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The Disclosure of Third-Party Litigation Funding Agreements Is Necessary to Resolve Ethical Dilemmas Created by the Third-Party Lender Industry

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COMMENT

Gareth Purnell[*]

The Disclosure of Third-Party Litigation Funding Agreements Is Necessary to Resolve Ethical Dilemmas Created by the Third-Party Lender Industry

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I. INTRODUCTION

Consider a hypothetical: Mike is walking on a sidewalk when he is injured by falling debris from a nearby construction project. His injuries are serious, and he receives treatment in a hospital for several days. Mike's insurance refuses to cover the expenses. During his hospitalization, his employer fires him, and the unemployment office denies him compensation. Mike's life savings are meager, and he can barely support himself or his aging parents, who live with him. In desperation, he consults an attorney, who recommends suing the construction company for negligence. Mike wants to retain her, but he would be unable to pay her up front. She agrees to take his case on a contingency basis.

Assuming the case will resolve quickly, Mike is relieved. He anticipates using his judgment to support himself and his parents until he is well enough to work again. However, weeks pass, and Mike's savings are depleted. He searches for a loan, but the banks are unwilling to work with him. He asks his attorney if she can extend a loan for his personal needs. She informs him that state ethics rules prohibit attorneys from extending personal funds to clients.[1] Left with no choice, Mike returns to the one lender who had offered him a loan and then takes the application to his attorney. She tells him the lender does not require Mike to pay back the loan himself; rather, the lender would be investing its money into his case, and its repayment would come directly from the proceeds of his lawsuit, with a high rate of interest. She also warns him that the loan requires Mike to tell the lender certain information traditionally protected by attorney-client privilege.[2]

Seeing no other option, Mike allows his attorney to disclose the information, and he signs off on the loan. Mike and his parents have instant financial relief. However, several weeks later, the construction company

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1. A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may: (1) acquire a lien granted by law to secure the lawyer's fee or expenses; and (2) contract in a civil case with a client for a contingent fee that is permissible under Rule 1.04.

TEX. DISCIPLINARY RULES PROF'L CONDUCT R. 1.08(h), *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G, app. A. *Contra* Chittenden v. State Farm Mut. Auto. Ins. Co., 788 So.2d 1140, 1149 (La. 2001) (allowing attorneys to extend personal funds to clients for minimum living expenses).

2. *See generally* Maya Steinitz, *Whose Claim is This Anyway—Third-Party Litigation Funding*, 95 MINN. L. REV. 1268, 1327–30 (2011) (giving background information on how a third-party lender begins to become intricately involved in the subject matter of the suit by not only providing funds but by reforming the attorney-client privilege relationship).

offers a settlement much lower than what Mike and his attorney expected. The amount would barely cover Mike's attorney fees and the amount owed to the lender. Mike declines the offer, insulted.

But then the lending institution learns of the construction company's settlement offer and immediately contacts Mike. The lender claims the contract Mike signed allows for the institution to participate in the decision-making of the case. Now frightened, Mike tells his attorney he wants to accept the company's offer. With the settlement money, Mike pays his attorney and the lender. His medical bills and other expenses remain, and Mike sits in no better position than he had been before.[3]

When clients ask their attorneys whether they should take out a third-party lender loan, difficulties arise. Can an attorney ethically advise her client to accept such a loan when she knows that loan will eat up the majority of the client's award in the suit?[4] Without state regulation of loan agreements, the answer is no. The relevant ethics issues include the lender's attempts to control the suit, conflicts of interest arising from the loan, and the disclosure of confidential client information.[5] In these situations, plaintiffs' attorneys must push back against lenders who offer tantalizing yet dangerous options to their clients. If attorneys fail to do so, clients are unprotected, as Texas courts will uphold these loan agreements absent a showing of public policy violations or severe malpractice.[6]

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3. *See* Ronen Avraham & Abraham Wickelgren, *Third-Party Litigation Funding—A Signaling Model*, 63 DEPAUL L. REV. 233, 233–34 (2014) (detailing the case of a plaintiff who received a $150,000 settlement and walked away with only $111 after paying his attorney and a third-party lender).

4. For the purpose of this Comment, the term "clients" will refer to a plaintiff bringing a civil action. The terms "third-party litigation funding agreement," "third-party agreement," "third-party loan" etc. refer to a loan received from a third-party lending entity. The terms "third-party lender," "third-party," "lender," etc., refer to a lending entity that has no inherent legal interest in the suit. Variations in terminology hold no significance for the purpose of this Comment outside linguistic appeal, unless specifically stated otherwise.

5. *See* Victoria A. Shannon, *Harmonizing Third-Party Litigation Funding Regulation*, 36 CARDOZO L. REV. 861, 873–74, 903–07 (2015) (listing possible conflicts, such as the state's maintenance and champerty doctrines, a lender attempting to establish any control over the client's legal representation, conflicts of interest between the lender and the client, the possible breach of attorney-client privilege, and the amount of influence a lender has over settlement negotiations).

6. *See* Thomas D. Morgan, *Sanctions and Remedies for Attorney Misconduct*, 19 S. ILL. U. L.J. 343, 349, 356 (1995) (clarifying the reversal of a settlement requires a severe malpractice on behalf of the attorney). *See generally* Gerald J. Kross, *Professional Ethics—Attorney Misconduct—Rules of Disciplinary Enforcement*, 36 DUQ. L. REV. 651 (1998) (outlining the notably punitive punishments available for attorneys who violate the code of ethics and lack of restorative avenues a plaintiff has besides bringing and entirely new suit).

State legislation mandating the disclosure of third-party litigation funding agreements is necessary.[7] The legislature should require courts to review the agreements and provide a baseline protection to plaintiffs against lender attempts to control the suit, conflicts of interest, and inappropriate disclosure of the plaintiff's confidential information[8] With this protection in place, attorneys could ethically advise their clients whether to take out third-party loans because they know courts will prevent lenders from interfering.

Currently, Texas attorneys stand in the difficult position of balancing clients' day-to-day financial troubles against those same clients' long-term interests and wishes.[9] In an effort to remedy the situation, this Comment will first describe the origin of third-party litigation funding. Then, it will address the lack of interest from Texas courts and identify the flaws in this approach. Finally, by exploring other jurisdictions' approaches to the dilemmas of third-party litigation funding, this Comment will propose regulation Texas should implement to facilitate transparency in third-party lender agreements. This regulation will serve to prevent or mitigate the ethical dilemmas attorneys and their clients encounter with these precarious agreements.

II. THE RISE OF THIRD-PARTY LITIGATION FUNDING

With an understanding of why third-party litigation funding became so widespread, one can better understand how to develop regulations which would still support the issues third-party lenders serve to fix while also protecting the interests of the plaintiffs entering into these agreements.

A. *A General Overview of Third-Party Litigation Funding and the Issues Associated with This Practice*

The classic litigation funding agreement involves three parties: the funding entity, the client, and the attorney.[10] The funding entity is typically

7. *Cf.* Christopher B. Little, *Third-Party Litigation Funding: Understanding the Risks*, 40 COLO. L. 69, 71 (2011) (highlighting the issues following a suit against an attorney for malpractice regarding a third-party loan).

8. Shannon, *supra* note 5, at 903–04.

9. *See* TEX. DISCIPLINARY RULES PROF'L CONDUCT R. 1.02, *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G, app. A (providing the few exceptions where an attorney would not need to follow what their client wants in a suit).

10. Shannon, *supra* note 5, at 870.

a bank, hedge fund, or insurance company.[11] Some entities invest in lawsuits as part of larger investment portfolios; others specialize in litigation funding.[12] These specialized lenders commonly operate in countries where the industry is well established, such as the United States, Canada, and Australia.[13]

The clients involved in these transactions may be individuals, classes, corporations, or sovereigns, but nearly all are seeking to initiate or defend against a claim.[14] In the initial discussions between the lender and the client, the lender will request to see information about the case so it can assess the merits of the claim and potential conflicts of interest.[15] This information would include all facets and relevant details of the case's merits, from statements and physical evidence to expected damages and the opposing party's recoverable assets. Although this information may be protected by attorney-client privilege, the lender will still want the information to perform due diligence before funding the suit.[16] If the lender remains interested, it will negotiate a funding agreement and extend funds to the client, covering the cost of litigation.[17] In sum, these lenders treat lawsuits as simple cost-

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11. *Id.* at 871.

12. *Id.*

13. *See* Jasminka Kalajdzic et al., *Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding,* 61 AM. J. COMP. L. 93, 95–96, 145–46 (2013) (describing why Australia, Canada, and the United States emerged as the leaders in the third-party litigation funding industry and became the driving forces behind the popularization of third-party litigation funding worldwide).

14. Steinitz, *supra* note 2, at 1302.

15. Jonathan D. Petrus, *Legal and Ethical Issues Regarding Third-Party Litigation Funding*, L.A. LAW., Nov. 2009, at 16, 17; Commonwealth v. Downey, 793 N.E.2d 377, 381–82 (Mass. App. Ct. 2003) (explaining why a lawyer's agreement with a third-party to disclose confidential information without the consent of the client creates a conflict of interest); *see also* MODEL RULES OF PROF'L CONDUCT R. 1.7 (AM. BAR ASS'N 2023) (stating a conflict of interests exists if "the representation of one client will be directly adverse to another client").

