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THIRD-PARTY FINANCING OF CLASS ACTION LITIGATION IN THE UNITED STATES: WILL THE SKY FALL?

*Deborah R. Hensler**

"One day Henny-penny was picking up corn in the cornyard when—whack!—something hit her upon the head. 'Goodness gracious me!' said Henny-penny; 'the sky's a-going to fall; I must go and tell the king.'"[1]

INTRODUCTION

The advent of third-party litigation financing—the funding of lawsuits by entities other than parties or their legal representatives—in the United States has stimulated legal scholarship, policy debate, and interest group advocacy. Some scholarship fails to distinguish among financers that use different business models and target different market segments, which can make it difficult to assess normative recommendations.[2] Nonetheless, most scholars are cautious in drawing conclusions about the cost–benefit ratio of introducing third-party financing into the legal system. Likewise, the policy debate has been cautious, as leaders of the bar have adopted a "wait and see" attitude in response to calls for regulation.[3] The advocacy has been strident, however, with corporate interest groups pressing hard for regulation —if not absolute prohibition—of third-party financing not only in the

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* Judge John W. Ford Professor of Dispute Resolution, Stanford Law School. I am grateful to Manuel Gómez for sharing his knowledge of the Chevron–Ecuador litigation, to Radoslaw Goral for sharing his research findings on the structure of the litigation financing market in the United States, and to Jasminka Kalajdzic for comments on an earlier draft.

1. JOSEPH JACOBS, *Henny-Penny*, *in* ENGLISH FAIRY TALES (London, David Nutt 1890), *available at* http://www.surlalunefairytales.com/authors/jacobs/english/hennypenny.html. In the United States, Henny-penny is frequently referred to as Chicken Little.

2. *See, e.g.*, Michelle Boardman, *Insurers Defend and Third Parties Fund: A Comparison of Litigation Participation*, 8 J.L. ECON. & POL'Y 673 (2012).

3. ABA COMM'N ON ETHICS 20/20, INFORMATIONAL REPORT TO THE HOUSE OF DELEGATES 2 (2012) [hereinafter ABA WHITE PAPER], *available at* http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf; Bethany Rabe, *NYC Bar Weighs in on Litigation Financing*, A.B.A. LITIG. NEWS (Aug., 29, 2011), http://apps.americanbar.org/litigation/litigationnews/top_stories/082911-new-york-city-bar-third-party-litigation-financing.html.

United States but in other jurisdictions as well.[4] No group has been as strident or as active in opposition to third-party litigation financing as the U.S. Chamber of Commerce's Institute for Legal Reform, and no area of legal practice has been more clearly targeted for prohibition of such financing than class action litigation.[5]

In its advocacy materials, the Chamber focuses attention on Australia,[6] where third-party litigation financing has shaped class action litigation over the past two decades. In the Chamber's telling, the Australian experience should warn the other animals in the barnyard that the sky is falling. Like Henny-penny, the Chamber mistakes an acorn for the sky. As in the fable, those who follow the Chamber's advice may find themselves in the clutches of Foxy-woxy, who ultimately lures Henny-penny and her animal followers to his den, only to eat them all.

This Article discusses the possible consequences of third-party litigation financing for class action litigation in the United States. Part II describes the market for third-party litigation financing in the United States and discusses the potential for litigation investment in U.S. class action litigation.[7] Part III unpacks the criticisms of third-party litigation financing with particular reference to U.S. class actions and considers their empirical basis. Part IV describes the Australian federal class action procedure and the role of third-party litigation financ-

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4. Letter from Lisa A. Rickard, President, U.S. Chamber of Commerce Inst. for Legal Reform, to Rt. Hon. Kenneth Clark QC MP, Lord Chancellor and Secr'y of State for Justice, UK Ministry of Justice (July 13, 2011), *available at* http://www.instituteforlegalreform.com/sites/default/files/images2/stories/documents/pdf/international/2011_07_13_us_chamber_letter_to_uk_moj.pdf (opposing collective litigation and third-party financing); *Comments of the U.S. Chamber of Commerce Institute for Legal Reform on the Civil Procedure Amendment (Supreme Court Representative Proceedings) Bill 2010*, U.S. CHAMBER INST. FOR LEGAL REF. (Nov. 10, 2010), http://www.instituteforlegalreform.com/sites/default/files/images2/stories/documents/pdf/international/ilrresponsetothecivilprocedureamendment.pdf. Other business groups have joined in opposition to third-party litigation financing. *See, e.g.*, State & Policy Affairs Dep't, *Third-Party Litigation Funding: Tipping the Scales of Justice for Profit*, NAT'L ASS'N MUTUAL INS. COMPANIES (May 2011), http://www.namic.org/pdf/publicpolicy/1106_thirdPartyLitigation.pdf.

5. *See, e.g.*, JOHN BEISNER ET AL., U.S. CHAMBER INST. FOR LEGAL REFORM, SELLING LAWSUITS, BUYING TROUBLE: THIRD-PARTY LITIGATION FUNDING IN THE UNITED STATES (2009); U.S. CHAMBER INST. FOR LEGAL REFORM, THIRD PARTY FINANCING: ETHICAL & LEGAL RAMIFICATIONS IN COLLECTIVE ACTIONS (2009) [hereinafter ETHICAL & LEGAL RAMIFICATIONS].

6. BEISNER ET AL., *supra* note 5, at 9–11; ETHICAL & LEGAL RAMIFICATIONS, *supra* note 5, at 17–22.

7. Some U.S. lawyers and legal scholars still mistakenly assume that class action litigation is unique to the United States. For a discussion of the global spread of class actions, *see* Deborah R. Hensler, *The Future of Mass Litigation: Global Class Actions and Third-Party Financing,* 79 GEO. WASH. L. REV. 306 (2011). The proliferation of class actions and other group litigation procedures offers an opportunity to investigate the consequences of different fee regimes for the implementation of collective litigation rules.

ing in the class action domain, presents statistical data on the frequency and types of class actions in Australia, and reflects on the lessons of the Australian experience for the United States. Part V concludes with a consideration of the likelihood that the sky would fall if third-party litigation financing were to become common in class action litigation in the United States.

II. BACKGROUND

Roughly speaking, there are two claim markets that third-party litigation financers in the United States have targeted: (1) ordinary tort claims, typically for modest amounts, brought by individuals of limited means; and (2) commercial claims for damages, typically for quite large amounts, brought or defended by corporations. Virtually everything about these markets is different, save for the fact that in each market the financers' interest in the lawsuits is solely monetary.

A. The Potential for Third-Party Litigation Financing of Class Actions in the United States

Some have likened the tort claims market to the payday loan market[8]: the financers provide funds to relatively unsophisticated people who have colorable personal injury claims, but whose personal circumstances are so straitened that they find it attractive to promise a large portion of the recovery they may ultimately receive in court in exchange for immediate help in covering current expenses. The funder provides money directly to the claimant, usually in the form of a nonrecourse loan,[9] in order to skirt usury law restrictions on the share of the recovery the funder can obtain. The loans are usually for a few thousand dollars, and sometimes tens of thousands of dollars, but rarely larger. The typical claims arise out of automobile accidents and slip-and-falls for which there is a high likelihood of recovery,[10]

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8. Page C. Faulk, U.S. Chamber Inst. for Legal Reform, Presentation on Third-Party Litigation Financing (executive summary available at http://www.wial.com/wwcms/wp-content/uploads/2012/09/Litigation-Loans.pdf). Others have analogized this part of the litigation financing industry to the subprime mortgage market. *See* Susan Lorde Martin, *Litigation Financing: Another Subprime Industry that Has a Place in the United States Market*, 53 VILL. L. REV. 83 (2008).

