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*Third-Party Financing of Litigation: Civil Justice  
Friend or Foe?*

**“Insurers Defend and Third-Parties Fund: A  
Comparison of Litigation Participation”**

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## INSURERS DEFEND AND THIRD-PARTIES FUND: A COMPARISON OF LITIGATION PARTICIPATION

Michelle Boardman

Insurance companies provide a legal defense for their liability policyholders who have been sued. This commonly takes the form of the insurer selecting, paying, and directing the lawyer. This lawyer has two *co-clients*—the insurer and the policyholder-defendant.<sup>1</sup> In rare cases where a conflict between the insurer and policyholder makes this impossible, the insurer withdraws from all but the obligation to pay for the defense. While it has downsides, the value of this arrangement is well known and accepted.

Proponents of expanding third-party litigation funding in the United States argue that the insurer defense model supports and even necessitates expansion. A comparison between these relationships is strained where the occasional similarity is overwhelmed by material differences. This article is the first to fully consider the value of the comparison between the two forms of litigation funding. In it I conclude that the insurer defense model can provide some insight but that several of the more causal, common analogies between the two funding forms should be put aside. I do not take a stance on the larger question of whether or how third-party litigation funding should be expanded in the United States.

Why compare third-party litigation funding with insurer litigation defense? Before evaluating the more specific claims that are being made about the two, there are several general reasons to explore insurer defense funding. First, an insurer's defense of its policyholder is considered *a form* of third-party litigation funding, a form already prevalent in the United States.<sup>2</sup> We might hope to see the future of the new funding forms by looking at the present of insurer defense. Second, insurance companies play a substantial

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<sup>1</sup> See § \_\_ *infra* on the insurer as co-client.

<sup>2</sup> See, e.g., Geoffrey McGovern et al. at 2, n.2 in “Third Party Litigation Funding and Claim Transfer: Trends and Implications for the Civil Justice System,” (RAND June 2009), *available at* [http://www.rand.org/pubs/conf\\_proceedings/CF272.html](http://www.rand.org/pubs/conf_proceedings/CF272.html). (hereafter RAND Conference 2009).

role in European litigation financing.<sup>3</sup> Litigation expense insurance is not an American phenomenon yet, however. Third, the large litigation investor funds like Juridica “partner[] and co-invest[] with other leading financial institutions and *insurers* in London and New York.”<sup>4</sup> (It is unclear if insurers are involved in American financing).

In addition to the more general argument that insurers already are litigation funders, this article will flesh out and examine two additional specific claims. First, there is the possible unfairness “of the defendant’s ability to transfer risk to an insurance company before the event, while plaintiffs are left to absorb all the risk of returns on their claims until the eventual outcome.”<sup>5</sup> The lack of parity between the plaintiff’s and defendant’s positions has consequences beyond fairness concerns as well. The next claim takes the form of the greater including the lesser: If an insurer’s *control* of a defendant’s litigation is palatable, then mere investor *involvement* must be even more so. In other words, insurers interject themselves into settlement decisions in defense actions; litigation funding will be less intrusive and thus we need not worry about interfering with either the lawyer’s or the client’s legal judgment. To evaluate both of these claims we will continue to return to the first general claim that insurers are litigation funders in the same relevant sense as that term is used to apply to third-party litigation funders.<sup>6</sup>

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<sup>3</sup> See Anthony Heyes, Neil Rickman, and Dionisia Tzavara, *Legal Expenses Insurance, Risk Aversion and Litigation*, 24 INTERNATIONAL REV. OF LAW AND ECON. 107 (2004).

<sup>4</sup> <http://www.juridica.co.uk/about.php> (emphasis added).

<sup>5</sup> RAND Conference 2009 at 52 (Appendix B: Presenter Materials, from Keynote Speech by Lord Daniel Brennan).

<sup>6</sup> There is another claim that merits discussion but falls outside the aim of this piece. [note: I am open to reconsidering its inclusion here.] Lord Daniel Brennan, who is Chairman of Juridica Capital Management, among many other positions, asks “Why should an insurance company be able to take direct control of a claim through the contract right of subrogation, while a financial institution is restricted from purchasing an interest in a legitimate legal claim held by a business?” RAND Conference 2009 at 52 (Appendix B: Presenter Materials, from Keynote Speech by Lord Daniel Brennan). This comparison is about the fitness of certain institutions to pursue claim transfer, which is not third-party litigation funding. Litigation funding and claim transfer may be substitutes in certain circumstances. Both allow for a market in litigation investment. Nonetheless, the legal and ethical restrictions on claim transfer are a substantial topic unto itself. The dynamics and incentives of insurer plaintiff subrogation suits likewise merit a full separate treatment.

For purposes of this article, third-party litigation funding will (a) often be shortened to “litigation funding” and (b) refer to investments in commercial plaintiff’s suits by funds and nonrecourse loans made to individual plaintiffs in tort suits. This paper does not fully address other forms of litigation funding such as lawyer-client contingency fee arrangements or outright claim transfer in which a legal claim is sold to and pursued by a party outside the original dispute. This division serves several functions. First, it is in keeping with “third-party litigation funding” becoming a term of art, not a bare description. Second, the analogies being drawn from insurer defense funding are focused on analyzing this subset of litigation funding. A comparison between insurer defense and contingency fees might well prove interesting another day. Third, sloppy thinking can result, and has resulted, from simultaneously using the phrase “litigation funding” in both the narrow and the broader sense in the same discussion.

Section I describes the type of third-party litigation funding at issue in this article. Section II sets forth the nature of the relationship between defendant policyholders and their third-party liability insurer. This section begins the comparison between litigation funding and insurer defense. Readers with a working knowledge of litigation funding and liability insurance may want to skim these sections but should not skip them. Section III delves into the three comparison claims described above.

## I. THIRD-PARTY LITIGATION FUNDERS

In this article “third-party litigation funding” refers to either investment in commercial plaintiff’s suits by litigation investment funds or nonrecourse loans made to individual plaintiffs in tort suits, known as lawsuit lending.<sup>7</sup> In short, these forms of litigation funding involve a potential plaintiff and a party who is not otherwise related to the litigation. The borrower-plaintiff may already be engaged in litigation but it is more likely that the borrower is a person or entity holding a legal claim. The third-party funder agrees to pay all or part of the plaintiff’s legal costs in exchange for payment, usually a percentage of the plaintiff’s recovery.<sup>8</sup>

The purpose of litigation funding depends upon the plaintiff. For commercial plaintiffs we can generally assume that

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<sup>7</sup> The possible but either absent (in the United States?) or rare case of a *defendant* receiving third-party funding may be address briefly later.

<sup>8</sup> Whether the amount invested in the litigation if fixed is discussed infra at \_\_\_.

the purpose is to transfer some or all of the litigation risk to a third-party.<sup>9</sup> The business can increase its expected value of the suit by shifting the litigation risk to a party who values the expected reward more than the expected risk.<sup>10</sup> For individual tort plaintiffs, we may generally assume the purpose is to make the litigation possible because the plaintiff does not otherwise have the resources to bring the case. Because contingency fee arrangements are permissible in the United States, unlike England, litigation funding for individual plaintiffs is not the only option.<sup>11</sup> Of course, in either the individual or the commercial case, litigation funding may make the difference between a suit brought or not brought; a commercial entity can have the resources to bring a suit but believe the suit is not worth the litigation risk.

The two primary investor funds in the United States are Juridica Capital Management (US) Inc., launched in 2007, and Burford Capital Limited, launched in 2009. Because the funds are relatively new, and their operations are not fully public, there is some uncertainty about how the fund model will develop in the United States. Juridica describes itself as “a lawyer-owned financial services company operated in an investment banking tradition and focused exclusively on capital and finance for corporations, law firms, lawyers, and claim-holders worldwide.”<sup>12</sup> It also touts its legal and case expertise, suggesting at least the possibility of its deeper involvement in case decisions after the initial investment decision.<sup>13</sup> It arranges various forms of funding

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<sup>9</sup> It is not surprising that commercial litigation funding, and the shifting to the funder of a portion of the litigation risk, initially attracted more interest in legal systems that require the loser to pay the litigation costs of the winner.

