pensioners, bondholders or unpaid suppliers) who typically have to wait until the finalization of insolvency proceedings before receiving a piece of the debtor's estate.⁵²

Concerns surrounding access to justice are also addressed through the use of TPLF as it enables firms to expand the scope of contingency fee arrangements to allow firms to assume more risk. In sharing the risk of funding legal expenses with litigation funders, a greater portion of the population benefits by ensuring their case gets its day in court. Increased accessibility to counsel by way of TPLF, particularly in the insolvency context, ensures that the litigant possesses sufficient funds to pay legal expenses.⁵³ TPLF can help insolvency practitioners such as trustees and receivers fulfil their duties to ensure that the debtor's estate is maximized. Although a portion of any settlement or award is ultimately paid to the litigation funder, the debtor's estate still comes out ahead because without the funding, the claim would have been left unpursued.⁵⁴ While a host of benefits accompany TPLF in the United States, legal and ethical concerns regarding its usage remain.

IV. LEGAL AND ETHICAL CONCERNS WITH THE USE OF TPLF

Attitudes toward TPLF in the United States appear more negative relative to other common law jurisdictions such as Australia and Canada. As previously discussed, there is concern in the United States that TPLF can present issues with the maintenance of privilege. The maintenance of privilege is absolutely critical to a plaintiff's case and the loss of privilege can be hugely detrimental to a plaintiff's chances of success. As the case law discussed above indicates, although there is a trend toward the protection of

52. *Id.*

53. Khalid Karim & Scott R. Venton, *The New Frontier: Commercial Third-Party Litigation Funding*, JUST (Aug. 17, 2016), [http://www.oba.org/JUST/Archives_List/2016/August-2016/Sample-\(6\)](http://www.oba.org/JUST/Archives_List/2016/August-2016/Sample-(6)) [<https://perma.cc/6C3N-2D9H>]; Ben-Ishai & Uza, *supra* note 51, at 6.

54. Ben-Ishai & Uza, *supra* note 51, at 7.

work product and information shared between litigants and litigation funders, some uncertainty still lingers.

One ethical concern of TPLF highlighted by the Institute for Legal Reform is that it can subvert the litigant's and lawyer's control over the litigation.⁵⁵ The goal of litigation should be to seek justice for the litigants, not litigation funders. Further, while a litigation funder may not intentionally alter the course of litigation, the mere appearance of doing so is problematic.⁵⁶ This power imbalance and the ability, or appearance of the ability, of litigation funders to control the course of the litigation, however, would be less prominent in the commercial insolvency and the involved on all sides. Further, as per case law on the doctrines of maintenance and champerty, the involvement of the litigation funder in or control of the litigation funder over the litigation bears potential to negate the funding arrangement on the basis of the violation of such doctrines. The current case law disincentivizes behaviour, such as extraneous control, by litigation funders.

Similarly, some have expressed concern that, due to their monetary rather than justice-driven goals, litigation funders may pressure litigants to settle even when not in the litigant's best interest. The concern of litigation funders exercising control over litigation remains prevalent despite being addressed in case law. However, if such concern is not mitigated as expected, an increase in the number of settlements has both positive and negative impacts on the legal system as a whole. On a positive note, increased settlement reduces the burden on an already-crowded court system and can result in the more expeditious resolution of cases. However, the negative effects of increased settlement are that it will lead to less case law and precedent over time and could result in a less public and transparent litigation process,⁵⁷ which may be particularly detrimental in cases that are of public interest or importance. Ethical concerns surrounding TPLF with respect to settlement still persist despite clear direction by courts.

Some American commentators have argued that TPLF is "harmful to an already flawed legal system, which will encourage unmeritorious and excessive litigation."⁵⁸ The United States is certainly considered to be a more

55. JOHN H. BEISNER & GARY A. RUBIN, U.S. CHAMBER INST. FOR LEGAL REFORM, STOPPING THE SALE ON LAWSUITS: A PROPOSAL TO REGULATE THIRD-PARTY INVESTMENT IN LITIGATION 1 (2012), http://www.instituteforlegalreform.com/uploads/sites/1/TPLF_Solutions.pdf [https://perma.cc/J77G-5EGG].