9. A nonrecourse loan is a loan in which the lender will not be reimbursed if the claim fails.

10. Available data indicate that insurance reimburses upwards of three-quarters of economic losses associated with automobile accident injuries and that roughly half of victims retain lawyers to represent them during claims processing. Most claims are settled, and plaintiffs win about half of the small percentage of cases that go to trial. In sum, automobile accident injury disputes are not high risk cases. JAMES ANDERSON ET AL., RAND CORP., THE U.S. EXPERIENCE WITH AUTOMOBILE NO-FAULT AUTOMOBILE INSURANCE: A RETROSPECTIVE 87–97 (2010), *available at* http://www.rand.org/content/dam/rand/pubs/monographs/2010/RAND_MG860.pdf; *see also*

and thus some return on the loan is almost certain. The funder has no formal relationship with the claimant's lawyer, thereby forestalling charges that lawyers and nonlawyers are splitting fees. The law firms representing claimants who obtain loans are typically small, although a single firm may handle a large volume of small-to-moderate-value claims.[11] The funders minimally screen claims to determine whether to offer funding;[12] like many of the lawyers in this claim market, their approach is routinized and their business model relies on handling a high volume of similar cases without much, if any, individualized treatment.[13] Many of the funders in this market advertise their loans online and some offer loans against other similar assets, such as structured settlements, annuities, and the lifetime value of a winning lottery ticket.[14] Lenders are attracted to the market by its potential to earn high rates of return per claim on a large volume of loans. The high rate of return is likely the result of the circumstances of the borrower-victims, rather than the riskiness of the loan. Because of its characteristics, some have described this market as the litigation lending market.

The second market is akin to an equity market: in exchange for a share of the damages recovered, the financers fund either a business with a colorable legal claim or the lawyers representing the business (or both) to pursue litigation that would otherwise be too risky or too expensive to pursue with the intensity that would maximize net benefit.[15] The claimants in this market are sophisticated business decision

LYNN LANGTON & THOMAS H. COHEN, U.S. DEP'T OF JUSTICE, CIVIL BENCH AND JURY TRIALS IN STATE COURTS, 2005, at 4 tbl. 5, 10 (2008), *available at* http://bjs.gov/content/pub/pdf/cbjtsc05.pdf.

11. *See* Nora Freeman Engstrom, *Run-of-the-Mill Justice*, 22 GEO. J. LEGAL ETHICS 1485, 1491–92 (2009) (describing these types of firms as "settlement mills").

12. For example, Woodbridge Pre-Settlement Funding, LLC advertises, "Any legal claim with good merits may qualify for a [sic] litigation funding from Woodbridge. We offer pre settlement funding for pending lawsuit cases that contain: Proven Negligence or Compelling Liability; Defendants with an established ability to pay the potential settlement; [and] Damage Documentation." *What Pending Lawsuits Will Qualify for Litigation Funding?* WOODBRIDGE PRE-SETTLEMENT FUNDING, http://www.woodbridgepresettlement2.pth4.com/attorneys-pending-lawsuit-litigation-funding/ (last visited Aug. 24, 2013).

13. *See* Deborah R. Hensler, *Financing Civil Litigation: The US Perspective*, *in* NEW TRENDS IN FINANCING CIVIL LITIGATION IN EUROPE: A LEGAL, EMPIRICAL, AND ECONOMIC ANALYSIS 149, 162–63 (Mark Tuil & Louis Visscher eds., 2010).

14. Woodbridge describes itself as a "pioneer in the cash now financial services industry." *About Woodbridge Pre-Settlement Funding*, WOODBRIDGE PRE-SETTLEMENT FUNDING, http://www.woodbridgepresettlement2.pth4.com/about-woodbridge-pre-settlement-funding/ (last visited Aug. 24, 2013).

15. Commentators note that commercial litigation financers may enter into funding and risk-sharing agreements with corporate defendants, *see, e.g.*, Maya Steinitz, *Whose Claim Is This*

makers who are represented by corporate law firms.[16] The funders are institutional investors—including banks, insurance companies, and hedge funds—whose investments are managed by specialized litigation financing firms. These entities focus on high-value claims, which they investigate carefully in order to estimate accurately the expected payoff.[17] The financers rarely consider funding claims worth less than several millions of dollars, and some operate at a much higher dollar threshold.[18] These claims are typically much more expensive to litigate than an automobile accident claim and also more risky. In contrast to the litigation lending market, this might be described as the "litigation investment" market, although the financial instruments, as in the first market, are loans.[19]

Anyway? Third-Party Litigation Funding, 95 MINN. L. REV. 1268, 1276–77 (2011), but there are few details publicly available about the nature of these agreements.

16. *See* Nate Raymond, *More Attorneys Exploring Third-Party Litigation Funding*, N.Y. L.J. (June 4, 2010), *available at* http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=1202459195060&slreturn=20130306182914 (highlighting the practices of corporate litigator Louis Solomon, attorney at Cadwalader, Wickersham & Taft LLP).

17. Burfurd Capital Ltd.—which claims it is the "world's largest provider of investment capital and risk solutions for litigation," BURFORD CAPITAL LTD., LAW FIRM FINANCING SOLUTIONS FROM BURFORD 1 (2013), *available at* http://www.burfordcapital.com/wp-content/uploads/2013/10/2013-10-01-Burford-Finance-One-Sheet.pdf—asserts: "[C]ommercial litigation financing involves sophisticated corporate parties, represented by major law firms, with the financier investing millions of dollars—sometimes more than $15 million. These are bespoke and highly-negotiated arrangements." *The Basics*, BURFORD CAPITAL [hereinafter BURFORD, *The Basics*], http://www.burfordcapital.com/litigation-finance/the-basics/ (last visited Aug. 24, 2013). Juridica Investments Ltd., which claims it is the leading commercial litigation financer in the United States and the United Kingdom asserts: "Juridica accepts only cases that have already been carefully vetted and undertaken by leading lawyers." It describes its market as "Fortune 1000 companies . . . and the leading law firms that represent them." *About Juridica*, JURIDICA INVESTMENTS LTD, http://www.juridicainvestments.com/about-juridica.aspx (last visited Aug. 24, 2013).

18. Juridica's threshold claim value for investment is $25 million. *Investment Policy*, JURIDICA INVESTMENTS LTD [hereinafter JURIDICA, *Investment Policy*], http://www.juridicainvestments.com/about-juridica/investment-policy.aspx (last visited Aug. 24, 2013). Bentham Capital LLC's threshold for consideration is $10 million if the case is still in the early stages and $7 million if it is in the appeal stage. *The Funding Process*, BENTHAM CAPITAL, http://www.benthamcapital.com/what-we-do (last visited Aug. 24, 2013). Bentham is the U.S. subsidiary of IMF (Australia) Ltd, which is generally regarded as the first actor in the third-party litigation finance industry.

19. However, Juridica terms its business "corporate claim finance." *Our Public Policy Statement*, JURIDICA INVESTMENTS LTD [hereinafter JURIDICA, *Public Policy*], http://www.juridicainvestments.com/about-juridica/our-public-policy-statement.aspx (last visited Aug. 24, 2013). In the United States, litigation lenders appeared before litigation investors, with the result that some refer to the lenders as "first wave" litigation financers and to the investors as "second wave" litigation financers. *See* Steinitz, *supra* note 15, at 1277. However, this pattern may be limited to the United States. Harbour Litigation Funding Ltd., the third-party litigation financing market leader in the United Kingdom, funds high-value commercial claims only. *See* Owen Bowcott, *Litigation Funders Become Big Business, Enjoying Booming Market in UK*, GUARDIAN (London) (May 25, 2012), http://www.guardian.co.uk/law/2012/may/25/litigation-funders-booming-market-uk/print. The largest third-party litigation financer in Australia, IMF, funds high-value commercial claims and damages class actions. *About Us*, IMF (AUSTL.) LTD., http://www.

Although not treated as third-party funders by most litigation financing scholars, law firms that invest time and expense in litigation with the expectation of sharing their clients' recoveries form another segment of the litigation financing market. However, in contrast to the funders and investors who are conventionally considered litigation financers, plaintiff-side law firms have a fiduciary duty to their clients. Law firms representing plaintiffs may receive funding from other law firms whose role is more similar to that of litigation investors.[20] The relationships between the law firm representing the plaintiffs and the law firms helping fund the litigation may not be known to all involved in the litigation. The role and characteristics of these investor law firms have yet to be systematically described.