<sup>10</sup> On the defendant side, Jonathan Molot has set forth a three-tier structure of litigation risks based on Guido Calabresi’s primary, secondary, and tertiary costs of accidents. See Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367, 372-75 (2009) (citing Guido Calabresi, *The Costs of Accidents* (Yale 1970)).

<sup>11</sup> Whether there are plaintiffs who could not secure a contingency-fee arrangement but who could interest a third-party litigation funder to invest in the litigation is a question that merits more investigation.

<sup>12</sup> <http://www.juridica.co.uk/about.php>

<sup>13</sup> See <http://www.juridica.co.uk/about.php>. (“Through over fifty years’ combined experience in finance and law product innovations, Juridica’s principals have developed an extensive, world-wide network of leading law, legal ethics, finance and consulting experts and scholars. Juridica calls on this network to assist in case and risk analysis, financial modeling and financial product design.”). Lord Brennan states that Juridica “employs: a cutting edge underwriting system; effective due diligence; full financial analysis of all factors affecting the investment,

for both law firms and claim owners. It “does not arrange finance for personal injury claims or for mass tort claims, except in special circumstances.”<sup>14</sup> Juridica is listed on the Alternative Investment Market of the London Stock Exchange.

The largest fund, “Burford Capital Limited[,] is a publicly listed fund that invests in commercial disputes.”<sup>15</sup> For now, Burford lists its focus as commercial disputes in the United States and international arbitration.<sup>16</sup> Despite its American focus, the “investment centre” portion of the Burford website is off-limits to a person residing in the United States. Like Juridica, many of Burford’s principals are lawyers. After all, legal expertise is central to decide in which cases to invest and how deeply. “Juridica prefers to examine potential business-related claim investments that have been vetted and accepted by qualified lawyers.”<sup>17</sup> The open question is whether the lawyers remain involved with the borrower’s case after the initial loan has been made. Burford Capital describes itself as a dispute financier. Burford *Group*, which describes itself as the investment advisor to Burford Capital, states its goal as “not only to arrange critical funding, but *to improve the odds of a favorable outcome.*”<sup>18</sup>

A litigation investment fund that has lent a set amount has every incentive to encourage a favorable outcome; payment may be contingent upon a positive settlement or award and it may be in the form of a percentage of the plaintiff’s recovery.<sup>19</sup> In this the fund mirrors an indemnity insurer with an incentive to minimize the amount paid under the policy in settlement or award. As discussed elsewhere, their incentives as to litigation *costs* may differ. An insurer is more like a contingency-fee lawyer in the

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legal, financial, and overall return on the investment; quality experts on ethics, liability, damages, and enforceability; and the best lawyers.” RAND Conference 2009 at 55 (Appendix B: Presenter Materials, from Keynote Speech by Lord Daniel Brennan).

<sup>14</sup> *Id.*

<sup>15</sup> <http://www.burfordcapital.com/index.html>

<sup>16</sup> Other funds, most of which do not have an American presence, include Allianz, Credit Suisse, Claims Funding International PLC, Context Capital, Harbour Litigation Funding, and IM Litigation Funding.

<sup>17</sup> [www.juridica.co.uk/how.php](http://www.juridica.co.uk/how.php). Are these lawyers principals or employees of Juridica or are they law firm lawyers who work repeatedly with Juridica?

<sup>18</sup> [www.burfordgrouppltd.com/purpose.html](http://www.burfordgrouppltd.com/purpose.html) (emphasis added).

<sup>19</sup> A fund that has pledged to lend a variable amount, depending on litigation costs, may reach a point where it prefers to cut its losses and accept a “losing” settlement over investing additional resources in the litigation or settlement negotiations.

sense that it must decide how much to spend on the litigation as the case unfolds. An insurer is dissimilar from either in that the insurer's funds are on the hook for the eventual settlement or court award.

Much of the analysis of litigation funding in the United States has assumed a model in which the funds do not attempt to influence the borrower's litigation or settlement decisions after the initial investment has been made. Whether advice or pressure is brought to bear during litigation, a fund could influence the litigation's path by requiring an agreement about approach and settlement stance before making the investment commitment. For purposes of this article, which does not turn on the question, it is reasonable to consider it possible, but not proven, that litigation investment funds would influence strategy before or during litigation.

On the individual tort-plaintiff side, the borrowing structure is a fairly simple non-recourse loan. If the would-be plaintiff's lawyer is the one making the loan, we call it a contingency fee. If an outside lender makes the loan, it is third-party litigation funding.<sup>20</sup> The "leading provider of litigation financing, plaintiff funding, and lawyer funding," at least according to itself, is LawCash, whose website describes its business model in detail.<sup>21</sup> If a plaintiff already engaged in a contingency-fee suit borrows money for non-litigation expenses during the suit, there does not seem to be a set name—"third-party litigation support funding" is too long and "lawsuit living lending" is too alliterative. A separate term is called for, although the term "lawsuit lending" is used to apply to the entire tort plaintiff field.

Lawsuit lenders have faced difficulty in some states. Courts have held the contracts void, calling the lenders "intermeddlers" who should not be "permitted to gorge upon the fruits of litigation."<sup>22</sup> In the case of this language from the Supreme Court of Ohio, the state legislature made the contracts legitimate again five years later.<sup>23</sup> The American Tort Reform Association has urged state legislatures and the ABA to resist approving or legitimizing this form of litigation funding. ATRA argues that lawsuit lending "generally targets low-income Americans with a convenient if usurious line of credit" and that it

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<sup>20</sup> See the chart, *infra* \_\_\_, for a comparison of the two.

<sup>21</sup> <http://www.lawcash.net/> LawCash does appear to be one of the largest lawsuit lenders.

<sup>22</sup> <http://www.iwatchnews.org/2011/02/02/2160/states-are-battleground-drive-regulate-lawsuit-funding> (Ohio Supreme Court 2003).

<sup>23</sup> *Id.*

“fundamentally shifts the focus of courts from promoting and administering justice to serving as a forum for investors to wager on lawsuits.”<sup>24</sup>

On the other side, the American Legal Finance Association is a trade association that represents some twenty third-party litigation support funders whose clients are individual plaintiffs in personal injury suits. The association sets forth industry “best practices” and coordinates with state governments on voluntary agreements, regulations, and legislation.<sup>25</sup> According to ALFA, its members provide non-recourse loans to individuals who already have an arrangement with a contingency fee lawyer. The ALFA member funds not the litigation but the non-litigation costs of living while awaiting an award of damages.<sup>26</sup> These include medical bills from the injury and house payments or other payments that have become difficult because the plaintiff is out of work.<sup>27</sup>

Of course, money is fungible. Does it make sense to think of ALFA members as funding living while litigating and not funding the litigation itself? Yes, it does, given that the loans for each are non-recourse. The plaintiff gives neither the contingency-fee lawyer nor its ALFA lender any money upfront. He is not using the money from the ALFA lender to repay his lawyer during or after the suit.

On the other hand, the existence of the ALFA lender will in some cases allow a plaintiff to bring or maintain suit where before he would have abandoned suit or settled earlier. A tort plaintiff

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<sup>24</sup> ATRA comments to the ABA Working Group on Alternative Litigation Funding (Feb. 15, 2011, revised March 7, 2011), available at [http://www.atra.org/files.cgi/8551\\_Alt-Litigation-FinanceLTR.pdf](http://www.atra.org/files.cgi/8551_Alt-Litigation-FinanceLTR.pdf).

<sup>25</sup> See <http://www.americanlegalfin.com/FactsAboutALFA.asp> (describing a voluntary agreement with the Attorney General of New York State and legislation in Maine and Ohio).

<sup>26</sup> “An ALFA client can be anyone who has hired an attorney on a contingency-fee basis to seek financial compensation for a personal injury suffered in an accident that wasn't their fault. Typically, the injury suffered has left them in financial hardship due to an inability to work. The consumer can contact one of the ALFA member companies directly to apply for legal funding or their Attorney may refer their clients to an ALFA member company when the client is experiencing financial distress during the course of his or her case. The client most often uses the funds received to make mortgage or rent payments, pay medical bills, purchase food, car payments, tuition, or basically anything else they need. Legal funding is used to pay for life's necessities.” <http://www.americanlegalfin.com/faq.asp>

<sup>27</sup> *Id.*

with little personal means, whose job is disrupted by injury and whose medical bills are due, will settle for less in order to get payment sooner than a plaintiff who can afford to wait while his bills are paid by a non-recourse loan. Any plaintiff who borrows from an ALFA-type member but who does *not* have a contingency fee arrangement is using the borrowed funds for litigation expenses as much as for any other expenses, again given that money is fungible. It is not clear what percentage of borrowers fall into this category.

