

Tuesday's 2-Minute Tip



Third-party litigation funding

Last week we mentioned that one of the multitude of reasons your [car insurance](#) has [increased](#) is due to an increase in lawyer involvement. This brings us directly to a newer business model that is still widely unregulated in the United States: Third-party litigation funding.

What is it?

Third-party [litigation funding](#) (TPLF) is “the process where third party funders provide money to a plaintiff or plaintiff’s counsel in exchange for a cut of the proceeds resulting from the underlying litigation or settlement.” This funding allows hedge funds, private equity firms, and other financial investors to invest in lawsuits with the intention of making a profit off the eventual settlement or final judgment.

TPLF is split into two categories: consumer and commercial. Consumer funding is between a funder and an individual, often for a personal injury case, where the funds pay for living expenses. Commercial arrangements are typically for large-scale suits or multiple cases where the investment is given to a law firm to pay for business expenses. These arrangements are typically non-recourse, [meaning](#) that if the lawsuit is unsuccessful, the funder receives nothing in return for their investment.

The practice of TPLF started in Australia in the mid-1990s before making its way to the United Kingdom and the United States, among many other countries. In the United States alone, commercial litigation investments are an [estimated](#) \$15.2 billion industry, and that’s just a rough estimate as there is still very little transparency in this industry.

Regulation and new business models

Two common law doctrines historically prohibited TPLF from existing: Champerty and Maintenance. As [described by legal scholar](#) Victoria Shannon Sahani, “Maintenance is about people who are not party to a legal case providing funding for that case, and Champerty is Maintenance for a profit.” Both of these were either prohibited or criminal, but legal changes in Australia and the UK [paved the way](#) for TPLF to take hold in the United States as well.

As we well know, the United States is a flurry of varying regulations. Prohibitions on either doctrine are left to individual state bars, legislators, and courts. Additionally, there is no national requirement that a lawsuit must disclose when it has third-party financing – a bill was [introduced](#) last October by California Congressman Darrell Issa to require transparency, but [no action](#) has been taken since it was referred to committee.

In 2020, Arizona became [the first state](#) to allow nonlawyers to co-own businesses that provide legal services, referred to as an “[Alternative Business Structure](#).” Since then, more than 100 businesses have been approved in the state, and other states have considered making similar changes to their laws. These business models are a perfect way for funders to maintain close relationships with lawyers and see more profit from their investments.

The problems with TPLF

Proponents of TPLF [argue](#) that since the funding is non-recourse it incentivizes investors to fund the cases with the strongest merit and provides a necessary screen for meritless or frivolous lawsuits. However, as [explained](#) by the Institute of Legal Reform, litigation is expensive for businesses and many will choose to settle cases whether the claim is legitimate or not. “Since TPLF lets plaintiffs off the hook for legal costs, there is little risk for them to advance non-meritorious claims.” The more a company pays out in settlement money, or even fighting lawsuits, the more likely it will pass those costs on to the consumer.

Potentially the biggest argument against TPLF is that it [prioritizes profit over justice](#). Some arrangements allow funders to make strategic legal decisions that may not be in the best interest of the plaintiff, such as settling instead of going to trial. This is a stark contrast to a lawyer’s fiduciary duty to act in the best interests of their clients.

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