Although class actions are sometimes brought on behalf of large numbers of individuals of modest means who resemble claimants in the litigation lending market, a damages class action most closely resembles a single large commercial claim, both procedurally and financially. Whether the class members receive damages depends on the outcome of a single lawsuit.[21] In the U.S. class action regime, a law firm is appointed as class counsel by the judge assigned to the case. Class counsel must invest resources up front to develop the facts and law relevant to the litigation and represent the class in court proceedings and settlement discussions. If the class prevails, the judge awards legal fees that usually are proportionate to the size of recovery;[22] if the class action fails, class counsel does not recoup its expenses. As a consequence of the procedural and financing rules, only firms with access to substantial financial resources can participate in this sector of the legal services market.

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imf.com.au/about-us (last visited Oct. 29, 2013). English law does not permit representative class actions along the American model.

20. At least one commercial lender offers loans exclusively to plaintiff law firms operating on contingent fees. Counsel Financial, founded by plaintiffs attorneys, offers its loans as alternatives to personal lines of credit. The loans are backed by the total value of anticipated contingent fees. *See About Counsel Financial*, COUNSEL FINANCIAL, http://attorneylending.com/about-us/ (last visited Oct. 29, 2013). Counsel Financial funded the lead plaintiffs' attorney firm in the nonclass World Trade Center follow-on litigation on behalf of recovery workers. Counsel Financial itself is said to be funded by Citigroup. Binyamin Applebaum, *Putting Money on Lawsuits, Investors Share in the Payouts,* N.Y. TIMES, Nov. 15, 2010, at 1.

21. The *amount* of damages received by individual class members may be uniform or differentiated depending on the terms of the resolution. In an opt-out regime class members may exclude themselves from the litigation, leaving themselves free to pursue individual lawsuits.

22. As a matter of formal law, fees may be awarded either on an hours-and-expenses basis (the "lodestar" method) or on a percentage-of-fund basis, but in practice most judges consider the size of the class recovery in awarding fees. *See* Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees and Expenses in Class Action Settlements: 1993–2008*, 7 J. EMPIRICAL LEGAL STUD. 248, 248–50 (2010).

Traditionally, plaintiff-side class action firms have financed their activities by lines of credit that are secured ultimately by their personal assets. As is the case with commercial litigation investors, plaintiff-side class action firms have good reason to carefully select cases that will permit them to maximize return on investment. Because litigating a class action is expensive and time consuming, class action firms are unlikely to represent a class unless there is a potential for large damages. If class actions were to attract litigation financing, the funding would come from the litigation investors, not the litigation lenders who target individual plaintiffs.

To date, it appears that only one class action initiative in the United States has secured third-party litigation financing: the Ecuadorian environmental damages litigation against Chevron. That investment occurred *after* the putative class action—which was never certified[23]—was dismissed by a U.S. court. The case began in 1993 as a putative class action on behalf of Ecuadorian residents of the Amazon in the federal court in the Southern District of New York.[24] The plaintiffs were represented by Steven Donziger, a crusading lawyer who had previously worked as a public defender and was not affiliated with any of the leading U.S. plaintiff-side class action firms. After nine years of litigation in federal court, the suit was dismissed on *forum non conveniens*.[25] Two years later, a new suit arising out of the same factual allegations was filed in Ecuador by a group of Ecuadorians that included some of the original class representatives. The proceedings have been incredibly complex, including criminal and civil litigation in Ecuador and two arbitrations pursuant to a bilateral investment treaty between the United States and Ecuador, administered under the UNCITRAL Arbitration Rules.[26] Along the way, the provincial court in Sucumbíos, Ecuador issued an $18 billion judgment against Chevron, which was upheld (although ultimately slashed in half) by Ecuador's appellate court.[27] By 2010 Chevron was back in the U.S. courts, pur-

23. *See* Aguinda v. Texaco, Inc., 1994 U.S. Dist. LEXIS 4718 (S.D.N.Y. Apr. 11, 1994).

24. *See* Aguinda v. Texaco, Inc., 945 F. Supp. 625, 626–27 (S.D.N.Y. 1996), *vacated*, Jota v. Texaco, Inc., 157 F.3d 153 (2d Cir. 1998).

25. Aguinda v. Texaco, Inc., 142 F. Supp. 2d 534, 537 (S.D.N.Y. 2001), *aff'd as modified*, 303 F.3d 470 (2d Cir. 2002).

26. *See* Chevron Corp. v. The Republic of Ecuador, PCA Case No. 34877, UNCITRAL Arbitration, Interim Award (Dec. 1, 2008), *available at* http://www.italaw.com/sites/default/files/case-documents/ita0150.pdf; *see also,* Chevron Corp. v. The Republic of Ecuador, PCA Case No. 2009-23, UNCITRAL Arbitration, Claimant's Notice of Arbitration (Sept. 23, 2009), *available at* http://www.italaw.com/sites/default/files/case-documents/ita0155_0.pdf.

27. Press Release, Amazon Watch, Chevron Guilty Verdict Upheld by Ecuador Appellate Court (Jan. 4, 2011), *available at* http://amazonwatch.org/news/2012/0104-chevron-guilty-verdict-upheld-by-ecuador-appellate-court.

suing charges of fraud in the Ecuadorian litigation, seeking a preemptive injunction against enforcement of the Ecuadorian judgment, and ultimately bringing RICO charges against Donziger and his colleagues.[28]

In the early years of the Ecuadorian litigation, Donziger was apparently funded by U.S. law firms.[29] Third-party litigation investment entities did not participate in the initial class action in U.S. federal courts, when they might have been subject to judicial regulation under Rule 23 of the Federal Rules of Civil Procedure.[30] Notably, Ecuador does not have a class action procedure that tracks the U.S. model. The Ecuadorian complaint was filed by a group of individuals who sought to protect the rights of the community under the Ecuadorian Environmental Management Act of 1999 (EMA).[31] The actions allowed under the EMA do not allow for personal injury claims, but instead allow individuals to bring "claims of collective nature affecting an unidentifiable group or the entire community,"[32] which are often termed "diffuse interest" claims in civil law jurisdictions.[33]

In late 2010, with plaintiffs' attorney Donziger apparently having depleted his resources and the Ecuadorian provincial court in Sucumbíos yet to deliver its judgment, Patton Boggs LLP received $4 million in funding from third-party litigation financer Burford Capital Ltd. to take over the case. Patton Boggs, a fifty-year-old Washington, D.C. firm that describes itself as a "public policy" law firm with roots in international trade and business law,[34] agreed to represent the Ecua-

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28. For descriptions of the hard-fought and controversial Ecuadorian litigation, see Steven Donziger et al., *Rainforest Chernobyl Revisited: The Clash of Human Rights and BIT Investor Claims: Chevron's Abusive Litigation in Ecuador*, HUM. RTS. BRIEF, Winter 2010, at 8; Patrick Radden Keefe, *Reversal of Fortune*, NEW YORKER, January 9, 2012, at 38; Michael Goldhaber, *The Global Lawyer: Latest Twists in Chevron's Amazon Case Run Through Latin America*, AM. LAW. (Nov. 12, 2012), http://www.americanlawyer.com/digestTAL.jsp?id=1202578138704&The_Global_Lawyer_Latest_Twists_in_Chevrons_Amazon_Case_Run_Through_Latin_America.

29. One of the early investors is said to have been Kohn, Swift & Graf, a Philadelphia-based plaintiff firm that represented Filipino citizens in a human rights abuse class action against Ferdinand Marcos and also participated in the Holocaust litigation against the Swiss Banks and German companies. *See Human Rights Cases*, KHON SWIFT & GRAF, P.C., http://www.kohnswift.com/site/PracticeAreas/HumanRights/tabid/66/Default.aspx (last visited Aug. 24, 2013).

30. *See* FED. R. CIV. P. 23.

31. Act No. 37/1999, Environmental Management Act (Ley de Manejo Ambiental), Registro Oficial No. 245 (July 30, 1999) (Ecuador).

32. Manuel A. Gómez, *The Global Chase: Seeking the Recognition and Enforcement of the Lago Agrio Judgment Outside of Ecuador*, 1 STAN. J. COMPLEX LITIG. 429, 436–37 (2013).

33. Deborah R. Hensler, *Of Groups, Class Actions, and Social Change: Reflections on* From Medieval Group Litigation to the Modern Class Action, 61 UCLA L. REV. DISCOURSE 126, 131 (2013) (book review).

