NOTE

THE CASE FOR A GOVERNMENT-AUTHORIZED SELF-REGULATORY ORGANIZATION FOR COMMERCIAL LITIGATION FUNDERS

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This Note argues that a self-regulatory organization can effectively regulate commercial litigation funders operating in the United States. Critics of litigation funding have argued that the existence of third-party funders could lead to meritless lawsuits. Regulations that require the disclosure of the involvement of litigation funders has been proposed as a potential solution. This Note refutes the argument that litigation funding leads to meritless lawsuits by showing that such lawsuits offer no financial incentive to litigation funders. Because of the time value of money, one major risk is that litigation funders will encourage clients they fund to settle lawsuits sooner rather than later so that funders can redeploy their capital and capture more gains in a specified period of time. To prevent such behavior, litigation funders need a regulatory monitor to prevent them from attempting to influence the legal decisions in the cases that they fund. This Note argues that a viable self-regulatory organization should be created in the United States by pulling from regulatory models in Australia and the United Kingdom, and coupling a government mandate with an already extant industry self-regulatory organization. Such an organization could effectively address the risk posed by litigation funders while allowing them to help offset the costs of litigation for their clients.

* J.D. 2022, Columbia Law School. Special thanks to my Dad, Byron Sr., my brother Andrew, and to my boyfriend Kieran Altmann.

I. INTRODUCTION

The practice of commercial litigation finance or third-party funding, whereby a third party invests in a lawsuit by funding the plaintiff in exchange for a share of the financial judgment, has been increasingly active in the United States for over a decade and remains unregulated at the federal level.[1] In the

[1] Roy Strom, *Litigation Funding Scores Regulatory Win Against Uniform Rules*, BLOOMBERG L. (July 31, 2021, 12:42 PM), https://news.bloomberglaw.com/business-and-practice/litigation-funding-

fall of 2020, a group of international litigation funders banded together to form the International Legal Finance Association (IFLA), which aims to "educate and influence legislative, regulatory[,] and judicial landscapes as the global voice of the commercial legal finance industry."[2] Meanwhile, another organization, the Commercial Litigation Finance Association (CLFA), has labeled itself as a self-regulatory body for its member organizations.[3] The CLFA is the only group in the United States currently operating as a self-regulatory organization for the commercial litigation funding industry. As voluntary organizations, the CLFA and ILFA both lack one critical function to be effective regulators—they have no legal enforcement power.

By the end of 2021, there were forty-seven active funders with approximately $12.4 billion in assets under collective management.[4] As Part II explains, notwithstanding the considerable size of their collective operations, litigation funders in the United States are not governed by a comprehensive set of rules. The only federal regulatory requirement for a litigation funder stems from regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), which requires advisors to private funds with greater than $150 million in assets under management to register with the Securities and Exchange Commission (SEC).[5] Otherwise, the current regulatory environment surrounding litigation funding

scores-regulatory-win-against-uniform-rules [https://perma.cc/6H5M-2ZVZ].

2 *International Legal Finance Association*, INT'L LEGAL FIN. ASS'N, http://www.ilfa.com [https://perma.cc/K2Q8-D3DL] (last visited May 24, 2022).

3 *About CLFA*, COM. LITIG. FIN. ASS'N, https://legalfinanceorg.wordpress.com/about-clfa/ [https://perma.cc/G8W3-4LQP] (last visited May 24, 2022).

4 WESTFLEET ADVISORS, THE WESTFLEET INSIDER: 2021 LITIGATION FINANCE MARKET REPORT (2021), https://www.westfleetadvisors.com/wp-content/uploads/2022/03/WestfleetInsider-2021-Litigation-Finance-Market-Report.pdf [https://perma.cc/9L3U-N2RH].

5 Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, 76 Fed. Reg. 39,646, 39,647 (July 6, 2011).

in the United States remains a patchwork of different state laws addressing the champerty doctrine and disclosure rules.[6] On the federal level, Senator Chuck Grassley has introduced comprehensive federal regulation requiring disclosure of the involvement of litigation funders in class actions and multidistrict litigation, but the legislation has not yet made it to a vote.[7]

Part III addresses the impetus behind litigation funding regulation and evaluates its merits. Before discussing regulation, there must be consensus on policy. Litigation funding has competing policy aims. On one side, proponents see themselves as expanding access to the justice system by providing funding to plaintiffs who would otherwise be unable to pursue their claims. This view has been espoused by courts in countries with active litigation funding markets.[8] Proponents have also noted that funding can even the playing field between large corporate defendants and less capitalized plaintiffs.[9] On the other side, opponents see a risk of third-party funders controlling litigation.[10] Opponents also raise the issue of frivolous lawsuits being brought due to the financial objectives of funders.[11] They seek disclosure requirements as a remedy to assure defendants and courts that plaintiffs are bringing legitimate claims and that

6 *See infra* Part II.

7 Litigation Funding Transparency Act of 2021, S. 840, 117th Cong. (2021).

8 *See* Arkin v. Borchard Lines, Ltd. [2005] EWCA (Civ) 655, [40] (Eng.) (noting that litigation funding can "facilitate[] access to justice"); Maya Steinitz, *The Litigation Finance Contract*, 54 WM. & MARY L. REV. 455, 483 (2012).

9 Steinitz, *supra* note 8.

10 *See* Letter from Lisa A. Rickard, President, U.S. Chamber Inst. for Legal Reform, to Rebecca A. Womeldorf, Sec'y of the Comm. on Rules of Prac. & Proc. of the Admin. Off. of the U.S. Cts. 18 (June 1, 2017), https://www.uscourts.gov/sites/default/files/17-cv-o-suggestion_ilr_et_al_0.pdf [https://perma.cc/53DS-9USN].

11 *Id.* at 7–8 (arguing that the expansion in the way that third-party litigation funders invest in litigation "increases the likelihood" of "spurious lawsuits").

plaintiffs and their lawyers, not the firms funding their lawsuits, are actually controlling the litigation.[12]

At root, the greatest legitimate concern is that litigation funders will unduly influence the cases that they fund.[13] Codes of ethics adopted by the current industry associations and self-regulatory organizations aim to prevent funders from exercising control over lawsuits by influencing lawyers, litigation strategy, or settlement talks.[14] In essence, these ethical codes seek to eliminate conflicts of interests between funders and their clients. This Note contends that the existence of a voluntary self-regulatory organization speaks to the desire of litigation funders to legitimize themselves—and that, as firms operating in the same, relatively nascent industry, litigation funders share a common industry reputation, which naturally incentivizes ethical behavior among them. However, there are financial incentives associated with the third-party funding model that can lead to conflicts of interest between the funders and the plaintiffs being funded. Such potential conflict necessitates a governance framework.

Notwithstanding the absence of self-regulation in the litigation funding industry to date in the United States, a framework for such self-regulation already exists. This framework is modeled by the Association of Litigation Funders ("ALF") in England and Wales, which has been given power by the Ministry of Justice to enforce its Code of Conduct among its members.[15] Moreover, CLFA has used the code of conduct generated by the United Kingdom's Civil Justice Council (an agency of the Ministry of Justice) as inspiration

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[12] *Id.* at 2.

[13] *See id.*

[14] *See Ethics Guidelines*, COM. LITIG. FIN. ASS'N, https://legalfinanceorg.wordpress.com/ethics-guidelines/ [https://perma.cc/TK67-H9P4] (last visited May 24, 2022) [hereinafter CFLR Ethics Guidelines].

[15] *About Us*, ASSOC. LITIG. FUNDERS, https://associationoflitigationfunders.com/about-us/ [https://perma.cc/688G-NBQ5] (last visited May 24, 2022); *see Code of Conduct*, ASS'N LITIG. FUNDERS, https://associationoflitigationfunders.com/code-of-conduct/ [https://perma.cc/Z9R6-FHKT] (last visited May 24, 2022).

for its own ethics guidelines.[16] This Note contends that the path to creating a government sanctioned self-regulatory organization is modeled by ALF in the United Kingdom as well as by the Financial Industry Regulatory Authority (FINRA) in the United States.

Part IV argues that the SEC should promulgate regulations empowering ILFA to enforce its Code of Conduct[17] among those of its members subject to SEC registration requirements pursuant to the Dodd-Frank Act. Furthermore, this Note argues that all other private firms required to register with the SEC that engage in litigation funding activity should be required to uphold ILFA's best practices. Equipping ILFA with government-sanctioned enforcement power will remedy any impropriety arising from the attempts of litigation funders to assert influence over the lawyers and clients to whom they provide funding. It also will foster an industry-wide commitment to ethical operations for investment firms engaging in litigation funding. Given the nature of commercial litigation funders, this solution is the optimal way to regulate the actions of the relevant firms without burdening existing government agencies.

II. BACKGROUND

Section A provides a background on the doctrine of champerty as it has developed in the United States. It also provides an overview of the current regulatory landscape in the United States. Section B reviews the proposed regulatory solutions put forward in Congress, outlines how litigation funding has been addressed in the United Kingdom, and lays the groundwork for the self-regulatory organization this Note proposes.

[16] CFLA Ethics Guidelines, *supra* note 14.

[17] *Best Practice*, INT'L LEGAL FIN. ASS'N, https://www.ilfa.com/#best-practice [https://perma.cc/FF45-T2UQ] (last visited May 24, 2022).

A. Legal Background

The doctrine of champerty has historically posed the greatest challenge to litigation finance by directly prohibiting third parties from having a financial interest in a lawsuit.[18] Champerty developed in France and migrated to England before making its way to the United States.[19] In the United States, state case law varies, with some state courts upholding champerty doctrines[20] and others narrowing their application or abolishing them entirely.[21]

South Carolina, Massachusetts, and Minnesota courts are among those that have refused to recognize the doctrine of champerty.[22] South Carolina's Supreme Court abolished the state's champerty doctrine in *Osprey, Inc. v. Cabana Ltd. Partnership*, writing that "it no longer is required to prevent the evils traditionally associated with the doctrine as it developed in medieval times."[23] In *Saladini v. Righellis*, the Supreme Judicial Court of Massachusetts similarly reasoned

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18 *See* 14 Am. Jur. 2d. Champerty § 1 (2022); *see also* *Champerty*, BLACK'S LAW DICTIONARY (11th ed. 2019) (defining "Champerty" as "an agreement to divide litigation proceeds between the owner of the litigated claim and a party unrelated to the lawsuit who supports or helps enforce the claim").

