AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
The Essential Resource for Today's Busy Insolvency Professional

Feature

By Thomas J. Salerno and Jordan A. Kroop[1]

Third-Party Litigation Funding: Where Do We Go Now?

Thomas J. Salerno
Stinson Leonard Street, LLP; Phoenix

Jordan A. Kroop
Perkins Coie LLP Phoenix

Thomas Salerno is a corporate restructuring and bankruptcy partner with Stinson Leonard Street, LLP. Jordan Kroop is a corporate restructuring and bankruptcy partner with Perkins Coie LLP. Both are based in Phoenix and serve on the advisory board of ABI's Southwest Bankruptcy Conference.

*"Where do we go? Where do we go?
Where do we go now?"*[2]

Litigants have long been limited to the standard three alternatives to pursue their civil claims. They can pay a lawyer, win or lose, an hourly fee. When they cannot afford that, they can sometimes persuade a lawyer to take the case *pro bono*. A litigant can also hire counsel on a contingency fee basis, an arrangement under which the lawyer pursues the claim without charge to the client in return for a percentage of the recovery.

Contingency fee arrangements can be famously lucrative for lawyers, particularly in mass tort and securities fraud class action matters.[3] The legal profession addressed the obvious ethical concerns, through ethical rules and guidelines, arising when a lawyer becomes economically invested to the outcome of litigation. Society benefits, as the theory goes, when claimants are given an opportunity to bring their claims — even when they lack personal resources to do so. The integrity of the legal system is protected (again, as the theory goes) because lawyers willing to bet on the outcome of litigation will carefully scrutinize potential claims to ensure that only meritorious claims likely to succeed will be brought.

The last 20 years have brought the world hybrid cars, securitized home mortgages (manipulated by computers and collected, diced, sliced and sold off in tranches to hungry investors), text messaging (without which an entire generation would be rendered mute), Wikipedia, Google, streaming digital music, advanced smartphones (Apple's iPhone launched in 2007) and social media (reconnecting us with all the people from high school we never wanted to see or hear from again).

It also brought the world third-party litigation funding (TPLF), where monied investors will finance litigation for a percentage of the litigation recovery (in gambling parlance, the "rake"). Often sarcastically and inaccurately called "contingency fee on steroids," TPLF is here to stay. An entire industry, awash in sometimes astonishing returns, has arisen and matured. Opposition within the legal profession and legislative bodies has been largely tepid and, to this point, ineffective.

As with other civil litigation, TPLF arises in several contexts in bankruptcy cases. A TPLF provider might already be present in a debtor's debt structure as a pre-petition secured or unsecured creditor where the TPLF provider funded litigation and acquired an interest in litigation proceeds or other assets as a result. Once a bankruptcy case has begun, a chapter 11 debtor in possession (DIP) may obtain TPLF in order to finance mission-critical post-petition litigation. A post-confirmation creditor trust created under a reorganization plan may use TPLF to pursue its claims.

The emergence of TPLF in bankruptcy cases is a relatively new development in the U.S. It has spawned numerous challenges and concerns that continue to develop and evolve in real time. This article focuses on seven areas where TPLF intersects with other legal considerations — and not always neatly: (1) calls for and against additional regulation of TPLF; (2) TPLF providers as possible non-statutory insiders; (3) the potential applicability of nonbankruptcy law restrictions on TPLF; (4) a TPLF provider's standing; (5) fiduciary duty issues

---

1 The opinions expressed herein are those of the the authors and do not necessarily reflect the opinions of their law firms or the publisher.

2 Guns N' Roses, "Sweet Child o' Mine," *Appetite for Destruction* (Geffen Records 1987).

3 One need only look at the spectacular rise and demise of the California-based class action law firm of Milberg Weiss (with the end resulting in prison terms for the firm's four founders) to understand the lure — and risks — of large-dollar contingency fee arrangements. *See* Peter Elkind, "The Fall of America's Meanest Law Firm: Milberg Weiss, the Lawsuit Factory that Took Corporations for $45 Billion, Is in the Feds' Cross Hairs," *Fortune* (Nov. 3, 2006); Martha Graybow, "U.S. Shareholder Lawyer Melvyn Weiss to Plead Guilty," Reuters (March 31, 2006).

related to TPLF; (6) discovery issues related to TPLF; and (7) potential ethical considerations for counsel in TPLF situations. These are rapidly developing areas to be carefully considered and reconsidered.

The "New Game in Town"

Numerous players have entered the TPLF marketplace.[4] Burford Capital, Bentham IMF, Gerchen Keller Capital (acquired in December 2016 by Burford), Therium Group Holdings (which announced a $300 million fund for commercial TPLF in April 2016), Longford Capital Management, Lake Whillans Litigation Finance, Harbour Litigation Funding, Vannin Capital, Pravati Capital, Juridica, Icahn Capital, Argo Partners and TownCenter Partners are just a few examples.

These well-capitalized funds recognize that TPLF returns can be enormous. Burford reported $378 million new investments in TPLF in 2016 (up 83 percent), with total investments in TPLF totaling more than $2 billion.[5] Burford announced a 75 percent increase in after-tax profits for 2016 compared with 2015, and $216 million in cash from investment returns in 2016 (48 percent increase over 2015).[6] These lucrative returns for TPLF providers are not reserved for only the largest funds. An advertisement in the *New York Times* solicits investors for the creation of new funds daily.[7] By one account, it currently represents a $5 billion market in the U.S.[8]

Of course, despite how lucrative TPLF can be, funders do not always win.[9] The fact that TPLF investments do not always pay off has not prevented TPLF's critics from portraying it as predatory and unseemly — undisclosed third-party financiers harassing litigants and corrupting the legal process. Whether real-world evidence supports this jaundiced view of TPLF is an open question, and much of the anecdotally based opinions about TPLF depend on the perspective of those forming those opinions. For its part, the TPLF industry is masterful at churning out positive press.[10]

The TPLF industry markets itself aggressively to law firms (which the industry correctly perceives as its most likely referral source) as a way to solve cash-cycle woes.[11] TPLF has emerged as big business with the potential for huge upside. Whether TPLF is the savior of underdog litigation for those without resources to protect and prosecute rights and claims, or "contingency fees on steroids," it has become commonplace in civil litigation and an increasingly common dynamic in the bankruptcy arena.

Brief Historical Context

Although TPLF is a relatively new concept in the U.S., having originated in Australia about 10 years ago, its underpinnings are not new. TPLF is essentially based on the same types of legal relationships addressed by old English legal principles of champerty and maintenance. But there is no need to blow the dust off your *Black's Law Dictionary*; "maintenance" essentially refers to the practice of generally assisting another in litigating a lawsuit. "Champerty" is a specific form of maintenance; it is maintaining a lawsuit in exchange for a financial interest in settlement or judgment of the suit.

Old English law prohibited maintenance and champerty because the practices were thought to encourage fraudulent or baseless litigation.[12] Owing to the old English prohibition, some U.S. states still prohibit or materially limit champerty (*e.g.*, Alabama, Colorado, Kentucky, Mississippi, North Carolina, Minnesota, New York and Pennsylvania), while others allow it with some restrictions (*e.g.*, Florida, Indiana, Ohio, New Jersey, Tennessee and Texas).[13]

Nonetheless, other courts have recognized certain social benefits of TPLF. Litigation funding "allows lawsuits to

4 *See, e.g.*, Henry Meier, "Litigation Costs Go Third Party," *Los Angeles Business Journal* (July 4, 2016) ("[TPLF] industry growth has been rapid."); Amy G. Pasacreta, "United States: Litigation Finance: A Brief History of a Growing Industry," Mondaq (April 4, 2016) ("[TPLF] firms now invest about $1 billion a year, and the industry seems to be growing.").