56. Taddese, *supra* note 3; Ben-Ishai & Uza, *supra* note 51, at 8.

57. Ben-Ishai & Uza, *supra* note 51, at 8.

58. Cento Veljanovski, *Third-Party Litigation Funding in Europe*, 8 J.L. ECON. & POL'Y 405, 445 (2012).

litigious jurisdiction than Australia or Canada, and one can see why opponents of TPLF would not want to see the courts even more crowded with increased litigation. However, it is integral to note that litigation funders conduct an analysis of the merits of a case before agreeing to fund, therefore decreasing the likelihood of increased TPLF resulting in an uptick of unmeritorious claims. The concern regarding the encouragement of excessive litigation, however, is valid. TPLF opens up litigation possibilities for those formerly unable to litigate, and the result of this is the potential for an increased amount of litigation. There is an inherent trade-off between this criticism and the access to justice benefit of TPLF. While TPLF has the potential to increase crowding in an already-busy court system, it also has the potential to provide access to justice to litigants.

The TPLF industry also creates some consumer protection concerns due to the lack of regulation of litigation funders. Without regulation, litigants cannot be assured of the reputation, financial position, or solvency of litigation funders on whom they are relying for funding. This concern is two-fold. First, it would be devastating for a litigant to be in the middle of litigation proceedings only to find out that their litigation funder is no longer capable of providing funds. Secondly, but less importantly in the American context where parties tend to pay their own costs, if the litigant is unsuccessful in the litigation, the litigant may be liable for costs which the litigation funder would typically be responsible for paying. If the litigation funder is not capable of paying the costs, the litigant would be responsible for a costs order that it never contemplated having to pay. The potential regulation of litigation funders is a necessary next step and is discussed at a later point in this Article.

Further, selective treatment by litigation funders emphasizes business interests, i.e., more lucrative claims, thus resulting in the tendency to ignore less lucrative, but equally as meritorious, claims.⁵⁹ Because litigation funders are repaid a percentage of the resolution sum but presumably have fairly fixed operating costs, it is more economical for litigation funders to fund larger claims, leaving litigants with smaller claims, and in turn smaller scope for compensation, without funding. Although we recognize that TPLF is a business, this has ethical implications in the insolvency context as it could result in the funding of the larger claims of some unsecured creditors with the smaller claims of other unsecured creditors being ignored. This is particularly problematic if unsecured creditors with smaller claims are the more

59. Ben-Ishai & Uza, *supra* note 51, at 8.

vulnerable and less powerful creditors, such as smaller suppliers, employees or tort victims.

V. REGULATION AND OVERSIGHT OF TPLF

In Australia, litigation funders operate virtually unregulated. Early case law imposing regulatory burdens on litigation funders was overruled by both legislation and case law from upper courts. Calls to implement licensing requirements for litigation funders have gone unanswered. The Australian government has made it clear that the access to justice benefit of TPLF is paramount and it appears unwilling to introduce any measures that would decrease the availability of TPLF, particularly in a jurisdiction where contingency fee arrangements are not permitted.⁶⁰ In the Australian insolvency context, courts play a role in the approval of litigation funding arrangements as they are required to approve any contract that will involve performance over a term of more than three months, resulting in approval being required for almost every litigation funding agreement.

In Canada, TPLF is a fairly new phenomenon. As in Australia, TPLF in Canada has carried on relatively unburdened by regulation, although in Canada this appears to be a result of the failure governments to turn their minds to this issue rather than an explicit decision not to regulate TPLF, as is the case in Australia. We have previously advocated for the regulation of litigation funders or litigation funding agreements in the Canadian context.⁶¹

Canadian courts' treatment of litigation funding agreements has developed over a series of cases commencing with the decision in *Dugal v Manulife Financial Corporation*.⁶² In a recent case, *Houle*,⁶³ Bentham IMF Capital Inc. ("Bentham") was engaged by the representative plaintiffs in a class action proceeding, the Houles, to provide litigation funding. The Houles sought an order of the court approving the litigation funding agreement between the Houles, Bentham, and class counsel. The funding agreement stipulated that Bentham would pay (a) all disbursements of class counsel up to a maximum amount (after which class counsel would fund the disbursements), (b) any costs assessed against the Houles, (c) any security for costs, and (d) 50% of the reasonable docketed time of class counsel up to a prescribed maximum amount (after which class counsel would only be paid by contingency fee). The funding agreement stipulated that while the Houles and class counsel

60. *Id.* at 13.

