NEW MEANS OF FINANCING TORT LAWSUITS AND LAW FIRMS: PRESENTATION OF PROFESSOR ANTHONY SEBOK*

PROFESSOR SEBOK:

Thank you very much for that introduction and thank you very much for inviting me. It's a pleasure to be here at the law school. This conference is a wonderful idea Byron, thank you for doing this.

I'm going to provide the 30,000-foot view of a gigantic area that maybe you didn't realize exists, but actually, is obvious when you think about it. I'm interested essentially in how it is that anyone other than a party pays for litigation. I'm interested basically in third-party finance of litigation.

Thinking about third-party supported litigation historically (I have written a piece about the history of champerty, maintenance, and barratry),[1] it's a fascinating history. Max Radin wrote the classic piece in the 1930s on this,[2] I recommend it to anyone that's interested in this topic. But historically, to the extent that it was permitted or allowed, things were not as Blackstone said.[3] It wasn't as he said, people imposing themselves, like pests on society. To the extent that third-party support for litigation has ever been allowed—it can come from different sources. And the most obvious source would be friends and family, the community. Then, technically if you think about it, first-party and third-party insurance is actually a form of third-party support of litigation. Subrogation liability, subrogation as a common law doctrine of liability. Insurance contracts are a form of third-party support of litigation.[4]

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1. *See* Anthony J. Sebok, *Betting on Tort Suits After the Event: From Champerty to Insurance*, 60 DEPAUL L. REV. 453 (2011); *see also* Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61 (2011) [hereinafter *The Inauthentic Claim*].

2. Max Radin, *Maintenance by Champerty*, 24 CAL. L. REV. 48 (1935).

3. *See* 4 WILLIAM BLACKSTONE, COMMENTARIES *134-35.

4. *See* DEBORAH L. RHODE & DAVID LUBAN, LEGAL ETHICS 698 (3d ed. 2001).

And then of course there is the logical possibility, but not always permitted, of true strangers. These inter-meddlers, these pests of society, as Blackstone put it. And I'm interested in these pests. I'm interested in the true strangers.

Now strangers can get involved in this in four ways, in my opinion. The first is the most debatable. I mean, there's a possibility of true assignment. Maybe this isn't really third-party financing. Real assignment is where the third party just takes over.[5] But I'm going to keep it in my basket today. And if you want to say that it isn't really third-party financing, we can talk about that in the Q&A. But assignment, I think, is an important way that third parties, after the event, get involved in litigation, and take over the litigation.

And then there is maintenance:[6] This has always been permitted historically, and it has been least controversial when, friends and families gratuitously offer help. And that's always been something that's been seen as human and natural, and it wasn't something anyone was really going to stop.

Then there's champerty, which is maintenance for profit—where a third party gives a hand, but they want something back,[7] they want some of the recovery, they want a share.

And then there's what I call "factoring." Here, I'm using a term that I have partly repurposed, because factoring can mean many different things in the world of commercial law. I'm talking about the assignment of legal fees, and I'm specifically talking about the assignment of contingent legal fees.[8] Not fees already earned. (For example, by Lawyer in July, which she factors by selling at a discount at the end of July.) I'm talking about fees that Lawyer is going to earn next July, because she has a contingent fee case. Or maybe she's a lawyer with a conventional firm that charges on an hourly rate. She could be a defense firm. If it's commercial work, if Lawyer is just doing a corporate transaction, it would be the same concept: She's going to factor fees that she's going to earn next July, after she does 1,000 hours on this deal. But the hours haven't been earned yet, and that's what I call factoring.

And while this is a way for the lawyer to "sell" her fees, it is hard to see why anyone would object. Especially in the case of factoring contingent fees, you really are in some sense making litigation possible, because after all, in

5. *See* Anthony Sebok, *Going Bare in the Law of Assignments: When Is an Assignment Champertous?*, 14 FIU L. REV. 85, 86 (2020).

6. WILLISTON ON CONTRACTS § 15:1.

7. *Id.*

8. Anthony J. Sebok, *Selling Attorneys' Fees*, 2018 U. ILL. L. REV. 1207, 1228 (2018) [hereinafter *Selling Attorneys' Fees*].

the American system, contingent fees are a way for individuals to access capital, to bring litigation, either for costs, for time, expertise, etc.

So now, how does this connect with mass torts and consumer litigation? Well, I just want to do a little background here, and many of the speakers here are more expert in this than I am. But of course, the problem with a mass tort consumer litigation is the basic problem of the negative value of the cost of litigation, with regard to the injury suffered by any individual, plaintiff or claimant.[9] The negative value problem is that, as it is often noted, only a fool or fanatic would sue over a $12 claim. It just doesn't pay, given the cost of legal proceedings, to invest the money it takes, to prove your claim.