5 *See* Paul Barrett, "The Business of Litigation Financing Is Booming," *Bloomberg Businessweek* (May 30, 2017). It also should come as no surprise that "mainstream financial institutions" will likely enter this field. *See* Jay Greenberg and Max Volsky, "Litigation Finance Trends to Watch in 2018," *Law360* (Jan. 4, 2018) ("On the investor side, as litigation finance evolves into a mainstream asset class, diversified investment managers will look to add litigation finance exposure to their portfolios. The industry, therefore, is expected to attract a more mainstream audience as established financial institutions and large multi-strategy asset managers alike continue to look for entry points in the litigation finance market.").

6 *See* Victor Li, "Litigation Funder Burford Had 75% Profit Increase in 2016 — and Thinks This Year Could Be Bigger," *ABA Journal* (March 15, 2017). Burford is a public company, and with returns like this, it is only a matter of time before the same people who brought securitized mortgage securities to the investing market will find ways to offer securitized litigation recoveries for every pension plan. On the plus side, interest in the judicial system will skyrocket as investors will demand that trials be televised so they can monitor their investments like a gambler watches a football game he wagered on. Judges will need to pause the proceedings for television timeouts. *See also* Adam Rhodes, "Litigation Financing Co. Closes Second Fund at $500M," *Law360* (Sept. 18, 2017) (reporting on new $500 million TPLF fund by Longford Capital Fund II LLP); Andrew Strickler, "Why Investors Are Taking the Leap to Third-Party Funding," *Law360* (Dec. 11, 2017) ("There have been [TPLF] failures, yes, but there is clearly evidence of significant earnings over time and generally really impressive returns.... We think there is significant runway for additional deployment of capital.").

7 From p. 3 of the Dec. 11, 2017, national edition of the *Times*: "PRIVATE BRIDGE FUNDING WANTED Private bridge funding and litigation funds wanted for large commercial, consumer and civil rights matters. All amounts considered. NDA-POF. Major results mentioned in Fortune Forbes Bloomberg Financial Times, etc. Principals only." The advertisement ends with the obligatory toll-free phone number.

8 *See* Kevin LaCroix, "The Latest on Third-Party Litigation Financing," *The D&O Diary* (Jan. 15, 2018).

9 *See, e.g.*, Natalie Rodriguez, "Going Mainstream: Has Litigation Finance Shed Its Stigma?," *Law360* (Dec. 12, 2017) ("And as the presence of litigation funding has grown, so have incidents where judges or other counsel have questioned its role — and effect — on a case, which recently occurred in a National Football League concussion lawsuit. On Friday, a Pennsylvania federal judge barred a host of funders from getting their proposed cut of the suit's more than $1 billion settlement. The judge found that the settlement language barred any funding deals and noted that the players are cognitively impaired. The funders had argued that the arrangements were forthright and did not hurt the players' interests. 'Third-party litigation financing puts investors' interests ahead of the plaintiffs,' incentivizes questionable lawsuits and threatens the integrity of our civil justice system,' said Lisa Rickard, president of the U.S. Chamber of Commerce's Institute for Legal Reform, a longtime opponent of litigation funding.").

10 Burford even puts out an annual Litigation Finance Research Whitepaper so all the statistics are easy to access. *See, e.g.*, 2017 Litigation Finance Survey: Litigation Research Shows Continued Strong Growth, Burford Capital Publication (2017), *available at* burfordcapital.com/2017-litigation-finance-survey (unless otherwise specified, all links in this article were last visited on Jan. 30, 2018).

11 *See* Travis Lenkner, "The Role Legal Finance Can Play in Firm Year-End Collections," *Law360* (Sept. 21, 2017). Lenkner is a managing director of Burford in Chicago. *See also* Sam Reisman, "Burford Clinches Portfolio Funding Deal with U.K. Firm," *Law360* (July 31, 2017); Aviva Will, "Law Firm Economics: Comparing the Costs of Self Finance vs. Outside Finance," Burford Capital Publication (Nov. 16, 2017); Cristina Violante, "What Your Colleagues Think of Litigation Finance," *Law360* (Dec. 11, 2017) (approximately "86 percent lawyers that have used [TPLF] view it favorably!"; and "[TPLF] is no longer solely used for impecunious clients ... it's a corporate finance tool"). Rodriguez adds, "some lawyers are wary of how much say a funder gets in a law firm's operations as relationships deepen." Maya Steinitz, a University of Iowa Law School professor who has studied the TPLF industry, says, "The big concern ... is control — that funders are looking over [lawyers'] shoulders, providing input that the lawyers don't necessarily welcome or agree with.... This is viewed as interfering with how lawyers are doing their job." *See* Maya Steinitz, "The Litigation Finance Contract," 54 *Wm. & Mary L. Rev.* 455, 457 (2012).

12 Of course, some argue that, but for baseless litigation, many lawyers would have no work at all, and our beloved "adversarial system" is at least somewhat fairly characterized by the notion that out of the clash of lies truth will emerge. Canada appears unfriendly to TPLF. *See, e.g.*, Andrew Strickler, "Rebuke of Bentham Deal May Chill Canada Class Suit Funding," *Law360* (Sept. 18, 2017) ("A recent decision by a Toronto judge throwing cold water on a third-party funding deal from Bentham IMF for plaintiffs in a medical device case may severely hamper interest from commercial funders in backing future Canadian class actions, experts say. In August, Ontario Superior Court Judge Paul M. Perell, one of just two jurists who oversee class actions in the country's foremost financial and business hub, called for significant changes to an 'uncapped' deal between international litigation funder Bentham and a couple suing over allegedly faulty heart implants, finding that an open-ended termination provision would allow Bentham 'to control whether and how this litigation will proceed.' While a challenge from the plaintiffs is already in the works, the August ruling invites strict court limits on returns for commercial investors and will likely set a precedent for tight control over deals deemed too favorable to investors, according to experts.").