34. *About: History*, PATTON BOGGS LLP, http://www.pattonboggs.com/about/history/ (last visited Aug. 24, 2013).

dorian plaintiffs on a contingency fee basis.[35] Patton Boggs's lead lawyer on the Ecuadorian case, James Tyrrell, Jr., was previously known for his role as chief trial counsel defending corporations in mass claims cases, including Agent Orange (typically described as the first successful mass tort class action), DES, and the World Trade Center follow-on litigation by rescue and recovery workers against the New York City government and the contractors that provided these services following the attacks.[36] Burford was said to have committed a maximum of $15 million to the litigation and reportedly hedged its investment by selling the initial $4 million share to another entity.[37] A year later, Burford announced that it would not invest further in the Ecuadorian litigation.[38] In January 2013, Chevron's lawyers filed a letter dated September 2011 from Burford to Donziger accusing him and the plaintiffs of fraud, pursuant to Chevron's ongoing RICO litigation against Donziger.[39] Burford subsequently charged that Tyrrell had provided the firm with a misleading analysis of the case.[40]

The history of the Chevron–Ecuador litigation seems unlikely to persuade third-party litigation investors to flock to high-profile, high-value mass litigation against multinational corporations. Indeed, since entering the U.S. litigation financing market, Juridica has consistently stated that it will not provide financing for class action lawsuits.[41] Prior to the publication of Burford's fraud charges against Donziger and his associates, Tyrrell told reporter Alison Frankel that Burford decided to move away from the Chevron case after Chevron "made it clear that there would be repercussions if [Burford] continued funding."[42] Tyrrell claimed that Chevron had voiced its unhappiness directly to Burford and that the company had declined further

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35. Leigh Jones, *Feud Escalates Between Chevron, Ecuador Lawyers*, REUTERS (October 6, 2011), http://www.reuters.com/article/2011/10/06/us-chevron-lawyers-idUSTRE7956CB20111006.

36. Michael Goldhaber, *Patton Boggs Explains Its Role in Explosive Chevron Case*, AM. LAW. LITIG. DAILY (Dec. 6, 2010), *available at* http://amlawdaily.typepad.com/amlawdaily/2010/12/pattonchevron.html; *see also Professionals, James E. Tyrrell, Jr.*, PATTON BOGGS LLP, http://www.pattonboggs.com/professional/james-tyrrell (last visited Oct. 30, 2013).

37. Alison Frankel, *Can Ecuadorean Plaintiffs Keep Funding Case Against Chevron?*, REUTERS (Dec. 12, 2011), http://blogs.reuters.com/alison-frankel/2011/12/12/can-ecuadorean-plaintiffs-keep-funding-case-against-chevron/.

38. *Id.*

39. Roger Parloff, *Investment Fund: We Were Defrauded in Suit Against Chevron*, CNN MONEY, (Jan.10, 2013), http://finance.fortune.cnn.com/2013/01/10/burford-capital-chevron-ecuador/.

40. Roger Parloff, *Litigation Finance Firm in Chevron Case Says It Was Duped by Patton Boggs*, CNN MONEY (Apr. 17, 2013), http://features.blogs.fortune.cnn.com/2013/04/17/burford-patton-boggs-chevron-suit/.

41. JURIDICA, *Public Policy*, *supra* note 19.

42. Frankel, *supra* note 37 (quoting James Tyrrell, Jr., Attorney, Patton Boggs LLP).

investment because it had been intimidated.[43] In 2011, Patton Boggs filed suit in federal court in Washington, D.C., charging Gibson, Dunn, & Crutcher, Chevron's hard-driving law firm, with "tortious interference" in Patton Boggs's relationship with its clients.[44] Burford's website currently makes no mention of the Ecuadorian litigation and describes its clients as businesses, law firms that do not operate on a contingency fee basis, and contingent fee lawyers.[45]

Selvyn Seidel, the co-founder and former non-executive chairman of Burford Capital who played a key role in Burford's original decision to invest in the Ecuadorian litigation, later left Burford and founded Fulbrook Capital Management LLC.[46] Fulbrook describes itself as an "institutional advisor in commercial claims" that "identifies, evaluates, manages, and arranges capital for commercial claimants to apply towards prosecuting meritorious claims."[47] Fulbrook's website makes no mention of class actions. It is difficult to avoid the inference that litigation investors who see their market as comprising large corporations believe that it is politic to give class actions a wide berth.

Putting aside Burford's experience with the Chevron–Ecuador experience and attendant public relations issues, how likely is it that third-party litigation financers will find success in the U.S. class action litigation market? In return for providing funding and absorbing a significant fraction of the risk associated with commercial claims, third-party litigation investors expect a large share of any monetary recovery. Today in the United States, the most successful plaintiff class action firms are unlikely to find these terms attractive in comparison to their return on investment that relies on conventional financing. Commercial litigation financing might be attractive to new entrants to the market or as a means of allowing an established firm to penetrate or develop a new segment of the class action market while limiting its risk. Experienced federal judges who appoint class counsel

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43. *Id.*

44. Press Release, Patton Boggs LLP, Patton Boggs Sues Chevron and Gibson Dunn for Tortiously Interfering with the Firm's Duties to Its Clients (Feb. 7, 2011), *available at* http://www.pattonboggs.com/files/News/f5ce5b6e-ccaa-40cf-8c91-009d978f1e3a/Presentation/NewsAttachment/e2313e74-5f72-44ca-b53a-0e2682e29937/Patton%20Boggs_Chevron_Gibson%20Dunn_Suit_02_07_11_FINAL.pdf.

45. *See* BURFORD, *The Basics*, *supra* note 17. The only specific type of litigation highlighted on Burford's website is commercial litigation. *Id.*

46. *See* Goldhaber, *supra* note 36; *see also* Roger Parloff, *Have You Got A Piece of This Lawsuit?*, CNN MONEY (June 28, 2011), http://features.blogs.fortune.cnn.com/2011/06/28/have-you-got-a-piece-of-this-lawsuit-2/.

47. *Selvyn Seidel, Professional Details*, CORP. LIVEWIRE, http://www.corporatelivewire.com/profile.html?id=6f946e26bbbc095620c42c4453cbf8df7ffca1a0 (last visited Aug. 24, 2013).

in Rule 23 class actions might balk at appointing inexperienced litigators to the position, but a firm with adequate financial resources might succeed in persuading a less experienced state court judge that it could satisfy the core class action requirement of "adequacy of representation."[48] However, one third-party litigation financer has speculated that a law firm that disclosed its need for third-party financing to support its representation would impair its chances of being selected as lead counsel in a class action.[49]

III. Unpacking the Critique of Third-Party Financing of Class Action Litigation

What concerns would third-party litigation financing raise in the U.S. class action domain? Traditionally, common law jurisdictions forbade third parties from taking a financial interest in someone else's lawsuit—a practice that lawmakers feared would encourage "frivolous" or "vexatious" litigation. Rules against champerty and maintenance are still on the books in many states and have acted as brakes on third-party litigation financing in those jurisdictions.[50] In the United States, contingency fee agreements between lawyers and clients do not violate these traditional rules, but such agreements are prohibited or restricted in many non-U.S. jurisdictions.

The critique of third-party litigation financing in class actions echoes both the traditional normative concerns about champerty and maintenance and the political attack on contingency fee litigation. However, critics of third-party litigation financing of class actions also have concerns that are specific to class actions.[51] The first set of concerns focuses on the effect of third-party litigation investment on the number of class actions, while the second set focuses on the potential of third-party investment to exacerbate conflicts of interest and representational issues inherent in class action litigation.

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48. *See* Fed. R. Civ. P. 23(a)(4), (g).

49. Jasminka Kalajdzic et al., *Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Financing*, 61 Am. J. Comp. L. 93, 133–34 (2013) (citing conversation with Ralph Sutton, CEO of Bentham Capital).

50. Third-party litigation financing has provoked new scholarship on champerty and maintenance. *See, e.g.*, Martin, *supra* note 8; Steinitz, *supra* note 15; Jason Lyons, Comment, *Revolution in Progress: Third-Party Funding of American Litigation*, 58 UCLA L. Rev. 571 (2010).