## II. THE INSURANCE DEFENSE PICTURE

The existing generalizations about the similarities between litigation funding and insurance defense have assumed knowledge of the insurance side. Some sloppy conclusions result from the lack of explicit comparison. To draw an analogy between litigation funding and insurance defense requires a more express picture of the insurance defense side. We can envision two typical defendants.

The first, an individual homeowner, purchases a homeowners insurance policy that includes personal liability and medical payments coverage. When a visitor is injured falling from the homeowner's deck, the policy provides coverage for the civil claim of injury and to pay medical expenses. The protection goes beyond the home; if the policyholder unintentionally injures a person or causes property damage while out in the world, there may be coverage. The liability sections of homeowners policies operate as liability insurance for individuals.

The second typical defendant is a corporation with a General Commercial Liability (CGL) policy. When a claim or suit is brought against the company, the insurer pays for both the defense and the damages award or settlement, subject to policy limits.<sup>28</sup> The relationship between the duty to provide a defense and the duty to pay proceeds in liability can be complex but in general the defense payments do not diminish the amount available to pay damages/settlement.

This article will spare the reader a treatise on the relationship and pitfalls between policyholder and liability insurer but a few key elements of the set-up are important.

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<sup>28</sup> It is possible to purchase a Commercial General Liability policy that provides coverage for damage awards against the policyholder but *does not give the insurer either the right or duty to* participate in the litigation. These policies are generally only available to large sophisticated corporations in whose litigation expertise the insurer is confident. Of course, the policy still provides for safeguards of the insurer's interests.

Key aspects of the insurer defense relationship include:

- (1) the contractual relationship precedes the litigation
  - Thus (2) the insurer's involvement in the litigation is *automatic*, not an investment *choice*
  - (3) litigation funding is not the primary purpose of the contract<sup>29</sup>
- Once a legal claim is made,
- (4) the policyholder has a duty to cooperate with the insurer
  - (5) the policyholder and the insurer are co-clients of the lawyer<sup>30</sup>

The first three are relevant to the incentives the contractual relationship creates before litigation. The last two are central to the nature of that relationship in the throes of litigation.

*(1)-(2) Insurer funding is aleatory and automatic if triggered*

The relationship between the policyholder and insurer obviously begins when the policyholder purchases liability insurance. The insurer commits to the policyholder before he becomes a defendant in need of a legal defense. Indeed, the insurer commits before knowing whether the policyholder will ever need a legal defense. Like the insurer's obligation to indemnify, therefore, the insurer's obligation to provide a defense is aleatory. Unlike a third-party litigation funder, neither party to the contract knows at the time the contract is made whether any litigation will in fact be funded.<sup>31</sup>

If the policyholder does become a defendant, the insurer is pulled into the litigation by pre-existing contract. In stark contrast to a third-party litigation funder, the insurer does not have a choice whether to fund the defense or not. Having entered into the insurance contract, it is a comparison between the contract and the plaintiff's complaint that determines whether the insurer owes a defense.<sup>32</sup>

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<sup>29</sup> Litigation funding is the primary or at least equal purpose of some insurance contracts, such as professional liability policies, which include medical malpractice and Directors & Officers insurance.

<sup>30</sup> See infra \_\_.

<sup>31</sup> This is a little simplistic on the commercial insurance side, especially for claims-made policies.

<sup>32</sup> This is often called the eight-corners rule, referring to the four corners of the insurance policy and the four corners of the plaintiff's complaint. See *Guide One Elite Ins. V. Fielder Rd. Baptist Church*, 197 S.W.3d 305, 308 (Tex. 2006). In certain jurisdictions the rule is not this simple. If the insurer has access to facts that show the true nature of the allegation to be

The insurer makes a promise to defend (and asserts the right to defend<sup>33</sup>) that is *not* based on the strength of the claimant's case.<sup>34</sup> If the act alleged in the complaint is one that falls within the scope of coverage, the insurer has an obligation to defend "even if the suit is groundless, false, or fraudulent."<sup>35</sup> The insurer does not first conduct a mini-trial only to join in the policyholder's defense if a finding of liability is likely. The duty to defend against potential liability is thus broader than the duty to compensate for liability.

This makes sense. If the policyholder is found liable after the insurer refuses a defense the insurer will still be on the hook for the liability; the reasonableness of judging the claim to be groundless will not be a defense. "The duty to defend arises not from the probability of recovery but from its possibility, no matter how remote. Any doubt as to whether the allegations state a claim covered by the policy must be resolved in favor of the insured as against the insurer."<sup>36</sup>

Insurers may have other defenses, such as when a complaint alleges intentional wrongdoing only, which is excluded from coverage under the policy and by public policy.<sup>37</sup> An insurer may disclaim the duty to defend on the basis of a policyholder's breached duty to cooperate, although success will require a substantial and material breach.<sup>38</sup> But the insurer will not be deciding whether it would prefer to defend the policyholder's suit or invest the resources elsewhere.

In the ideal case, an insurer does not first learn of a suit when the complaint is filed; in order to investigate and create

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under liability coverage, the insurer may have a duty to defend despite a poorly drafted complaint.

<sup>33</sup> See Douglas R. Richmond, *Liability Insurers' Right to Defend Their Insureds*, 35 CREIGHTON L. REV. 115 (2001).

<sup>34</sup> See, in general, James M. Fischer, *Insurer-Policyholder Interests, Defense Counsel's Professional Duties, and the Allocation of Power To Control the Defense*, 14 CONN. INS. L.J. 21 (2007).

<sup>35</sup> ISO, Homeowners 3 Special Form (HOMEOWNERS 00 03 05 06) (2006). This language is common.

<sup>36</sup> *George Muhlstock & Co. v. American Home Assur. Co.*, 502 N.Y.S.2d 174, 178 (N.Y.App.Div. 1986).

<sup>37</sup> If the complaint alleges both intentional wrongdoing and, in the alternative, negligence, the duty to defend is usually triggered. See, e.g., *Sharonville v. American Employers Ins. Co.*, 846 N.E.2d 389 (Ohio 2006).

<sup>38</sup> See Robert H. Jerry, II & Douglas R. Richmond, UNDERSTANDING INSURANCE LAW § 110 (4th ed. 2007).

reserves, the insurer wants to be informed when the policyholder realizes it has committed an act that could lead to liability. Similarly, a plaintiff seeking funding can approach (or be approached by) a litigation funder either before or after the plaintiff has brought suit. The difference, of course, is that the litigation funder must decide whether to take on a contractual obligation to fund. The insurer has no such decision to make; its prior contractual obligation has been triggered by an event outside its control.<sup>39</sup> This difference is relevant to the claim the insurers-as-litigation funders claim and the parity claim.

*(3) Litigation funding is not the primary purpose of the contract*

For an individual homeowner, the primary purpose of the contract is indemnification from damage to the home and personal items. Even if we optimistically assign the liability coverage equally billing, the litigation funding of a defense is at most half of the value of the liability coverage. Thus, with generosity, the litigation funding portion of the contract is one-fourth of purpose or value of the insurance policy to the policyholder. For a commercial policyholder, the litigation funding function is more valuable. While some homeowners are at best vaguely aware of their liability coverage, businesses purchase liability coverage in part to have protection against the cost of suit. With generosity again, we can even say that the Commercial General Liability policyholder values the litigation funding portion at up to one-half the function of the policy.<sup>40</sup>

Nor is litigation funding the primary purpose of the contract for the insurer. Once a liability insurer's policyholder is charged by another party with potential liability, the insurer has a financial stake in the outcome of that dispute, whether the dispute settles or is resolved in litigation. This can be seen most clearly by considering a liability insurance contract in which the insurer takes no part in the litigation.<sup>41</sup> In these cases the insurer retains the

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<sup>39</sup> The same is true of before-the-event litigation expense insurance available in parts of Europe.