13 *See* Risto Pribisich, "Maintenance, Champerty and Usury: Ethical Issues Of Alternative Litigation Financing," ABA Presentation (2015); John Beisner and Jordan Schwartz, "How Litigation Funding Is Bringing Champerty Back to Life," *Law360* (Jan. 20, 2017) (discussing two cases that invalidated TPLF agreements based on, among other things, concepts of champerty); Michael McDonald, "The Best And Worst States for Litigation Finance (Parts I and II)," *Above the Law* (June 28 and July 11, 2017); *see also Justinian Capital SPC v. WestLB AG*, 65 N.E.3d 1253 (N.Y. 2016) (New York Court of Appeals invalidated TPLF agreement on basis that it violated champerty restrictions under Judiciary Law § 489(1)); *Frank v. TeWinkle*, 45 A.3d 434, 438 (Pa. Super. 2012) (stating that "champerty remains a viable defense in Pennsylvania"); *Maslowski v. Prospect Funding Partners LLC*, 2017 Minn. App. LEXIS 26 (Minn. Ct. App. Feb. 13, 2017) (court refusing to enforce New York forum-selection clause on litigation to enforce TPLF agreement based on public policy and Minnesota's prohibition on champerty).

be decided on their merits, and not based on which party has deeper pockets or stronger appetite for protracted litigation."[14] A federal court in Illinois held that "[w]here a defendant enjoys substantial economic superiority, it can, if it chooses, embark on a scorched earth policy and overwhelm its opponent.... But even where a case is not conducted with an ulterior purpose, the costs inherent in major litigation can be crippling, and a plaintiff, lacking the resources to sustain a long fight, may be forced to abandon the case or settle on distinctly disadvantageous terms."[15]

In addition, as a New York state trial court held, "Modern litigation is expensive, and deep-pocketed wrongdoers can deter lawsuits from being filed if a plaintiff has no means of financing her or his case. Permitting investors to fund firms by lending money secured by the firm's accounts receivable helps provide victims their day in court."[16] According to a Florida-based U.S. bankruptcy court, "without litigation funders, parties owed money, or otherwise stymied by deep-pocketed judgment debtors, might have reduced or no ability to pursue their claims. Litigation funders may be essential to the provision of legal advice in such cases."[17]

The Financially Distressed Litigant

TPLF thrives in a milieu where the high cost of war-of-attrition-style litigation (which might have material monetary benefits if won) must be bourne by financially strapped litigants.[18] Innovative ways to finance (and financially benefit from) such high-risk, high-reward litigation has spawned the development of an ever-growing TPLF industry. Where best to find financially distressed litigants than the bankruptcy arena, where they are as common as sick people in a hospital?[19] Given the realities of bankruptcy cases, bankruptcy trustees, DIPs and litigation trustees increasingly focus on opportunities provided and issues raised by TPLF.

A highly publicized case in point was *In re Magnesium Corp. of America* (*MagCorp*).[20] In September 2016, MagCorp trustee **Lee Buchwald** auctioned off the rights to receive $50 million of a $213 million judgment in favor of the estate (obtained after 13 years of hard-fought litigation) against billionaire Ira Rennert (MagCorp's former majority shareholder) and the Renco Group based on fraudulent transfers and other theories.[21] The judgment was on appeal to the Second Circuit at the time of the auction. The buyer at the auction was Gerchen Keller Capital, which paid $26.2 million and has since been acquired by Burford.[22]

The auction and sale process received objections from both Rennert (who offered to "buy" the judgment against himself for $45 million, payable even if he lost the appeal, and $100 million if the trustee prevailed on appeal), as well as Jeffries LLC (MagCorp's largest noteholder) based on what it asserted were inadequate disclosures by the trustee. Despite the Rennert offer being higher than the Gerchen bid, the trustee voiced concerns about whether Rennert could fund the bid.

The bankruptcy court (Hon. **Mary Kay Vyskocil**) approved the sale to Gerchen in September 2016. The judgment was ultimately upheld on appeal in March 2017, making the recovery to Gerchen approximately $24 million over what it paid for the portion of the judgment (or about a 92 percent return on a seven-month investment).[23] Everyone other than the judgment debtor was happy with the results.[24] The trustee and estate professionals were paid (always good news),[25] and the TPLF funding source made a healthy return on its short-term investment, all in a highly publicized chapter 11 case.[26]

While proponents of TPLF hail the *MagCorp* result as a blanket acceptance of TPLF in bankruptcy cases ("blessing with a capital B"), in reality it is not that broad. The TPLF provider in that case did no more than purchase a portion of the litigation claim. In essence, the transaction was really a sale of an asset under § 363 of the Bankruptcy Code, although the trustee went to great lengths to avoid characterizing it as such for obvious reasons: The "sale" of an asset for $26 million that seven months later would turn out to be $50 million was not the best business deal, at least in hindsight. In *MagCorp*, the TPLF did not control the litigation after acquiring the stake in the judgment — a point that the trustee emphasized.[27]

Call for Regulation

Publicity is a double-edged sword: It has the potential to create both positive and negative backlash. The MagCorp

14 *Lawsuit Funding LLC v. Lessoff*, Index No. 650757/2012, 2013 WL 6409971, at *6 (N.Y. Sup. Dec. 9, 2013).

15 *Miller UK Ltd. v. Caterpillar Inc.*, 17 F. Supp. 3d 711, 718 (N.D. Ill. 2014).

16 *Hamilton Capital VII LLC I v. Khorrami LLP*, No. 650791/2015, 2015 WL 4920281 at *5 (N.Y. Sup. Aug. 17, 2015).

17 *In re Int'l Oil Trading Co. LLC*, 548 B.R. 825, 835 (Bankr. S.D. Fla. 2016). California is not as restrictive. *See, e.g., Del Webb Communities Inc. v. Partington*, 652 F.3d 1145, 1156 (9th Cir. 2011) ("'Champerty' generally refers to an agreement in which a person without interest in another's litigation undertakes to carry on the litigation at his own expense, in whole or in part, in consideration of receiving, in the event of success, a part of the proceeds of the litigation.... The consistent trend across the country is toward limiting, not expanding, champerty's reach.") (citations and internal quotation marks omitted); *Abbott Ford Inc. v. Superior Court*, 43 Cal. 3d 858, 885, n.26 (Cal. 1987) ("California ... has never adopted the common law doctrines of champerty and maintenance"); *Pac. Gas & Elec. Co. v. Bear Stearns & Co.*, 791 P.2d 587 (1990) ("In fact we have no public policy against the funding of litigation by outsiders.... Our legal system is based on the idea that it is better for citizens to resolve their differences in court than to resort to self-help or force. It is repugnant to this basic philosophy to make it a tort to induce potentially meritorious litigation.").

18 It is axiomatic that absent the ability to print money (like the U.S. government does) or access to substantial insurance backing, litigation can be and often is hugely expensive. As a practical matter, all litigants might be deemed to be financially strapped to some degree.

19 *See, e.g.*, Alison Frankel, "Litigation Funding in Bankruptcy 'Should Be in Every Trustee's Toolkit,'" Reuters (March 14, 2017); *see also* Michael McDonald, "The Value of Middle-Market Litigation Finance," *Above the Law* (May 2, 2017) (defining middle-market litigation as involving between $500,000 to a "few million" in damages); Order Authorizing and Approving Litigation Funding Agreement, *In re Tropicana Entm't LLC*, Case No. 08-10865 (Bankr. D. Del. Jan. 20, 2017).

20 Case No. 01-14312-MKV (Bankr. S.D.N.Y. Aug. 2, 2001).

21 The trustee alleged that Rennert siphoned money from MagCorp in order to build a 43,000-square-foot mansion in the Hamptons valued at more than $200 million. *See* Daniel Fisher, "Billionaire Rennert's Loss Is a Quick Double for Litigation Finance Firm Burford," *Forbes* (March 8, 2017).

22 *See* Ryan Boysen, "Renco Loses Challenge to Trustee's Sale of $26.2M Stake," *Law360* (July 19, 2017); Roy Strom, "Litigation Funder Burford Poised to Cash In from First-Ever Bankruptcy Deal," *American Lawyer* (March 13, 2017) (Burford acquired Chicago-based Gerchen for $160 million in December 2016); Julie Triedman, "Topping $1 Billion Mark, Big Litigation Funder Gets Bigger," *Am Law Daily* (Jan. 6, 2016), *available at* americanlawyer.com/id=1202746351295/Topping-1-Billion-Mark-Big-Litigation-Funder-Gets-Bigger?slreturn=20160006110304; "Burford Acquires Gerchen Keller: What Is Going On?," Fulbrook Capital Management LLC (Dec. 20, 2016), *available at* fulbrookmanagement.com/burford-acquires-gerchen-keller-what-is-going-on.