16. Petrus, *supra* note 15, at 16–17; *see also* Michele DeStefano, *Claim Funders and Commercial Claim Holders: A Common Interest or a Common Problem,* 63 DEPAUL L. REV. 305, 337 (2014) (explaining why lenders may take up to three months assessing a case, as they are not only assessing the financial situation of the plaintiff but also "the merits of the case, the credibility of the witnesses, and the value of the evidence"); Michele DeStefano Beardslee, *Taking the Business out of Work Product,* 79 FORDHAM L. REV. 1869, 1897 (2011) ("[T]he work product doctrine directly promotes the integrity of the adversary system, as opposed to the attorney-client privilege which only does so indirectly by protecting communications and encouraging full disclosure, thereby supporting the health and integrity of the attorney-client relationship, an integral component of the adversary system.").

17. Petrus, *supra* note 15, at 16–17; *see also* DeStefano, *supra* note 16, at 337 (describing the months-long processes of case assessments by lenders).

benefit analyses and risk assessments.[18] If the risk is deemed acceptable, the funds will be provided after negotiation of a detailed funding agreement.[19] These agreements contain a nonrecourse loan solely contingent upon the client winning the case.[20] Other provisions may include a duty by the funder to cover an adverse cost reward.[21] An adverse cost reward "requires the losing party to [cover] some or all of the winning party's cost of" litigation, such as attorneys' fees, administrative fees, and costs of witnesses and experts.[22]

Attorneys have limited but varied roles in the actual creation of litigation funding agreements.[23] But, in most states, ethical rules prohibit a funder from exercising legal control over litigation.[24] Because attorneys are bound by these rules,[25] they must follow them when navigating situations involving their clients and third-party lenders. The attorney holds a duty to ensure her client's interest remains paramount to any other.[26] These duties make third-party loans a danger for plaintiffs and attorneys alike.

B. *The Driving Forces Behind Third-Party Litigation Funding's Worldwide Spread*

The sometimes-unsavory third-party litigation funding industry developed from the noble idea that all plaintiffs should have an opportunity to pursue their legal rights and claims, regardless of those plaintiffs' financial

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18. Fausone v. U.S. Claims, Inc., 915 So.2d 626, 627 (Fla. Dist. Ct. App. 2005) (describing a plaintiff selling multiple portions of her claim to different lenders). In this Comment, all claims analyzed are loans to an individual lender investing in the suit, rather than purchasing a stake in the underlying subject matter.

19. Champerty, an important concept in the realm of professional responsibility, is the "partial assignment of the proceeds of litigation in which the property interest of the funder is by definition contingent on an uncertain event happening in the future—that is, the positive resolution of a lawsuit by either judgment or settlement." Anthony J. Sebok, *Betting on Tort Suits after the Event: From Champerty to Insurance*, 60 DEPAUL L. REV. 453, 453 (2011).

20. Andrew Hananel & David Staubitz, Note, *The Ethics of Law Loans in the Post-*Rancman *Era,* 17 GEO. J. LEGAL ETHICS 795, 800 (2004).

21. LISA BENCH NIEUWVELD & VICTORIA SHANNON SAHANI, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION 22 (2d ed. 2016).

22. *Id.*

23. Shannon, *supra* note 5, at 872.

24. *See e.g.,* TEX. DISCIPLINARY RULES PROF'L CONDUCT R. 1.02, *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G, app. A ("In advising or otherwise representing a client, a lawyer shall exercise independent professional judgment and render candid advice.").

25. *See generally id.* preamble ¶ 10 (casting the Texas Disciplinary Rules of Professional Conduct as "imperatives" for Texas lawyers).

26. *See* Shannon, *supra* note 5, at 873 (explaining the array of the conflicts related to third-party funding).

situations.[27] The justice at the heart of the concept primed the civil litigation business for large financial institutions to begin funding the claims of individual plaintiffs.[28] Likewise, the common law doctrines of champerty and maintenance—which frowned upon outsiders funding the claims of other plaintiffs—were gutted.[29] Ostensibly seeking to expand access on this justice, law firms jumped at the opportunity to get paid for litigation work at no risk to their daily businesses.[30] In countries where third-party litigation funding is well established, these two forces created a prime breeding ground for third-party lending companies to step in and provide a solution to both plaintiffs and law firms.[31] Remarkably, these forces allowed for the rapid growth of the third-party funding industry in certain countries, despite stark differences in legal rules and practices.

1. Australia

Prior to 2006, Australia prohibited the practice of "encouraging litigation and funding another's claim for profit."[32] Once Australia changed the policy by lessening restrictions on champerty and maintenance, the third-party lending industry flourished.

Australia has long practiced "fee-shifting," which is the custom of requiring a losing party in a lawsuit to pay for costs and expenses of the winning party.[33] This practice forces potential plaintiffs to think twice before filing a lawsuit; wrong-sided verdicts are expensive. Australia also

27. *Id.* at 869.

28. *Id.*

29. *Id.* at 870; *see also* Paul Bond, Comment, *Making Champerty Work: An Invitation to State Action,* 150 U. PA. L. REV. 1297, 1297 (2002) ("Contemporary scholarship tends to assert that the doctrine [of champerty] is vestigial and on the wane."). This new wave of thought stands in stark contrast to common law, which considered maintenance "an offense against public justice, as it keeps alive strife and contention, and perverts the remedial process of the law into an engine of oppression." HENRY JOHN STEPHEN, NEW COMMENTARIES ON THE LAWS OF ENGLAND 263 (1st ed. 1846).

30. *Cf.* Shannon, *supra* note 5, at 869 (emphasizing many businesses sought third-party lenders so they could maintain their daily business without spending all their cash reserves on lawsuits).

31. Joseph J. Stroble & Laura Welikson, *Third-Party Litigation Funding: A Review of Recent Industry Developments*, 87 DEF. COUNS. J. 1, 2–3 (2020).

32. Jason Geisker & Dirk Luff, *The Third Party Litigation Funding Law Review: Australia*, L. REVS. (Nov. 22, 2022), https://thelawreviews.co.uk/title/the-third-party-litigation-funding-law-review/australia [https://perma.cc/MU46-E94H]; *see also* Cento Velijanovski, *Third-Party Litigation Funding in Europe*, 8 J.L. ECON. & POLICY 405, 406–07 (2012) (clarifying in different Australian states maintenance and champerty laws were abolished in the 1950s and 1990s).

33. Kalajdzic et al., *supra* note 13, at 98, 139; *see also* Chen Wenjing, *An Economic Analysis of Third Party Litigation Funding*, 16 US-CHINA L. REV. 34, 35 (2019) (clarifying the lack of fee shifting in the United States).

bans the use of contingency fees, meaning attorneys are hesitant to invest their own funds into litigation.[34] Litigation costs came directly from plaintiff pockets or firm coffers.[35] For client and attorney, risk was high.

But when third-party lenders began operating, plaintiffs jumped at the opportunity to avoid risk by taking out nonrecourse loans covering all potential expenses in exchange for a portion of the award in the suit.[36] These lenders had created a preferable option allowing both plaintiffs and attorneys to protect their personal funds while pursuing justice through litigation.

2. United States

The United States holds a much deeper tradition in this area.[37] The third-party litigation funding industry is an outgrowth of two common types of preexisting lending agreements: presettlement funding and syndicated lawsuits.[38] Presettlement funding agreements are loans extended to plaintiffs to cover living expenses during the course of litigation.[39] In a syndicated lawsuit, private investors secure loans against the proceeds of the plaintiff's recovery.[40] Both concepts were established decades before third-party litigation funding, but they both revolve around securing the loan against the recovery of the lawsuit, rather than against plaintiff themselves.[41] Third-party litigation lenders took this concept and combined it with the driving forces of expansion of access to justice and relaxation of champerty and maintenance rules. Furthermore, the rising cost of litigation, as well as its extended duration, encouraged parties to seek outside aid to offset costs.[42]

Although the United States allows contingency fees, the risk behind accepting a case purely on this basis is not one attorneys take lightly. Under

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34. Kalajdzic et al., *supra* note 13, at 117.

35. *Id.*

36. Shannon, *supra* note 5, at 871.

37. *See* Jason Lyon, *Revolution in Progress: Third-Party Funding of American Litigation*, 58 UCLA L. REV. 571, 573–74 (2010) (providing two examples of private lending schemes which had already been in place).

38. *Id.* at 574.

39. *Id.*

40. *Id.*

41. *See* Hananel & Staubitz, *supra* note 20, at 800 ("From the perspective of the plaintiff, the loan is fully nonrecourse in that if the lawsuit does not generate a settlement or award, the loan is forgiven and there is no further liability.").