61. *Id.* at 14–18.

62. *Dugal v. Manulife Fin. Corp.*, 2011 ONSC 1785, ¶ 33 (Can.).

63. *Houle v. St. Jude Med. Inc.*, 2017 ONSC 5129 (Can.).

were required to keep Bentham regularly informed about the action, Bentham was not permitted to interfere with or interject itself into the lawyer–client relationship between the Houles and class counsel. It also stipulated that Bentham may not be provided with information or documentation if such disclosure would jeopardize privilege.

In exchange for providing funding, Bentham was entitled to receive a portion of the proceeds of a successful action as follows: (a) if the action settled or was otherwise resolved within eighteen months after the funding agreement’s execution, 20% of the proceeds were payable to Bentham; (b) if the action settled or was otherwise resolved between eighteen and thirty-six months from the funding agreement’s execution, 22.5% of the proceeds were payable to Bentham; and (c) if the action settled or was otherwise resolved after thirty-six months from the funding agreement’s execution, 25% of the proceeds were payable to Bentham. In addition, the funding agreement provided that the class counsel would be entitled to 10%, 11.5%, or 13%, respectively, of the proceeds if the action was resolved within the timeframes set out above.⁶⁴

In discussing the merits of the funding agreement, the court acknowledged that the funding agreement was necessary for the Houles to proceed with their action given their financial position and was sufficient to achieve the goals of the class action regime and the administration of justice.⁶⁵ However, the court pointed out several issues with the funding agreement. First, it did not satisfy the principle that the litigation funder not be overcompensated which can indicate that an agreement is champertous. The court noted that Bentham’s recovery was uncapped and its eventual recovery could be unfair and disproportionate because its recovery could not be adjusted by court approval. To resolve this issue the court proposed making 10% of the recovery pre-approved, with the remainder subject to court approval.⁶⁶ The court also expressed concern that the funding agreement, although containing provisions purporting to ensure lack of interference by Bentham in the litigation proceedings, did not effectively do so. The court indicated that its approval of the funding agreement would be subject to deletion and replacement of such provisions. In addition, the court also indicated that the termination provisions also interfered with the Houles’ litigation autonomy by providing Bentham with broad discretionary rights to terminate the agreement, the solution for which was to require that termination be made subject

64. *Id.* ¶ 32–33.

65. *Id.* ¶ 76, 79.

66. *Id.* ¶ 80, 84–87.

to court approval.⁶⁷ Ultimately, the court approved the funding agreement subject to the revisions discussed above. It should be noted that Bentham has sought leave to appeal this decision with respect to the rejected portions of the funding agreement.

The decision in *Houle*, and the other recent Canadian case law regarding TPLF, indicates that Canadian courts take a balanced approach to TPLF in that they recognize the importance of TPLF as a source of access to justice for litigants and a tool for the administration of justice, but continue to scrutinize funding agreements on a case-by-case basis to ensure that such agreements do not jeopardize plaintiff autonomy or reach the point of becoming champertous. Given the level of court scrutiny, less regulatory oversight of the TPLF industry may be required. We acknowledge, however, that in the bankruptcy and insolvency context particularly, litigation funding agreements are often entered into under the radar, that is without court scrutiny, and thus regulatory oversight may be required to capture these transactions.

Like in Canada, TPLF is still emerging in the United States. Particularly given the minimal level of U.S. court consideration and scrutiny of litigation funding agreements to this point, the TPLF industry in the United States may benefit from a legal and regulatory framework to ensure that the industry develops in a way that promotes the benefits of TPLF while also protecting litigants. Such a framework needs to balance the protection of litigants and the legal system with the commercial realities of the TPLF; such a framework cannot make compliance so burdensome that the United States becomes an unattractive market for litigation funders to operate. The reality, however, is that in states where the doctrines of maintenance and champerty are still strictly enforced, this discussion of regulation is unnecessary as litigation funders are effectively barred from operating in such states.