19 Steven K. Davidson et al., *Litigation Funding Update—Abolishing Common Law Champerty*, STEPTOE & JOHNSON LLP (July 7, 2020), https://www.steptoe.com/en/news-publications/litigation-funding-update-abolishing-common-law.html [https://perma.cc/AF6X-VDJL].

20 *See, e.g.*, WFIC, LLC v. LabBarre, 148 A.3d 812, 818 (Pa. Super Ct. 2016) (ruling litigation finance was "champertous"); *cf.* Wilson v. Harris, 688 So. 2d 265, 270 (Ala. Civ. App. 1996) (recognizing the doctrine of champerty, though invalidating the relevant contract on other grounds).

21 *See, e.g.*, Maslowski v. Prospect Funding Partners LLC, 944 N.W.2d 235, 238 (Minn. 2020); Landi v. Arkulis, 835 P.2d 458, 464 n.1 (Ariz. Ct. App. 1992) ("[C]hamperty is not recognized in Arizona[.]" (citing Strahan v. Haynes, 33 Ariz. 128, 262 P. 995 (1928))).

22 These states are just a few of the many state courts that have abandoned the doctrine of champerty. *See, e.g.*, Landi, 835 P.2d at 464 n.1; Abbott Ford, Inc. v. Superior Ct., 741 P.2d 124, 141–42 n.26 (Cal. 1987) ("California . . . has never adopted the common law doctrines of champerty[.]" (citations omitted)).

23 Osprey, Inc. v. Cabana Ltd. P'ship, 532 S.E.2d 269, 279 (S.C. 2000).

that they "no longer are persuaded that the champerty doctrine is needed to protect against the evils once feared: speculation in lawsuits, the bringing of frivolous lawsuits, or financial overreaching by a party of superior bargaining position."[24] Most recently, in evaluating a case that arose out of a champertous agreement between a personal injury litigant and a litigation financing company in *Maslowski v. Prospect Funding Partners LLC*, the Supreme Court of Minnesota stated, "We decline . . . to hold that the contract between Maslowski and Prospect is void as against public policy as we understand it today."[25] The court reasoned that the state's prohibition on champerty was established before the rules of ethics and rules of civil procedure were adopted, and that those rules have obviated the need for the champerty prohibition.[26] Ohio went one step further by writing litigation financing into its civil code.[27]

Not all states have abandoned champerty. In 2016, the Pennsylvania Superior Court, one of Pennsylvania's intermediary appellate courts, held that a funding arrangement was champertous because the funders were "completely unrelated parties who had no legitimate interest in the [litigation]."[28] The court found that "[t]he Litigation Fund Investors loaned their own money simply to aid in the cost of the litigation, and in return, were promised to be paid 'principal, interest, and incentive[.]'"[29] As a result, the court summarily held that all the elements of champerty in the state had been satisfied and that the agreement with the funders was invalid, meaning the appellant was not entitled to any fees.[30] In 2019, the Sixth Circuit, interpreting Kentucky's statute prohibiting champerty, invalidated a

[24] Saladini v. Righellis, 687 N.E.2d 1224, 1226 (Mass. 1997).

[25] *Maslowski*, 944 N.W.2d at 238.

[26] *Id.* at 238–39.

[27] Ohio Rev. Code Ann. § 1349.55 (LexisNexis 2022).

[28] WFIC, LLC v. LabBarre, 148 A.3d 812, 819 (Pa. Super. Ct. 2016).

[29] *Id.* (emphasis omitted).

[30] *Id.*

funding agreement.[31] Kentucky law explicitly invalidates contracts where a non-party renders aid to a lawsuit and receives an interest in the lawsuit in return, and the court held that the district court below correctly determined that litigation funding would be champertous under Kentucky law and violative of Kentucky's public policy.[32]

Despite a small minority of states upholding their respective champerty doctrines,[33] litigation funders continue to operate in the states where they are not constrained by these restrictions. This suggests a broader question: What do we really need in terms of disclosure and transparency to become comfortable with litigation funders taking part in our legal system?

B. Proposed Solutions

Recognizing the forward momentum of litigation funders and the industry's continuing growth, there has been movement towards federal regulation that would emphasize disclosure for class actions and multi-district regulation. As noted, Senator Chuck Grassley introduced the Litigation Funding Transparency Act of 2021.[34] The bill calls for counsel to "disclose in writing to the court and all other parties the identity of any commercial enterprise, other than the named parties or counsel, that has a right to receive payment that is contingent on the receipt of monetary relief in the civil action

31 Boling v. Prospect Funding Holdings, LLC, 771 F. App'x 562, 576 (6th Cir. 2019) (citing KY. REV. STAT. ANN. § 372.060).

32 *Id.* at 577–82.

33 *See* Julia Gewolb & Joshua Libling, *INSIGHT: The Fall of Champerty and the Future of Litigation Funding*, BLOOMBERG L. (Jun. 16, 2020, 4:00 AM), https://news.bloomberglaw.com/us-law-week/insight-the-fall-of-champerty-and-the-future-of-litigation-funding [https://perma.cc/L9N3-X8FU]; *see also* Paul Bond, *Making Champerty Work: An Invitation to State Action*, 150 U. PENN. L. REV. 1297, 1333 app. (2002) (cataloging state champerty laws as of 2002).

34 S. 840, 117th Cong. (2021). Senator Grassley originally proposed a version of the legislation in 2018. *See* Litigation Funding Transparency Act of 2018, S. 2815, 115th Cong. (2018).

by settlement, judgment, or otherwise[.]"[35] The legislation has yet to be approved by Congress.

Progress may be on the horizon, however. A January 2020 update from the Judicial Conference Committee on Rules of Practice and Procedure noted that the Advisory Committee on Civil Rules approved a recommendation from its Multidistrict Litigation Subcommittee ("MDL Subcommittee") to hold open the question of a rule change to address developments in third-party litigation funding, removing it from the MDL Subcommittee's agenda and returning it to the Advisory Committee for monitoring.[36] At this stage, the Advisory Committee on Rules of Practice and Procedure would need to move forward with hearings and draft a rule before forwarding it to the Standing Committee.[37] The Standing Committee can then forward the rule to the Supreme Court for approval, who then sends it to Congress.[38] If Congress fails to act after receiving the proposed rule from the Court, the rule becomes law by default.[39] While there is a lack of consensus on the proper way to address the litigation funding issue, the desire for transparency in the funding process speaks to the greater concern: Litigation funders are unduly influencing the lawsuits that they fund.

The most cohesive effort at standardizing the conduct of litigation funders has come from the industry itself. ILFA pitches itself as the global voice for the industry and aims to promote "the highest standards of operation and service for the commercial legal finance sector."[40] In a telephone interview, William P. Farrell, Jr.—a member of ILFA's management committee and Managing Director and General

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35 S. 840, § 3.

36 MEETING MINUTES OF JANUARY 28, 2020, COMM. ON RULES OF PRAC. & PROC., ADMIN. OFF. OF THE JUD. CONF. 12 (2020).

37 28 U.S.C. § 2703 (2018); *see How the Rulemaking Process Works*, U.S. CTS., https://www.uscourts.gov/rules-policies/about-rulemaking-process/how-rulemaking-process-works [https://perma.cc/UPG4-GSTC] (last visited May 24, 2022) [hereinafter Rulemaking Process].

38 28 U.S.C. § 2073–74; *see* Rulemaking Process, *supra* note 37.

39 28 U.S.C. § 2074; *see* Rulemaking Process, *supra* note 37.

40 INT'L LEGAL FIN. ASS'N, *supra* note 2.

Counsel of Longford Capital, a commercial litigation funder operating in the United States[41]—shed light on the motives behind the creation of ILFA.[42] He discussed the challenges faced by funders and his hopes for future regulations addressing the industry.[43] Mr. Farrell expressed that, for most plaintiffs, access to justice is a virtue of litigation funding, and that the funding provided by funders, such as Longford Capital, should even the playing field.[44] This view corresponds with the policy aims of other proponents of litigation funders mentioned above. Mr. Farrell explained that the goal of ILFA is to develop guidelines and best practices in order to codify what is already standard practice for industry players.[45]

The biggest resistance to litigation funding comes from the U.S. Chamber of Commerce, a lobbying organization composed of large companies that frequently defends suits brought by plaintiffs supported by litigation funders.[46] In Mr. Farrell's opinion, these larger companies believe that litigation funding generates frivolous litigation.[47] He refuted this belief with several assertions. Mr. Farrell noted that the equity nature of litigation funders' investment, which gives them a financial stake in the lawsuit, rebuts the proposition that they would fund frivolous suits.[48] Indeed, funders reject

[41] *ILFA Names New Chairman, Board of Directors, and Executive Committee*, LIT. FIN. J. (May 2, 2022), https://litigationfinancejournal.com/ilfa-names-new-chairman-board-of-directors-and-executive-committee/ [https://perma.cc/NC3Y-EBUQ].

[42] Telephone Interview with William P. Farrell, Jr., Managing Dir. & Gen. Couns., Longford Capital (Nov. 16, 2020) [hereinafter Farrell Interview].

[43] *Id.*

[44] *Id.*; *see also* Interview by Craig W. Budner with William P. Farrell, Jr., Managing Dir. & Gen. Couns., Longford Capital, at 37:40 (Aug. 20, 2020), https://www.klgates.com/Client-Conversations-Interview-with-Bill-Farrell-Managing-Director-and-General-Counsel-at-Longford-Capital-8-20-2020 [https://perma.cc/UP4V-5ZQT].

[45] Farrell Interview, *supra* note 42.