51. Concerns about third-party litigation financing of nonclass aggregated litigation are not addressed in this Article.

A. *The Effect of Third-Party Litigation Investment on the Number of Class Actions*

No one knows the total number of class actions that are filed annually in U.S. federal or state courts (or in most jurisdictions outside the United States),[52] but it likely ranges in the thousands, constituting a small fraction of the total U.S. civil litigation caseload.[53] If there are many instances that could lead to class actions but do not because law firms lack the financial resources to pursue these cases, then the introduction of additional financing into the legal market could logically lead to an increase in litigation. There are no data that allow us to determine the number of *potentially* viable class actions, but available data on individual litigation rates suggest that a sizeable fraction of individual justiciable injurious incidents do not result in litigation, and there is reason to think that this is also true with regard to mass injuries.[54]

However, in attacking the third-party litigation financing of class actions, the corporate community does not assert that there are proper class actions that are currently barred from the courts because of insufficient funding, but rather that third-party litigation financing will produce a flood of *frivolous* class actions. This assertion is based on three assumptions about U.S. class actions: first, that the current class action regime produces a host of frivolous class actions that defendants are forced to settle because of their *in terrorem* effect; second, that class action jurisprudence enables easy access to courts for frivolous class claims; and third, that litigation investors' business models will favor frivolous claims.[55] The available empirical data do not support the first assumption about the current regime, and recent U.S. Supreme Court jurisprudence as well as the economics of third-party litigation financing militate against a flood of frivolous class actions going forward.

52. *See The Globalization of Class Actions*, 622 ANNALS AM. ACAD. POL. & SOC. SCI. 1 (Deborah Hensler et al. special eds., 2009) (in response to requests for information on the number of class action or group litigations filed in their jurisdictions, most authors responded that courts in their jurisdictions did not report these data).

53. Deborah R. Hensler, *Using Class Actions to Enforce Consumer Protection Law*, *in* HANDBOOK OF RESEARCH ON INTERNATIONAL CONSUMER LAW 515, 528–29 (Geraint Howells et al. eds., 2010).

54. Deborah R. Hensler, *The Socio-Economics of Mass Torts: What We Know, Don't Know and Should Know*, *in* RESEARCH HANDBOOK ON THE ECONOMIC ANALYSIS OF TORTS, (Jennifer Arlen ed., 2014).

55. The Chamber of Commerce supports its argument that third-party litigation financing inevitably will increase the number of class action lawsuits by reference to the Australian experience, where it claims this has occurred. Part IV addresses the experience in Australia to date, which does not support the Chamber's argument.

1. *Assumption 1: The In Terrorem Effect of Class Actions Currently Forces Defendants to Settle Frivolous Class Claims*

The claim of *in terrorem* effects of class filings leading to settlement of frivolous complaints is so ingrained in public policy rhetoric that it has been echoed by the U.S. Supreme Court.[56] The claim may have gained credence as a result of an apparent increase in consumer class actions against insurers and other financial institutions during the 1990s,[57] but there is little empirical evidence of *in terrorem* effects. The two best sources of empirical information on the outcomes of class action complaints are a 2007 RAND Institute for Civil Justice study of class actions against insurers brought in state and federal courts[58] and a 2008 Federal Judicial Center study of diversity class action complaints filed in federal court prior to the effective date of the Class Action Fairness Act of 2005 (CAFA).[59] Only 14% of the state and federal class actions that RAND studied were certified; of these, most settled. As a result, 12% of all class complaints resulted in class-wide remedies. In contrast, 37% resulted in a ruling on a dispositive motion in favor of defendants; 20% resulted in a settlement with an individual class representative; and 27% of the cases were voluntarily dismissed by the plaintiffs.[60] The Federal Judicial Center reports that of the class action lawsuits that were filed in federal court pre-CAFA and not remanded to state courts, more than half (55%) were dismissed without class certification or class settlement, 29% were resolved by a ruling in favor of the defendant on a dispositive motion, and 13% resulted in a class certification and settlement.[61] Corporate lobbyists opposing class actions do not generally refer to these data with regard to the alleged *in terrorem* effects; however, in the recent oral argument in *American Express v. Italian Colors Restaurant*, the lawyer for American Express stated that only 20% of "putative class

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56. *See, e.g.*, Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184, 1200 (2013).

57. DEBORAH R. HENSLER ET AL., RAND CORP., CLASS ACTION DILEMMAS: PURSUING PUBLIC GOALS FOR PRIVATE GAIN 62–68 (2000); *see also* NICHOLAS M. PACE ET AL., RAND CORP., INSURANCE CLASS ACTIONS IN THE UNITED STATES, at xvii–xxv (2007), *available at* http://www.rand.org/content/dam/rand/pubs/monographs/2007/RAND_MG587-1.sum.pdf.

58. PACE ET AL., *supra* note 57.

59. EMERY G. LEE III & THOMAS E. WILLGING, FED. JUDICIAL CTR., IMPACT OF THE CLASS ACTION FAIRNESS ACT ON THE FEDERAL COURTS: PRELIMINARY FINDINGS FROM PHASE TWO'S PRE-CAFA SAMPLE OF DIVERSITY CLASS ACTIONS (2008), *available at* http://www.fjc.gov/public/pdf.nsf/lookup/cafa1108.pdf/$file/cafa1108.pdf.

60. PACE ET AL., *supra* note 57, at xxi.

61. LEE & WILLGING, *supra* note 59, at 6.

actions" are certified.[62] If there is an *in terrorem* effect of class action filings, its magnitude is likely modest.

2. *Assumption 2: Class Action Jurisprudence in the United States Enables Easy Access to the Courts for Class Actions*

If a marked increase in damages class actions in state and federal courts during the 1990s really did provoke an *in terrorem* effect among corporate defendants, by now that effect should be significantly diminished. Over the past two decades, the Supreme Court, aided on occasion by the U.S. Congress, has steadily raised the bar for plaintiff success in damages class actions.[63] Mass tort class actions, which never had much of a run in the United States, have virtually disappeared as a result of the Supreme Court decisions in *Amchem Products, Inc. v. Windsor*[64] and *Ortiz v. Fibreboard Corp.*,[65] replaced by aggregated lawsuits resolved in multidistrict litigation.[66] The Private Securities Litigation Reform Act of 1995 (PSLRA) raised the standards for selecting class representatives,[67] and the Securities Litigation Uniform Standards Act of 1998 (SLUSA) prevented plaintiff class counsel from turning to state courts to evade these restrictions.[68] CAFA shifted formerly state court class actions to federal court in an effort to subject them to more conservative judicial rulings.[69] The Supreme Court met these hopes by restricting federal court jurisdiction over securities class actions in *Morrison v. National Australia Bank Ltd.*[70] and over Alien Tort Statute claims in *Kiobel v. Royal Dutch Petroleum Co.*;[71] narrowing the substantive definitions of Rule 23(a)'s core requirements for certification[72] and increasing plaintiffs' evidentiary burden of proving that the certification requirements are met;[73]

62. Transcript of Oral Argument at 5, Am. Express Co. v. Italian Colors Rest., 133 S. Ct. 2304 (2013) (No. 12-133).

63. *See generally* Robert H. Klonoff, *The Decline of Class Actions*, 90 WASH. U. L. REV. 729 (2013).

64. Amchem Prods., Inc. v. Windsor, 521 U.S. 591 (1997).

65. Ortiz v. Fibreboard Corp., 527 U.S. 815 (1999).

66. *See* Charles Silver & Geoffrey P. Miller, *The Quasi-Class Action Method of Managing Multi-District Litigation: Problems and a Proposal,* 63 VAND. L. REV. 107, 113–14 (2010).

67. *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.).

68. *See* Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (codified as amended in scattered sections of 15 U.S.C.).

69. *See* Class Action Fairness Act of 2005, Pub. L. No. 109-2, 119 Stat. 4 (codified in scatted sections of 28 U.S.C.).

70. Morrison v. Nat'l Austl. Bank Ltd., 130 S. Ct. 2869 (2010).

71. Kiobel v. Royal Dutch Petroleum Co., 133 S. Ct. 1659 (2013).

72. Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541 (2011).