42. *See* Petrus, *supra* note 15, at 16 (detailing how reception of a third-party litigation funding agreement covers legal costs); Stroble & Welikson, *supra* note 31, at 6.

a contingency fee structure, if the opposing party wins, the losing attorney receives nothing.[43] While a third-party loan will not ensure an attorney receives payment under a contingency fee agreement, the loan will ensure the attorney will not use her own funds for a lawsuit when there is no guarantee of success. Conveniently, the third-party agreement allows for an attorney to invest another's money into the suit with little risk to the attorney.[44]

3. European Jurisdictions

Third-party litigation funding agreements are common across Europe and allowed in nearly all countries.[45] The relatively newfound support for the industry contrasts with the historical ban on the practice.[46] As in Australia and the United States, Europe recognized the growing cost of litigation and its myriad complexities as the industry's impetus, particularly in common law jurisdictions.[47] Conversely, litigation tended to be substantially cheaper in civil law countries.[48]

The United Kingdom has endorsed the third-party litigation funding; the Civil Justice Council allows for such agreements in mainstream litigation, so long as they are "properly regulated."[49] This caveat is worth repeating: although litigation funding plays a necessary role to expand access to justice, regulations are needed to protect all parties.

C. *What Ethical Dilemmas are Created by Third-Party Lender Agreements*

Third-party litigation funding is not only popular but often necessary. Financially desperate plaintiffs have few other options to fund their pursuits of justice and legal claims.[50] Unfortunately, with desperation comes willingness to do whatever necessary. Here, the prime catalyst behind the ethical dilemmas created by third-party litigation funding arises.

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43. *Contingent Fee*, BLACK'S LAW DICTIONARY (11th ed. 2019) ("A fee charged for a lawyer's services on if the lawsuit is successful or is favorably settled out of court. Contingent fees are [usually] calculated as a percentage of the client's net recovery (such as 25% of the recovery if the case is settled, and 33% if the case is won at trial.").

44. Shannon, *supra* note 5, at 869, 871.

45. Velijanovski, *supra* note 32, at 406.

46. *Id.*

47. *Id.* at 407; *see also* Petrus, *supra* note 15, at 16 (explaining the driving forces behind the popularization of third-party litigation funding in the United States).

48. Velijanovski, *supra* note 32, at 422.

49. *Id.* at 407–08.

50. Petrus, *supra* note 15, at 16.

An unregulated lending industry can take advantage of plaintiffs in various ways. First, the lender may attempt to exercise control over the attorney. Although most jurisdictional ethical rules prohibit an attorney from being too close to the lender, if a lender does attempt to exert its influence over the attorney, the attorney has few actionable options.[51] The attorney could withdraw from the case and refrain from referring future clients to that lender, but in the moment, the attorney can only ignore the lender to the best of her ability and follow her best judgment.[52]

Second, several conflicts of interest are associated with these loans. If a lawyer and a lending company refer clients to each other, their business between each other may trump or influence the attorney's ability to represent his clients' interests.[53] On the other hand, a lending company may pressure the plaintiff to accept a settlement only because the company wants a guaranteed return on its investment.[54]

Third, attorney-client privilege is at stake. Before third-party lenders will loan money to a plaintiff, they often demand access to typically privileged information such as the facts of the case, possible evidence, and any other information a client would disclose to his attorney.[55] A plaintiff has the right to determine who can access this information, but when pressured by the lending company to disclose it in exchange for the loan, most plaintiffs will allow it. With such serious ethical concerns at play, can a Texas attorney ethically advise her client to seek a problematic third-party loan?

The third-party litigation lending industry is booming. As such, states must firmly regulate it. For this process to operate ethically and efficiently, any precedent or legislation enacted by individual states needs to properly navigate the major ethical dilemmas of attorney control, conflicts of interest, and attorney-client privilege.

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51. Texas holds an attorney must "exercise independent professional judgment and render candid advice." TEX. DISCIPLINARY RULES PROF'L CONDUCT R. 2.01, *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G, app. A.

52. *Id.*

53. P & M Elec. Co. v. Godard, 478 S.W.2d 79, 80 (Tex. 1972) (listing conflicts of interest which can be created by an attorney, such as accepting employment in a matter which is inherently opposed to the client's interests).

54. Inherently, the third-party funder maintains a mere financial interest in the suit. In the lender's mind, as long as a return was made on the investment, the suit was successful. Conversely, an attorney and his client may have interests outside of finances, or at the very least, they may not be satisfied with a settlement only covering attorney's fees and the lender's interest in the case.

55. Commonwealth v. Downey, 793 N.E.2d 377, 381–82 (Mass. App. Ct. 2003) (explaining why a lawyer's agreement with a third-party to disclose confidential information without the consent of the client creates a conflict of interest under the Massachusetts Rules of Professional Conduct Rule 1.7(b)).

III. TEXAS'S CURRENT REGULATION REGARDING THIRD-PARTY LITIGATION FUNDING AGREEMENTS

Texas is no stranger to the use of alternative funding.[56] Texas law firms innovated the use of contingency fees, which operate hand-in-hand with third-party lending agreements.[57] But despite having one of the longest traditions of third-party funding, Texas has implemented little regulation of the industry. The state has even lessened some traditional regulations regarding third-party lenders, making it easier for litigation funding lenders to operate.[58] The lenient regulations allow parties wide discretion for champerty and maintenance of lawsuits.[59]

In 2006, Texas determined the "limits and extent of the Texas champerty doctrine with regard to litigation funding agreements . . . ."[60] Van Dyke was the president and owner of Anglo-Dutch Petroleum International, Inc.[61] He sued several other oil companies, claiming they had wrongly

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56. *See generally* Bentinck v. Franklin, 38 Tex. 458 (1873) (highlighting Texas's historical leniency towards champerty).

57. Eric Chenoweth, *The Ethics of Litigation Funding in Texas*, TEX. LAWBOOK (Feb. 28, 2018), https://texaslawbook.net/the-ethics-of-litigation-funding-in-texas/ [https://perma.cc/NEV5-GJRB]. *See generally* Hill v. Cunningham, 25 Tex. 25 (1860) (exemplifying the early use of contingency fees in Texas).

58. *See* Christy B. Bushnell, *Champerty is Still No Excuse in Texas: Why Texas Courts (and the Legislature) Should Uphold Litigation Funding Agreements*, 7 HOUS. BUS. & TAX L.J. 358, 362 (2006) ("Because all champertous devices are permissible in Texas by default with certain exceptions, there is little general state champerty jurisprudence in existence."). Gradually more states are starting to lessen their restrictions as they realize "[t]he changing view of maintenance recognizes that supporting litigation is not an evil and that third parties with reasonable justification may properly involve themselves." Daniel C. Cox, *Lawsuit Syndication: An Investment Opportunity in Legal Grievances*, 35 ST. LOUIS L.J. 153, 161 (1990).

59. Bushnell*, supra* note 58 at 361.

> An agreement between an officious intermeddler in a lawsuit and a litigant by which the intermeddler helps pursue the litigant's claim as consideration for receiving part of any judgment proceeds; specif., 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.

Champerty, BLACK'S LAW DICTIONARY (11th ed. 2019). Maintenance is "[i]mproper assistance in prosecuting or defending a lawsuit given to a litigant by someone who has no bona fide interest in the case . . . ." *Maintenance*, BLACK'S LAW DICTIONARY (11th ed. 2019). Currently, twenty-eight states permit maintenance, while sixteen of those twenty-eight explicitly allow one to profit off maintenance. *See* Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61, 107 (2011). Note, a champertous agreement is not an assignment. A champertous agreement is an investment, whereas an assignment is the "transfer of rights or property." *Assignment*, BLACK'S LAW DICTIONARY (11th ed. 2019).

60. Bushnell, *supra* note 58, at 361.

61. Anglo-Dutch Petroleum Int'l, Inc. v. Haskell, 193 S.W.3d 87, 93 (Tex. App.—Houston [1st Dist.] 2006, pet. denied).

appropriated a possible oil field in Kazakhstan.[62] To prevent the bankruptcy of his business during the litigation, Van Dyke solicited funding from third-party litigation lenders and individual investors.[63] Despite claiming $650 million in damages, Van Dyke received a judgment of only $81 million.[64] After reaching a settlement for even less, Van Dyke then had to repay the investors.[65] As Van Dyke lobbied for legislation to regulate the types of agreements into which he had entered, the Texas First Court of Appeals in Houston finally considered his issue in *Anglo-Dutch Petroleum Int'l, Inc. v. Haskell*.[66] Before this case, third-party lender agreements had received little to no attention from the Texas judiciary or legislature. This lack of precedent allowed the court to create its own interpretation of how third-party lender agreements fit into the scope of Texas law.[67]

A. *The Texas Case*

Anglo-Dutch made three major contentions attacking third-party litigation funding agreements: they are (1) usurious; (2) invalid, unregistered securities; and (3) contrary to Texas public policy.[68]

Disposing of the securities issue, the court declined to decide whether these agreements are considered securities.[69] Nonetheless, the argument failed because even if Anglo-Dutch had presented more sufficient evidence; federal and state securities law protects purchasers, not sellers.[70]

1. Are Third-Party Lender Agreements Usurious?

"Usury" is the "charging of an illegal rate of interest as a condition to lending money" or "an illegally high rate of interest."[71] The essential part of this definition is the word "lending." For a transaction to be usurious, the money needs to be loaned to the customer by the seller.[72] Texas courts

62. *Id.* at 90; *see also* Bushnell, *supra* note 58, at 387 (depicting the details of *Anglo-Dutch* that gave rise to the champerty debate in Texas).