[46] *Id.*

[47] *Id.*

[48] *Id.*

the vast majority of the cases with which they are presented.[49] They only make money when they win, which means that they endeavor to find the most meritorious cases that will make good investments.[50] Mr. Farrell estimates that seventy-five to ninety percent of cases chosen by funders are victorious.[51]

Mr. Farrell also identified Rule 11 of the Federal Rules of Civil Procedure (FRCP) as a mechanism that weeds out frivolous litigation.[52] Contrary to current concerns about the legitimacy of suits funded by third-party funders, Mr. Farrell believes that, in the long term, the success of cases supported by litigation funding could lead the judiciary to have a favorable view of the merits of these cases. If disclosure regulations come into effect, Mr. Farrell believes they will reveal that third-party funders have a strong track record of meritorious claims.[53] Although Mr. Farrell was optimistic about implementing regulation that would require all funders to adhere to best practices, he also wondered whether litigation funders are being singled out for behavior that banks, hedge funds, private equity funds, and high net worth individuals all currently engage in to achieve similar results.[54]

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49 *Id.*; *see also* A PRACTICAL GUIDE TO LITIGATION FUNDING, WOODSFORD LITIG. FUNDING 8 (2021). https://woodsford.com/wp-content/uploads/2021/01/Woodford-White-Paper-A-Practical-Guide-Lit-Fund-NLogo.pdf [https://perma.cc/4BJ6-MF4Z] (detailing the phases that a case goes through between initial intake at Woodsford and the ultimate decision to fund, with only 3.5% of the cases that enter the intake process ultimately funded.)

50 Farrell Interview, *supra* note 42.

51 *Id.*; *cf. Third Party Litigation Funding: Buying Trouble Across the Globe*, U.S. CHAMBER INST. FOR LEGAL REFORM (Apr. 7, 2022), https://instituteforlegalreform.com/third-party-litigation-funding-buying-trouble-across-the-globe/ [https://perma.cc/8PHC-T6ET] (reporting that a 96-98% success rate among third party litigation funders in Australia).

52 *Id.* FRCP Rule 11 specifically requires that pleadings made to the court "not be[] presented for any improper purpose" and that "factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery[.]" Fed. R. Civ. P. 11(b)(1), (3).

53 Farrell Interview, *supra* note 42.

54 *Id.*

CLFA has been proactive in attempting to standardize conduct among litigation funders in the United States. Their overall framework consists of being a voluntary group of commercial litigation funders holding themselves to the association's adopted Ethics Guidelines.[55] CLFA basis its Ethics Guidelines on the same Code of Conduct used by their English counterpart, ALF,[56] which is the Code of Conduct provided by the Civil Justice Council, an agency of the United Kingdom's Ministry of Justice.[57] The Code of Conduct, first issued in November of 2011,[58] consists of three areas of concern: capital adequacy of funders, termination and approval of settlements, and control.[59] The capital adequacy component requires funders to have sufficient capital to meet the needs of their clients for at least thirty-six months.[60] The termination and approval of settlements section provides the circumstances under which a funder can withdraw from a funding agreement. It also provides a neutral independent dispute resolution mechanism for disputes that arise out of the termination of a funding agreement or a settlement.[61] Finally, the section on control stipulates that "funders are prevented from taking control of litigation or settlement negotiations and from causing the litigant's lawyers to act in breach of their professional duties."[62] This third section of ALF's Code of Conduct addresses the overarching concern of litigation funding in the United States, which is that funders could exert undue control over litigants.

[55] *About CLFA*, COM. LITIG. FIN. ASS'N, *supra* note 3; CFLR Ethics Guidelines, *supra* note 14.

[56] CFLR Ethics Guidelines, *supra* note 14.

[57] ASS'N LITIG. FUNDERS, CODE OF CONDUCT (2018), https://associationoflitigationfunders.com/wp-content/uploads/2018/03/Code-Of-Conduct-for-Litigation-Funders-at-Jan-2018-FINAL.pdf [https://perma.cc/FP42-2GRA]; *see Code of Conduct*, ASS'N LITIG. FUNDERS, *supra* note 15.

[58] *Code of Conduct*, ASS'N LITIG. FUNDERS, *supra* note 15.

[59] *Id.*

[60] ASS'N LITIG. FUNDERS, *supra* note 57, at 2–3.

[61] *Code of Conduct*, ASS'N LITIG. FUNDERS, *supra* note 15.

[62] *Id.*; *see also* ASS'N LITIG. FUNDERS, *supra* note 57, at 2–3.

CFLA's Ethics Guidelines are best defined as a watered-down version of ALF's Code of Conduct. The capital section only requires that members "have direct access to capital immediately within its control."[63] Conspicuously absent are any references to sufficient capital for the client or any durational commitment. The control section more closely mirrors ALF's Code of Conduct: CLFA members are prevented from exerting any control over the litigation or settlement talks and explicitly prohibited from providing legal advice.[64]

CLFA has two additional sections which are not directly comparable to the ALF's Code of Conduct, one on privilege and protection and another on attorney ethics. The privilege section requires members to employ non-disclosure agreements and "other protective measures" to ensure that sensitive information is protected.[65] The attorney ethics section prevents members from paying referral fees or kickbacks to attorneys in exchange for referrals of clients who need funding.[66] The additional provisions may instill public confidence in the members of the CLFA, but one wonders about the consequences for a member of the CLFA who violates one of these guidelines. ALF has a formalized complaint procedure that enables clients of member firms to lodge complaints against their funders, and ALF explicitly states that it will willingly make the details of the complaint handling procedure "readily available to claimants and their advisors."[67] The same cannot be said for the CLFA.

As discussed above, another key distinction between the CLFA and ALF is ALF's governmental link. ALF's founding coincided with the Civil Justice Council's creation of the Code of Conduct for Litigation Funders in 2011.[68] Whereas the Civil

63 CFLR Ethics Guidelines, *supra* note 14.

64 *Id.*

65 *Id.*

66 *Id.*

67 *How We Work*, ASS'N LITIG. FUNDERS, https://associationoflitigationfunders.com/about-us/how-we-work/ [https://perma.cc/BF92-P8BN] (last visited May 24, 2022).

68 *Id.*

Justice Council also approved the creation of ALF,[69] the CLFA has not received such approval from the relevant government agency. However, such a relationship between a regulatory government agency and a self-regulatory organization is not unprecedented in the United States. After the passage of the Maloney Act[70] in 1938, which granted self-regulation to the over-the-counter (OTC) market for securities, the National Association of Securities Dealers (NASD) became the sole securities self-regulatory organization to be registered with the SEC to oversee broker-dealers in the OTC market.[71] The NASD and the New York Stock Exchange Regulation, Inc. merged in 2007 to form FINRA, which today is the "single self-regulator for all securities firms conducting business with the public."[72] This Note argues that litigation funding industry should adopt a similar regulatory framework and become governed by a self-regulatory organization registered with a governmental regulatory agency.

III. LITIGATION FUNDING NEEDS SELF-REGULATION TO MONITOR CONFLICTS OF INTEREST

Part III delineates the sources of risk posed by litigation funding. The threat of frivolous lawsuits is dismantled by looking at how the FRCP precludes them from gaining traction. This Part specifically analyzes who assumes financial risk in the context of litigation funding and how prepared those parties are to bare that financial risk. Finally, this Part addresses how financial incentives for litigation funders can create a conflict of interest and details how a self-regulatory organization could map onto existing frameworks

69 *Id.*

70 Pub. L. No. 75-719, 52 Stat. 1070 (1938) (codified as amended at 15 U.S.C. § 78o-3 (2018)).

71 Jonathan Macey & Caroline Novogrod, *Enforcing Self-Regulatory Organization's Penalties and the Nature of Self-Regulation*, 40 HOFSTRA L. REV. 963, 980 (2012) (citing 15 U.S.C. § 78o-3).

72 *Id.* at 981.

and mitigate the conflicts of interests created by the financial incentives of litigation funders.

A. Who Invests in Litigation Funding

Litigation funding is available as an investment primarily to financial firms, hedge funds, and other types of accredited investors.[73] Accredited investors are individuals who satisfy requirements set out by the SEC that enables them to invest in private capital markets that are not regulated by federal securities laws. Regulation D defines "accredited investor,"[74] which was recently amended in October 2020.[75] Prior to the amendment, the previous definition required, *inter alia*, an investor to have a certain level of income ($200,000 for the prior two years)[76] or financial assets ($1,000,000 net worth excluding their primary residence) to qualify to invest in unregistered securities.[77] The amended definition now enables investors with demonstrable financial sophistication to join the ranks of accredited investors and take advantage of investment opportunities not covered by SEC regulations "irrespective of their wealth."[78] Clearly, the investors pouring money into litigation funders are not average consumers. To the contrary, they are either investors who have substantial means to withstand a financial loss, investors with demonstrable financial acumen to decipher what is (and what is not) a worthwhile investment, or both.

73 *See* Michael Perich, *Practical Guidance: Profile of Litigation Funders*, BLOOMBERG L., https://pro.bloomberglaw.com/litigation-funding/ [https://perma.cc/U5H8-32VC] (last visited May 24, 2022); Sarah O'Brien, *Litigation Financing May Tempt Investors with High Returns. What To Know Before Buying In*, CNBC (Jun. 25, 2020, 11:35 AM), https://www.cnbc.com/2020/06/25/litigation-financing-tempts-with-high-returns-tips-before-buying-in.html [https://perma.cc/6R73-UEA5].

74 17 C.F.R. § 230.501 (2021).

75 Accredited Investor Definition, 85 Fed. Reg. 64,234, 64,234–35, 64,277 (Oct. 9, 2020) (to be codified at 17 C.F.R. pt. 230, 240).

76 17 C.F.R. § 230.501(a)(5).

77 *Id.* § 230.501(a)(6).

78 Accredited Investor Definition, 85 Fed. Reg. at 64,235; *see* 17 C.F.R. § 230.501(a)(10).

B. Risks Assumed by Investors in Litigation Funding

Like any type of investment, litigation funders risk losing their capital investments in litigation. Limiting investors in litigation funding to accredited investors is meant "to ensure that all participating investors are financially sophisticated and able to fend for themselves or sustain the risk of loss, thus rendering unnecessary the protections that come from a registered offering."[79] The hope, as with any financial investment, is that the capital invested will garner returns. Such returns are exactly what litigation funders offer investors.