73. *Id.* at 2551–52; *see also* Comcast Corp. v. Behrend, 133 S. Ct. 1426, 1432 (2013).

and endorsing defendants' strategy of precluding any kind of collective proceeding by imposing mandatory pre-dispute arbitration clauses.[74]

3. Assumption 3: The Third-Party Litigation Investment Model Will Favor Frivolous Class Claims

The U.S. class action fee regime is unlikely to enable a plaintiff-side firm to long sustain itself on frivolous claims, which available data suggest would result, at best, in a small settlement with a putative class representative—with proportionately small fees for the putative class counsel. At worst, bringing a frivolous claim would result in an expensive pretrial battle and a defense victory, with a financial loss for class counsel, who will neither recover expenses nor win fees for time spent on the case. Whether because of this financial regime or because of class action jurisprudence, there are no objective data to support the proposition that the U.S. class action system is overrun with frivolous suits. Nor is there an empirical basis for Juridica's claim that "class action cases are not susceptible to the market-based determinants that should drive settlements of corporate claims between businesses."[75] To the contrary, the frequent corporate community charge that plaintiff-side class action lawyers are "entrepreneurs" is intended to convey that they are market-driven, rather than driven by nonmonetary professional or ideological ideals.

The financial incentives inherent in class actions (and other civil litigation where fee amounts depend on damages obtained) are more likely to pervert lawyers' settlement behavior than filing behavior. A class counsel whose fees and recovery of expenses depend on obtaining a settlement from the defendant may well agree too easily to suboptimal (from the class members' perspective) settlement offers so as to ensure some payment.[76] As the value of the class injuries increases, the divergence between class counsel's interests and the interests of individual class members may grow. Defendants' ability to achieve *res judicata* "on the cheap" in return for an overly generous class counsel fee is central to the scholarly critique of class actions. Requiring judges to approve class action settlements and to award

74. *See* AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740 (2011).

75. Juridica, *Public Policy*, *supra* note 19.

76. There is a rich theoretical literature on the effects of contingent fee financing on settlement behavior, which reaches inconsistent conclusions as to whether this type of financing increases or decreases settlements (versus trial). For a review of the literature and an argument that contingent fee lawyers are more likely to go to trial than settle, see A. Mitchell Polinsky & Daniel L. Rubinfeld, *A Note on Settlements Under the Contingency Fee Method of Compensating Lawyers,* 22 Int'l Rev. L. & Econ. 217 (2002).

class counsel fees—neither of which judges have authority to do in ordinary individual litigation—and encouraging judges to require detailed notices that specify settlement provisions and the amount of fees that has been requested are all intended to mitigate the agency costs of class actions. However, anecdotal evidence suggests that these restraints are not always effective, with the result that defendants are at least sometimes able to obtain settlements favorable to themselves and to plaintiff class counsel, but less so to class members. There are no systematic data indicating how frequently this occurs.

From a defendant's perspective, providing class counsel with access to resources by introducing a new funding model that incentivizes the latter to pursue class complaints more doggedly poses a more realistic threat than the possibility of an avalanche of new class actions. Third-party litigation investors who have carefully screened claims to determine where to place their funds have a strong interest in ensuring that the plaintiffs' lawyers maximize the value of the claims in which the financers invest. There is no reason to expect that third-party litigation investors' screening processes, which are emphasized in their individual commercial claims' policies and practices, would not apply similarly to class actions if and when investors decided to enter the class action market.

Moreover, an investor managing a portfolio of class action claims might have a different risk calculus with regard to a single class action lawsuit than a plaintiff-side law firm whose resources are concentrated in that same class action. Like third-party investors, successful plaintiff-side class action firms invest in a portfolio of cases. Rather than changing these successful firms' risk calculus (and settlement behavior), the entrance of third-party litigation investors into the class action market might produce more competition for such firms by providing access to resources for smaller, and perhaps new, plaintiffs' law firms.

Third-party investment might also incentivize corporate law firms to agree to represent business entities that step forward as class representatives in securities or antitrust litigation, as seems to be occurring in Europe and is already happening in individual business-to-business patent litigation in the United States.[77] How third-party litigation investment would affect settlement values for different types of class actions if and when third-party investors enter the market is unclear, but corporate defendants might have a rational basis for fearing these

77. Juridica's website mentions patent litigation as an area for appropriate investment (in contrast to class actions). *See* JURIDICA, *Investment Policy*, *supra* note 18. Bentham also sees patent litigation as an attractive area for investment in partnership with corporate law firms.

outcomes. However, it is difficult to discern the public policy argument against increased settlement values in meritorious cases if such values are currently suboptimal as a result of the agency costs of class action litigation, as some scholars have argued.

B. The Effect of Third-Party Litigation Financing on Conflicts of Interest and Representational Challenges in Class Actions

Scholars have long treated "low ball" settlements as the primary indicator of conflicts of interest between class counsel and class members.[78] As I argue *supra,* there is reason to believe that such settlements would be less attractive to third-party litigation investors than to underfinanced plaintiff-side class action law firms, and that plaintiff-side class action firms that secure third-party funding would be enabled as well as incentivized to pursue litigation and obtain better settlements for class members.

Some observers are concerned that the terms of third-party litigation contracts with plaintiff class counsel might be contrary to class members' interests, albeit attractive to class counsel. Even if the class representative were privy to the contract terms, there is a reasonable concern that absent class members would be unaware of the terms, and, indeed, unaware of third-party involvement in the case.[79] Some have suggested that this is a reason to prohibit third-party litigation financing of class actions. However, federal judges (and judges in states with class action rules that mimic the Federal Rules) have tools for confronting this challenge: Under Rule 23(e)(3), "[t]he parties seeking approval must file a statement identifying any agreement made in connection with the [settlement] proposal," which should include an agreement between class counsel and third-party litigation financers.[80] In reviewing and approving a proposed settlement, the judge could decide that such an agreement is not fair to class members and decline to approve the settlement. Under Rule 23(e)(1), the judge could direct that the notice to class members of a pending settlement include the terms of the litigation financing agreement, so that class members would understand how their share of the settlement would be affected by these terms, and either have the chance to object to the terms or opt out. Given the tradition of public interest organi-

78. *See* HENSLER ET AL., *supra* note 57, at 79–86; *see also* Susan P. Koniak, *Feasting While the Widow Weeps:* Georgine v. Amchem Products, Inc., 80 CORNELL L. REV. 1045, 1077–78 (1995).

79. I assume for this analysis that the class actions of interest are opt-out class actions and that the class representative would not herself be able to bind absent class members to a litigation financing agreement.

80. FED. R. CIV. P. 23(e)(3).

zations and others coming forward to object to proposed settlement terms and proposed class counsel fees,[81] it seems likely that litigation financing agreements would attract attention. The potential for such attention would likely constrain class counsel and third-party litigation investors from agreeing to terms that were clearly against class members' interest.

However, federal judges need not rely on the interest of public or private intervenors to inquire into the terms of third-party litigation financing contracts with class counsel because the judges control the appointment of counsel. Under Rule 23(g)(1)(A)(iv), in appointing class counsel, the judge *must* consider "the resources that counsel will commit to representing the class." Under Rule 23(g)(1)(B), the judge "may consider any other matter pertinent to counsel's ability to fairly and adequately represent the interests of the class," and under Rule 23(g)(1)(C), the judge "may order potential class counsel to provide information on *any subject pertinent to the appointment*."[82] Together these provisions give the judge broad authority to inquire into the terms of any litigation financing agreement the proposed class counsel has entered into and to decline such an appointment if she believes the terms do not serve the class well.

When considering how third-party litigation financing might evolve in the class action context, it is useful to recall that the much criticized third-party litigation investment contract in the Chevron–Ecuador case related to proceedings in Ecuador, which has no procedural rules governing collective actions. It is also notable that aggregated non-class proceedings in the United States do not authorize judges presiding over such litigation to inquire into attorneys' fee agreements with their clients nor, perhaps by extension, their agreements with third-party investors.[83] In this regard, as in many others, the U.S. class action regime provides greater due process protections for claimants than nonclass aggregated litigation—protections that could be deployed to protect class members against third-party litigation financing agreements that are inimical to their interests.[84]

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81. *See* Hensler et al., *supra* note 57, at 94–99.