63. *Anglo-Dutch*, 193 S.W.3d at 90–91.

64. *Id.*

65. *Id.* at 91.

66. Anglo-Dutch Petroleum Int'l, Inc. v. Haskell, 193 S.W.3d 87 (Tex. App.—Houston [1st Dist.] 2006, pet. denied).

67. *Id.* at 104–05.

68. *Id.* at 93.

69. *Id.* at 102–03.

70. *Id.*

71. *Usury*, BLACK'S LAW DICTIONARY (11th ed. 2019).

72. *See id.* (defining usury as "[h]istorically, the lending of money with interest").

have further defined requirements for an agreement to be usurious.[73] These elements are "(1) a loan of money; (2) an absolute obligation that the principal be repaid; and (3) the extraction of a greater compensation than allowed by law for the use of the money by the borrower."[74] If any element is missing, then the transaction cannot be considered usurious.[75] An agreement signed between a party to a lawsuit and a third-party lender stipulates the repayment of the loaned money is contingent solely on any recovery by the party in the lawsuit.[76] The funders

> purchase a contingent right to a portion of the plaintiff's recovery. The funding agreement does not create an absolute obligation on the part of the plaintiff to repay the advance. As a result[,] . . . these transactions are investments, not loans, and therefore not subject to state usury limitations.[77]

Inherently, this means if a party loses the suit, the lender receives nothing. This possibility of receiving nothing makes these loans fail the second usury element in Texas. In *Anglo-Dutch*, the court said the plaintiff's repayment to the lenders "depended upon a contingency beyond [the lenders'] control."[78] Nor would Van Dyke's sureness about the strong merits of the case suffice as a guarantee that the lenders would receive their money back.[79]

2. Do Third-Party Lender Agreements Violate Public Policy?

Anglo-Dutch contended third-party litigation funding agreements were champertous, allowed lenders to exercise control over the lawsuit, and propagated frivolous lawsuits.[80] Should any of these outcomes violate Texas public policy, then the contract would be immediately declared void.[81]

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73. *See, e.g.,* First Bank v. Tony's Tortilla Factory, Inc., 877 S.W.2d 285, 287 (Tex. 1994) (discussing usury doctrine).

74. Holley v. Watts, 629 S.W.2d 694, 696 (Tex. 1982). *See generally* LFG Nat'l Capital, LLC v. Gary, Williams, Finney, Lewis, Watson, and Sperando P.L., 874 F. Supp. 2d 108 (N.D.N.Y. 2012) (furthering the analysis of usury by providing examples and definitions from New York and California).

75. *Holley*, 629 S.W.2d at 697.

76. Anglo-Dutch Petroleum Int'l, Inc. v. Haskell, 193 S.W.3d 87, 96 (Tex. App.—Houston [1st Dist.] 2006, pet. denied) (quoting Catalina v. Blasdel, 881 S.W.2d 295, 297 (Tex. 1994)).

77. W. Bradley Wendel, *Are There Ethical Pitfalls in the Use of Third-Party Litigation Financing?*, 80 ADVOC. (TEX.) 51, 52 (2017).

78. *Anglo-Dutch*, 193 S.W.3d at 98.

79. *Id.*

80. *Id.* at 103.

81. *See id.* at 104 ("[T]he general rule is that a contractual assignment may be 'inoperative on grounds of public policy.'" (quoting State Farm Fire & Cas. Co. v. Gandy, 925 S.W.2d 696, 698 (Tex. 1996))).

The court held the agreements, although champertous, "do not violate Texas public policy."[82] Although a contract can be vacated when found to violate public policy, Anglo-Dutch failed to bring evidence showing champertous agreements are automatically against public policy.[83] Moreover, Anglo-Dutch failed to give a compelling argument showing how these third-party litigation funding agreements "prey[ed] on financially desperate plaintiffs"; the court noted Anglo-Dutch approached the lenders, not the other way around.[84] Although Anglo-Dutch was a financially desperate plaintiff, it would not have been able to pursue its claim and recover without support from third-party lenders.[85] Van Dyke himself testified that without the funds extended by the lenders, Anglo-Dutch would not have been able to continue operating and most likely would have gone bankrupt.[86]

The court had no evidence of lender control over the lawsuit, and the agreement included no provisions allowing the lenders to "select counsel, direct trial strategy, or participate in settlement discussions, nor [did] they permit appellees to look to Anglo-Dutch's trial counsel directly for payment."[87] The lenders were mere silent investors.

Finally, the court addressed Anglo-Dutch's contention that third-party litigation funding agreements violate public policy because they propagate frivolous lawsuits.[88] The court said it is doubtful that a third-party lender would choose to fund a lawsuit based on frivolous merits.[89] Rather, before choosing to fund a lawsuit, the lender will perform due diligence, which includes a "calculated risk assessment on the probability of a return on its investment."[90] A lender would not fund a suit unless it is likely to prevail on the merits; thus, such agreements are inherently unfrivolous.[91]

By holding these agreements are neither usurious, nor against public policy, *Anglo-Dutch* let third-party litigation funding agreements have free reign. This allowed plaintiffs in need of financial assistance the ability to receive that funding from third-party lenders. However, the court firmly

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82. *Id.* at 104–05.
83. *Id.* at 104 (citing *State Farm*, 925 S.W.2d at 707).
84. *Id.*
85. *Id.*
86. *Id.*
87. *Id.*
88. *Id.* at 104–05.
89. *Id.* at 104.
90. *Id.* at 105.
91. *Id.*

established the only way for a third-party funding agreement to be nullified, once entered into, is a finding the agreement violated public policy.[92] Such an agreement would fail, subject to the general rule that "a contractual assignment may be 'inoperative on grounds of public policy.'"[93]

B. *Enacted Regulations in Texas*

Anglo-Dutch laid the groundwork for treatment of third-party litigation funding agreements but did not clarify the issue of regulation.[94] The court implied no regulation should be imposed, as long as the agreement does not violate public policy.[95] Thus, plaintiffs seeking protection must look to legislation for substantive regulation regarding the creation and enforcement of their agreements.

Unfortunately, the Texas legislature has not fixed the issue, apparently deferring to the *Anglo-Dutch* case law.[96] Absent regulation, attorneys are left with standard ethics rules to guide them as they assist clients in navigating these third-party agreements. The Texas Rules of Professional Conduct are the bare minimum standard which attorneys must follow to preserve ethical integrity and avoid disciplinary action.[97] While they do not specifically pertain to third-party lender agreements, attorneys can attempt to navigate many ethical issues arising from these contracts by referring to these rules.

1. Rule 1.05

Rule 1.05 governs the confidentiality of client information.[98] An attorney may not knowingly reveal the "confidential information of a client or former client" to anyone the client has stated shall not receive the information, or anyone who is not the client's attorney, "representatives, or the members, associates or employees of the lawyer's law firm."[99] A lawyer may only

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92. *Id.* at 104.

93. State Farm Fire & Cas. Co. v. Gandy, 925 S.W.2d 696, 707 (Tex. 1996) (citation omitted).

94. *See Anglo-Dutch*, 193 S.W.3d at 105 (holding the agreements do not violate public policy).

95. *Id.* at 104–05.

96. *See* Bushnell, *supra* note 58, at 361–62 (discussing unsuccessful ventures to regulate third party funding, including failed bills).

97. TEX. DISCIPLINARY RULES PROF'L CONDUCT Preamble ¶ 7, *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G, app. A.

98. *Id.* R. 1.05.

99. *Id.* R. 1.05(b).

> 'Confidential information' includes both 'privileged information' and 'unprivileged client information.' 'Privileged information' refers to the information of a client protected by the lawyer-client privilege of any of the following rules: Rule 503 of the Texas Rules of Evidence, of

disclose this information in very specific circumstances. Confidential information may be revealed when a client expressly authorizes her attorney to do so, in order to either carry out representation or when the client consents to the disclosure after consultation.[100] An attorney may reveal unprivileged information when the "attorney is impliedly authorized to do so" to assist with the suit.[101] At the heart of these rules and exceptions lie the client's consent.

The sharing of confidential information is a common practice in the negotiation of third-party lender agreements.[102] To assess the merits of a case, third-party lenders require an in-house review of information normally protected under Rule 1.05.[103] The information allows lenders to perform due diligence in determining whether the plaintiff's case presents a worthwhile investment.[104] An attorney who discloses confidential information to a third-party lender without the client's consent would clearly violate the rule.[105] Yet most, if not all, financially desperate plaintiffs will take advantage of the consent exception, sacrificing the confidentiality associated with the attorney-client relationship for the opportunity to pursue a legal claim. From the lender's perspective, the lender is neither strong-arming nor forcing the plaintiff into the disclosure of the information. The lender is merely making the disclosure a requirement of the contract, which the plaintiff would consider on his own accord.