Part of the role of the litigation funder is to mitigate investment risk. As the intermediaries between investors and the lawsuits that are being funded, litigation funders add value by directing investors' capital towards the lawsuits with the most potential for success (and thus return).[80] By both performing due diligence on lawsuits before deciding to fund them and spreading the risk out over a number of lawsuits as opposed to putting all of their capital behind one lawsuit, litigation funders mitigate the risk to which the accredited investors are exposed.[81] If this risk mitigation fails, only a small class of investors will be affected: The SEC has limited the pool of litigation fund investors to those the agency anticipates are in the best position to stomach the financial loss.[82]

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79 *Accredited Investors—Updated Investor Bulletin*, U.S. SEC. & EXCH. COMM'N (Apr. 14, 2021), https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins/updated-3 [https://perma.cc/N56L-K5F4].

80 *See* Eric Blinderman, *INSIGHT: How Litigation Funders Decide Which Legal Matters To Fund*, BLOOMBERG L. (Mar. 27, 2019, 4:01 AM), https://news.bloomberglaw.com/us-law-week/insight-how-litigation-funders-determine-which-legal-matters-to-fund [https://perma.cc/P6V6-DZ9E].

81 *See id.*

82 Accredited Investor Definition, 85 Fed. Reg. at 64,235 ("[C]haracteristics of an investor . . . . include the ability to assess an investment opportunity—which includes the ability to analyze the risks and rewards, the capacity to allocate investments in such a way as to mitigate

Because the SEC has determined that accredited investors are capable of making their own investment decisions without the protections usually provided by the SEC for unsophisticated investors in regulated securities, it is hard to argue that accredited investors need substantial federal regulation to protect their investments. What *is* needed, however, is monitoring of the private funds that are investing in lawsuits. The funding supplied by these funds should not spur frivolous lawsuits, and the firms must not remove control of the lawsuits from the plaintiffs and their attorneys.

C. The Non-Threat of Frivolous Lawsuits

Critics of litigation funding have raised concerns that making funds readily available to putative plaintiffs will lead to an avalanche of frivolous lawsuits that would clog up and further delay the already overburdened judicial system.[83] This parade of horribles ignores the fact that the federal court system already has mechanisms in place to prevent meritless lawsuits from progressing past the pleading stage. FRCP Rule 11(b) requires attorneys making representations to the court to attest, *inter alia*, that the representations are not being made for any improper purposes, that the claims are nonfrivolous, and that factual contentions have evidentiary support.[84] FRCP Rule 11(c) allows for the imposition of

or avoid risks of unsustainable loss, or the ability to gain access to information about an issuer or about an investment opportunity—or the ability to bear the risk of a loss.")

83 *See, e.g.*, INST. FOR LEGAL REFORM, SELLING MORE LAWSUITS, BUYING MORE TROUBLE: THIRD PARTY LITIGATION FUNDING A DECADE LATER 4–5 (2020), https://instituteforlegalreform.com/wp-content/uploads/2020/10/Still_Selling_Lawsuits_-_Third_Party_Litigation_Funding_A_Decade_Later.pdf [https://perma.cc/8MKJ-ZNBR] (discussing how third-party litigation funding fuels frivolous litigation); *see also* Jean Xiao, *Heuristics, Biases, and Consumer Litigation Funding at the Bargaining Table*, 68 VAND. L. REV. 261 268–69 (2019) (summarizing argument of those who claim litigation funding encourages frivolous lawsuits).

84 FED. R. CIV. P. 11(b).

sanctions for violating Rule 11(b), including both monetary and non-monetary sanctions.[85]

Most states have adopted the FRCP (with appropriate modifications for jurisdictional purposes), which ensures that Rule 11 is broadly applied in most of the nation's state courts as well.[86] Many states also provide for penalties against a party, or their attorney, who is found responsible for bringing a lawsuit that is determined to be frivolous. California, for example, allows for sanctions to be brought against the attorney, the law firm, or the party who brought a frivolous suit.[87] These penalties can be imposed in addition to requiring the offending party that brought the frivolous suit to pay reasonable expenses, including attorneys' fees, that were incurred by the other party as a result of the bad-faith actions and tactics of the offending party.[88] Colorado,[89] Florida,[90] Massachusetts,[91] Missouri,[92] New Hampshire,[93] New Jersey,[94] Rhode Island,[95] South Carolina,[96] South Dakota,[97] and Vermont[98] similarly require plaintiffs to make restitution for defendant's attorney's fees in the event that the lawsuit is found to be frivolously commenced.

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85 *Id.* at 11(c).

86 *See* Gerald F. Hess, *Rule 11 Practice in Federal and State Court: An Empirical, Comparative Study*, 75 MARQ. L. REV 313, 315–16 (1992); *see also Rules: Federal Rules of Civil Procedure*, FED. JUD. CTR., https://www.fjc.gov/history/courts/rules-federal-rules-civil-procedure [https://perma.cc/RQT6-9K5Q] (last visited May 24, 2022).

87 CAL. CIV. PROC. CODE § 128.7(c) (West 2022).

88 Id. § 128.5(a).

89 COLO. REV. STAT. § 13-17-102(4) (2022).

90 FLA. STAT. § 57.105(1) (2022).

91 MASS. GEN. LAWS ch. 231, § 6F (2022).

92 MO. REV. STAT. § 514.205 (2022).

93 N.H. REV. STAT. ANN. § 507:15 (2022) (applying only to contract or tort actions, and allowing the court to enter summary judgment against the frivolous plaintiff or defendant).

94 N.J. STAT. ANN. § 2A:15-59.1 (West 2022).

95 9 R.I. GEN. LAWS ANN. § 9-29-21 (West 2022).

96 S.C. CODE ANN. § 15-36-10 (2022).

97 S.D. CODIFIED LAWS § 15-17-51 (2022).

98 VT. R. CIV. P. 3 (2022).

Even setting all of these protective provisions aside, an important common-sense argument weighs against the concern that litigation funding will lead to proliferation of frivolous lawsuits: Litigation funders make money only by funding suits that are legitimate and result in financial award for the plaintiff. Thus, it would be a waste of the funder's time and their investors' dollars to place bets on frivolous lawsuits with the knowledge that they will not result in a trial, much less an award,[99] and that they could lead to their clients incurring liability for their opponents' attorney fees. Keep in mind, litigation funders bear a concurrent risk of financial loss with their investors with the money they provide clients for litigation expenses in the form of a non-recourse loan.[100] A firm that regularly loses money rather than earns a positive return almost certainly will see a decline in investor appetite. Ultimately, a firm with negative profit margins may find itself without any investors at all. Thus, in addition to the legal obstacles that prevent frivolous lawsuits from gaining traction, there is simply no business reason for litigation funders to spend time and resources funding frivolous suits. Concerns about frivolous lawsuits cuts against the realities of the legal or business worlds.

D. The Conflict of Control

One place where interests of the litigation funder and their plaintiff client could conflict is the litigation strategy of the lawsuit—specifically the decision to settle the suit. Such a conflict could arise from the funder's interest in getting its capital back quickly so that it is able to redeploy the capital into new cases. The time value of money may make it more lucrative for a funder if their client were to settle earlier for a smaller award than they might get after a trial at a later date. This is because the funder may be able to invest the capital it

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[99] *See* Douglas R. Richmond, *Other People's Money: The Ethics of Litigation Funding*, 56 MERCER L. REV. 649, 660–61 (2005).

[100] *See* Mary Ellen Egan, *Other People's Money: Rise of Litigation Finance Companies Raises Legal and Ethical Concerns*, A.B.A. J., Dec. 1, 2018, at 54, 56.

receives from this smaller award in other cases promising bigger returns.

1. The Time Value of Money

The time value of money is a financial concept used to illustrate that money in hand now is more valuable than an identical amount received at some point in the future.[101] This is true because having money now allows you to profit by investing it or earning interest on it, and because inflation tends to deflate the value of money in the future. The following formula allows the present value of an amount received in the future to be calculated with some basic assumptions[102]:

Figure 1

Formula: $PV = x_n / [1 + k]^{(n)}$

PV = *Present value of money*
x_n = *Future value of money*
k = *interest rate*
n = *number of periods*

An example will help illustrate this conflict. Suppose that a litigation funder provides $1 million in funding to a client for legal fees, with an anticipated award for a successful suit estimated at $10 million. As payment, the funder will recoup their investment and charge a fee equal to 10% of their client's award. Here, this means that the funder would recoup their $1 million and receive another $1 million ($10 million x 10%) as a fee, thus doubling their investment. The fee, in turn, is the funder's return on investment. If the litigation moves fairly quickly and generates an award two years after the original investment, the funder's return on investment can be calculated as set forth below (a 5% interest rate is used for illustrative purposes).

101 JEFFREY J. HAAS, CORPORATE FINANCE 39 (2014).
102 *Id.* at 53.

Figure 2

PV = \$1,000,000 / (1 + 5%)^2
PV = \$863,837.60 (Present Value of the receiving \$1,000,000—i.e., the 10% fee—at the end of two years)

Dividing the present value of the return (\$863,837.60) by the initial investment (\$1 million) nets a total return on investment of roughly 86.4%.

What if this client could have settled more quickly in exchange for a smaller reward? Posit that the client had the option to settle for \$8 million after the first year of litigation at half the funding expense for legal fees (assuming a billable hour legal fee model). The litigation funder would then have recouped its smaller \$500,000 legal fee investment (half of the above \$1 million expense) plus an \$800,000 fee (\$8 million x 10%).

Because the funder only invested \$500,000 in this second scenario rather than the \$1 million from the first scenario, it could have invested the remaining \$500,000 in another year-long suit. For illustrative purposes, we will assume that the additional suit provides a similar \$800,000 return at the end of the year.

Figure 3

PV = [\$800,000 / (1 + 5%)^1] x 2
PV = [\$761, 904.76] x 2
PV = \$1,523,809.52

Investing less in the first lawsuit, committing capital to a second lawsuit, and recouping the two investments and fees in a shorter timeframe thus yields significantly higher returns for the funder than if it were to invest in one longer suit. Dividing the total fee return over the \$1 million invested yields a total return on investment of 152.4%. By investing in two one-year suits rather than one two-year suit, the funder realized a return roughly 66% higher than the return funder would have earned had its capital been tied up in the first suit until the trial verdict two years later.