<sup>40</sup> For specific types of business that are more likely to be sued than to be liable, the litigation funding portion would be worth *more* than one half.

<sup>41</sup> It is possible to purchase a Commercial General Liability policy that provides coverage for damage awards against the policyholder but does not give the insurer either the right or duty to participate in the litigation. These policies are generally only available to large sophisticated corporations in whose litigation expertise the insurer is confident. Of course, the policy still provides for safeguards of the insurer's interests.

same financial stake in the outcome of the underlying litigation but maintains little or no control over the litigation.

With third-party litigation funding the purpose of the contract is . . . litigation funding. The plaintiff seeks to shift litigation risk and the funder seeks to make money by investing; the path to both of these objectives is the financier's funding of the litigation. Burford, and other investment funds, may add the function of increasing the chances of litigation success.

This difference in purpose matters in two ways. [at least two ways, others are being drafted] First, to the extent that third-party litigation funding has negative externalities that are difficult to measure, one might be inclined to restrict contracts with litigation funding as the goal more readily than contracts that include litigation funding. The most obvious externality of litigation funding will be an increase in litigation. Whether this is a negative externality is a large theoretical and empirical question that will not be answered here; it is possible that litigation funding increases primarily legitimate claims being brought and increases efficient settlement.<sup>42</sup> While this debate plays out, the point to note here is that insurer defense does *not* obviously increase litigation. The difference between plaintiff litigation funding and defendant litigation funding is simply and powerful but easily overlooked.

With plaintiff litigation funding, an obvious first-line effect of the funding is to increase the number of claims brought. Again, whether it then increases the number of courts cases, desirable settlements, or undesirable settlements is an empirical question. Liability insurance has the same effect of increasing the number of claims brought but it is the funding of the *damage award*, and not the litigation funding, that attracts plaintiffs.<sup>43</sup>

Providing an otherwise judgment-proof tortfeasor with insurance increases substantially the value of bringing a claim against him. The effect of also providing a sophisticated, managed

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<sup>42</sup> See Jonathan T. Molot, *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L. REV. 65 (2010); Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367 (2009) (commercial defendant litigation funding); Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61 (2011); Anthony J. Sebok, *Betting on Tort Suits After the Event: From Champerty to Insurance*, 60 DEPAUL L. REV. 453 (2011); and contra Sebok, Catherine M. Sharkey, *The Vicissitudes of Tort: A Response to Professors Rabin, Sebok & Zipursky*, 60 DEPAUL L. REV. 695 (2011).

<sup>43</sup> See Kenneth S. Abraham, *THE LIABILITY CENTURY: INSURANCE AND TORT LAW FROM THE PROGRESSIVE ERA TO 9/11* (2008).

defense is less clear. Insurer management of a defense should please quality plaintiffs, in general, and displease weak plaintiffs or those looking for an easy settlement from a nuisance suit. In other words, the high quality of the defense should lead to more accurate settlements, which is good for those with strong cases and bad for weak ones.

Second, the purpose of each contract affects the potential alignment of incentives for the funder. The insurer is more fully invested in the litigation than the third-party litigation funder. This does not necessarily mean the insurer's incentives are always better aligned than the litigation funder, far from it. It does mean that any claims about the workings of litigation funding based on the workings of insurer defense required detailed scrutiny.

Knocking aside all subtleties for the moment, we can envision a continuum of services for litigation stake and for litigation control. At one end of the spectrum is the lawsuit lender. The lender exerts no litigation control and is indifferent to the cost of litigation; his sole interest is in the fact of and amount of settlement or award. At the other end of the spectrum, imagine a litigation coach who has no stake in the outcome of the case; the coach's job is to help the litigant (plaintiff or defendant) get his desired outcome, which, roughly, will be maximizing the outcome while minimizing the cost of suit. The coach's pay for this job does not vary with the litigant's outcome. It is not a percentage of the damages awarded or saved. There is no premium for success, however defined, as there is in English conditional fee arrangements. Nor did the coach lend money to the litigant. In fact, let us assume the litigant has paid up front, so the coach has no reason to fear payment cannot be made if the suit fails. In other words, the coach has no financial stake whatsoever in the outcome of the litigation.<sup>44</sup> (See the chart on the next page for a visual representation of how these two bookend the spectrum).

The value of the fictitious litigation coach is two-fold. First, it fills the box of litigation stake = 0 and litigation control at the high end, say 90%. Second, in the insurance defense context it is not fanciful. The insurer often controls the entire litigation, from a client standpoint; the lawyer still has a role. Of course, the insurer is not a 0 for litigation stake, as the coach is.

In contrast to the litigation coach, the lawsuit lender is a 0 for control but very high for a stake in the settlement. "Lawsuit lender" here refers to an entity that lends a set amount of money to a plaintiff who already has an arrangement with a contingency-fee

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<sup>44</sup> The coach has an obvious reputational stake in his client's view of the outcome.

lawyer. The lender has no control over the litigation. The lender has no stake in the cost of the litigation in that the lawyer is the lender for litigation cost purposes and the lawsuit lender has lent a set amount that does not vary with litigation costs.

The following chart shows the position of various entities in three categories: how much control the party exercises over litigation and settlement decisions; how much of a stake compared to others involved the party has in the cost of litigation; how much of a stake the party has in the case outcome, which here is assumed to be settlement. The percentages are not exact, with the exception of the zeroes and a few of the 100 percentages.

<b>Party providing litigation support</b>	<b>Litigation Control</b>	<b>Stake in Cost of Litigation</b>	<b>Stake in Settlement</b>
<b>“Lawsuit Lender”</b>	0%	0%	20% - 60% <sup>45</sup>
<b>Litigation Coach</b>	90%	0%	0%
<b>Liability Insurer</b>	80% - 100%	100%	90% - 100%
<b>Litigation Funder</b>	0% - 50%?	80% - 100%	10% - 45% <sup>46</sup>
<b>Contingency-fee Lawyer</b>	90%	100%	30%

The liability insurer could have a lower stake in the settlement depending on the case, of course; the 90 to 100 percentage stake is more accurate for individual defendants and less accurate for commercial defendants. Likewise, it is not

<sup>45</sup> “Unrestrained by laws that cap interest rates, the rates charged by lawsuit lenders often exceed 100 percent a year, according to a review by The New York Times and the Center for Public Integrity.” Binyamin Applebaum, “Lawsuit Loans Add New Risk for the Injured,” N.Y. Times A1 (Jan. 16, 2011) available at <http://www.nytimes.com/2011/01/17/business/17lawsuit.html?pagewanted=all>.

<sup>46</sup> Law 360 Portfolio Media, “The Rise of 3rd-Party Litigation Funding,” (Jan. 21, 2011), *available at* [http://www.jenner.com/files/tbl\\_s20Publications%5CRelatedDocumentsPDFs1252%5C3476%5CSchaner\\_Appleman\\_The\\_Rise\\_Of\\_3rd\\_Party\\_Litigation\\_Funding\\_Law360.pdf](http://www.jenner.com/files/tbl_s20Publications%5CRelatedDocumentsPDFs1252%5C3476%5CSchaner_Appleman_The_Rise_Of_3rd_Party_Litigation_Funding_Law360.pdf).

possible to put an exact percentage on the amount of litigation control an insurer exerts, although the control is high. It no doubt reaches full control (100%) for most individual tort plaintiffs. As discussed elsewhere, the insurer's stake in the settlement depends upon the likelihood of settlement exceeding the policy limits. The insurer numbers are based on average cases.

The point of the chart stands even if we fill the insurer's numbers based on less common cases. The chart shows that the insurer's incentives are well-aligned. Where (in most cases) the insurer is heavily invested in both litigation costs and settlement costs, the insurer does not have an incentive to minimize one at the expense of the other. Because the insurer is in control of the litigation, it acts in keeping with its own interests as to cost and settlement. Unless there is misalignment caused by the policyholder having a substantial stake in the settlement, the insurer is poised to efficiently litigate and settle.