2. Rule 2.01

Another rule which does not directly govern third-party litigation funding agreements but may give rise to ethical issues regarding such contracts is

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> Rule 503 of the Texas Rules of Criminal Evidence, or by the principles of attorney-client privilege governed by Rule 501 of the Federal Rules of Evidence for United States Courts and Magistrates. 'Unprivileged client information' means all information relating to a client or furnished by the client, other than privileged information, acquired by the lawyer during the course of or by reason of the representation of the client.

Id. R. 1.05(a); *see also* P & M Elec. Co. v. Godard, 478 S.W.2d 79, 80 (Tex. 1972) ("An attorney may not represent conflicting interests; and may not divulge a client's secrets or confidences, or accept employment from others in matters adversely affecting an interest of the client with respect to which confidence has been reposed.").

100. TEX. DISCIPLINARY RULES PROF'L CONDUCT R. 1.05(c).

101. *Id.* R. 1.05(d).

102. Wendel, *supra* note 77, at 53.

103. TEX. DISCIPLINARY RULES PROF'L CONDUCT R. 1.05(d); Petrus, *supra* note 15, at 17.

104. Petrus, *supra* note 15, at 17.

105. TEX. DISCIPLINARY RULES PROF'L CONDUCT R. 1.05(b).

Rule 2.01.[106] The rule requires an attorney to exercise independent judgment regarding her client's case.[107] Essentially, this rule means a lawyer must not allow outside sources to cloud or impact her judgment while advising her client.[108] A third-party lender's material involvement in the case involves an entity with interests different or adverse to those of the client and attorney.[109] The lender wants a positive return on its investment, while the attorney and the client follow the client's interests. If the opposing party offers a settlement, even if it barely covers the lender's fees, the lender would want the client to accept. It becomes the attorney's duty to ensure she and her client exercise independent judgment when making decisions in the case.[110] If the third-party lender sways the attorney, the attorney violates her fiduciary duty.[111]

3. Rule 2.02

Rule 2.02 governs the evaluation of a case or matter relating to the client for use by a third party.[112] Concerning third-party lender agreements, a lender may request that the attorney evaluate the case to determine the suit's merits. Under this rule, an attorney may not disclose this information, unless he meets two conditions, aside from the confidentiality concerns previously discussed.[113] First, the attorney must believe the disclosure will relate to "other aspects of the lawyer's relationship with the client."[114] In a third-party lending agreement, if a lender refuses to grant a loan unless the attorney supplied the information, it is apparent the disclosure of information directly relates to other matters concerning the client. Second, the attorney may not disclose the information unless the client consents

106. *Id.* R. 2.01 ("In advising or otherwise representing a client, a lawyer shall exercise independent professional judgment and render candid advice.").

107. *Id.*

108. *Id.*

109. Inherently, the third-party funder maintains merely a financial interest in the suit. In the lender's mind, as long as they get a return on their investment the suit was a success. Conversely, an attorney and his client may have interests outside of finances, or at the very least they may not be satisfied with a settlement which merely covers attorney's fees and the lender's interest in the case.

110. TEX. DISCIPLINARY RULES PROF'L CONDUCT R. 2.01.

111. *Id.* R. 2.01 cmt. 1; *see also* Wendel, *supra* note 77, at 54 (explaining how if an attorney properly makes sure her interests are not intertwined with the interest of the third-party lender, then maintaining an independence of counsel should be an easy endeavor).

112. TEX. DISCIPLINARY RULES PROF'L CONDUCT R. 2.02 ("A lawyer shall not undertake an evaluation of a matter affecting a client for the use of someone other than the client.").

113. *Id.*

114. *Id.* R. 2.02(a).

after consultation.[115] This factor is not as simple as it appears. Not only must the client consent, but he must consent after his attorney has consulted with him;[116] this implies a joint decision. The attorney is not seeking permission, nor is he informing the client that a decision will be made. The lawyer must consult with his client, and together they must determine whether disclosure will further the purpose of the suit.

4. Rule 1.01

Hand-in-hand with the need to consult a client is the need for competent and diligent representation.[117] Rule 1.01 requires an attorney to reject offers of employment in areas which the attorney is not competent.[118] Thus, if a client tells her attorney she met with a third-party lender to fund the suit and is considering signing an agreement, the attorney would need to ensure he is competent with knowledge of third-party funders.[119] If the attorney was not competent to diligently represent his client in such matters, then he would either need to refuse the case, withdraw, or bring in another attorney who understands the intricacies of these agreements.[120] This need for competence is necessary for the attorney to confer with the client; the attorney must be able to adequately explain the pros and cons of third-party agreements for the client to make an informed decision.[121]

5. Rules 1.06 and 1.08

A lawyer must ensure the absence of conflicts of interest, per Rule 1.06.[122] In the context of third-party lending, the lawyer cannot have an interest in both the client and the third-party lender.[123] In plain terms, the lawyer cannot represent the client while having a proprietary interest in the third-party lending company.[124] If a lawyer accepts a client who requires a third-

115. *Id.* R. 2.02(b).

116. *Id.*

117. *Id.* R. 1.01.

118. *Id.* R. 1.01(a).

119. *Id.*

120. *Id.* R. 1.01(a)(1).

121. *See id.* R. 2.02 (describing a situation in which an attorney would be required to confer with the client before making decisions regarding a case).

122. *Id.* R. 1.06.

123. *Id.*

124. *Id.*

party loan, the lawyer must ensure any loan his client receives is not one in which the attorney has a monetary interest.[125]

A lawyer is not permitted to obtain a "proprietary interest in the . . . subject matter of litigation," besides the contingency fees allowed under Rule 1.08.[126] This rule prohibits an attorney from extending funds to her client to help her client pursue the case.[127] Nor can an attorney have a monetary interest in the lending entity, potentially limiting the options of a desperate plaintiff seeking financial assistance. The limitation drives more plaintiffs to third-party lenders who may lawfully invest in the litigation, so long as the extended loans are nonrecourse loans.[128] This regulation does not serve to limit third-party lenders but showcases the lenient endorsements Texas has afforded third-party lenders.[129] Not only do case law and lack of legislation neither limit nor regulate the industry, but they also encourage the practice by limiting plaintiffs' options.

C. *Proposed Legislation of Third-Party Loans in Texas*

Texas legislators have filed three bills on this issue, each of them serving as possible bases for future regulatory schemes.[130] The first, House Bill 2987, essentially repeated Van Dyke's allegations in *Anglo-Dutch*.[131] The second, House Bill 2096, pushed for the mandatory disclosure of third-party

125. *Id.*

126. *Id.* R. 1.08(h).

127. *Id.*

128. Hananel & Staubitz, *supra* note 20, at 800.

129. Bushnell, *supra* note 58, at 361.

130. Tex. H.B. 2096, 86th Leg., R.S. (2019); Tex. S.B. 1567, 86th Leg., R.S. (2019); Tex. H.B 2987, 79th Leg., R.S. (2005).

131. *Compare* Tex. H.B 2987, 79th Leg., R.S. (2005) (prohibiting types of funding that repayment is "contingent [on] the person's recovery in a lawsuit is a loan subject to the usurious interest provision"); *with* Bushnell, *supra* note 58, at 390 (using *Anglo-Dutch* as an example where his litigation funding agreements would have been deemed usurious if prohibited through legislation).

litigation financing agreements.[132] Senate Bill 1567 was its counterpart.[133] The twin bills stalled in the House Judiciary & Civil Jurisprudence and the Senate State Affairs Committees, respectively.[134]

1. House Bill 2987

By its holding in *Anglo-Dutch*, the First Court of Appeals declined to provide judicial protections for plaintiffs who enter into third-party lender agreements. House Bill 2987 attempted to remedy by reiterating the claims made by Anglo-Dutch, specifically, that "[a]ll funding advanced to a person whose repayment is contingent upon the person's recovery in a lawsuit is a loan subject to the usurious interest prohibition,"[135] and "[a] contract to provide such funding that allows a rate of return in excess of the usurious interest prohibition . . . is against the public policy of this state."[136]

However, the lenders in *Anglo-Dutch* rightfully pointed out an interesting inconsistency in the argument: if the third-party funding agreements were inherently against public policy, they were already null and void.[137] Thus, it would be "unnecessary and redundant for [Van Dyke] to raise the issue in the legislature."[138] Legislators interested in regulating these agreements should protect plaintiffs by measuring the agreement's legality either before

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132. Filed on February 20, 2019 by Representative Matt Krause, the bill pushed for mandatory disclosure of third-party litigation financing agreements by adding the following language to Chapter 22 of the Texas Government Code:

> 'Financing' means the provision of monetary or in-kind support to a person or group of persons who have or will file or prosecute a civil action, including a payment to an attorney who represents the person or group, a payment to a fact or expert witness, a payment of the costs of the civil action, or the provision of funds or credit to be used in the future to support the civil action. The term includes the provision of monetary or in-kind support, regardless of whether the support is called a loan, an advance, a purchase, or another term.
> 'Third-party litigation financing' means the provision of financing with repayment being conditioned on and sourced from the person's or group's proceeds from the civil action, regardless of whether the proceeds are obtained through collection of a judgment, payment of a settlement, or otherwise. The term does not include . . . an extension of credit to any attorney or law firm.