The conflict for the client is clear. The client is not concerned with maximizing their funder's return, nor are they concerned with investor timeframes—rather, the client wants to maximize their award. In the illustrative example, the $10 million award is substantially more than what the client would receive by settling for $8 million, especially once the client pays the litigation funder's investment and fees:

Table 1

The Client's PV Calculation

	PV Going to Trial	PV of a Settlement
Award	$10 million	$8 million
Fees to Funder	$1 million expenses + 10% x ($10 million)	$500,000 expenses + 10% x ($8 million)
Net Award	$8 million	$6.7 million
Time Frame	2 years	1 year
PV of Award	PV = $8,000,000 / $(1 + 5\%)^2$ PV =$7,256,235.83	PV = $6,700,000 / $(1 + 5\%)^1$ PV = $6,380,952.38

The client in this scenario will forgo approximately $875,000 if it settles a suit for 20% less than it could have received from a trial verdict. Meanwhile, the funder will earn significantly more if it invests less money in suits that settle quickly, as this enables the funder to invest in a larger number of suits overall. The potential for this type of conflict of interest is one clear reason to regulate litigation funding—namely, to protect the autonomy of lawyers and their clients to make decisions regarding when to settle a suit and when to go to trial.

2. Attorney's Conflict of Interest and the ABA Rules

In most litigation funding arrangements, some, if not all, of the plaintiff's lawyer's fees are paid by the litigation funder.[103] Thus, the financial interests of the attorneys and the firm representing the plaintiff may conflict with the best interests of their clients. The attorneys will want to ensure that they paid for their work, which could put pressure on the attorneys and their client to bend to the will of the litigation funder if that is the only way for the firm to get paid and the client to get funding for their suit. A civil suit in Florida illustrates the dangers of a funder with too much power. In *Abu-Ghazaleh v. Chaul*, the plaintiff and its funder entered in an agreement that gave the funder the right to approve when the lawsuit was filed, the selection of plaintiffs' attorneys, counsel's bills, and any settlement agreements.[104] This is exactly the type of agreement that worries opponents of litigation funding.

Fortunately, some protections are already in place to ensure that lawyers are not unduly influenced in the representation of their clients. The ABA Rules of Professional Conduct ("ABA Rules") state that a "lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services."[105] This directly addresses the issue of funders influencing the way in which lawyers advise their clients or perform their work. These same rules provide that a "concurrent conflict of interest exists if . . . there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to

[103] *See* Andrew Stulce & Jonathan Parente, *Demystifying the Litigation Funding Process*, BLOOMBERG L. (June 16, 2021, 4:00 AM), https://news.bloomberglaw.com/us-law-week/demystifying-the-litigation-funding-process [https://perma.cc/UF9R-XPKR] (describing various models of litigation funding).

[104] Abu-Ghazaleh v. Chaul, 36 So. 3d 691, 692–93 (Fla. Dist. Ct. App. 2009). In *Abu-Ghazaleh*, a financial investment company financed a lawsuit for a plaintiff against Abu-Ghazaleh. *Id.* at 691. Despite not being a named plaintiff in the litigation, the Florida court found the financial investment company to be a "party" in the case, and held it liable for attorney's fees related to the litigation. *Id.* at 692–93.

[105] MODEL RULES OF PROF'L. CONDUCT r. 5.4(c) (AM. BAR ASS'N 2020).

. . . a third person or by a personal interest of the lawyer."[106] On its face, the type of litigation funding agreement signed in *Abu-Ghazaleh* also violates ABA Rule 1.2, which provides, in part, that a "lawyer shall abide by a client's decision whether to settle a matter."[107] In addition to the ABA Rules, CLFA and ILFA both include language in their respective ethics guidelines that warn funders not to influence decisions for lawyers and their clients, such as making settlement decisions.[108]

Despite the existence of these protective rules and standards, the issue of funders' undue influence on litigation remains. Not all active litigation funders operating in the United States are part of the CLFA or ILFA. Furthermore, as noted above, both organizations lack enforcement power. Asking funders to police themselves and hold themselves accountable to a standard of ethics when they have a financial interest that could be better served by violating those standards is counterintuitive at best. The solution to this conflict must come from a proactive regulator, as identifying violations of these rules after the fact is too late. In that same vein, all active funders must be subject to registration and oversight by a regulatory body to prevent their circumvention of these standards.

3. Troubleshooting a Real Litigation Funding Contract

A litigation funding contract between Therium, a major international litigation funding firm, and one of its clients[109]

[106] *Id.* r. 1.7(a)(2).

[107] *Id.* r. 1.2.

[108] CFLR Ethics Guidelines; *Best Practice*, INT'L LEGAL FIN. ASS'N, https://www.ilfa.com/#best-practice [https://perma.cc/ABX4-5HBS] (last visited May 24, 2022).

[109] Declaration of Caroline N. Mitchell in Support of Chevron Corporation's Memorandum in Opposition to Motion for Class Certifications & Motions To Exclude the Reports & Testimony of Onyoma Research & Jasper Abowei at Ex. 13, at 69, Gbarbe v. Chevron Corp., No. 3:14-cv-00173-SI (N.D. Cal. Sept. 16, 2016) (No. 186-04) [hereinafter Therium Litigation Funding Agreement].

involved in an arbitration illustrates some of the sources of conflict that exist between the funder and the parties being funded. Section three of the agreement, entitled "The Lawyer's Principal Obligations," notes that the lawyer is obligated "to recover the maximum possible Contingency Fee in respect of the Claim . . . as soon as reasonably possible."[110] This time pressure that is exerted on the lawyer by the funder could push the lawyer to act outside their client's interest. It also highlights the fact that as investment managers, funders need to recoup their investments in a certain timeframe for their returns to be meaningful on an annualized basis. Section 10 of the agreement, entitled "Lawyers' Further Obligations," restricts the lawyers from engaging co-counsel, forensic accountants, or other third parties without the written consent of the funder.[111] This speaks directly to the issue of control. If the policy argument in favor of funding is expanding access to justice while allowing litigants to retain control of how they bring their lawsuits, then this highlights the need for the litigant's control of the lawsuit to be protected under a code of conduct to which funders adhere.

Another interesting part of this particular funding agreement is that it allows the funder to pull out of the agreement if the funder believes that there has been a "material breach" of the contract that is not remedied within twenty business days.[112] If this provision is triggered, the lawyer then has only five business days to reimburse the funder the "Reasonable Costs Sum"[113] plus interest.[114] This certainly puts pressure on the lawyer to ensure that she does not run afoul of the funding agreement, as their entire fee plus interests and related expenses are on the line. In effect, the

[110] *Id.* at 74.

[111] *Id.* at 80.

[112] *Id.* at 85.

[113] *Id.* at 72. "Reasonable Costs Sum" is defined in the contract as "a sum equal to the total of all Costs paid or otherwise funded by Therium pursuant to this Agreement, whether or not those Costs were reasonably incurred by the Claimants in accordance with this Agreement and whether or not they were specified in the Project Plan." *Id.* 72–73.

[114] Therium Litigation Funding Agreement, *supra* note 109, at 85.

agreement highly restricts the lawyer's conduct, potentially ingratiating the lawyer to the funder at the expense of the lawyer's client. This potential conflict is yet another reason why funders and their funding contracts should be monitored by a regulatory body.

IV. THE CASE FOR THE SELF-REGULATORY ORGANIZATION

Part IV discusses how self-regulatory organizations for litigation funders operate in the United Kingdom and Australia. The structure of these organizations in these two jurisdictions are evaluated with a view to their surrounding regulatory environments. Based on the similarities and distinctions between the United States and these two model jurisdictions, this Note proposes a design for an effective self-regulatory organization in the United States.

A. Regulating Funders in the United Kingdom

As discussed in Part II, the United Kingdom is home to ALF, a voluntary organization that holds its members to a Code of Conduct and administers a complaint process when clients of its member firms believe that their funder has violated the Code.[115] As part of the application process for ALF membership, ALF reviews a prospective member's litigation funding agreement (LFA) to determine if it complies with ALF's Code of Conduct.[116] Among the thirteen litigation funders listed as members on ALF's website are Burford Capital, Omni Bridgeway, and Woodsford Litigation Funding,[117] each of which are prominent funders operating

[115] *About Us,* ASSOC. LITIG. FUNDERS, *supra* note 15.

[116] *Membership*, ASS'N LITIG. FUNDERS, https://associationoflitigationfunders.com/membership/ [https://perma.cc/DWJ7-Y8JM] (last visited May 24, 2022).

[117] *Membership Directory,* ASS'N LITIG. FUNDERS, https://associationoflitigationfunders.com/membership/membership-directory/ [https://perma.cc/8CPQ-Z557] (last visited May 24, 2022).

globally.[118] Burford Capital and Omni Bridgeway are publicly traded financial service companies, which subjects them to a set of regulations by the Financial Conduct Authority.[119] It is significant that these market leaders with strong name recognition have joined ALF, as it indicates to smaller, lesser-known funders that they may benefit from joining an association which counts industry heavyweights among its membership.

ALF also urges claimants and lawyers seeking funding to work only with ALF member firms.[120] Because the Ministry of Justice has charged ALF with enforcing its Code of Conduct, ALF member firms submit themselves to government-endorsed regulation.[121] The United Kingdom's judiciary seems to recognize the efficacy of ALF's regulatory efforts. In analyzing a case involving Therium, an ALF member, the Competition Appeal Tribunal, a specialized judicial body that hears cases on competition and economic regulatory issues, wrote of the ALF's Code of Conduct:

> [T]his is a voluntary code and not a binding legal obligation, but we think that it is wholly unrealistic to suppose that a leading litigation funder that is commercially active in this field would not honour

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118 *See About Burford*, BURFORD CAP., https://www.burfordcapital.com/about-burford/ [https://perma.cc/B2XF-8KNJ] (last visited May 24, 2021); *About Us*, OMNI BRIDGEWAY, https://omnibridgeway.com/about/overview/# [https://perma.cc/8WTX-Y23L] (last visited May 24, 2022); *About Woodsford*, WOODSFORD, https://woodsfordlitigationfunding.com/us/about-woodsford/our-global-reach/ [https://perma.cc/3PF7-YA55] (last visited May 24, 2022).

119 *See The Financial Services Register: Burford Capital (UK) Limited*, FIN. CONDUCT AUTH., https://register.fca.org.uk/s/firm?id=001b000000NMRtdAAH [https://perma.cc/LL3P-6PD3] (last visited May 24, 2022); *The Financial Services Register: Omni Partners LLP*, FIN. CONDUCT AUTH., https://register.fca.org.uk/s/firm?id=001b000000MfP7eAAF [https://perma.cc/9KQS-TVJ3] (last visited May 24, 2022).