23 *See* "MagCorp Bankruptcy Trustee on Litigation Finance: 'The Only Limits Are Your Imagination,'" Burford Capital Press Release (May 1, 2017); Daniel Fisher, "Billionaire Rennert's Loss Is a Quick Double for Litigation Finance Firm Burford," *Forbes* (March 8, 2017). In fairness to the *MagCorp* trustee, he had been involved in ugly litigation with Rennert for five years after the *MagCorp* bankruptcy filing in 2001. Getting cash to exit the bankruptcy (and pay administrative expenses) was undoubtedly a highly attractive option for him, his professionals and the estate.

24 Clearly, the judgment debtors (and their lawyers) were less than thrilled. The judgment debtor was upset enough that they sued their attorneys for malpractice for allegedly bungling the case. *See* Emma Cueto, "Renco Sues Ex-Kaye Scholer Attorneys Over $214M Verdict," *Law360* (Jan. 9, 2018). Litigation begets litigation, which begets litigation....

25 Including the contingency fee lawyers, who obtained their 40 percent contingency fee award (amounting to almost $90 million) even after objection by the same parties that objected to the third-party litigation financing part of the deal. *See* Cara Salvatore, "Beus Gilbert Granted $88M Fee Request for RenCo Suit Win," *Law360* (Jan. 31, 2018) (bankruptcy court overruled objections by noteholders who asserted that Beus Gilbert retention was not a true contingency fee retention approved under § 328(a), but rather a traditional hourly rate retention subject to review for reasonableness).

26 *See, e.g.*, Alison Frankel, "Litigation Funding in Bankruptcy 'Should Be in Every Trustee's Toolkit,'" Reuters (March 14, 2017) ("Travis Lenkner of Burford, who was on the Gerchen Keller team that made the MagCorp investment, told me [that] Judge [Mary Kay] Vyskocil's 'blessing with a capital B' should open the way for other bankruptcy trustees to work with litigation financiers — a concept he's pushing with trustees and their lawyers.").

dynamic proved this axiom. TPLF has great rewards for the funder, and attendant great risks as well. In this simple sense, TPLF can fairly be seen as a gamble.

In *MagCorp*, the huge return — and the short period between the investment and the return (to the ostensible detriment of unpaid creditors) — has resulted in gushing commentary praising TPLF in bankruptcy cases and has renewed more fervent calls to regulate the TPLF industry, including a letter from numerous groups to the Secretary of the Committee on Rules of Practice and Procedure of the U.S. Courts (the "Chambers Letter") seeking amendments to Fed. R. Civ. P. 26(a)(1)(A) to require, among other things, full and complete disclosure of all TPLF details in federal court litigation (similar to the required disclosure of liability insurance).[28] One commentator argued:

> While reasonable minds can disagree on the propriety of TPLF in the abstract, there is a growing consensus that these arrangements should, at the very least, be disclosed. And for good reason. Informing the court and all parties of the usage of TPLF at the beginning of a civil case will allow the stakeholders in the litigation to nip conflicts of interest in the bud and more effectively monitor and avoid potential ethical violations during the course of the litigation.[29]

According to one report:

> In one of the first federal decisions addressing questions of confidentiality of third-party funders in class actions, a California judge ruled in August 2016 that the plaintiffs' attorneys had to disclose who was funding their $1.5 billion proposed class action against Chevron Corp. over a deadly 2012 natural gas rig explosion off the coast of Nigeria.... [T]he U.S. District Court for the Northern District of California said Chevron had the right to find out who was funding the lawsuit so that it could assess whether the attorneys bringing the case would adequately represent a proposed class of 12,600 people who were allegedly harmed by the explosion and resulting fire.[30]

Material reforms have yet to take hold:

> No comprehensive regulation of the litigation finance industry exists in the U.S., leaving a mostly open playing field for third-party funders. But experts say this is likely to change as the market continues to grow and attract more attention from regulators and courts. Proposed federal legislation and suggested changes to the Federal Rules of Civil Procedure threaten to make disclosure of third-party funding contracts mandatory. But there are other issues being targeted for regulation as well, such as whether communications between funders and clients are privileged, and whether third-party finance is a loan subject to usury laws.[31]

Not surprisingly, proponents of TPLF decry any such regulation, asserting that regulation is both unnecessary and unduly burdensome.[32] In a Sept. 6, 2017, letter from Bentham IMF responding to the Chambers Letter, Bentham IMF argued:

> The Chamber's radical proposal to invade parties' financial privacy and their attorneys' work product is inconsistent with the underlying purpose of the federal rules "to secure the just, speedy, and inexpensive determination of every action".… The Chamber attempts to tag litigation funding with "problems" that largely either do not exist, or are in truth, benefits. "Frivolous litigation" is the Chamber's principal whipping boy. Nothing suggests that litigation funding causes cases of little or no merit to be filed in federal court, or that the Chamber's automatic disclosure proposal would head off such filings.
>
> Litigation funding ... encourages careful assessment of litigation prospects and costs — the antithesis of "frivolous litigation" — and therefore *discourages* frivolous litigation and *promotes* fair settlements, both in theory and in practice.... Litigation funding represents only one of many ongoing developments in the evolution of litigation and dispute resolution. These developments include increased reliance on technology to perform tasks that formerly only lawyers performed, increased use of private resources in resolving disputes, increased control of litigation by the parties themselves, and increased focus on the resource constraints for litigation. These developments are largely beneficial. The Chamber's proposal is an ill-disguised attempt to thwart perhaps the most significant and salutary of them all, namely litigation funding, and we urge the committee to reject it.[33]

---

27 *See* Memorandum of Chapter 7 Trustee in Opposition to the Emergency Motion of Ad Hoc Consortium of Noteholders of Renco Metals Inc. for Stay Pending Appeal of Order Approving Sale of Renco Litigation Interest, filed on Sept. 7, 2016, in *Ad Hoc Consortium of Noteholders of Renco Metals Inc. v. Buchwald*, Civil Action No. 16-cv-06844 (UA) (S.D.N.Y.) (Dkt. 9), in which the trustee stated at p. 18:

> The Trustee wants to make it clear: he is NOT selling the avoidance action against the Defendants, or even a portion of the Amended Judgment against Renco, or any of the Trustee's rights to prosecute the Renco Group Litigation. Rather, the Trustee is selling to [Funder] the right to receive a portion of the net proceeds of the amounts the Trustee recovers with respect to the Amended Judgment. [Funder] will only be entitled to receive the portion of net proceeds after a successful appeal of the Amended Judgment or a settlement of the Renco Group Litigation. [Funder] has absolutely no control or input on the Trustee's prosecution of the Renco Group Litigation, his appeal of the Amended Judgment, or settlement discussions with the Renco Group Defendants.