The policyholder-defendant may exert some litigation decision-making in commercial cases and will share more of a stake in the final settlement/court award if the policy limit is reached, requiring the defendant to pay a portion directly. There is a subset of cases where the policyholder's and insurer's interests are significantly misaligned because one bears the litigation costs and the other a large share of the settlement costs.<sup>47</sup> [These cases will be fleshed out.] The point here, again, is not that insurer defense has no pitfalls but that the pitfalls *differ* from those caused by third-party litigation funding.

#### *(4) The Duty to Cooperate in the Defense*

The policyholder's duty to cooperate with his insurer is usually in the policy but courts will imply it if it is not; the insurer's performance obligation is conditioned on the policyholder's cooperation. Any lack of cooperation must be substantial and material in order to relieve the insurer of its duties. A key requirement of cooperation is that the policyholder may not settle the claim against it without the insurer's consent.<sup>48</sup> If the

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<sup>47</sup> Indeed, Jonathon Molot's most convincing point in two excellent pieces is that commercial *defendants* may need additional litigation risk insurance. See Molot, *Market in Litigation Risk*, 76 U. CHI. L. REV. 367 (2009).

<sup>48</sup> The requirement to cooperate in settlement comes from both the duty to cooperate and the subrogation clause. The subrogation clause is relevant because an insurer subrogated to its policyholder's claims has only the rights of the policyholder would have had; a policyholder who has settled may have no remaining rights, depending on the various claims at issue.

policyholder does settle without the insurer's knowledge or against the insurer's will, the policyholder (usually) forfeits having the insurer pay the settlement.

In litigation funding the plaintiff does not have a duty, at least not that we know of, to cooperate with the funder in any way regarding the litigation. In some states, courts "have held that a champerty contract that gives the power to settle to the funder" is impermissible intermeddling.<sup>49</sup> It is exceedingly likely that the plaintiff has a contractual duty, owed to the funder, to cooperate with the lawyers in pursuing the claim. How the funder incentivizes the plaintiff to accept an appropriate settlement offer is unknown but such incentives must exist in order for the funder to be willing to play.

As the relationship between funder, lawyer, and plaintiff evolves it will become clearer if funded plaintiffs have a duty similar to insured defendants. On the other hand, the need for such a duty is surely lower. The plaintiff has ever incentive to aid in the winning of the case; certain insured defendants may be recalcitrant to the hassle of involvement if the insurer is the one on the hook for the outcome. In insurance, the duty to cooperate also serves to combat a policyholder attempting to collude with a plaintiff at the insurer's expense.

#### *(5) Co-Clients: Policyholder and Insurer*

The historic debate over whether insurance defense counsel has one or two clients is not entirely over but in many ways insurers' have won; the policyholder and the insurer are both clients.<sup>50</sup> "Today, absent a contrary agreement as to the identity of the client, the prevailing view appears to be that the lawyer represents both the insured and the insurer, at least for some purposes."<sup>51</sup> The insurer is not only integral to the defense decision-making, it often runs the defense. Indeed, one of the services the insurer provides is that of repeat-player litigation expert; the insurer is familiar with common claims and has a network of lawyers and experts.

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<sup>49</sup> Sebok, *Inauthentic Claim*, 64 VAND. L. REV. at 110.

<sup>50</sup> This is not true in all states. For an important part of the debate, and an argument for allowing two clients, see Charles Silver, *Does Insurance Counsel Represent the Company or the Insured?*, 72 Tex. L. Rev. 1583 (1993).

<sup>51</sup> ABA Formal Ethics Opinion 96-401 (Aug. 2, 1996). See also 5 Bus. & Com. Litig. Fed. Cts. § 59:53 (2d ed.).

Third-party litigation funders vary in their stated and probable involvement in the underlying litigation. Given the newness of the funding in the United States, it is not clear what the precise relationship between the plaintiff and the funder is meant to be or how it actually manifests. What is clear is that the funder and the plaintiff are not co-clients of the plaintiff's lawyer.

At first blush, this difference between the litigation funder and the insurer might seem fundamental and intractable. The insurer is a co-client *not* because it funds the litigation but because it will pay all or part of the defendant's damages owed.<sup>52</sup> The insurer's money is the money at stake in the litigation. The funder, on the other hand, cannot be a co-client because it has no stake in the underlying litigation. It has lent money to a person or entity who uses that money to bring a suit.

This description reveals the financial similarity between the plaintiff's funder and defendant's insurer, however. The insurer's money is at stake; if the defendant loses, the insurer pays. The funder's money is at stake; if the plaintiff wins, the funder gains. Is the difference merely that one stands to lose and one stands to gain? A key difference is that in the average case the insurer stands to pay nearly all and in the average case the funder stands to recoup only a portion of the proceeds, usually much less than half.

To further explore the difference between the two, consider each relationship in the absence of litigation funding. A policyholder could purchase a liability insurance policy that provided coverage for damages but not for defense funds. The insurer's funds would still be at stake in the outcome of the litigation. The insurer could still be a co-client of the (now policyholder-paid) lawyer. What differs dramatically in this scenario is the potential conflict between the policyholder and insurer, in a way that shows the benefit of coupling insurer liability with insurer defense funding.<sup>53</sup>

Returning to the plaintiff's litigation funder, removing the litigation funding alters the relationship beyond recognition. To preserve the investment aspect of the relationship, we can envision a third-party who lends money to the plaintiff. We can even envision that the lender is aware of the plaintiff's potential suit and

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<sup>52</sup> [In \_\_ percentage of cases, the policyholder/insurer settle with the plaintiff within the policy limits, meaning that the insurer pays the entire amount, minus any deductible.]

<sup>53</sup> More may be said on this point but the obvious observation is that a defendant who bares all the litigation costs and none of the settlement costs within the policy limits will settle at the policy limits as soon as possible, even if the expected value of the claim is much less.

views it as a potential asset. But the lender has no legal or contractual right to influence the plaintiff's litigation strategy or even to condition the loan upon pursuing the claim. The lender is not a co-client and would never be included in the suit as a party or brought into litigation discussions by the plaintiff's lawyer.

The purpose of this thought experiment, in part, is to reinforce trait (3) that litigation funding is not the central purpose of the policyholder-liability insurer contract. We can *remove* litigation funding from the relationship and retain the other key aspects of the relationship. But the main revelation the co-client status reveals is this: on one level the insurer is not a third party. Of course the insurer is not the party who committed an act triggering a liability suit. In all other ways, however, the insurer is fully involved in the litigation, perhaps with more at stake than the policyholder. Unlike the contingency-fee lawyer, the fund financier, or the lawsuit lender, the insurer's involvement does not stem from the funding of the litigation and its stake precedes the funding decision.

### III. The Comparison Claims

Accepting for the moment the value of the insurance defense/litigation funding comparison, we can examine three claims that have been made on the basis of the comparison.<sup>54</sup> Do not necessarily blame litigation-funding supporters for any inconsistency among these claims; the claims come from various sources.<sup>55</sup>

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<sup>54</sup> There are other claims about the relevance of insurance defense to litigation funding that will not be explored here. In a potential future of litigation funding for *defendants*, for example, the funding would operate as a form of insurance against the possibility of a large judgment.

<sup>55</sup> For each claim I have cited an individual or group who has supported the specific claim but these claims are in the ether. Variants on each can be seen in the many recent symposia, conferences, or programs on third-party litigation funding. In addition to the 2009 RAND Civil Justice Institute Conference, RAND hosted "Alternative Litigation Finance in the U.S.: Where Are We and Where Are We Headed with Practice and Policy?" (May 2010). See Steven Garber, *Alternative Litigation Financing in the United States: Issues, Knowns and Unknowns* (RAND Corp. 2010), [http://www.rand.org/pubs/occasional\\_papers/2010/RAND\\_OP306.pdf](http://www.rand.org/pubs/occasional_papers/2010/RAND_OP306.pdf). Erasmus University in Rotterdam hosted the conference "New Trends in Financing Civil Litigation in Europe: A Legal, Empirical and Economic Analysis" (April 24, 2009), [http://www.frg.eur.nl/home/research/research\\_programmes/behavioural\\_](http://www.frg.eur.nl/home/research/research_programmes/behavioural_)

First, insurers are third-party litigation funders (as are contingency-fee lawyers). Thus, we can see that third-party litigation funding works well in the United States already and should not cause alarm. Second, litigation funding is necessary on the plaintiff side to restore parity between plaintiffs and insurer-backed defendants. Supporters have not used this language but one version of the claim is that insurer defense creates an imbalance with negative externalities. Third, insurer control of policyholder litigation is less intrusive than funder involvement will be. Because insurer control is accepted, a lower level of funder involvement should be as well.