120 *About Us*, ASSOC. LITIG. FUNDERS, *supra* note 15.

121 Alex Hickson, Jonathan Barnes & Steven Friel, *Regulation of Litigation Funding in United Kingdom (England & Wales)*, LEXOLOGY (Dec. 17, 2019), https://www.lexology.com/library/detail.aspx?g=8fdbaef7-1ea3-47b8-a7fb-4f46aa42fb20 [https://perma.cc/RG6W-T6DX].

> these commitments to the Association of which it is a founder member, and thus place at risk the whole regime of self-regulation.[122]

This raises a critical point about the prospects of self-regulatory bodies. Members have an interest in abiding by the rules rather than risk imperiling the absence of government involvement. If members violate the Code of Conduct and cause harm to their clients, they risk inviting enhanced scrutiny from would-be regulators. As an industry, litigation funders share a collective reputation. This theory, developed by Jean Tirole, has three precepts: that (1) "a group's [or industry's] reputation is only as good as that of its members," (2) the past behavior of individuals is "imperfectly observed" by outsiders, and (3) this imperfect observability leads to the group's collective reputation.[123] According to the theory, and as implied by the Competition Appeal Tribunal, "[e]ach member's welfare and incentives are . . . affected by the group's reputation."[124]

But what happens when a firm that is part of the industry, but not part of ALF, misbehaves? Will that behavior be imputed onto all litigation funders, or is the client base sophisticated enough to parse ALF member firms from non-member firms and thus spare the member firms the reputational harm? Obviously, it would seem that ALF relies on clients to make this distinction. But why take this risk? Would it not be better to require all litigation funders to join ALF and merge their reputations, so that the well-behaved

[122] UK Trucks Claim Ltd. v. Fiat Chrysler Autos. N.V. [2019] CAT 26, [54] (appeal taken from Eng.).

[123] Jean Tirole, *A Theory of Collective Reputations (with Applications to the Persistence of Corruption and to Firm Quality)*, 63 REV. ECON. STUD. 1, 1–2 (1996) (emphasis omitted). Tirole discusses the idea that some groups benefit and are able to take advantage of "rents" from their collective reputations, and that members of a group will want to behave in a manner that reaffirms the group reputation due to a fear of internal exclusion from the group, which ensures that outside trading partners continue to behave favorably by trading with the group. *Id.*

[124] *Id.* at 2.

firms at least have the ability to sanction firms that misbehave?

At present, funders operating in the United Kingdom do not have to submit to regulation. Funders need not join ALF or register with any other regulatory body.[125] If a client chooses a funder that is not an ALF member firm and is disappointed with their funding arrangement or believes it to be unethical, their options for recourse against the funder are limited, at least as far as regulatory intervention is concerned. For self-regulatory institutions, "when new information is revealed about the characteristics of one firm, it reflects to some degree on all firms within its industry."[126] Left un-remedied, one litigation funder's bad acts could harm the collective reputation of the entire industry.

Aside from ALF regulating its members firms, lawyers are also held accountable for their role in orchestrating funding arrangements and litigating matters that are supported by litigation funders. Similar to the American Bar Association in the United States, the Solicitors Regulation Authority (SRA) regulates lawyers in England and Wales. The SRA's purpose is to protect the public by ensuring that solicitors meet the standards it promulgates and by acting when there are violations of those standards.[127] All solicitors are bound to the principles outlined by the SRA, and several principles govern the conduct of lawyers working with a client who is using litigation funding, including the principal of "independence."[128] The SRA Code of Conduct for Solicitors, RELs, and RFLs addresses referrals, introductions, and

125 Hickson, Barnes & Friel, *supra* note 121.

126 Michael L. Barnett & Andrew A. King, *Good Fences Make Good Neighbors: A Longitudinal Analysis of An Industry Self-Regulatory Institution*, 51 ACAD. MGMT. J., 1150, 1152 (2008).

127 *How We Work*, SOLICS. REGUL. AUTH., https://www.sra.org.uk/sra/how-we-work/ [https://perma.cc/N54M-TT5E] (last visited May 24, 2022).

128 *SRA Principles*, SOLICS. REGUL. AUTH. (Nov. 25, 2019), https://www.sra.org.uk/solicitors/standards-regulations/principles/ [https://perma.cc/Y69R-FMTP].

separate business.[129]. Notably, it provides that a solicitor must ensure that his or her "*clients* are informed of any fee sharing arrangement that is relevant to their matter[.]"[130] Furthermore, the SRA Principles require that all solicitors act with independence[131].

Between the ALF Code of Conduct governing funders and the SRA Code of Conduct governing solicitors, it would seem that there is relatively little risk of a wayward litigation funder wreaking havoc on a client or on the legal system. However, funders are allowed to operate without registering with a regulatory body or without joining ALF, which appears to be a glaring omission in an otherwise seemingly well-functioning self-regulated industry in the United Kingdom[132]

B. Regulation of Litigation Funding in Australia

Australia, along with the United Kingdom, helped pioneer litigation funding beginning in the 1990s.[133] Class action lawsuits were legalized in the country in 1992, and the state of New South Wales abolished champerty and maintenance with the Maintenance, Champerty and Barratry Abolition Act in 1993.[134] Since that time, the use of litigation funding for class action suits in Australia has increased regularly,

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129 SOLICS. REGUL. AUTH., SRA CODE OF CONDUCT FOR SOLICITORS, RELS AND RFLS, paras. 5.1–5.3 (2018) (emphasis added).

130 *Id.* at para. 5.1.

131 *SRA Principles*, *supra* note 128.

132 Litigation Capital Management, Bench Walk Advisors, and Manolete Partners are all listed in the ranked leaders league table for litigation funders in the United Kingdom, but are not, as of the time of this writing, members of ALF per ALF's membership directory. The other eleven ranked firms are ALF members. *See Litigation Support*, Leaders League, https://www.leadersleague.com/en/rankings/litigation-support-ranking-2021-litigation-funding-united-kingdom [https://perma.cc/65LV-UCWE] (last visited May 24, 2022); *Membership Directory,* ASS'N LITIG. FUNDERS, *supra* note 117.

133 *A Brief History of Litigation Finance: The Cases of Australia and the United Kingdom*, PRACTICE, Sept.–Oct. 2019, https://thepractice.law.harvard.edu/article/a-brief-history-of-litigation-finance/ [https://perma.cc/SX55-PHT8].

134 *Id.*

recently stabilizing at roughly seventy-five of suits as of June 2020.[135]

Australian courts, similar to American courts, have rules to prevent litigants from bringing frivolous actions without cause, which are known as "abuses of process rules."[136] Following the abolition of champerty and maintenance doctrines as torts in New South Wales, the High Court of Australia evaluated and ultimately reversed a lower court's decision to stay litigation in which the plaintiff was funded.[137] The High Court of Australia held that:

> No separate consideration of the suggestion that the proceedings should be stayed as contrary to public policy [was] necessary. The suggested arguments of public policy, as they were presented, effectively amount[ed] to the same bases upon which the abuse of process was propounded. They involved no different or separate point. There was no abuse of process.[138]

This holding suggest that absent the champerty and maintenance doctrines, there is no default assumption that third-party funding of a litigant is an automatic violation of public policy or necessarily amounts to an abuse of process. In the same ruling, the High Court of Australia relied on reasoning from the English Court of Appeal in *Gulf Azov Shipping Co. Ltd. v. Idisi*, in which that court stated, "Public policy now recognises that it is desirable, in order to facilitate access to justice, that third parties should provide assistance designed to ensure that those who are involved in litigation have the benefit of legal representation."[139]

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135 Piper Alderman, *At a Glance: Regulation of Litigation Funding in Australia*, LEXOLOGY (Nov. 25, 2020), https://www.lexology.com/library/detail.aspx?g=08d1c989-1e56-43fb-8240-53bbddff49d7 [https://perma.cc/PG8K-K4F3].

136 *Id.*

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

138 *Id.* at [149]

139 *Id.* at [256] (citing Gulf Azov Shipping Co. Ltd v Idisi [2004] EWCA (Civ) 292 [54] (appeal taken from Eng.)).

Confident in the efficacy of controls that prevent frivolous lawsuits that would pester defendants and abuse the court system, Australian courts seem to look favorably on the use of litigation funding. However, 2020 saw the introduction of new regulations aimed at litigation funders operating in Australia. The Corporations Amendment (Litigation Funding) Regulations 2020[140] was introduced in May of 2020 and enacted in July of 2020,[141] imposing two major changes: Litigation funders are no longer exempted from being classified as "managed investment schemes" and "financial services licensing schemes" under the Corporations Act 2001.[142] Therefore, as of August 22, 2020, litigation funders operating in Australia must obtain an Australian Financial Services License and register each fund as a managed investment scheme.[143] Litigation funders are under the regulatory scrutiny of the Australian Securities and Investments Commission (ASIC).[144] Practically speaking, firms funding class action and multi-plaintiff actions must be operated by a "responsible entity," comply with the license conditions, and report breaches of the law to ASIC.[145] The motivation behind this heightened level of regulation was to "increase transparency" into how litigation funders operate and impose the "same level of regulatory oversight and scrutiny" that is subjected on similar financial service providers.[146] The introduction of these regulations into the regulatory space in the birthplace of litigation finance speaks to a common push for transparency in third-party litigation funding that is occurring around the globe.

140 *Corporations Amendment (Litigation Funding) Regulations 2020* (Cth) (Austl.).

141 JONES DAY, *Australia Increases Scrutiny for Litigation Funders*, INSIGHTS (Aug. 2020), https://www.jonesday.com/en/insights/2020/08/australia-increases-scrutiny-for-litigation-funders [https://perma.cc/5YD9-NDFZ].