28 The Chambers Letter was sent by the following groups: U.S. Chamber Institute for Legal Reform, the Advanced Medical Technology Association, the American Insurance Association, the American Tort Reform Association, the Association of Defense Trial Attorneys, DRI — The Voice of the Defense Bar, the Federation of Defense and Corporate Counsel, the Financial Services Roundtable, the Insurance Information Institute, the International Association of Defense Counsel, Lawyers for Civil Justice, the National Association of Mutual Insurance Companies, the National Association of Wholesaler-Distributors, the National Retail Federation, the Pharmaceutical Research and Manufacturers of America, the Product Liability Advisory Council, the Property Casualty Insurers Association of America, the Small Business and Entrepreneurship Council, the U.S. Chamber of Commerce, the Michigan Chamber of Commerce, the State Chamber of Oklahoma, the Pennsylvania Chamber of Business and Industry, the South Carolina Chamber of Commerce, the Virginia Chamber of Commerce, Wisconsin Manufacturers and Commerce, the Las Vegas Metro Chamber of Commerce, the Florida Justice Reform Institute, the Louisiana Lawsuit Abuse Watch, the South Carolina Civil Justice Coalition and the Texas Civil Justice League. *See* Letter Dated June 1, 2017, *available at* instituteforlegalreform.com/uploads/sites/1/Proposal_to_Amend_Rule_26_for_Third-Party_Litigation_Funding_Disclosure.pdf.

29 John H. Beisner, "Shine a Light on 3rd-Party Litigation Funding," *Law360* (Dec. 11, 2017).

30 Erin Coe, "Judges Search for Balance on Disclosing Litigation Finance," *Law360* (Dec. 11, 2017) ("In contrast, the U.S. District Court for the Southern District of New York in September 2015 denied a bid to compel class action plaintiffs to disclose details on a funding deal, finding that the defendant failed to show the requested information was relevant to its claims or defenses. In *Kaplan v. SAC Capital Advisors LP*, Magistrate Judge Kevin Nathaniel Fox held that when plaintiffs admit they are part of a litigation funding deal that does not, by itself, 'constitute a basis for questioning counsel's ability to fund the litigation adequately.' His ruling was later upheld by the federal judge overseeing the case. 'Requests for discovery of funding agreements have been denied in New York, while California has taken a completely 180-degree view, finding that [the defendants] are entitled to all information with respect to funding agreements, especially in the class action scenario,' said Glen Waldman, comanaging partner at Waldman Barnett PL in Florida.").

31 Cristina Violante, "Regulating Litigation Finance, at Home and Abroad," *Law360* (Dec. 5, 2017); *see also* "Third-Party Litigation Funding in U.S. Enters Mainstream, Leading to Calls for Reform," *Financier Worldwide* (November 2016); Victoria Sahani, "Harmonizing Third-Party Litigation Funding Regulation," 36 *Cardozo L. R.* 861 (2015).

32 *See, e.g.*, Sam Reisman, "Critics Pushing Back on Third-Party Funding Disclosure Rule," *Law360* (June 21, 2017); Allison Chock, Matthew Harrison and Priya Pai, "Big Business Lobby Tries to Hobble Litigation Finance, Again," *Law360* (June 6, 2017) ("The Chamber raises several supposed concerns about litigation finance to justify its overbroad proposed rule, which is rather obviously meant to reveal a plaintiff's ability to withstand protracted litigation.").

33 *See* "Bentham Urges Rules Committee to Reject Chamber's Proposed New Requirement For Federal Cases," Bentham (Oct. 12, 2017), *available at* benthamimf.com/news/bentham-publications.

Specific Issues Related to TPLF in Bankruptcy Cases

Bankruptcy cases (and litigation arising in those cases) can create unique challenges. Economics aside, serving as an example are settlements of bankruptcy-related litigation. These litigation matters are quintessentially public affairs: Terms, conditions, economics and the like are all approved by the bankruptcy court after a notice to all the constituencies in the case.

The reason is simple and obvious: bankruptcy litigation is almost always "trust fund" litigation in that it is being pursued by a fiduciary for the benefit of a group of creditors (much like class-action cases). This unique dynamic also creates some interesting challenges that present themselves in a more immediate and vivid fashion than in nonbankruptcy litigation. The authors do not pretend to have the answers to these sometimes thorny issues, but identifying them can be part of the resolution process.

TPLF as an "Insider"?

In a situation where a TPLF is in place before the bankruptcy case begins, and given the possibility of an extremely close connection between the TPLF source and the debtor (access to confidential information, control over the financed litigation, communications with counsel and similar dynamics), should the TPLF be considered a non-statutory insider as someone in control of the debtor-plaintiff?[34] This is certainly a possibility for parties looking to either challenge a lien or claim of a TPLF in bankruptcy cases.

According to the Chambers Letter, "Bentham's own 2017 'best practices' guide contemplates robust control by funders. Specifically, it notes the importance of setting forth specific terms in litigation funding agreements that address the extent to which the TPLF entity is permitted to '[m]anage a litigant's litigation expenses,' '[r]eceive notice of and provide input on any settlement demand and/or offer, and any response' and participate in settlement decisions."[35] It is easily understood from the TPLF provider's perspective why such control is needed — is it so unreasonable to want to manage an enormous investment of this type? — but the ethical and legal overlay makes this particular "investment" considerably more peculiar than the usual cookie-cutter deal to be managed.

Understandably, prudent TPLF providers will perform substantial due diligence before deciding to fund any litigation. This will involve the exchange of material, presumably non-public (and possibly proprietary) information.[36] While nondisclosure and similar agreements would be common in such a due-diligence process, once the TPLF provider decides to fund (and then does so), it is undeniable that it has gained extraordinary access to information and a level of control that no noninsider would ever have.

The peculiar relationship between a TPLF provider and the funded litigant (and its counsel) raises important questions about the scope of the attorney/client privilege. For example, at least one court has held that a TPLF provider's communications with its funded plaintiff's counsel are protected by the attorney/client privilege and attorney work-product doctrine.[37]

If a TPLF provider is also characterized as a nonstatutory insider, the legal implications are numerous. A TPLF's claim could be subject to potential equitable subordination, recharacterization as equity, or equitable disallowance. Transactions with the TPLF provider could be subject to the longer look-back periods for preference and fraudulent transfer as would be applicable to insiders. Certainly, a debtor-plaintiff's transactions with the TPLF provider, especially if the provider is regarded as a nonstatutory insider, invites increased scrutiny.

It is possible that a TPLF provider found to be a nonstatutory insider can "cleanse" itself of that status by transferring the claim to a transferee who takes the claim free of that nonstatutory insider status. For example, one Ninth Circuit decision held (in an analogous situation not involving TPLF) that a claim of an insider, transferred to a noninsider, sheds its characteristic of an insider claim for plan-voting purposes.[38]

Such attempts at "cleansing" might meet considerable opposition from other parties in a bankruptcy case. Because TPLF involves cases featuring large potential economic recoveries and high-stakes contentious litigation, it should come as no surprise that the "gloves come off" when these cases are pursued. TPLF is not for the faint of heart. The economic power that TPLF providers have, especially given that plaintiffs need such funding expeditiously, can and often does lead to decidedly hardball tactics.

Epicenter Partners provides a cogent example of these dynamics.[39] Hon. **Madeleine C. Wanslee** held that a secured claim initially held by Burford, but sold prebankruptcy to a subsequent unrelated transferee, was "cleansed" by a transfer to the noninsider, relying on *Village of Lakeridge*. Interestingly, the claim purchaser (CPF Vaseo Associates LLC) purchased two claims (secured by first and second liens on the estate's principal real estate asset). The first was the Burford TPLF claim, in first position. The second was a claim of the prior litigation counsel (Simpson Thatcher Bartlett) for unpaid legal fees, secured by a second lien on the assets.