There are two key ways in which the TPLF industry can be regulated: through the courts and through regulatory or licensing requirements. TPLF arrangements can be regulated by the courts by way of requiring the courts to approve all TPLF agreements at the outset. Such a requirement would ensure that the benefits and drawbacks of a TPLF arrangement are considered on a case-by-case basis. However, this method presumes that all litigation proceedings go to court, which is far from the case. In addition, this method would add to an already overburdened court system.⁶⁸

The second way of regulating the TPLF industry is by the introduction of regulatory or licensing requirements. This can be done by regulating TPLF

67. *Id.* ¶ 89–93, 96–98.

68. Ben-Ishai & Uza, *supra* note 51, at 15.

arrangements or by regulating the litigation funders themselves. Governments could regulate TPLF arrangements by legislating certain requirements for TPLF agreements, such as a cap on the fees or percentage that a litigation funder could charge, stipulating what types of termination provisions are permitted and a requirement for standard non-disclosure provisions to protect litigants' confidentiality and claims of privilege. This would ensure that TPLF arrangements meet some sort of baseline test, which would add a consumer protection measure for less sophisticated litigants.⁶⁹

Regulation of the TPLF industry can also be done by placing regulatory or licensing requirements on litigation funders themselves and providing an effective means of enforcement. One commentator suggested that the Securities and Exchange Commission could regulate litigation funders in the United States by requiring them to register as investment advisors.⁷⁰ Two of the benefits of such a registration requirement are that (a) litigation funders would be subject to SEC rules requiring them to maintain compliance, privacy, ethics, funding, disclosure, and management policies, and (b) the SEC has a well-established regulatory framework adept at data collection, consumer protection, and compliance enforcement. Thus, in requiring litigation funders to register as investment advisors with the SEC, the consumer protection element of the regulation of the TPLF industry would certainly be achieved as there would be clear requirements in place for litigation funders and effective enforcement of such requirements. However, such a registration requirement would result in litigation funders being considered fiduciaries required to act in the best interests of their clients.⁷¹ A fiduciary duty seems too significant of a burden to place on litigation funders. Such a duty is generally reserved for those in positions of trust, such as those who are managing the money or assets of another.

In the case of litigation funders, they are simply extending funds to the litigant for expenses. If in compliance with the principles noted in the case law, the litigation funder has no control over the direction of the litigation. It seems unreasonable to expect litigation funders to abstain from participating in the litigation that they are funding but then place a fiduciary duty on them. An ideal licensing framework would ensure that the benefits of SEC registration that we discussed (requirement for the implementation of policies and procedures which would protect litigation) exist while not overburdening litigation funders with legal duties.

69. *Id.* at 16–18.

70. Glickman, *supra* note 1, at 1066–67.

71. *Id.* at 1067.

As we have previously suggested in the Canadian context, it would be prudent for state governments and the federal government to commence a public consultation process on the regulation of TPLF to gather feedback from members of the TPLF industry and from the legal community.⁷² They are inextricably linked and TPLF cannot exist in the legal system unless it works in a balanced and equitable manner for litigation funders, litigants, lawyers, and the courts.

VI. CONCLUSION

The United States provide a unique challenge for the successful adoption of TPLF in that individual states pose restrictions to the adoption of this emerging litigation funding model. TPLF's success in Australia is indicative of the potential to address concerns of access to justice for vulnerable populations. While ethical and legal concerns, namely qualms surrounding maintaining privilege as well as influence on the litigation, persist, benefits of this funding model offer an innovative solution to age-old issues such as case management and expedited processes. The benefits of TPLF, however, are counter-acted by a lack of regulation present in the United States. The insolvency context presents an ideal terrain for TPFL to expand and overcome potential ethical and legal concerns.

This Article has offered two major recommendations to expand the use of TPLF into the U.S. insolvency context. As seen in the Canadian context, courts have accepted the use of litigation funding agreements fitting within certain parameters. If U.S. courts follow suit, friction against the implementation of TPLF can be mitigated. Alternatively, regulation may occur through legislative and regulatory models to govern and set out precisely what types of arrangements are permitted. Involving entities such as the SEC may expedite the acceptance of TPLF, but special attention is necessary not to intermingle notions of fiduciaries into the discussion of TPLF, as there are contentious definitional elements present. Ultimately, a framework wherein regulation coupled with judicial oversight presents the best opportunity for the United States to adopt TPLF in the insolvency context to ensure maximum delivery of benefits to vulnerable parties.

72. Ben-Ishai & Uza, *supra* note 51, at 17–18.