142 *Id.*

143 *Id.*

144 *Id.*

145 *Id.*

146 *Id.*

Does transparency matter if the underlying concerns regarding conflicts of interest and undue influence are obviated by court rules and professional codes of conduct that already exist? Australian law requires the courts to approve class action settlements.[147] This approval process can serve as an effective check on the professional conduct of lawyers and funders. This is exemplified by the *Banksia Securities* case in the Supreme Court of Victoria, in which a disgruntled class member challenged the professionalism of the plaintiff's representatives and the professional fees being paid to the lawyers and the litigation funders during the settlement process.[148] The court subsequently appointed a contradictor to act on behalf of the plaintiffs and determine if the court should approve the legal fees and litigation funder fees.[149] When the plaintiffs' legal representatives filed legal action to limit the role of the contradictor, the court struck those actions down by reasoning that there were "serious" issues raised about the conduct of the plaintiffs' legal representatives.[150] This precedent demonstrates that Australian courts have sufficient ambit to review the conduct of attorneys representing parties before them and of funders who are compensating attorneys on behalf of the plaintiffs bringing a suit. Moreover, this case also highlights the need to create a dispute resolution mechanism to govern disputes between plaintiffs and their attorneys and funders when plaintiffs want to challenge their attorney's conduct or the details of the Litigation Funding Agreement.

The Association of Litigation Funders of Australia (ALFA) is an industry organization similar to ILFA that holds its members to Best Practice Guidelines and also works proactively to influence the regulatory framework addressing litigation funders in Australia.[151] According to its

147 Piper Alderman, *supra* note 135.

148 *Bolitho v Banksia Sec. Ltd* (No. 6) (2019) 63 VR 291 (Austl.).

149 *Id.*

150 *Id.*

151 *About Us*, ASS'N LITIG. FUNDERS AUSTL. LTD., https://www.associationoflitigationfunders.com.au/about-us.html [https://perma.cc/2RTG-84KF] (last visited May 24, 2022).

constitution, the organization seeks to educate the market about litigation funding and lobby legislators to create and maintain a regulatory environment favorable to their operations.[152] Although ALFA lacks a regulatory charter and dispute resolution mechanisms, the absence of such safeguards is mitigated by the more developed regulatory environment for litigation funders already extant in Australia. Because the United States lacks a similarly well-developed regulatory environment around litigation funding, a self-regulatory organization empowered by a regulatory charter is necessary.

C. Designing an SRO for Litigation Funders Operating in the U.S.

This Section argues that a self-regulatory organization (SRO) for litigation funders in the United States needs three key features in order to be effective. First, membership must be compulsory for all funders participating in the commercial litigation funding market in the United States. Second, the SRO must have enforcement power to discipline members who violate the code of conduct. Third, there must be a dispute resolution body to handle disputes that arise between funders and their clients.

1. Compulsory Membership

A roadmap for compulsory membership in a self-regulatory body already exists in this country. The American securities industry has long been monitored by the regulatory actions of congressionally designated SROs.[153] Today, FINRA is the only SRO in the financial securities industry with government authorization, overseeing more than 624,000 brokers in the United States.[154]

152 ASS'N LITIG. FUNDERS AUSTL., CONSTITUTION § 4.1, at 4 https://www.associationoflitigationfunders.com.au/uploads/5/0/7/2/50720401/constitution-_the_association_of_litigation_funders_of_australia_limited-_final.pdf [https://perma.cc/8RL2-MPG2] (last visited May 24, 2022).

153 *See supra* Section II.B.

154 *About FINRA*, FIN. INDUS. REGUL. AUTH., *supra* note 159.

The history that laid the groundwork for FINRA to exist stretches back over eighty years. As previously discussed, the passage of the Maloney Act was integral to FINRA's eventual existence.[155] The Maloney Act permitted the NASD to promulgate rules for its members to deal preferentially with each other as compared to dealing with non-members.[156] This created a large economic incentive for OTC brokers to join the NASD and submit to its regulatory authority.[157] Non-members were also virtually excluded from participating in large offerings.[158] Today, all broker-dealers in the securities industry, along with the individuals working in the securities business of those firms, are required to register with FINRA, the NASD's successor.[159]

Litigation funders should be similarly required to register with the SEC and an SRO. In this instance, the creation of a new SRO and rulemaking organization may not be necessary since ILFA already exists, is headquartered in Washington, D.C., and counts fifteen of the largest global litigation funders amongst as members.[160] The Dodd-Frank Act requirement that all private funds with an excess of $150 million in assets under management register with the SEC is a preliminary step which is already in place.[161] An addendum should be added to capture litigation funders with assets under management beneath this threshold. Step two should be requiring litigation funding firms that meet these requirements to register with ILFA. To require this, the government would need to (1) authorize the SEC to delegate

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155 Macey & Novogrod, *supra* note 71, at 968; *see supra* Section II.B.

156 *Id.* at 981.

157 *Id.*

158 *Id.*

159 *Registration*, FIN. INDUS. REGUL. AUTH., https://www.finra.org/registration-exams-ce/registration [https://perma.cc/4XAY-DM8P] (last visited May 24, 2022).

160 INT'L LEGAL FIN. ASS'N, *supra* note 1; *Membership Directory*, INT'L LEGAL FIN. ASS'N, https://www.ilfa.com/membership-directory [https://perma.cc/EBM4-HZZ5] (last visited May 24, 2022).

161 Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, 76 Fed. Reg. 39,646, 39,647 (July 6, 2011).

enforcement and rulemaking authority to ILFA as an SRO for the litigation funding industry and (2) require private funds acting as litigation funders to register with ILFA after they have registered with the SEC. This would require a congressional act (1) establishing litigation funders (and any other fund investing in commercial litigation) as private funds that must be regulated by an SRO, (2) authorizing ILFA to act as that SRO, and (3) delegating rulemaking authority and enforcement power to ILFA.

2. Rulemaking and Enforcement Power

FINRA has both the authority to make rules and the power to enforce them.[162] To succeed, a litigation funding SRO must mirror FINRA's rulemaking and enforcement power. Moreover, the member firms of the new SRO should be able to capitalize on the self-regulatory aspect of the organization by creating their own rules and standards of conduct. ILFA has already curated best practices for its members, and it aims "to engage with legislative, regulatory and judicial interests to ensure that legal finance is understood objectively and treated reasonably when under consideration by those authorities."[163] Because the organization aims to influence the regulatory framework in which its members operate, it could easily go one step further and become the regulatory decision-making authority.

Research has shown that individuals are more likely to obey legal authorities if those authorities use neutral decision-making processes, treat regulated individuals fairly, and provide these individuals with an opportunity to raise concerns about the applicable rules to the authorities.[164]

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[162] *See Rules & Guidance,* FIN. INDUS. REGUL. AUTH., https://www.finra.org/rules-guidance [https://perma.cc/56ET-8HZZ] (last visited May 24, 2022); *Enforcement*, FIN. INDUS. REGUL. AUTH., https://www.finra.org/rules-guidance/enforcement [https://perma.cc/6X6T-57DW] (last visited May 24, 2022).

[163] *Core Mission*, INT'L LEGAL FIN. ASS'N, https://www.ilfa.com/#about-legal-finance [https://perma.cc/E562-JTML] (last visited May 24, 2022).

[164] Kristina Murphy, Ben Bradford & Jonathan Jackson, *Motivating Compliance Behavior Among Offenders: Procedural Justice or Deterrence?*,

Professor Tom R. Tyler, a researcher working on the procedural justice theory, posits that legitimacy is the key to encouraging obedience to authority: "Central to the idea of legitimacy is the belief that some decision made or rule created by these authorities is valid in the sense that it is entitled to be obeyed by virtue of who made the decision or how it was made."[165] Professor Tyler explains how social norms lead to self-regulation:

> People who internalize social norms and values become self-regulating, taking on the obligations and responsibilities associated with those norms and values as aspects of their own motivation. One aspect of values—obligation—is a key element in the concept of legitimacy. It leads to voluntary deference to the directives of legitimate authorities and rules.[166]

Given that ILFA is already composed of a collection of industry firms that are attempting to influence policy as a group, there is reason to believe that these firms would confer legitimacy on the rules they themselves propagated. An example would be the best practices to which they currently hold themselves as a condition of ILFA membership.[167] Following the procedural justice theory, there is also reason to believe that each ILFA member firm, and the individuals who work in them, have internalized the norms with which they operate and would voluntarily defer to the directives that the organization as a group would create. As ILFA points out, "Legal finance transactions are overwhelmingly private bargains between commercial entities."[168] ILFA also states, "Just as other capital transactions with commercial parties are free to be conducted on whatever terms are agreed

43 CRIM. JUST. & BEHAV. 102, 104 (2016) (discussing Professor Tyler's theory of Procedural Justice).

165 Tom R. Tyler, *Psychological Perspectives on Legitimacy and Legitimation*, 57 ANN. REV. PSYCH. 375, 377 (2005).

166 *Id.* at 378 (discussing Max Weber's argument that social norms become part of people's internal motivational system and guide their behavior).

167 *Best Practice*, INT'L LEGAL FIN. ASS'N, *supra* note 17.

168 *Core Mission*, INT'L LEGAL FIN. ASS'N, *supra* note 163.

between the parties, so, too, should commercial legal finance transactions."[169] This sentiment suggests that, if Congress were to subject litigation funders to regulation that does not apply to other similar financial institutions, litigation funders would view such regulation as illegitimate. From the beginning, this would create an undesirable contentious dynamic between the funders and their potential regulator. Enabling ILFA to promulgate its own, narrowly tailored, industry specific rules should theoretically avoid any tension between the regulator (ILFA) and the regulated (ILFA members).

Considering both the skepticism with which the U.S. market views litigation funding as recently as one decade ago and the collective reputation that litigation funders share as part of a burgeoning industry, litigation funders are already incentivized to hold themselves to a high standard of conduct. Combined with the fact that accredited investors and institutions compose the litigation funding investor base, it follows that the SRO's most important role would be holding its members accountable for violating rules. This concern underlines the importance of the enforcement power.

FINRA can sanction its members through monetary fines as well as suspension or expulsion,[170] the latter of which would preclude the firm or individual from participating in the industry given the mandatory registration requirements. Such enforcement power should apply in the litigation funding context. The threat of expulsion from an industry is a significant deterrent that should keep member firms of the proposed SRO from violating the best practices to which they subscribe.