Tex. H.B. 2096, 86th Leg., R.S. (2019).

133. Tex. S.B. 1567, 86th Leg., R.S. (2019).

134. Tex. H.B. 2096, 86th Leg., R.S. (2019); Tex. S.B. 1567, 86th Leg., R.S. (2019).

135. Tex. H.B 2987, 79th Leg., R.S. (2005).

136. *Id.*

137. *See* Bushnell, *supra* note 58, at 391 (providing the context of Van Dyke's arguments: defining Anglo-Dutch's funding agreements as loans and the retroactivity clause at the end of House Bill 2987).

138. *Id.*

or immediately after the plaintiffs enter into the agreement. Otherwise, the regulation would either redundantly declare an agreement void—when it was already against public policy—or it would waste the time and resources of courts with lawsuits merely to find the agreement was in fact enforceable.

Currently, the only recourse the parties have regarding these contracts is to bring an entirely new suit to determine whether the contract violates public policy, as was the situation in *Anglo-Dutch*. Again, legislation requiring third-party litigation funding agreements to not violate public policy would serve no use because if the contracts violate public policy, they are void anyhow. Supporters of House Bill 2987 argued instead of deciding whether the provisions of the contract violate public policy, the legislation should overturn the holding in *Anglo-Dutch* that third-party litigation funding agreements do not inherently violate public policy.[139] However, as opponents of the bill and the *Anglo-Dutch* court also made clear, plaintiffs deserve a chance to bring their suit to court, and third-party funders allow that.

Any proposed legislation needs to allow plaintiffs to seek the funding they need to pursue their claims. But it must also proactively protect the parties from entering into unfair agreements, which may later be declared against public policy in a subsequent suit.

2. House Bill 2096 and Senate Bill 1567

The disclosure mandated by House Bill 2096 and Senate Bill 1567 would be limited to loans where payment was contingent on the proceeds of the action.[140] Other financing agreements, such as a lawyer's contingency fee, would not fall under this requirement. These bills sought to give courts a chance to review the third-party agreements for issues before the suit concluded. Such issues could theoretically include violations of public policy, a provision granting the lender control over the suit, conflicts of interest, or possible coercion on the part of the lender to receive privileged information. Although the policy succinctly and narrowly solved the ethical dilemmas created by third-party litigation funding, it did not become law.

139. *See* Jarrett Lewis, Note, *Third-Party Funding: A Boon or Bane to the Progress of Civil Justice?*, 33 GEO. J. LEGAL ETHICS 687, 699 (2020) (explaining the benefit of third-party litigation funding on equal access to litigation for lower income Americans and smaller businesses).

140. Tex. H.B. 2096, 86th Leg., R.S. (2019); Tex. S.B. 1567, 86th Leg., R.S. (2019).

IV. THE LACK OF REGULATION HAS LEFT DILEMMAS UNANSWERED

Anglo-Dutch made clear: third-party litigation funding agreements will be upheld, absent public policy violations.[141] The plaintiff in *Anglo-Dutch* was neither financially desperate nor vulnerable.[142] While Van Dyke attempted to frame himself this way, he was merely attempting to avoid the bankruptcy of his company.[143] His situation was vastly different from the hypothetical plaintiff in the introduction. That plaintiff, Mike, is truly desperate, having no means to support himself or his family while his suit transpired. He will give up certain rights to maintain his suit. A lender can take advantage of this desperation by demanding the disclosure of information as a condition of signing the loan.[144]

Texas legislators should consider substantial regulation regarding third-party litigation funding, but the discoverability of such agreements is a logical entry point to the discussion. The Federal Rules of Civil Procedure 23(g)(1)(A)(iv) and 23(g)(1)(B) further the argument for mandatory disclosure to the court. These rules require courts to review the "resources that counsel will commit to representing the class" when appointing class counsel, along with "any other matter pertinent to counsel's ability to fairly and adequately represent the interests of the class."[145] A facial reading of these rules indicate courts are required to review the financial condition of counsel, which would include any financial agreements into which they have entered to fund the suit.[146] Courts do this to adequately determine whether the counsel has the resources to properly represent the class, as well as to determine "whether any funding arrangement may affect the strategic decisions made on behalf of the class."[147] In the context of this discussion, a third-party litigation funding

141. Anglo-Dutch Petroleum Int'l, Inc. v. Haskell, 193 S.W.3d 87, 104 (Tex. App.—Houston [1st Dist.] 2006, pet. denied).

142. *See id.* ("Moreover, if Anglo-Dutch was financially desperate, as it alleges, it would have been unable to prosecute the Haliburton lawsuit without the appellees' funding since . . . it could not obtain a conventional loan from a commercial bank.").

143. *See id.* ("Even Van Dyke testified that the funds advanced by appellees were necessary, in part, so that Anglo-Dutch could continue to operate its business and avoid bankruptcy.").

144. *See* Devon IT, Inc. v. IBM Corp., No. 10-2899, 2012 WL 4748160 (E.D. Pa. Sept. 27, 2012) (providing examples, such as "legal memoranda, drafts of pleadings, motions, and briefs" that lenders may want when determining the feasibility of granting a loan).

145. Audra J. Soloway, *Disclosure of Third-Party Litigation Funding Arrangements in Class Action Litigation*, CLASS ACTIONS & DERIVATIVE SUITS, SUMMER 2018, at 9, 9 (first quoting FED. R. CIV. P. 23(g)(1)(A)(iv); and then quoting FED. R. CIV. P. 23(g)(1)(b)).

146. *Id.*

147. *Id.*

agreement may contain provisions requiring settlements to occur only if a certain amount is offered or at a certain time in the suit.[148] This provision would drastically affect counsel's strategy in the suit, and courts would not know about these provisions if they were not required to review the agreements.[149] As such, courts would not have the entire picture when determining whether counsel had the resources to adequately represent the class. This analysis heavily leans in favor of allowing the discoverability of third-party litigation funding agreements, at the bare minimum, in class action suits.[150] Whether an agreement will be discoverable varies drastically from jurisdiction to jurisdiction.

A. *New York*

Like Texas, New York does not require the disclosure of third-party litigation funding agreements, at least in federal court. In 2015, the U.S. District Court for the Southern District of New York denied a motion to compel the production of "contracts, litigation funding agreements, other similar documents executed between their counsel and third parties relating to this case, and correspondence with those funders or third parties about this case."[151] In this case, a class of traders filed an insider trading claim against SAC Capital.[152] The counsel for the class had entered into a third-party litigation funding agreement to fund a class action, and SAC Capital argued for disclosure of the agreement.[153] The defense argued because the plaintiff's counsel admitted to entering into a third-party litigation funding agreement but failed to enter the agreement into discovery, the plaintiff denied the defense any opportunity to assess whether the agreement would affect the strategic decisions made by plaintiff's counsel or whether conflicts of interest existed.[154] Additionally, the defense claimed the court should have access to the agreement to ensure the plaintiff had satisfied Rule 23, which governs class actions.[155] Specifically, the court needed the opportunity to "assess whether plaintiff's (i) possess sufficient resources to

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148. *Id.*

149. *Id.*

150. *Id.*

151. Kaplan v. S.A.C. Capital Advisors, L.P., No. 12-CV-9350, 2015 WL 5730101, at *1 (S.D.N.Y. Sept. 10, 2015) (quoting the defendant's letter motion to compel).

152. Soloway, *supra* note 145 at 9.

153. *Kaplan*, 2015 WL 5730101, at *3.

154. *Id.*

155. *Id.*; *see also* FED. R. CIV. P. 23(g)(1) (requiring courts to take certain factors into consideration when appointing class counsel).

commit to the class; (ii) will adequately represent the class; and (iii) can fund proper notice to the many thousand absent class members."[156] The court, however, held this argument was speculative, and because a "nonspeculative basis" was not raised, the court had no basis on which to conclude the financial resources of the plaintiff were inadequate.[157] The court was satisfied with the plaintiff counsel's assurances that the firms representing the plaintiff had "sufficient resources to see the case through to trial and appeal, if need be."[158]

This ruling should be treated negatively to the issue because it contradicts the plain reading of Rule 23.[159] This rule does not require the opposing party present any evidence regarding the financial status of the party involved in the third-party agreement.[160] Rather, Rule 23 requires the court to consider the resources counsel will be committing to the suit, along with any other factors that may affect an attorney's ability to adequately represent the interests of the class.[161] As the defense for SAC Capital correctly pointed out, third-party litigation funding agreements are intricate and essential instruments that determine a plaintiff's counsel would be able to satisfy the prerequisites of Rule 23.[162] By declining to admit the third-party litigation funding agreement into discovery, this court did not create a comprehensive analysis of the adequacy of counsel before appointing them as class counsel.

B. *California*

Conversely, as of 2017, the U.S. District Court for the Northern District of California now requires the disclosure of third-party litigation funding agreements.[163] This amendment to the local rules appeared when the court mandated "[i]n any proposed class, collective, or representative action, the required disclosure includes any person or entity that is funding the

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156. *Kaplan*, 2015 WL 5730101, at *3 (quoting the defendant's letter motion to compel).

157. *Id.* at *5.