Now there's a problem here in two dimensions. One problem with negative value claims is that, if the first mover was crazy enough to spend all the money it takes to actually prove the claims, they're not going to actually get any of that back. It might benefit later movers, but even if they were willing to do it, they're unlikely to do it on a rational basis. So, there is a failure of corrective justice, injured parties don't get redress, because it just doesn't pay for the first mover to do it.

Now even if some people are willing to do it, because they are fanatics, because they are obsessed, there is a problem of deterrence. Most people who are injured are not going to pursue negative value claims. So even if some people pursue them, you're still not going to have enough people pursuing it, you are not going to get efficient deterrents, so nobody is happy. So, in the end, neither the corrective justice nor the efficient deterrence folks are happy. Not the John Goldbergs of the tort world, nor the Cathy Sharkeys of the tort world. Nobody is happy in the world of tort theories, because under this collective action problem, the defendant is left undeterred, and the victims are left uncompensated.

Okay, so what's the solution? We have many solutions. The most common solution is the Rule 23 class action.[10] Again, there are people in this room, much more familiar than I am with the promise and peril of the Rule 23 Class Action. And I just want to remind you that even when possible—if one can overcome the high doctrinal hurdles, there is the principal-agent problem that was identified early on by Richard Nagareda and others,[11] that is, there's a risk that the lawyer is going to not act in the best interest of the class. And, as mentioned, there are doctrinal problems—the doctrinal hurdles

9. *See* Lucian Arye Bebchuk, *Suits with Negative Expected Value*, *in* 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 551-54 (1998).

10. *See* FED. R. CIV. P. 23(a).

11. *See* Richard A. Nagareda, *Autonomy, Peace, and Put Options in the Mass Tort Class Action*, 115 HARV. L. REV. 747 (2002).

to getting classes certified.[12] And there are also barriers to access because of barriers built into consumer contracts. More and more consumer contracts require you to opt in to arbitration, and if you opt in to arbitration, you're going to opt in to individual arbitration, not class arbitration.

Are there alternatives to class actions to solve the problem? As a solution to the negative value problem I described, the MDL may offer a way of aggregating claims efficiently. And then there is individual arbitration, which, if possible, is a different type of solution, because it is supposed to lower the cost of individual dispute resolution. The "secret sauce" of arbitration is that it is supposed to be so cheap that no claim is a negative value claim anymore. According to Scalia it's not a negative value claim anymore, because after all, it's so cheap and easy to bring your individual claim. In fact, AT&T is even willing to pay you if they lose, thus making it worthwhile for you to bring the claim. [13] So in theory, arbitration should solve the problems described as well.

I want to take a step back and talk about how third-party financing can help or deal with the problems posed by the negative value problem, by enabling class or mass litigation, and individual arbitration. With the time I have remaining, I will go through three solutions or three techniques.

First, class actions, which is a solution of sorts where it's permitted. Here the value added by third-party financing is easy to see: Let a well-capitalized stranger carry the cost of a class action by allowing the class (with judicial oversight) assign it. Or let that third party become a passive investor, not a party, by having third-party investment in the class's recovery. Obviously, this too requires judicial supervision. Interestingly, you can already do this in Ontario, Canada. You actually can have a judge supervise a bid by a private company, to buy into the class recovery.[14]

Second, factoring. In some sense you really cannot distinguish between recourse lending and what I call factoring. Because the truth is, that for many of these law firms, they'll never be able to actually pay back what they promise to pay back on the recourse lending, so in some sense even loans are a non-recourse transaction, if you're a law firm.

Law firms factor their attorney's fees after settlement all the time, and I think that's perfectly appropriate. But the question is what about before

12. *See, e.g.*, Comcast Corp. v. Behrend, 569 U.S. 27 (2013); Wal-Mart Stores, Inc. v. Dukes, 564 U.S. 338 (2011).

13. *See* AT&T Mobility LLC v. Concepcion, 563 U.S. 333 (2011).

14. For a thorough overview of how third-party litigation finance has developed under Canadian law, see Hugh A. Meighen, *The Third Party Litigation Funding Law Review: Canada*, THE LAW REVIEWS (Dec. 2019), https://thelawreviews.co.uk/edition/the-third-party-litigation-funding-law-review-edition-3/1212001/canada.

there's a settlement for a class? Can they factor their unearned fees? Here the question is, if they could do it, at what point would they disclose this to the court? It's an open question whether or not they should disclose when they petition to be appointed class counsel. Maybe they should disclose after they've already been appointed class counsel, and they've already spent all the money, and now they're trying to get their fee calculated by the court, at the fee petition stage.