The Epicenter adversary was filed to characterize the claims as insider claims and equitably subordinate and disallow the two secured claims, then held by CPF. The court dismissed the claim, seeking to characterize (and subordinate) the CPF claim related to the prior Burford TPLF claim, but did not do so as to the Simpson Thatcher secured claim that essentially arose from the same prebankruptcy litigation. (Arizona has no champerty, maintenance or other

34 The concept of non-statutory insiders (as opposed to statutorily defined insiders) is well-accepted. *See, e.g., In re The Village at Lakeridge LLC*, 814 F.3d 993 (9th Cir. 2016); *see also* "A *Sui Generis* Approach to 'Insider' Status in Bankruptcy," *Chapman Insights* (Feb. 18, 2016).

35 Chambers Letter at 16-17. Bentham denied that it seeks or exercises control over litigation.

36 *See, e.g.*, Eva Shang, "The Future of Litigation Finance Is Analytics," *Law360* (July 17, 2017) (discussing "the moneyball effect in litigation finance").

37 *See In re Int'l Oil Trading Co. LLC*, 548 B.R. 825, 838 (Bankr. S.D. Fla. 2016) (litigation in which Burford was TPLF provider); *see also* Ian Innes, "Litigation Funding: Key Considerations," *Global Insolvency & Restructuring* (March 21, 2017) ("INSOL Article").

38 *In re The Village at Lakeridge LLC*, 814 F.3d 993, 1002-03 (9th Cir. 2016). The U.S. Supreme Court has granted *certiorari* and recently heard oral arguments on this case.

39 *See* First Amended Complaint (Fraudulent Transfers; Equitable Subordination; Recharacterization; Objection to Claims) filed Nov. 28, 2016, *In re Epicenter Partners LLC*, Case No. 2:16-bk-05493-MCW, Adv. P. No. 2:16-ap-00334-MCW, (Bankr. D. Ariz.) [Docket No. 59] ("Epicenter Adversary"), involving the history of the initial TPLF by Burford (the "Epicenter Complaint"). The Epicenter Complaint against the transferee of Burford's claim was subsequently dismissed. *See* Memorandum Decision Granting in Part and Denying in Part Defendant's Motion to Dismiss Adversary Complaint dated June 2, 2017, Epicenter Adversary (the "Epicenter Memorandum Decision"). The entire adversary proceeding was initially maintained under seal due to confidentiality provisions in the original TPLF documents. Judge Wanslee subsequently unsealed the file. *See* Order Granting Motion to Unseal Adversary, No. 2:16-AP-00334 at Docket No. 229 (Bankr. D. Ariz. Nov. 21, 2016).

law regarding the ultimate enforceability of TPLF claims.) However, not all courts allow a TPLF claim to be cleansed in this way.[40]

Potentially Applicable Nonbankruptcy Law Restrictions

While disputes have arisen and will continue to arise in bankruptcy cases and, therefore, necessarily involve an important federal bankruptcy law component, there is also a material nonbankruptcy law layer that cannot be ignored. Whether TPLF claims are enforceable in bankruptcy must be determined with reference to nonbankruptcy law.[41]

Designline involved a post-confirmation TPLF situation. The bankruptcy judge declined to approve a TPLF by a post-petition litigation trust (the existing lawyers did not wish to continue in the case on a contingency basis) on the grounds that, among others, such arrangements violated North Carolina's law prohibiting champerty. The judge also expressed concern about the control that the TPLF would have over the litigation process.

Other nonbankruptcy law issues pertain here as well. Because TPLF is essentially a type of lending arrangement, does TPLF implicate state mortgage banking laws? For example, certain states require that loans over a certain amount be made by lenders who register or otherwise are authorized by state regulators. Does TPLF implicate state usury laws?[42] When analyzing the legality of TPLF arrangements (at least pre-petition arrangements), what applicable nonbankruptcy law would control? For example, in the *Epicenter* adversary, the TPLF arrangement provided that the U.K. law would apply. Would such provisions be enforceable in bankruptcy litigation?

There are yet more questions. Many TPLF agreements mandate binding arbitration of disputes. Are these provisions enforceable in bankruptcy cases? Likely not.[43] Even with respect to post-petition TPLF, a binding arbitration clause might not be enforceable.[44] Precisely who has standing to seek approval of post-petition TPLF arrangements? If a DIP refuses to bring litigation claims (and seek TPLF resources), can an official committee obtain TPLF (at least in states where such arrangements are otherwise legal)? Probably not (at least in the Ninth Circuit).[45]

In the *Blue Earth* case, the official creditors' committee sought to obtain TPLF from Bentham in order to fund investigations and legal fees related to certain transactions over the debtor's objection.[46] The bankruptcy judge issued a tentative ruling on the committee's motion on the basis that, among other things, the TPLF was post-petition financing that only the DIP could legally seek.[47] After this tentative ruling, the committee abandoned its efforts.

Fiduciary Duty Issues

At its core, TPLF is either a sale of a cause of action (and its potential proceeds) or an unconventional form of DIP financing,[48] but rather than being secured by tangible assets, it is secured by the proceeds of the litigation being financed.[49] Related to all these issues, especially with post-petition TPLF and as underscored in the *Blue Earth* situation, is the issue of who controls the litigation and directs counsel once the TPLF is in place.

DIPs and trustees are fiduciaries, but terms of certain TPLF agreements give control and discretion to the funder (perhaps understandably, given the risk, uncertainty and cost of litigation). Thus, a tension exists between a TPLF provider's desire for control and the estate fiduciary's inability to abandon or even delegate its fiduciary duties.[50] Because TPLF is a relatively new, unregulated form of post-petition financing, in most cases with huge potential costs associated with it, the TPLF's control over the subsequent funded litigation could be viewed as a delegation of the estate's fiduciary duties.

On a related note, if the funded litigation takes an ugly turn and sanctions are assessed, who pays them? If the TPLF provider is controlling the litigation, should it not also bear the burden on sanctions? While not yet specifically addressed in a bankruptcy case, such a situation has arisen in the U.K. (where TPLF is common). In one case, an English court held that the TPLF source was liable, jointly and severally with the litigants, for the costs of litigation on indemnity if the litigation was unsuccessful and fees and costs were awarded.[51]

Discovery Issues Related to TPLF

A hallmark of litigation in the U.S. is the pervasive and extensive discovery rights afforded litigants. In situations where TPLF becomes a factor, there are two areas where this becomes potentially problematic.

40 *See, e.g., In re Enron Corp.*, 379 B.R. 425 (S.D.N.Y. 2007) (holding transferee of insider claim might still be subject to equitable subordination-type claims that could have been brought against the insider-transferor); *In re KB Toys Inc.*, 470 B.R. 331 (Bankr. D. Del. 2012), *aff'd*, 736 F.3d 247 (3d Cir. 2013) (transferees take subject to claims/defenses assertable against transferor).

41 *See, e.g., In re Designline Corp.*, 565 B.R. 341 (Bankr. W.D.N.C. 2017).