FINRA also publishes a monthly report of disciplinary actions that it has imposed on registered member firms and

169 *Id.*

170 FIN. IINDUS. REGUL. AUTH., SANCTION GUIDELINES 10–11 (2021), https://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf [https://perma.cc/U6CJ-S6ZH].

individuals.[171] In addition, it keeps a list of barred individuals posted on its website.[172] The attention attracted by corporate liability in particular arguably increases deterrence.[173] In keeping with this model, enforcement actions taken by the litigation funding SRO should be publicized, both for deterrence purposes and to provide transparency to the public and to potential clients. An effective SRO should combine government authorization to regulate the SRO's membership with the its own inherent legitimacy. In this instance that legitimacy is conferred to the SRO's rulemaking body by members who participate in the rulemaking process and therefore perceive the rulemaking body as neutral and fair. This leaves one concern, however: managing the fallout of disputes between funders and their clients.

3. Dispute Resolution

FINRA operates a dispute resolution forum in order to resolve disputes between investors on one side and brokerage firms and individual brokers on the other.[174] Disputes can be resolved either through arbitration or mediation.[175] An SRO regulating litigation funders should also have a dispute resolution service to handle disputes between its members and their clients.

The Litigation Funding Agreement is the likely source of any dispute between the funders, lawyers, and clients. While the structure of standard LFAs remain relatively opaque, the

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171 *See Monthly Disciplinary Actions*, FIN. INDUS. REGUL. AUTH., https://www.finra.org/rules-guidance/oversight-enforcement/disciplinary-actions [https://perma.cc/E57P-KBBM] (last visited May 24, 2022).

172 *Individuals Barred by FINRA*, FIN. INDUS. REGUL. AUTH., https://www.finra.org/rules-guidance/oversight-Oversight%20%26%20Enforcement/individuals-barred-finra [https://perma.cc/P3MC-VBFN] (last visited May 24, 2022).

173 *See* Stavros Gadinis, *The SEC and the Financial Industry: Evidence from Enforcement Against Broker-Dealers*, 67 BUS. LAW. 679, 723 (2012).

174 *FINRA Dispute Resolution Services*, FIN. INDUS. REGUL. AUTH., https://www.finra.org/arbitration-mediation [https://perma.cc/4KVG-PP4V] (last visited May 24, 2022).

175 *Id.*

documents typically address the amount of funding being committed to the matter, when funding will be disbursed, the budget for legal counsel, and the funder's right to terminate funding.[176] Each of these is a source of potential conflict. Funders could backtrack on the amount of funding they initially committed to provide or terminate funding altogether. They could also disburse funds late, leading to lawyers getting paid late. Disagreements over compensation to counsel could arise as a matter stretches on. A funder could also reverse course and terminate funding which would be extremely disruptive to an ongoing litigation that was dependent on funding to pay legal counsel.

Having a mechanism to resolve these disputes should be a function of the litigation funding SRO and could enhance the legitimacy surrounding the industry. Arbitration and mediation are both desirable methods of dispute resolution. Given that the parties to a dispute regarding an LFA would already be involved in either litigation or arbitration, there would certainly be a desire on both ends to resolve any dispute arising out of the LFA as quickly as possible so that efforts can be refocused on the original dispute that was the subject of the LFA. Arbitration and mediation are often both quicker and more expedient than litigation, which is why FINRA employs both as a method of dispute resolution for issues involving their members.[177]

D. Implementing the Solution

Submitting private funds to the regulatory authority of a self-regulatory organization will require an act expanding the authority of the SEC. As discussed, the Maloney Act of 1938 amended the 1934 Securities and Exchange Act, paving the way for SROs to register with the SEC and regulate brokers

176 *See* Sean Thompson, Dai Wai Chin Ferman & Aaron Katz, *United States*, *in* THE THIRD PARTY LITIGATION FUNDING LAW REVIEW 217, 224–26 (Leslie Perrin ed., 2019).

177 *FINRA Dispute Resolution Services: Overview*, FIN. INDUS. REGUL. AUTH., https://www.finra.org/arbitration-mediation/overview [https://perma.cc/HWL9-GN57] (last visited May 24, 2022).

in the securities industry.[178] This, in turn, paved the way for the NASD and its successor, FINRA.[179] Replicating this process for the creation and authorization of an SRO for private funds acting as litigation funders is appropriate given the relatively small size of the litigation funding industry and the level of self-regulatory behavior already being evidenced by industry actors and associations. By the end of 1939, the year in which the NASD registered with the SEC as an SRO for the securities industry under the Maloney Act, 2,616 broker-dealer firms had joined the NASD.[180] As of 2020, FINRA had 3,435 securities firms registered and 617,549 registered representatives.[181] Contrasting these figures with the number of litigation funders that would be subject to a newly created regulatory authority, the prospect of an SRO effectively overseeing its members seems much more manageable: as of the publication of this Note, ILFA lists only fifteen members in its membership directory.[182] Although this figure excludes hedge funds and other types of private funds which occasionally participate in litigation funding transactions, the aggregate number of entities that would need to be monitored can only be fully determined once an act is passed compelling other private firms which participate in litigation funding transactions to register with the SEC and the newly-created SRO.

Two concerns are addressed by requiring funds that engage in this type of activity to disclose their participation in litigation funding. Recall that the Litigation Funding Transparency Act of 2021 (which has yet to be enacted) seeks to identify the entities other than the named parties to a

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[178] The Maloney Act of 1938, 15 U.S.C. § 78o-3 (2018).

[179] Macey & Novogrod, *supra* note 71, at 968.

[180] *The Institution of Experience: Self-Regulatory Organizations in the Securities Industry, 1792–2010*, SEC. & EXCH. COMM'N HIST. SOC'Y, http://www.sechistorical.org/museum/galleries/sro/sro04b.php [https://perma.cc/CK73-US4C] (last visited May 24, 2022).

[181] *Key FINRA Statistics for 2020*, FIN. INDUS. REGUL. AUTH., https://www.finra.org/media-center/statistics [https://perma.cc/8LYD-2XYK] (last visited May 24, 2022).

[182] *Membership Directory*, INT'L LEGAL FIN. ASS'N, *supra* note 160.

lawsuit and their respective counsel who had a financial interest in the outcome of the suit.[183] An act requiring litigation funders and other private funds engaged in commercial funding to submit to monitoring via an SRO would accomplish a less granular, albeit broader, level of transparency. The proposed legislation focuses on the involvement of litigation funders being disclosed in class action lawsuits and multidistrict litigation.[184] Requiring all litigation funding participants to disclose that activity and submit to a code of conduct enforced by an SRO captures a much wider swath of activity without forcing individual litigants to disclose the use of litigation funding.

This latter point is contentious. In 2017, Wisconsin enacted a law requiring the disclosure of any litigation funding arrangements for lawsuits in its state courts.[185] West Virginia approved similar legislation in 2019, requiring disclosure of consumer litigation funding.[186] In 2021, the District of New Jersey adopted a local rule requiring disclosure of litigation funding in New Jersey federal district courts.[187] The commercial litigation funding industry seems firmly opposed to making such disclosures. ILFA, for its part, clearly states its position:

> The use of legal finance in a private action by a commercial client is a private matter that should not be disclosed to anyone. In the rare event that a court requires disclosure, it should occur *ex parte* and *in camera* and the disclosure should be carefully tailored to address the court's concern. The economic terms of litigation finance arrangements represent protected assessments of legal risk and should not be disclosed to the funded party's opponents.[188]

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183 Litigation Funding Transparency Act of 2021, S. 840, 117th Cong. (2021).

184 *See id.* §§ 2–3.

185 2018 Wis. Sess. Laws 851 (codified at WIS. STAT. § 804.01(2)(bg) (2022)).

186 2019 W. Va. Acts. 583 (codified at W. VA. CODE §§ 46A-6N-5 (2022)).

187 D. N.J. CIV. R. 7.1.1 (2021).

188 *Core Mission*, INT'L LEGAL FIN. ASS'N, *supra* note 163.

ILFA believes that the activity of providing capital, not the actors participating in it, should be regulated by governmental regulatory regimes.[189]

The second concern addressed by the creation of an SRO is requiring litigation funders and private funds engaging in litigation funding to monitor their own behavior. As seen, this is the preferred model of the industry on a global level with ALFA in Australia[190] and ALF in England and Wales,[191] each of which represent the two most established markets for litigation finance and hold their members to behavioral standards. The worldwide litigation funding industry has demonstrated that it is content to submit itself to an ethical standard of conduct that addresses the concerns about conflicts of interest and third-party funders exerting control over litigants and their counsel. If the model from the United Kingdom can be considered indicative of the efficacy of an SRO enforcing a code of conduct in the litigation finance industry, there is ample reason to support the formation of, and delegation of authority to, a similar organization to monitor the industry in the United States.

V. CONCLUSION

Commercial litigation funding in the United States already operates in large part as a self-governed industry. Legitimate concerns about third-party funders influencing the judicial process are generally addressed by rules of professional conduct to which lawyers are already bound. Litigation funders also have banded together in professional associations to hold themselves accountable to ethical standards of conduct. Given that the risk posed by these financial operators

189 *Id.*

190 ASS'N LITIG. FUNDERS OF AUSTL., BEST PRACTICE GUIDELINES FOR LITIGATION FUNDERS AND MANAGERS (2019), https://www.associationoflitigationfunders.com.au/uploads/5/0/7/2/50720401/alfa_best_practice_guidelines.pdf [https://perma.cc/WTR2-6HXP].

191 ASS'N LITIG. FUNDERS, 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/QG3F-52AK].

falls entirely on individual and institutional accredited investors, the regulatory solution for this problem need not encumber the industry with burdensome disclosure requirements. Instead, the creation of a registration requirement and formation of an SRO would accomplish two key goals: First, it would enable the SEC to track the amount of litigation funding activity, and second, it would ask litigation funders to do what they claim to be doing already—hold themselves to an ethical standard of conduct.

The result, if implemented, should achieve legitimate policy aims. First, it should reinforce a robust market for commercial litigation funding, which expands access to justice and evens the playing field between smaller plaintiffs or claimants and larger and more capitalized defendants and respondents. Second, an active regulatory body composed of industry participants should ensure that the concerns raised by opponents to litigation funding—frivolous lawsuits spurred on by greedy financiers who seek to control the litigation strategies of litigants—never come to fruition.