### COMPARISON 1: INSURERS *ARE* LITIGATION FINANCIERS.<sup>56</sup>

This is the most general of the comparisons between litigation funding and insurer defense. Time is better spent on the more detailed versions of this general claim. However, it is worth addressing initially because it has some intuitive appeal and some truth behind it. Moreover, as long as this position holds, causal observations about the insurance defense model will continue to seep into discussions of third-party litigation funding.

Insurers fund litigation already. This is true on two different levels. First, in England and some other jurisdictions, litigation expense insurance (LEI) bears a closer relation to third-party litigation financing. LEI comes in two basic forms: Before-the-event (BTE) insurance and after-the-event (ATE) insurance, in which “the event” is litigation in want of funding.<sup>57</sup> LEI is usually purchased by the plaintiff, or plaintiff-to-be, but it can be purchased by a defendant.<sup>58</sup> A plaintiff who purchases ATE litigation insurance has a litigation funder, as that term is used here, who is a third-party and an insurer.

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approaches\_to\_contract\_and\_tort\_relevance\_for\_policymaking/financing\_civil\_litigation. An “International Conference on Litigation Costs and Funding” was organized by the Centre for Socio-Legal Studies and the Institute of European and Comparative Law University of Oxford. (July 2009), <http://www.csls.ox.ac.uk/CivilJusticeSystems.php>.

<sup>56</sup> See, e.g., RAND Conference 2009 at 2.

<sup>57</sup> See Willem H. van Boom, “Financing civil litigation by the European insurance industry,” in *NEW TRENDS IN FINANCING CIVIL LITIGATION IN EUROPE*, 92 (Mark Tuil & Louis Visscher, eds. 2010); Marco de Morpurgo, *A Comparative Legal and Economic Approach to Third-Party Litigation Funding*, 19 *CARDOZO J. OF INT’L & COMP. L.* 343, 353-54 (2011).

<sup>58</sup> [a longer discussion of LEI may be merited here]

Unfortunately, this fact does not advance the discussion of potential third-party litigation funding in the United States. In the U.S., litigation expense insurance is not widely available.<sup>59</sup> If it were, profitable comparisons could no doubt be drawn between ATE insurer litigation funding and ATE litigation funding by investors. As it is, the available comparison is between European insurers that fund (plaintiff) litigation expenses and American insurers that fund defense expenses as part of liability coverage. The differences between the European litigation context and the American one—including our tort system structure, higher litigation costs, and the American Rule—render this comparison difficult.<sup>60</sup> “Virtually every aspect of financing civil litigation in the United States differs from the European model, at least with regard to formal rules.”<sup>61</sup> Moreover, this is not the comparison upon which scholars and policy makers are drawing, as the analysis of the more specific claims below will show.

On a second, different level, the claim that insurers fund litigation could refer to subrogation. After an insurer has paid its policyholder for a loss, the insurer may by right or by contract pursue whatever claim the policyholder would have had against the party who caused the loss.<sup>62</sup> The insurer takes the role of plaintiff

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<sup>59</sup> In the United States, Sonoma Risk Insurance Agency, underwritten by Zurich, sells Contract Litigation Insurance. CLI covers the risk of having to pay the attorneys’ fees of one’s contracting partner under a “prevailing party” provision—in essence, when the parties have contracted around the American Rule. This coverage can be purchased by either the plaintiff or the defendant before or shortly after the start of litigation.

<sup>60</sup> Third-party litigation funding has been present in England (over 10 years) and Australia (over 20 years) for longer than it has in the United States. The background in which litigation funding takes place in those countries differs quite dramatically from the U.S. In England, for example, the losing party pays the winning party’s litigation costs and contingency fees are prohibited, although conditional fee arrangements have recently been permitted. In addition, until recent cut-backs, publicly provided legal aid allowed many individual plaintiffs to bring suit. There are other relevant differences but these alone are sufficient to alter the need for and the effect of litigation funding.

<sup>61</sup> Deborah R. Hensler, “Financing civil litigation: the US perspective,” in *NEW TRENDS IN FINANCING CIVIL LITIGATION IN EUROPE*, 149 (Mark Tuil & Louis Visscher, eds. 2010).

<sup>62</sup> See generally Spencer L. Kimball & Don A. Davis, *The Extension of Insurance Subrogation*, 60 Mich. L. Rev. 841 (1962). Equitable subrogation may be limited as equity requires. The insurance contract can provide the right to “conventional” subrogation, although whether conventional subrogation can apply when equitable subrogation would not is a question of some debate. Subrogation is not limited to insurance,

and funds what is now its own litigation. (Insurer subrogation thus might shed light on a discussion of expanded claim transfer in the United States). This will be discussed in more detail in a separate section but for purposes of this claim it is important to note that subrogation is not the type of funding that is a competitor to or a substitute for all the various funding methods described as third-party litigation funding. Moreover, as with insurance defense litigation, the insurer's interest in the subrogated claim is pre-existing.

In short, the problem with the claim that insurers are litigation financiers is not its inaccuracy but its superficiality. Insurers obviously pay for legal costs in litigation. In the vast majority of cases, insurers do this either as co-clients of the lawyer representing the defendant or as plaintiffs with claims in subrogation. In other words, the insurer is either not a third-party or is *the* party as a result of claim transfer. The difference between these relationships and third-party litigation funding does not mean that two should never be mentioned in the same breath. It does mean that in an analysis of third-party litigation funding, little can be said to automatically follow from the fact that insurers fund litigation.

## **COMPARISON 2: RESTORING PARITY BETWEEN POLICYHOLDERS AND DEFENDANTS**

Some “question[] the fairness of the defendant’s ability to transfer risk to an insurance company before the event, while plaintiffs are left to absorb all the risk of returns on their claims until the eventual outcome.”<sup>63</sup> While fairness may be in the eyes of the beholder, it is useful to examine the potential effects of evening out what may be a lop-sided arms race between plaintiff and defendant. First, however, it is worth examining the breadth of the factual claim, both in the commercial and individual context.

In both contexts there will be defendants who cannot rely on an insurance company to provide a defense. For the individual, the largest set of uninsured suits will be those brought for intentional harms. Whether it is the act, the outcome, or both that must be “expected or intended from the standpoint of the insured” to exclude coverage depends on the policy but mostly on the

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of course. When a surety pays a creditor to satisfy a debtor’s debt, the surety is subrogated to the creditor’s original claim against the debtor.

<sup>63</sup> RAND Conference 2009 at 52 (Appendix B: Presenter Materials, from Keynote Speech by Lord Daniel Brennan).

jurisdiction.<sup>64</sup> In the majority of jurisdictions courts require an intentional act and some level of intent to cause injury, although intent can be inferred and the intent to cause a lesser harm will apply to a worse outcome.<sup>65</sup> The saving grace for some defendants is not the level of intent required but the propensity of plaintiffs to bring suits arguing intentional harm and, in the alternative, unintentional harm. Such mixed suits often do trigger an insurer-provided defense.<sup>66</sup>

For the commercial defendant, the largest set of uninsured suits may be those brought for contract disputes and breach of contract. In non-contractual disputes between commercial entities both parties will likely have Commercial General Liability insurance and other forms of commercial coverage. In many of these cases the plaintiff is *not* left to absorb all the risk until the eventual outcome; the plaintiff may recover under its own insurance and then support the insurer in its subrogation claim against the defendant. In this scenario the plaintiff receives some compensation for the harm before suit and moves some or all of the risk of suit to its insurer. In many circumstances, then, a defendant will not be able to transfer the risk of suit to an insurer or a plaintiff will be able to transfer some risk of suit.

Nonetheless, in plenty of cases the plaintiff will have to bear his own litigation risk while the defendant has been able to transfer some of his risk to an insurer. The insurer also brings a trait that proponents of third-party litigation funding wish to extend to plaintiffs: risk neutrality. Without insurance, a risk averse defendant is not indifferent between a known settlement of \$50,000 and a 50% chance of a \$100,000 damages award even though the expected value is identical; he may settle for \$60,000 to avoid the risk of owing \$100,000.<sup>67</sup> This works to the obvious advantage of the plaintiff.