42 A class action lawsuit was filed in Florida against Certified Legal Funding in December 2017 to determine whether TPLF funding (in that case, a loan of approximately $10,000 for a lawsuit, and charging what amounted to an effective 51 percent interest rate for a six-month period, plus a $600 processing fee and a $345 origination fee) is a "loan" under applicable state law and, therefore, subject to a state's usury and other laws. *See* Angela Underwood, "Lawsuit Could Determine if Companies Funding Litigation Are Violating Florida Interest Rate Laws," *Legal News Online* (Jan. 25, 2018) (action brought under Florida's Deceptive and Unfair Trade Practices Act, Florida's Consumer Finance Act, and the Interest, Usury and Lending Practices Act). These disputes usually arise in funding of personal injury/tort-type actions involving consumers. It remains to be seen whether the challenges spill over into the TPLF of large commercial matters, where the recipients of the TPLF may not be considered as "vulnerable" as the ordinary individual litigant. Such challenges in the individual litigation area have been brought in Colorado and South Carolina. *Id.*

43 *See, e.g., Kirkland v. Rund (In re EPD Inv. Co.)*, 821 F.3d 1146 (9th Cir. 2016); *Bethlehem Steel Corp. v. Moran Towing Corp. (In re Bethlehem Steel Corp.)*, 390 B.R. 784 (Bankr. S.D.N.Y. 2008).

44 *See, e.g., FBI Wind Down Inc. Liquidating Trust v. Heritage Home Grp. LLC*, Adv. Pro. No. 15-51899 (CSS) (Bankr. D. Del. Sept. 15, 2016) (Sontchi, B.J.) (dispute over court-approved sale transaction, with binding arbitration provision in asset-purchase agreement determined to be unenforceable); "Bankruptcy Court Denies Motion to Compel Arbitration," *Fox Rothschild Update* (Sept. 19, 2016).

45 *See, e.g., Debbie Reynolds Management Co. Inc. v. Debbie Reynolds Hotel & Casino Inc. (In re Debbie Reynolds Hotel & Casino Inc.)*, 238 B.R. 831 (B.A.P. 9th Cir. 1999), *rev'd on other grounds*, 255 F.3d 1061 (9th Cir. 2001).

46 *See* Official Motion of Unsecured Creditors' Amendment to Motion: (1) Approve Retention of Bartko, Zankel, Bunzell & Miller and Romero Park P.S. as Co-Special Investigation/Litigation Counsel on a Fixed Fee of $200,000 to Conduct Claims Analysis; (2) Pre-Approve Expenditure of Up to $200,000 for Retention of Experts and Other Related Costs; and (3) Approve Terms of the Bentham IMF Investigation Funding, Certain Break-Up Fees and a Right to Fund Future Litigation, *In re Blue Earth Inc.*, Case No. 16-30296-DM (Bankr. N.D. Cal.).

47 Tentative Ruling on Amended Motion to Approve Investigation Funding Agreement, May 3-4, 2016, at Docket No. 129, *In re Blue Earth Inc.*, Case No. 16-30296-DM (May 19, 2016).

48 In this regard, an interesting issue has arisen as to the extent of a funder's collateral. In one case, the TPLF provider funded litigation that was apparently botched by counsel, such that the ultimate recovery to the estate was a malpractice claim against that counsel. The TPLF asserted that it had a lien on the malpractice proceeds. The bankruptcy judge held that the TPLF did not have a lien on the malpractice proceeds because the language of the security agreement at issue lacked any indication that the malpractice proceeds were a part of the collateral for the funding. *See* "Litigation Funders' Collateral Did Not Include Malpractice Claims," Dec. 8, 2017, *available at* jdsupra.com/legalnews/litigation-funders-collateral-did-not-67548. The authors are certain that this type of language will appear in all future TPLF documents; the TPLF industry learns and reacts quickly to issues like these, and the irony is apparent: The TPLF provider funds litigation costs to the lawyers, then recovers from the lawyers if they botch the case. TPLF giveth and taketh away (assuming that the documentation is good).

49 Of course, there is nothing that says that TPLF could not also be secured by traditional assets (real estate, etc.). This is what essentially happened in the *Epicenter Partners* case. In any event, the issues discussed in this article are further complicated by such an arrangement; the potential for huge returns is more suspect if the risk is mitigated by a security interest in tangible collateral.

50 *See, e.g., Butch v. Sec. Pac. Bank Ore. (In re Mushroom Transp. Co. Inc.)*, 247 B.R. 395 (Bankr. E.D. Pa. 2000); § 327 of the Bankruptcy Code.

51 *See Excalibur Ventures LLC v. Texas Keystone Inc. & Ors.* (Rev 2) [2014] EWHC 3436 (Comm); *see also* INSOL Article, *supra* fn.37.

The first area is where the TPLF source and party seeking the financing discuss the potential transaction. This involves due diligence and a candid analysis of the merits of the litigation to be funded. Those discussions might involve a litigant's counsel.

The second area involves communications between the TPLF source and counsel once the funding occurs. Are these discussions and materials subject to discovery?[52] At least one court has held, in denying a motion to compel a plaintiff to produce communications with its TPLF source (including the actual funding agreement), that such communications and documents fall within the work product privilege and are, therefore, not subject to discovery.[53] Of course, these communications could be a treasure trove of information for litigants.

What has not yet been explored is what happens when a litigant seeks TPLF but fails to get any takers, or when a litigant is turned down by some sources but ultimately gets TPLF from one source. Might the communications between the party or its counsel and the declining TPLF sources be subject to discovery? Establishing relevancy is important, but that bar is pretty low. Is there a waiver of attorney/client privilege when counsel is in discussions with a TPLF source that declines the investment? Even when appropriate nondisclosure/confidentiality agreements are in place, those agreements always have an exception for legally required disclosures such as discovery orders. Compare and contrast this with discussions between a party and a prospective lawyer that declines to take the case. Those are clearly privileged communications, but discussions with a prospective "investor" in the litigation who declines the investment? The law is much less clear here.[54]

Ethical Issues for Counsel

Many commentators have noted that TPLF creates potential ethical issues for counsel proposing it to a client, as well as for counsel prosecuting the litigation being funded. Who is the client, and to whom does the duty run?[55] How does TPLF intersect with most states' ethical prohibition on sharing fees between lawyers and non-lawyers?[56] Does TPLF create a potential conflict of interest among a plaintiff, its counsel and the TPLF source?

The practical and economic pressure on counsel is real. Contentious litigation can be economically burdensome on counsel, and the prospect of TPLF that will result in cash flow to counsel is appealing, to say the least. Once that happens, who is the attorney's master? Numerous Model Rules are implicated with TPLF, including Rules 2.1 (requiring a lawyer to exercise independent judgment and render candid advice), 5.4(c) (prohibiting third-party direction of lawyer), 1.7(a)(2) (prohibiting conflicts of interest), 1.8(a) (regulating the entry into business relationships between lawyers and clients), 1.8(e) (prohibiting financial assistance other than contingency fee arrangements) and 1.8(i) (prohibiting lawyers from obtaining a proprietary interest in litigation other than contingency fee arrangements, a rule that has its roots in the prohibition against champerty and maintenance). TPLF makes this dynamic a bit murky.[57]

The *Epicenter Partners* case again provides a real-world example of the ethical issues involved when TPLF pays for litigation counsel. As outlined in detail in the complaint, there were issues related to the acquisition of the TPLF proposed by counsel (STB) and its interaction with the TPLF provider after the funding was in place. Judge Wanslee declined to grant a motion to dismiss with respect to claims against STB based on (among other things) serious ethical concerns in the way that counsel interacted with the TPLF source (which was alleged to be in detriment to the interests of the actual client).[58] While Judge Wanslee determined that a creditor who acquires insider claims is not automatically itself an insider (and thereby subject to the defenses and other implications of that), if the prior claimholder had been involved in "gross and egregious" conduct, such claims and defenses could arguably be asserted against the new claimholder.