158. *Id.*

159. *Compare id.* (failing to take the third-party litigation agreement into consideration), ***with*** FED. R. CIV. P. 23(g)(1)(iv) ("In appointing class counsel, the court . . . must consider . . . the resources that counsel will commit to representing the class.").

160. FED. R. CIV. P. 23(g).

161. *Id.*

162. *Kaplan*, 2015 WL 5730101, at *3.

163. Soloway, *supra* note 145, at 10; *see also Gbarabe v. Chevron*, No. 14-cv-00173-SI, 2016 WL 4154849, at *2 (N.D. Cal. Aug. 5, 2016) (concluding third-party loans are relevant evidence and should be admitted).

prosecution of any claim or counterclaim."[164] This amendment came on the heels of a 2016 decision, *Gbarabe v. Chevron Corp.*,[165] which dealt with the 2012 oil spill off of Nigeria.[166] There, the court held the identity of the litigation funder should be disclosed to Chevron because the information was "relevant to determining the adequacy of the representative plaintiffs."[167] The identity was crucial within the court's determination as a whole whether the funding agreement would have an "impact, if any, on plaintiff's ability to adequately represent the class."[168] This court acknowledged a whole and accurate assessment of a plaintiff's ability to pursue a suit is necessary to all aspects of finances, including third-party litigation funding agreements. Even the plaintiff's proposal to submit the agreement for in camera inspection would fail compliance of the rule, the court said, because Chevron would be denied the opportunity to make its own assessment of the plaintiff's adequacy.[169]

The details of these cases reveal smaller steps for the Texas legislature to explore: (1) requiring disclosure of third-party litigation funding agreements only in class action cases; (2) requiring in camera review of such agreements in all or certain types of cases; or (3) requiring in camera review of such agreements only in class action suits. Any of these options would, at the least, resolve the ethical dilemmas for attorneys.

C. *Proposed Federal Legislation in the United States*

In 2017, the House of Representatives passed the Fairness in Class Action Litigation and Further Asbestos Claim Transparency Act.[170] The Bill stalled in the Senate; however, the third-party litigation disclosure portion of the Bill was introduced to the Senate the following year as a new, stand-alone bill.[171] Renamed the Litigation Funding Transparency Act of 2018, this Bill required class counsel to:

> disclose in writing to the court and all other named parties to the class action the identity of any commercial enterprise, other than a class member or class

164. Soloway, *supra* note 145, at 10 (quoting N.D. Cal. R. 16–9 Standing Order ¶ 19).
165. Gbarabe v. Chevron, No. 14-cv-00173-SI, 2016 WL 4154849 (N.D. Cal. Aug. 5, 2016).
166. Soloway, *supra* note 145, at 10 (citing *Gbarabe*, 2016 WL 4154849, at *1).
167. *Id.* (citing *Gbarabe*, 2016 WL 4154849, at *2).
168. *Gbarabe*, 2016 WL 4154849, at *2.
169. *Id.*
170. H.R. 1927, 114th Cong. (2016); Soloway, *supra* note 145, at 10.
171. Soloway, *supra* note 145, at 10.

> counsel of record, that has a right to receive payment that is contingent on the receipt of monetary relief in the class action by settlement, judgment, or otherwise.[172]

This bill successfully navigates the pitfalls created by third-party litigation and should be heavily considered by Texas legislators if they attempt to draft their own intrastate regulations.

With this Act, Congress realized the conflicts of interest when the lender takes its return on the investment out of the award in the suit. It sought to limit the scope of discoverability to third-party litigation funding agreements tying repayment to the outcome of the suit.[173] This narrow scope ensures the court will not be swamped with third-party agreements where the lender has no interest in the outcome of the case, and thus a very limited chance of a conflict of interest, while also allowing a court to review nearly all documents that may create possible conflicts of interest. By doing so, this bill protects plaintiffs when plaintiffs need judicial protection, but the policy does not waste the court's time by interfering in contracts that have no obvious potential for these specific ethical dilemmas. However, this bill and similar follow-up bills have yet to become law.

D. *Europe*

Examining European third-party funding regulations wholly is difficult for several reasons.[174] The industry is still developing, and regulations vary wildly from country to country.[175] The industry overall has only seen slight regulation, and comprehensive data regarding third-party lenders is difficult to find.[176] Only four dedicated brokers offer third-party lending services in the United Kingdom.[177] Closed-end funds, private equity, and hedge funds provide the majority of third-party lending.[178] Unfortunately, this lack of regulation and oversight has not received much academic attention either. Most scholarly writings focus on the benefits of the growing industry and

172. S. 2815, 115th Cong. § 2 (2018).

173. Soloway, *supra* note 145, at 10.

174. Velijanovski, *supra* note 32, at 8.

175. *Id.*

176. *Id.*

177. *Id.* at 11 ("There are four active brokers offering TPLF in the UK – Ligata, Maxima, The Judge, and Global Arbitration and Litigation Services.").

178. *Id.* at 10.

are content to observe its development before calling for intervention.[179] Taking a wait-and-see approach to the third-party litigation funding industry is problematic because its harms can quickly become wrongheaded traditions.[180]

Axel Voss, a member of the Parliament's Legal Affairs Committee, emphasized this issue.[181] He wrote, "we must not allow millions of European consumers and Europe's justice systems to become pawns in profit seeking."[182] The third-party litigation funding industry is "largely unregulated in Europe," rendering these agreements "ripe for abuse."[183] These agreements are largely made in secret, so judges and defendants may never know that the plaintiff has procured a lender.[184] Under this veil, the fees agreement, the amount of influence the lender has over the suit, and any conflicts may remain secret from class action defendants.[185] Moreover, in class actions, members of these suits may not know a third-party lender has a claim to the proceeds of the suit.[186] Given these dangers and the industry's rapid growth, Voss called for the European Parliament and the Commission to act quickly and enact support for mandatory reporting of private litigation funding.[187] When legislatures fail to take preventative measures, plaintiffs and consumers are inherently harmed. This can be avoided by preemptively looking at the industry and creating regulations to protect plaintiffs and defendants.[188]

V. HOW SHOULD TEXAS INCORPORATE ASPECTS OF OTHER STATES AND

179. *See* Axel Voss, *The EU Must Regulate Third Party Litigation Funding, Argues Axel Voss*, PARLIAMENT (Dec. 9, 2021), https://www.theparliamentmagazine.eu/news/article/protecting-eu-consumers [https://perma.cc/W9MB-5J8G] ("Critics of TPLF regulation claim that we should wait and see how this industry develops in Europe before we intervene; I beg to differ."); *see also* Louis Goss, *Legal Sector Hits Back at EU Calls for Regulation of Third-Party Litigation Funders*, CITY A.M. (Sept. 14, 2022), https://www.cityam.com/legal-sector-hits-back-at-eu-calls-for-regulation-of-third-party-litigation-funders/ [https://perma.cc/PM86-P6PA] (including arguments from anti-regulation lawyers).

180. *See generally* Voss, *supra* note 179 (providing examples of potential issues arising from a lack of oversight, such as: undue influence on the suit, or conflicts of interest).

181. *Id.*

182. *Id.*

183. *Id.*

184. *Id.*

185. *Id.*

186. *Id.*

187. *Id.*

188. *See* Lewis, *supra* note 139, at 700–01 (emphasizing the need for third-party funding for the legal profession to progress with the modern world).

COUNTRIES' REGULATIONS TO REMEDY THE DILEMMAS?

Texas's current regulations are essentially nonexistent.[189] In *Anglo-Dutch*, the court suggested that so long as a third-party lending agreement does not violate public policy, it will be upheld.[190] Moreover, the court ruled these agreements are not usurious.[191] Only the Texas Disciplinary Rules of Professional Conduct regulate the use and implementation of third-party lending agreements in a highly indirect manner.[192] The disciplinary rules, of course, do not protect plaintiffs but merely establish guidelines for attorneys to advise their clients concerning these agreements.[193] Therefore, Texas needs entirely new regulations.

Texas lawmakers must resolve three key ethical dilemmas. First, third-party lending agreements must refrain from granting third-party lenders control over lawsuits.[194] Second, these agreements must not include conflicts of interest by either attorneys or lenders.[195] Third, these agreements must not coerce plaintiffs or attorneys into sharing otherwise privileged information.[196]

To begin, in order to ensure third-party lenders do not exert any undue influence over the suit, oversight through transparency is necessary.[197] In Texas, New York, and most European countries, a judge will never see a

189. *See generally* Anglo-Dutch Petroleum Int'l, Inc. v. Haskell, 193 S.W.3d 87 (Tex. App.—Houston [1st Dist.] 2006, pet. denied) (establishing Texas's basic approach to third-party lending agreements); TEX. DISCIPLINARY RULES PROF'L CONDUCT, *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G, app. A (providing the only other possible substantive regulation affecting third-party lending agreements in Texas).

190. *See Anglo-Dutch*, 193 S.W.3d at 105 (affirming the trial court's holding that the agreements should be upheld because they "do not violate Texas public policy").

191. *Id.* at 101.