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<sup>64</sup> See Jerry, UNDERSTANDING INSURANCE LAW § 63C.

<sup>65</sup> *Id.* § 63C[a].

<sup>66</sup> Indeed, plaintiffs may plead in the alternative for the purpose of bringing the tortfeasor's insurer into the picture. An otherwise judgment-proof defendant may be worth suing if the plaintiff either can convince the insurer that winning on the unintentional claim is likely enough to merit settlement or can convince the insurer that settling a mixed claim early on will be less expensive than proving in court that the policyholder's actions were intentional and not indemnified.

<sup>67</sup> The literature on why and when parties settle is deep. See, e.g., William M. Landes, *An Economic Analysis of the Courts*, 17 J. OF LAW & ECON. 61 (1971); John P. Gould, *The Economics of Legal Conflicts*, 2 J. OF LEGAL STUD. 279 (1973); [additional]; Samuel R. Gross & Kent D. Syverud, *Getting to No: A Study of Settlement Negotiations and the*

Having taken this advantage away from the plaintiff through insurance defense, should we restore parity (if that is what it does) by allowing the plaintiff to transfer his litigation risk? For individual plaintiffs the question is what value litigation funding will add over contingency-fee arrangements; lawsuit lending will give some plaintiffs the resources and time necessary to continue a suit he would otherwise be forced to settle “early.” For commercial plaintiffs the question of parity also comes down to efficient settlement. Litigation funding may increase the accuracy of settlements so that they are based on the parties’ expectations about the value of the suit and not a reflection of the risk preferences of one party.<sup>68</sup> This is the strongest point to have emerged from the insurer defense/litigation funding comparisons.

Whatever the value of risk neutrality on the part of a plaintiff, the value of coupling litigation cost with liability insurance is high. Assume a scenario in which the plaintiff’s payment is expected to be below the policy limits; the policyholder has no fear of an award or settlement going up to that limit. If we imagine a policyholder who has liability insurance coverage for the award or settlement, but *not* for lawyer’s fees, he will want to settle as quickly as possible for two reasons. First, going to trial gains him nothing because a damages award of either less than the settlement offer or zero benefits his insurer only. Second, going to trial or any choice that keeps the lawyer employed is a direct cost borne by him alone. This scenario has assumed the possibility of settlement, which is the most likely outcome, and settlement at or below insurance policy limits, a common outcome. In short, decoupling the insurer’s liability burden from the litigation cost burden results in higher and more inaccurate settlements.<sup>69</sup>

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*Selection of Cases for Trial*, 90 MICH. L. REV. 319 (1991); Bruce L. Hay, *Effort, Information, Settlement, Trial*, 24 J. LEGAL STUD. 29 (1995); Russell Korobkin, *Aspirations and Settlement*, 88 CORNELL L. REV. 1 (2002).

<sup>68</sup> For a thorough presentation of this argument, see Jonathan T. Molot, *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L. REV. 65 (2010). Prof. Molot is now also the Chief Investment Officer of Burford Group Limited, the largest litigation investment fund in the United States, *see supra* \_\_\_. At Burford, Prof. Molot is also a Managing Director and Chairman of the Investment Committee. This is not to question Prof. Molot’s belief in the value of third-party litigation funding; indeed, he has put more than his money where his mouth is.

<sup>69</sup> Note that while the policyholder prefers immediate settlement the insurer may prefer a full trial. The closer the expected settlement to the policy limit, the more an insurer has to gain from even a tiny chance of success at trial. The policyholder bears the full burden of the trial’s legal costs and the insurer’s expected damages payment goes down.

Professor Stephen Yeazell makes a related parity claim that litigation funding will make “plaintiffs parallel with defendants whose insurers are implicitly vouching for the credibility of the defense.”<sup>70</sup> If insurers do vouch for the credibility of a defense by mounting one, it is “credibility” in a limited sense. And it pales in comparison to the “credibility” a litigation funder provides by agreeing to invest in a plaintiff’s case.

The value of credibility here is the ability to bring the other party to a favorable settlement. Insurers have a duty to defend a case, whereas third-party funders have a choice; their choice to invest in a claim sends a strong signal. (One can imagine, however, a signal that is blurred by hedging. A litigation fund could invest in both sides of an open legal question, perhaps if the legal winds seem to change after the initial investment is made).

The insurer’s signal is much more ambiguous. An insurer’s decision to be involved in a policyholder’s defense is not based on the merits of the case. It is the decision to settle, and at what price, that reveals something of the insurer’s opinion of the case. However, the vast majority of civil litigation settles, including the vast majority of civil suits against tortfeasors with liability insurance. Eventual settlement may thus be presumed by both sides. A willingness to delay coming to a settlement may not reveal much either, as the insurer may be working from a belief in the strength of the case or the luxury of taking a negotiating position.

In this sense an insurer does provide a level of credibility; it is harder to force a defendant to settle out of the inability to bear litigation risk when a more risk-neutral party is involved. If both plaintiff and defendant could pursue and defend a claim without cost, settlement decisions would be more “pure” in that they would reflect more accurately the parties’ view of the strength and value of the claim. Instead, each party chooses a settlement point that takes account of litigation/negotiation costs, where litigation risk is one of the costs. Stated in this way, the value of credibility parity is the same point as the value of each party making decisions from a point of risk-neutrality.

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<sup>70</sup> RAND Conference 2009 at 130 (Appendix B: Presenter Materials, from Stephen C. Yeazell’s presentation “Third Party Finance: Legal Risk and Its Implications”). Prof. Yeazell is an expert on civil litigation and one should assume his full view is more nuanced than this sentence, which is taken from a power point presentation. That said, the idea that litigation funding will equalize the negotiating position of plaintiffs with insurer-backed defendants is a common one.

**COMPARISON 3: IN LITIGATION, IF INSURER CONTROL IS ACCEPTABLE, MERE INVESTOR INVOLVEMENT MUST BE EVEN MORE SO**

Insurers interject themselves into settlement decisions in defense actions; litigation funding will be less intrusive and thus we need not worry about interfering with either the lawyer's or the client's legal judgment. This comparison speaks to ethical concerns that litigation funding will interfere with the lawyer's duty to his client and legal concerns that funding asymptotically approaches claim transfer, which is permitted but restricted in the United States. The claim has been made about, and makes the most sense with, investor funds, not lawsuit lenders who lend to individual tort plaintiffs.

For example, in discussing the ethical concerns about litigation funding, Nathan Crystal has argued that funders be allowed the contractual right to *advise* lawyers and clients on settlement but not the right to decide. In considering the general purpose of the American ethical rule against fee-splitting (lawyers sharing fees with non-lawyers), Crystal's focus is on allowing the lawyer to make independent legal judgments in his client's best interest: "The insurance defense practice is an important model that can be used for comparison here. The insurance company retains the right to decide whether to accept or reject a settlement, except perhaps in medical malpractice cases. If anything, the financing arrangements discussed here are less intrusive on the attorney-client relationship . . . ." <sup>71</sup>

This claim is unsatisfactory on both sides of the comparison. On the insurer side, it is not simply that insurers have more control over their policyholder's defense; insurers have more at stake in the litigation and play a more equal role as co-client. On the fund side, it is not at all clear that investor funds do or will maintain the lower level of influence that Crystal and others advocate. Overlaying the comparison is the fact that one side is initiating litigation and one side is responding; it may be that third-party intervention in one raises concerns not raised by the other.

Taking the funder side first: Skepticism about the ability of a funder to "advise" but not influence the outcome of a case is natural. This risk seems especially high if the lawyer or law firm and funder are repeat players; the lawyer who does not take advice on when to settle may expect to avoid the advice in the future by having no further dealings with the funder. Some have thus gone farther than Crystal, arguing for a complete exclusion of the funder from the legal process so that litigation funding can have "the

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<sup>71</sup> RAND Conference 2009 at 18 (summary of Crystal's remarks).

benefits of champerty without the downside.”<sup>72</sup> For now, the casual reports of these arrangements place the funder lawyers “in the room” with the plaintiff-borrower and their litigation attorney during discussions, including settlement decisions.