Third, MDLs. Here it is the same basic analysis I offered of class actions, without the extra complication of Rule 23. Can you assign the individual cases that are going into the MDL? You probably can, unless they are personal injury cases (in many states).[15] Even if they're personal injury cases, you probably can assign the proceeds. But what if they're not personal injury cases, what if they're the classic AT&T consumer cases? In theory, you can, but there's some doctrine and there's even some legislation which might throw up a barrier, which I cannot go into now. But the research I have done suggests that these assignments can happen, and the more they happen, the more courts are going to endorse the idea that choses in action can be freely assigned.

Now, what about MDLs and champerty? There are some significant legal ethics questions, if you have MDL lawyers brokering or connecting the cases they have with the third-party financiers who are not lawyers. But I think they can do it if they're very careful about how they follow and conform their conduct to the rules of professional responsibility. But there are policy questions here, and the policy questions are real.

So, for example, in the TVM cases, the medical care that was paid for by the money advanced by the third-party funders, seemed unnecessary. And it seems that there was an abuse of the trust between the recipients of the funds, who were the plaintiffs' doctors, the plaintiffs who were transferring the funds, and the plaintiffs' lawyers who arranged for those transfers. And that's very disturbing. Now if the third-party advances are for legal expenses, this raises the question about why the lawyers aren't funding the cost themselves.[16] I mean, why should a third party be taking a premium off of a case, for something which lawyers used to do themselves? Again, while I don't think it's unethical per se, I think there are policy questions about what we would want to see encouraged.

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15. *See* Marc J. Shukaitis, *A Market in Personal Injury Tort Claims*, 16 J. LEGAL STUD. 329, 330 (987); *see also The Inauthentic Claim*, *supra* note 1, at 74-75.

16. Matthew Goldstein & Jessica Silver-Greenberg, *How Profiteers Lure Women into Often-Unneeded Surgery*, N.Y. TIMES (Apr. 14, 2018), https://www.nytimes.com/2018/04/14/business/vaginal-mesh-surgery-lawsuits-financing.html.

And finally, if I assume that third-party financing is possible or desirable in MDLs, there is still something I'm just going to say, which is against my own interests in promoting litigation finance. It is this: It isn't clear how much champerty in MDLs helps with the negative value issue, because the funds are not typically going to be used for legal expenses. The money is going into the pocket of the client, which is important to the client, but that doesn't mean it's necessarily going to help to move the case forward.

To return to factoring, for a moment. I'll note that the problem with factoring, is that with every case, whether it's mass tort, or individual tort, is the problem with fee splitting under the Model Rules of Professional Conduct, Rule 5.4(a).[17] I don't think that there is a fee-splitting problem, but whether there is or isn't doesn't turn on whether the case is a single plaintiff or a mass of plaintiffs.[18]

So finally, with arbitration, there's a lot of promise here. In theory, again, as long as you're not talking about personal injury cases, you should be able to assign an arbitral claim.[19] Of course, if there is an anti-assignment clause in the contract, that might bar assignment of a claim for damages, but then one might ask whether such a clause serves any public policy, and if it doesn't, could a state like California prohibit such clauses? I think the Supreme Court has not clearly rejected this possibility.

About champerty and arbitration: There should be no problem here, except it only solves the negative value problem if a firm coordinates the arbitration on behalf of its clients. And if a firm coordinates this way, and I know that this is already happening, then there will be challenges about whether or not a law firm can adequately represent all these parties that are going to show up in front of the same arbitrator. If the firm shows up with a gigantic file, 8,000 cases, all being represented by one lawyer. And in fact, that's why there was a challenge to the capacity by one law firm Keller Lenkner, to do this recently in San Francisco.[20]

And finally, arbitration and factoring. There's no reason why a law firm like Keller Lenkner can't factor its estimated fees in an arbitration. Their lawyers, however, like any other lawyers, must follow the Model Rules of Professional Conduct. Some people believe this practice violates Rule 5.4(a).

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17. MODEL RULES PROF'L CONDUCT r. 5.4 (AM. BAR ASS'N 2018).

18. *See Selling Attorneys' Fees*, *supra* note 8, at 1217.

19. *See* Myriam Gilles & Anthony Sebok, *Crowd-Classing Individual Arbitrations in a Post-Class Action Era*, 63 DEPAUL L. REV. 447, 456–57 (2012).

20. *See* Michael Corkery & Jessica Silver-Greenberg, *'Scared to Death' be Arbitration: Companies Drowning in Their Own System*, N.Y. TIMES (Apr. 6, 2020), https://www.nytimes.com/2020/04/06/business/arbitration-overload.html.

But if a lawyer can factor unearned fees in litigation, in theory, one should be able to do the same with unearned fees in arbitration.