192. TEX. DISCIPLINARY RULES PROF'L CONDUCT R. 1.08 cmt. 5 (providing guidance on disclosure, conflict of interest, and confidentiality when "the lawyer's services are being paid for by a third party").

193. *Id.*

194. *See* Shannon, *supra* note 5, at 873 ("Controversial ethical issues worldwide relating to . . . how much influence the funder may have over the legal representation . . . .").

195. *See id.* at 903–04 ("Given the potential for ongoing conflicts of interest . . . the parties should disclose the identity of the funder, at least to the decisionmaker, in order to prevent a future challenge to the award or judgment on the grounds of bias.").

196. *See id.* at 907 ("Thus, ethical regulations should clarify how much influence the funder may exercise in relation to the underlying client's control over the attorney and how the funder can and cannot exert that influence.").

197. *See* William J. Harrington, *Champerty, Usury, and Third-Party Litigation Funding*, BRIEF, Winter 2020, at 54, 60 ("When evaluating champerty defenses to funding agreements, courts carefully scrutinize whether third-party funding erodes client control, concerned that a funder's financial leverage over a case will enable the funder to influence the plaintiff or her attorney.").

lending agreement.[198] Because of this, she will not know if the attorney is making decisions by his own accord, or if the lending company has pressured him into certain scenarios, such as accepting a settlement.[199] The policy of California and the proposed federal Litigation Funding Transparency Act of 2018 offer a concise solution to this problem.[200] Mandatory disclosure allows the court to review the document and assess whether the third-party lender included provisions allowing it to influence the decision making of the suit.[201] Moreover, disclosure allows the court to ensure the attorney is in an adequate financial situation to properly represent the plaintiff.[202]

The federal legislation goes one step further by narrowing the scope of discoverability to lenders whose return is tied solely to the case's outcome.[203] This narrow scope is the preferable approach. Regulation should only protect plaintiffs and their attorneys from specific ethical dilemmas. Other loans not tied to the outcome of the suit do not necessarily trigger these dilemmas, and, as such, casting too wide of a regulatory net would perhaps hinder the pursuit of justice more than it would protect plaintiffs.

Next, Texas needs regulation to ensure lending agreements do not create conflicts of interest. Jurisdictions which do not regulate the industry have no procedure to evaluate whether conflicts of interest exist.[204] Granted, under the Disciplinary Rules of Professional Conduct, attorneys are charged with withdrawing from a case where they have a conflict of interest.[205] If a judge or opposing counsel never see the agreement or even learn the lender's

198. *See* Anglo-Dutch Petroleum Int'l, Inc. v. Haskell, 193 S.W.3d 87, 105 (Tex. App.—Houston [1st Dist.] 2006, pet. denied) (failing to mandate the disclosure of a third-party lending agreement); Kaplan v. S.A.C. Capital Advisors, L.P., No. 12-CV-9350, 2015 WL 5730101, at *5 (S.D.N.Y. Sept. 10, 2015) (holding third-party loans are not required to be entered into evidence); Voss, *supra* note 179 (explaining how European judges likely never see or know of third-party agreements due to the industry being new and therefore unregulated).

199. *See Kaplan*, 2015 WL 5730101, at *5 (acknowledging an attorney's strategy could be unduly influenced by the presence of a third-party lending agreement).

200. Soloway, *supra* note 145, at 10.

201. *See Kaplan*, 2015 WL 5730101, at *5 ("[T]he funding arrangements 'could cause counsel's interest to differ from those of the putative class members they purport to represent.'" (quoting the defendant's letter motion to compel)).

202. *See id.* at *3–5 (analyzing the argument by the defense that third-party loans are an intrinsic part of an attorney's ability to financially support the suit).

203. Soloway, *supra* note 145, at 10 (citing S. 2815, 115th Cong. § 2 (2018)).

204. *See Kaplan*, 2015 WL 5730101, at *3–5 (concluding a third-party litigation agreement is not relevant to any claim or defense and therefore fails to analyze any potential conflicts of interest).

205. TEX. DISCIPLINARY RULES PROF'L CONDUCT R. 1.06, *reprinted in* TEX. GOV'T CODE ANN., tit. 2, subtit. G, app. A.

identity, then it is solely up to attorneys to hold themselves accountable.[206] Furthermore, courts also remain in the dark on whether the lender has a conflict of interest. Once again, California and the proposed Litigation Funding Transparency Act of 2018 provide an answer.[207] By requiring the entrance of these agreements into discovery, a judge can review these documents for any potential conflicts of interest.[208] This review protects the plaintiff by ensuring that his attorney does not have a monetary interest in the lender, which could affect the attorney's judgment in the suit. Moreover, it ensures the lender does not interfere in the suit by prioritizing its financial return over the plaintiff's pursuit of justice.

Finally, any regulation must ensure that a third-party lender does not coerce a plaintiff to share or otherwise gain access to information protected by attorney-client privilege or work-product privilege. Again, jurisdictions that do not regulate this industry provide no protection.[209] And while the Disciplinary Rules of Professional Conduct require attorneys to protect this information, again, there is no enforcement mechanism outside of self-regulation.[210] Whether the sharing of protected information is purposeful or accidental, a plaintiff's rights have still been violated. Regulation should require the mandatory disclosure of third-party lending agreements when the lender's return is tied to the suit's outcome.[211] This disclosure will allow the court to review the agreement and make its own determination as to whether the lender is receiving, or will receive, protected information. Of course, a client has the right to share this information with whomever they so choose. However, by allowing a court an opportunity to review the document, the judge can ensure the attorney adequately informed the plaintiff of his rights and protected confidential information.[212]

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206. *Id.*

207. Soloway, *supra* note 145, at 10 ("Perhaps precipitated by inconsistency across courts, there has also been legislative activity in this area." (citing S. 2815, 115th Cong. § 2 (2018)).

208. *Id.*

209. *See, e.g.*, *Kaplan*, 2015 WL 5730101, at *5 (holding third-party loans are not required to be entered into evidence).

210. TEX. DISCIPLINARY RULES PROF'L CONDUCT R. 1.05.

211. *See* Soloway, *supra* note 145, at 10 ("That bill would require class counsel to 'disclose in writing to the court and all other named parties to the class action the identity of any commercial enterprise . . . that has a right to receive payment that is contingent on the receipt of monetary relief in the class action by settlement, judgment or otherwise.'" (quoting S. 2815, 115th Cong. § 2 (2018)).

212. TEX. DISCIPLINARY RULES PROF'L CONDUCT R. 1.05.

VI. Conclusion

Texas plaintiffs need protection from the consequences of third-party litigation funding agreements. Under legislation requiring the mandatory disclosure of these agreements, courts would determine whether serious ethics rules are followed. Plaintiffs could then enter into these agreements with confidence that should their attorney make a mistake, either purposefully or accidentally, the court will have the power to review and declare the agreement null and void. This review would eliminate the possibilities of lenders taking undue control of the suit, attorneys or lenders creating conflicts of interest and usurping the plaintiffs' interests, or the lenders gaining access to privileged information due to the clients' lack of knowledge or consent.

This is the most basic form of regulation which should be enacted in Texas, but other conditions would increase its efficiency. First, as seen in proposed federal legislation, by narrowing the requirement of discoverability to loans which are tied directly to the suit's outcome, the regulation would refrain from flooding the court with any and all loans a plaintiff uses to fund his suit.[213] Second, in contrast with California's requirement that these loans be disclosed to both the court and opposing party, this legislation could require that a plaintiff disclose his loan solely to the court.[214] Further narrowing this regulation would prevent an opposing party from reviewing the loan that may contain information about the plaintiff's strategy in the case. For example, if a lender requires detailed information about the suit and the plaintiff consents to the disclosure of this information, the plaintiff and his attorney would not want opposing counsel to have automatic access to documents containing trial strategy. This limitation on the disclosure of the loan would still allow a court to review the documents without invading the plaintiff's privacy or giving the opposing counsel the upper hand. Another regulatory option is to mandate disclosure of the agreements in class actions; this would benefit both plaintiffs and defendants.

These are mere examples of how the legislature could narrowly tailor regulations for third-party litigation funding agreements. The legislature could implement these limitations later, but it should mandate the disclosure

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213. Soloway, *supra* note 145, at 10 ("This disclosure requirement is fairly narrow; it excludes TPLF arrangements that do not tie repayment to the outcome of the action." (citing S. 2815, 115th Cong. § 2 (2018)).

214. *See id.* ("That bill would require class counsel to 'disclose in writing to the court *and all other named parties* to the class . . . .'" (emphasis added) (quoting S. 2815, 115th Cong. § 2)).

of third-party loans as soon as possible. This industry is relatively young and growing rapidly. Now is the time to regulate these loans to protect plaintiffs. If state leaders do not act, plaintiffs will continue entering into potentially unethical agreements. The attorneys' hands are tied, as they will either be forced to advise their client to refuse such funding—and therefore be unable to pursue their claim—or to try and regulate the potential harm to the client alone. With this in mind, Texas courts and legislators need to propose and enact a mandatory disclosure for third-party litigation funding loans, as this is the only way to protect plaintiffs from these loans and shift the burden of protection away from attorneys, thereby allowing them to ethically represent their clients.