82. Fed. R. Civ. P. 23(g)(1) (emphasis added).

83. A few judges presiding over nonclass aggregated litigation have claimed authority to review and approve settlements and fees, arguing that these cases are "quasi-class actions." Silver & Miller, *supra* note 66, at 114; *see also* Alvin K. Hellerstein et al., *Managerial Judging: The 9/11 Responders' Tort Litigation*, 98 Cornell L. Rev. 127, 176–77 (2012).

84. Where class members arguably have conflicts of interests among themselves the issues would become more complex. Under *Amchem Products, Inc. v. Windsor*, certification of such a class would require subclasses with separate class representatives and separate class counsel, raising the spectre of separate litigation financing agreements with each class counsel. *See* Amchem Products, Inc. v. Windsor, 521 U.S. 591, 626–27 (1997). Applying *Amchem*'s represen-

IV. Lessons from Australia

In its advocacy materials, the U.S. Chamber of Commerce draws attention to the experience of third-party litigation financing in Australia, where it claims the advent of litigation investment has increased the amount of civil litigation generally and the number of class actions in particular.[85] The Chamber rests this assertion on two sources: an analysis by David Abrams and Daniel Chen of the relationship between civil and criminal caseloads and expenditures by Australia's leading third-party litigation financer,[86] and an article by Stuart Clark, a leading defense attorney, which describes and comments on Australia's class action procedure and practice, but which contains no case statistics.[87]

Class actions were introduced by statute in Australia's federal courts effective 1992, and in the states of Victoria, effective 2000, and New South Wales, effective 2011.[88] The federal rule was modeled after Rule 23(b)(3) by plaintiffs attorneys who had represented Australian plaintiffs in mass litigation in the United States and concluded that their clients' interests would be better protected in their home jurisdiction. Third-party litigation financing emerged in Australia to address the barriers the traditional Australian fee regime imposed on class action litigation and has succeeded in enabling class lawsuits.

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tational principle might require that each class counsel contract with a different third-party litigation investor. As a practical matter this might preclude third-party litigation financing in circumstances requiring subclassing.

85. Beisner et al., *supra* note 5, at 9–11; Ethical & Legal Ramifications, *supra* note 5, at 17–22.

86. The Chamber's publications cite a 2009 version of this article that is not currently available on the web. My description of Abrams and Chen's methodology relies on David S. Abrams & Daniel L. Chen, *A Market for Justice: A First Empirical Look at Third Party Litigation Funding*, 15 U. Pa. J. Bus. L. 1075 (2013), which appears to be an update of the 2009 article. A third version of the article that appears to rely on the same methodology but is singly authored by Chen was provided to me by John Walker, the executive director of IMF (Australia) Ltd, whose assistance with Abrams and Chen's research is acknowledged by them. In an e-mail to me, Professor Abrams provided this clarification: "None of our work is specifically about class action suits; we look at all civil litigation"; he also offers "a note of caution about interpretation of our findings of a correlation between third-party funding levels and rates of litigation and duration of litigation." E-mail from David S. Abrams to author (June 3, 2013) (on file with author). As discussed above, the Australian data on third-party litigation financing compiled by Professor Abrams and his co-author include large commercial claims and class actions.

87. S. Stuart Clark, *Thinking Locally, Suing Globally: The International Frontiers of Mass Tort Litigation in Australia*, 74 Def. Couns. J. 139 (2007).

88. Vince Morabito, *Australia*, 622 Annals Am. Acad. Pol. & Soc. Sci. 320, 320–21 (2009); Law Reform Comm'n of W. Austl., Representative Proceedings: Discussion Paper Project No. 103, at 26 (2013), *available at* http://www.lrc.justice.wa.gov.au/P/project_103.aspx?uid=2035-7229-1142-4710. The Western Australia Law Reform Commission is currently considering recommending a class procedure. *See generally id.*

However, contrary to the suggestion of the U.S. Chamber of Commerce, the empirical data show that the actual number of class lawsuits has been small. Moreover, the outcomes of financed cases suggest that third-party litigation financers have adopted quite conservative strategies in deciding whether to invest in class litigation.

A. *The Australian Class Action Regime*

The Australian class action procedure is well documented.[89] Briefly, under Part IVA of the *Federal Court of Australia Act 1976* (Cth), a class proceeding requires seven or more persons with claims against the same defendant arising out of the same or similar circumstances and raising common issues of law or fact.[90] There is no certification proceeding, but at any time during the process a judge may rule that the statutory requirements for a class are not met and halt the proceeding. The statute mandates an opt-out procedure similar to the American model: after notice and hearing, any class member who does not opt out is bound by the outcome. The judge may assess the adequacy of class representation and require subclasses, and must approve any settlement.[91] Civil lawsuits in Australia, including class actions, are decided by judges, not juries, and some class actions have been tried to verdict.[92]

B. *The Australian Legal Fee Regime*

Although described by Clark as "plaintiff friendly,"[93] the Australian class action was introduced into a plaintiff *unfriendly* legal fee regime. Australia requires fee-shifting, meaning that plaintiffs, including class representatives, are subject to defense costs if defendants prevail. Since the mid-1990s, attorneys have been permitted to enter into "no win, no fee" agreements with their clients, including class representatives.[94] These agreements protect plaintiffs against the risk of having to pay their own attorneys if they lose their case. When plaintiffs prevail, they pay their attorneys' hourly charges and expenses, plus a possible premium of up to 25% of total hourly fees. However, the

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89. *See, e.g.*, DAMIAN GRAVE ET AL., CLASS ACTIONS IN AUSTRALIA (2d ed. 2012); Stuart Clark & Christina Harris, *The Push to Reform Class Action Procedure in Australia: Evolution or Revolution?* 32 MELBOURNE U. L. REV. 775 (2008); Morabito, *supra* note 88.

90. *Federal Court of Australia Act 1976* (Cth) pt IVA; *see also* Morabito, *supra* note 88, at 322.

91. Morabito, *supra* note 88 at 322–23.

92. According to Clark, "There are numerous examples of class actions that have been either successfully defended at trial or that were successfully struck through an attack on deficient pleadings." Clark, *supra* note 87, at 148.

93. *Id.* at 139.

94. Morabito, *supra* note 88, at 323–24.

attorney may not charge a percentage of damages obtained for the plaintiff, as is often allowed in the United States in ordinary litigation and awarded by U.S. judges to successful class counsel. In the context of Australian class actions, the allowable 25% premium may not be sufficient to outweigh the considerable risks faced by the attorney on a "no win, no fee" agreement. Finally, with no contractual relationship between the class representative's attorney and the class members, class members have no need to pay attorney fees (and are not at risk for adverse costs), but are eligible to share in the settlement, which creates a significant "free rider" problem. Additionally, the U.S. concept of authorizing judges to award fees in "common fund" cases[95] does not exist in Australian law.

C. Enter the Third-Party Litigation Investors

Third-party litigation investment appeared on the Australian class action scene in the early 2000s, in response to the aforementioned financial barriers.[96] The challenge for funders was how to capture more of the value of class litigation than permitted to plaintiffs' attorneys in return for protecting the class representative from the risk of adverse costs. The model that emerged was one in which the third-party litigation financer contracts with the individual class members to pay the lawyer's fees and up-front expenses and to take on the risk of adverse costs, in exchange for a share of each class member's recovery (if any). This model solves three problems: it ensures that the lawyers have sufficient resources to pursue an optimal recovery; it frees individuals to come forward as class representatives without the risk of adverse costs; and it eliminates the free rider problem (since all class members contract with the third-party investor). However, the result in Australia has been that the formal opt-out regime has become, in practice, an opt-in regime. After its inception, the third-party litigation funding model was challenged on the grounds that it subverted the legislature's intention, but in 2007 the federal court of Australia endorsed it.[97] Most funded class actions now proceed as "closed classes," comprising only those who have signed contracts with the funder, which in effect amounts to opting in.

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95. *See* Boeing Co. v. Van Gemert*,* 444 U.S. 472, 477–78 (1980).