Looking now at the insurer defense side of the comparison, it is not as simple as noting that if insurer control of litigation is acceptable then funder influence that stops short of control is acceptable too. In a sense, the insurer/defendant relationship is horizontal integration and the plaintiff/funder relationship is vertical integration. Thus the potential conflicts that arise in the insurance relationship differ from those in third-party financing. The claims that the ethical considerations are similar have been too quick. In addition to the pre-existing alignment of the policyholder and insurer’s interests—as opposed to the prior estrangement of the litigant and third-party financier—both the insurance contract and the common law charge the policyholder with cooperation duties and the insurer with fiduciary duties toward one another.

Most important, the insurer’s stake is often much higher than the defendant’s while the litigation funder’s stake is always less than the plaintiff’s. Given this, one would expect more and different problems with increased funder control of the litigation. If the funder’s control exceeds its stake in the litigation, it will be tempted to privilege its interests over those of the plaintiff when they diverge.

In addition, unlike the funded plaintiff, the policyholder/defendant has the opportunity to gain at the hands of the insurer. The insurer must be concerned about collusion between their policyholder and the plaintiff. The policyholder’s incentive is not to minimize the amount the plaintiff receives but to minimize the amount the policyholder pays. Thus the insurer must monitor the policyholder’s behavior. The insurance contract usually states the policyholder’s duties to cooperate in litigation, seek agreement on settlement, etc. Likewise, the insurer’s incentives can easily misalign with the policyholder’s. Unlike the third-party financier, who is on the hook for litigation costs, the insurer is potentially on the hook for litigation costs and the final judgment awarded by a court or jury. It is also possible for the litigation to reveal facts that relieve the insurer of any duty to pay, again, unlike third-party financiers.

Next, the insurer and the financier play different roles in their support and instigation of litigation. As discussed, the insurer’s duty to defend in most policies extends to baseless claims

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<sup>72</sup> RAND Conference 2009 at 19 (summary of remarks by Kathleen Flynn Peterson).

with little chance of success as long as the allegations are within coverage. After the policy coverage is set, insurers do not get to choose which cases to fund. Financiers, on the other hand, select their cases. Second, if the policyholder's and insurer's interests diverge, the duty to defend becomes a duty to pay for the defense; the insurer ceases to control the litigation. (A common example occurs when a plaintiff alleges both negligent and intentional conduct. The insurer would benefit from a finding of intentional conduct, which in most cases ends insurance coverage. The defendant policyholder obviously prefers a finding of no tort or negligence to intentional conduct.) Third, and perhaps most obvious, an insurer funding the defense of a case will not have the same potential affect on the quantity or type of litigation as funding plaintiffs' instigation of suit.<sup>73</sup> In short, between insurer involvement in policyholder litigation and third-party litigation financing there are differences in structure, incentives, ethical rules and questions, and likely effect.

#### *Assignment versus Investment*

Another difference stems from the level of insurer control over the litigation. At first look, the insurer's domination of their policyholder defendants should be scandalous. The insurer manages to inhabit the small space between claim transfer and champerty without fully committing either of them.<sup>74</sup> The first reason the insurer is given a pass is that "defense transfer" is not claim transfer. In contrast to the huge judicial and scholarly energy spent on trying to decide if, how, and when to permit the assignment of claims, there is little said about defense transfer.

"[T]he central issue around which the distinction between the practice of selling claims and TPLF—in its 'narrow' sense—is

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<sup>73</sup> The existence of liability insurance coverage creates a strong incentive for suit and the creation of new torts. See Ken Abraham's *THE LIABILITY CENTURY*. But this incentive stems from the insurance coverage itself, not from defense funding.

<sup>74</sup> Champerty is "[a]n 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." Black's Law Dictionary 262 (9th ed. 2009). Three related concepts are well explained here: "[P]ut simply, maintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome; and barratry is a continuing practice of maintenance or champerty." *Osprey, Inc. v. Cabana Ltd.*, 532 S.E.2d 269, 273 (S.C. 2000) (quoting *In re Primus*, 436 U.S. 412, 424 n.15 (1978)).

control over the litigation.”<sup>75</sup> For individual defendants, insurers exert such a high level of control over the litigation that the law would label it claim transfer or assignment were it a claim.<sup>76</sup> For commercial defendants control over the litigation is likely more evenly shared, although insurers retain the *right* to defend and a *veto* over settlement.<sup>77</sup>

In other words, insurers and policyholders engage in what might be called defense transfer or defense assignment.<sup>78</sup> Why call it defense transfer instead of defense control? A claim holder can pay a third party to manage its litigation or it can transfer the claim. In transfer the new owner alone benefits from a positive settlement or award. In insurer defense of individual policyholders it is largely the insurer alone who pays the settlement or award. The ability to settle a claim against the policyholder’s wishes smacks of an insurer with a property right in the claim over the policyholder. In the commercial general liability context the policyholder is more likely to share some of the burden. On a continuum between claim/defense transfer and litigation support, insurer defense is approaching transfer and third-party litigation funding is not.

This lack of claim transfer is fundamental to litigation funders. Effectuating claim transfer is tricky.<sup>79</sup> Personal injury

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<sup>75</sup> Marco de Morpurgo, *A Comparative Legal and Economic Approach to Third-Party Litigation Funding*, 19 *CARDOZO J. OF INT’L & COMP. L.* 343, 356 (2011).

<sup>76</sup> Anthony Sebok states that “full control of the lawsuit collapses the distinction between maintenance and assignment.” Sebok, *Inauthentic Claim*, 64 *VAND. L. REV.* at 109. This is correct in every way but one; in assignment the assignee internalizes all the costs and *benefits* of pursuing the claim. The litigation funder who controls the litigation still shares the benefit of suit with the claim holder. Perhaps the distinction is trivial because in the first the assignee pays the claim-holder for the claim up front and in the second the funder “pays” the claim-holder after a win, with payment in the form of taking only a portion of winnings. Where the timing of payment affects incentives, however, the distinction is not trivial.

<sup>77</sup> For an excellent discussion of settlement control in the contingency fee context, see Neil Rickman, *Contingent fees and Litigation Settlement*, 19 *INT’L REV. L. & ECON.* 295 (1999).

<sup>78</sup> The concept of a “defense transfer” is an obvious one but only one other author has used the phrase. See Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 *MINN. L. REV.* 1268 (2011).

<sup>79</sup> Two outstanding articles on property rights in claims and claim transfer generally are: Michael Abramowicz, *On the Alienability of Legal*

claims in tort cannot be assigned at all; given the existence of contingency-fee arrangements in the United States, third-party litigation funding for the tort plaintiff might not exist were assignment permitted. Some of the claim areas that investment funds have focused on would be extremely difficult or impossible to achieve in the form of transfer, such as antitrust claims and shareholder disputes.<sup>80</sup>

### *Conclusion*

This article does not take a position on the general desirability of third-party litigation funding in the United States or on the form that such funding would ideally take. However, it does reject the basic claim that if insurer defense is a net benefit then litigation funding must be a net benefit as well. Insurer defense funding stems from an existing relationship with a separate aim. Once a policyholder is charged with potential liability, the insurer has a financial stake in the outcome of that dispute, whether the dispute settles or is resolved in litigation. Third-party litigation financing introduces a new party into the litigation relationship, one that at the margin engenders the litigation. At a minimum, this means that the cost-benefit analysis in the two cases must diverge. While tensions and direct conflicts can follow from either third-party financing or insurer litigation, the cost of constraining litigation funding is unknown. Because it is not possible to avoid the conflicts in insurance without banning liability coverage, the cost of fundamentally altering the liability coverage system is unfathomable.<sup>81</sup>

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*Claims*, 114 YALE L.J. 698 (2005) & Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61 (2011).

<sup>80</sup> See <http://www.juridica.co.uk/claim.php>.

<sup>81</sup> *But see* Alan I. Widiss, *Abrogating the Right and Duty of Liability Insurers to Defend Their Insureds: The Case for Separating the Obligation to Indemnify from the Defense of Insureds*, 51 OHIO ST. L.J. 917 (1990).