Of the two original claimants in *Epicenter Partners*, one was Burford and the other was STB. These original claimants held first and second liens against estate assets, respectively. As previously noted, CPF Vaseo acquired both claims.

The court dismissed the claims related to the Burford pre-petition conduct, but denied the motion to dismiss as to the pre-petition conduct of STB, finding it was a factual matter for trial whether STB breached its "ethical duties of loyalty, care and obedience, whose relationship with the client must be one of 'utmost trust.'"[59] In other words, counsel's actions in guiding negotiations with the TPLF funder that counsel recommended, then its interactions with the TPLF funder, created potential liability for counsel (under both ethical rules, and also the "gross and egregious" standards for equitable subordination under bankruptcy law).

In February 2012, the American Bar Association (ABA) weighed in on the ethical issues inherent in TPLF, which it referred to as "alternative litigation finance" (ALF), with respect to lawyers advising clients considering TPLF.[60] As set forth in the report's executive summary: "[T]he

52 It would not be beyond the realm of possibility, for example, that communications between a prospective TPLF and party or counsel involved emails, such as "No court in the land will buy this theory!" or similar assessments of the merits of litigation.

53 *See Lambeth Magnetic Structures LLC v. Western Digital Corp., et al.*, Case No. 2:16-cv-00541-CB (Dkt. 113) (Jan. 16, 2018). *See also* Katharine Wolanyk, "Another Favorable Ruling for Legal Finance: Pre-Litigation Funding Communications Protected by Work-Product Doctrine," Buford Capital (Jan. 25, 2018), *available at* burfordcapital.com/blog/another-judge-rules-disclosure-pre-litigation-funding-communications-protected-work-product-doctrine.

54 It is at best a murky area. Litigants might argue that there was some sort of "common interest" privilege (albeit one where the "common interest" — *i.e.*, the funding of the litigation — did not materialize.) The law certainly recognizes such a privilege. *See, e.g., In re Leslie Controls Inc.*, 437 B.R. 493, 496 (Bankr. D. Del. 2010). One wonders what the "common interest" could be if the TPLF source declines to become involved in the litigation. The bottom line is that this might become a litigated matter in the future. *See, e.g.*, Katherine Schaffzin, "An Uncertain Privilege: Why the Common Interest Doctrine Does Not Work and How Uniformity Can Fix It," 15 *Public Int. L.J.* 49 (2005).

55 *See, e.g.*, Maya Steinitz, "Whose Claim Is It Anyway? Third Party Litigation Financing," 95 *Minn. L. Rev.* 1268, 1291-1292 (2011); Marla Decker, "A Litigation Finance Ethics Primer," *Above the Law* (March 8, 2017) (Lake Whillans is a TPLF). *See also* ABA Report discussed herein, at fn.60, *infra*.

56 *See* Chambers Letter at 13-15; Model Rules of Professional Conduct, R. 5.4(a) ("Model Rules").

57 *See, e.g.*, Chambers Letter at 14-15. The Chambers Letter further suggests that without strict disclosure of TPLF sources, there exists the possibility that judicial conflicts of interest might arise because judges do not have sufficient information to determine whether recusal is warranted. *See* Chambers Letter at 15-16.

58 "It is alleged that on numerous occasions, STB actively worked against the interests of its client, causing duress. For instance, STB told ... the principal of its client that he was 'in no position to negotiate' [regarding the TPLF].... STB threatened to resign as [the client's] counsel unless [the client] agreed to [Burford's] demand, thus further violating its general duty of loyalty to [its client]. Worst of all, STB negotiated a contract with a party holding adverse interests to its client [*i.e.*, the TPLF] *without consulting* its client, or permitting its client to suggest changes [to the terms of the TPLF].... After the [litigation] settlement, [Burford] began demanding payment from [the client]. Rather than protect its clients' interests, STB refused to perform any work and instead demanded a settlement between [the client and Burford]." Epicenter Memorandum Decision, at 24-25 (emphasis in original).

59 *Id.*

60 *See* ABA Commission on Ethics 20/20 Informational Report to the House of Delegates (the "ABA Report"), *available at* americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf.

Informational Report should not be interpreted as suggesting that alternative litigation finance raises novel professional responsibilities, since many of the same issues discussed below may arise whenever a third party has a financial interest in the outcome of the client's litigation." The ABA report was the result of a working group whose purpose was limited in scope:

> The Working Group was directed to limit its consideration to the duties of lawyers representing clients who are considering or have obtained funding from alternative litigation finance suppliers. It did not consider social policy or normative issues, such as the desirability of this form of financing, or empirical controversies, such as the systemic effects of litigation financing on settlements (except insofar as this has an impact on the ethical obligations of lawyers), or the effect that alternative litigation finance may have on the incidence of litigation generally, or unmeritorious ("frivolous") lawsuits specifically. Nor did the Working Group consider legislative or regulatory responses to perceived problems associated with alternative litigation finance in the consumer sector, such as excessive finance charges or inadequate disclosure. However, to the extent a lawyer is representing a client and advising or negotiating with respect to an ALF transaction, the duties considered in this Informational Report are applicable.[61]

The ABA Report is aimed at lawyers advising clients on seeking out TPLF, but it does not intend (by its own scope) to deal with the many issues that might arise from TPLF.

What's the Problem?

The concept of contingency fee arrangements has been around for many years, and it is both lawful and ethical under applicable law and ethical rules. The same is true of a class-action plaintiff representations.

Why, then, is TPLF drawing so much attention and concern from certain segments these days? One reason is self-interest, of course. To be on the receiving end of a well-funded plaintiff is a marked tactical disadvantage. Hence, certain defense groups that participated in the Chambers Letter are lobbying for their own self-interests. A poor plaintiff is more easily outspent and, therefore, a defeated plaintiff.

Why isn't it accurate to view TPLF as just a version of contingency fee financing? Is it a question of degree? The answer is "probably not." In reality, TPLF is materially different from contingency fee financing for a simple reason: contingency fee financing is regulated and constrained by ethical rules binding the "financier" (*i.e.*, the lawyer). There are real constraints on what a lawyer can and cannot do in a contingency fee arrangement that are not present in TPLF. Consider how Judge Wanslee viewed the respective actions of Burford and STB in the *Epicenter Partners* case, and one can plainly see this key difference.

In some respects, TPLF is "the wild west," or at least a financing mechanism in uncharted territory: contingency fee financing without the usual regulation and ethical boundaries. In the end, it is contingency fee financing in an arena with no "drug testing policies": bigger, more aggressive, more powerful, with the potential for huge returns, all existing in a context bereft of ethical checks or constraints. As it unfolds and evolves, the legal and ethical issues surrounding TPLF will develop as well.

So where do we go now? abi

61 ABA Report at 2-3 (footnotes omitted).

Reprinted with permission from the ABI Journal, Vol. XXXVII, No. 3, March 2018.