96. *See* Wayne Attrill, *Litigation Funding: Access to Justice in a Time of Economic Crisis*, IMF (AUSTL.) LTD. 4 (Feb. 20, 2009), http://www.imf.com.au/docs/default-source/site-documents/globalaw-conference—-feb-2009. Initially, IMF provided funding for insolvency proceedings.

97. *See Multiplex Funds Mgmt. Ltd. v P Dawson Nominees Pty Ltd.* (2007) 164 FCR 275 (Austl).

The leading litigation funder in Australia is IMF (Australia) Ltd, a publicly traded company. IMF's portfolio includes both individual commercial claims and class claims. Most claims that IMF funds, including class actions, are filed in federal court.[98] In 2003, IMF funded its first shareholder class action.[99] According to a 2012 review conducted for IMF by Ernst & Young, IMF funded a total of 137 completed cases from 2001 to 2012, including individual and class action lawsuits.[100] IMF's executive director John Walker estimated that IMF has funded a total of approximately 200 cases, including matters funded prior to its public listing in 2001. Walker estimated that IMF's cases comprised about 70% of all claims that have been funded by third-party investors in Australia over that period.[101] According to Ernst & Young's review, the completed cases from 2001 onward generated AUD $803.7 million total income to IMF's clients (including recovered costs) and AUD $402 million total income to IMF, for a total of AUD $1.2 billion.[102] If IMF's competitors were equally successful, the net value of total funded litigation (including individual and class action lawsuits) in Australia from 2001 to 2012 was about AUD $1.7 billion.

D. *Investment and Litigation Dynamics*

Contrary to Juridica's speculation about class action market behavior, IMF appears to pursue a cautious investment strategy. From February 1999 to 2007, IMF is said to have agreed to fund 90 of the 763 cases that it considered.[103] Of the 130 completed cases audited by Ernst & Young, plaintiffs settled 67%, won trial judgments in 9%, and lost five cases (4%) at trial. In 20% of the cases, IMF terminated funding before the case was concluded.[104]

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98. E-mail from John Walker, Exec. Dir., IMF (Austl.) Ltd., to author (Apr. 2, 2013) [hereinafter Walker E-mail] (on file with author).

99. Hugh McLernon, *Delivering Better Returns for Superfund Members Through Responsible Investment*, IMF (AUSTL.) LTD. 1 (June 25, 2012), http://www.imf.com.au/docs/default-source/site-documents/delivering-better-returns-for-superfund-members-through-responsible-investment—-hm-29-jun-12.

100. ERNST & YOUNG, INDEPENDENT AUDITOR'S REPORT TO IMF: STATEMENT OF COMPLETED MATTERS (2012), *available at* http://www.imf.com.au/pdf/PortfolioAudit.pdf.

101. Walker E-mail, *supra* note 98.

102. ERNST & YOUNG, *supra* note 100.

103. Abrams & Chen, *supra* note 86, at 22 (Note that this may be a later version of the paper cited by BEISNER ET AL., *supra* note 5, which I have been unable to locate). Abrams and Chen cite confidential data provided to them by John Walker, executive director of IMF (Australia) Ltd, as the basis for these numbers. Abrams & Chen, *supra* note 86, at 22 n.81.

104. ERNST & YOUNG, *supra* note 100.

Do defendants in Australian class actions settle cases because of an *in terrorem* effect? According to Clark, "There are numerous examples of class actions that have been either successfully defended at trial or that were successfully struck through an attack on deficient pleadings."[105] Cases are tried to judges rather than juries, discovery is limited, and exemplary (punitive) damages—although legal—are rarely awarded.[106] Additionally, litigation may move briskly: "In the Federal Court of Australia, even complex matters can be scheduled for hearing in a comparatively short time; indeed, it is not uncommon for a matter to result in a hearing within nine months or less of being filed."[107]

The "closed classes" that are a product of third-party litigation investment benefit defendants by allowing them to better estimate likely damages than in an opt-out regime. Some Australian defense counsel also say that the involvement of litigation investors facilitates settlements by promoting business-like negotiations.[108]

E. Trends in Class Action Filings in Australia

Australia's courts, like courts in other jurisdictions including the United States, do not officially report the total number of class action filings. However, over the past several years, the Australian Research Council has funded Professor Vince Morabito's creation of a comprehensive database on class actions. Morabito's work is ongoing; his most recently published database includes all federal class actions filed from 1991 to 2009 and all Victorian class actions filed from 2000 to 2008.[109] As shown in Figure 1, through calendar year 2008, a total of 249 class action lawsuits had been filed in the federal court, and a total of 24 in Victoria, with annual averages of 15 in the federal courts and three in Victoria. The federal class actions constituted less than 1% of annual federal court proceedings during the entire period.[110]

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105. Clark, *supra* note 87, at 148.

106. *Id.* at 144–45, 149.

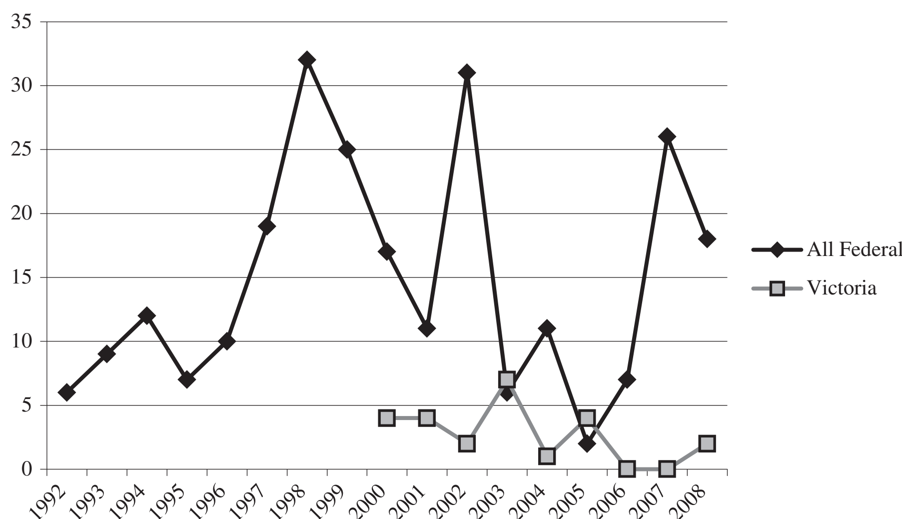
107. *Id.* at 144. Clark suggests that the expeditious nature of Australian federal court litigation can be problematic for defendants, an interesting contrast to U.S. class action opponents' claims of delays. *Id.*

108. Interviews with defense counsel, at Comparative Class Actions Seminar, Melbourne Univ., Melbourne, Austl. (August 3–9, 2011) (on file with author).

109. VINCE MORABITO, AUSTRALIAN RESEARCH COUNSEL, AN EMPIRICAL STUDY OF AUSTRALIA'S CLASS ACTION REGIMES: LITIGATION FUNDERS, COMPETING CLASS ACTIONS, OPT OUT RATES, VICTORIAN CLASS ACTIONS AND CLASS REPRESENTATIVES 16, 18 (2010), *available at* http://globalclassactions.stanford.edu/sites/default/files/documents/Vince%20Morabito%202nd%20Report.pdf.

110. *Id.* at 16 & tbl. 5.

FIGURE 1: TRENDS IN AUSTRALIAN CLASS ACTION FILINGS, FEDERAL AND VICTORIA (STATE) COURT[111]



As one would expect for such small populations, there is substantial variation from year to year, making it difficult to discern a pattern or attribute increases or decreases to a single factor. The largest number of class actions was filed in 1998, which predated the development of third-party litigation financing of class actions. The second-largest number appeared in 2002, around the time that IMF was publicly listed, and the third largest appeared in 2007, after the federal court's August 2007 decision endorsing third-party funding. However, as shown in Figure 2, the 1998 and 2002 spikes appear to have nothing to do with third-party litigation funding, but rather reflect an unusual number of union actions on behalf of employees, which constituted almost 20% of all federal class action filings from 1992 to 2008. Securities class actions started to be a factor in 2004, but these types of class actions alone do not explain the 2007 peak.[112] In 2008, the total of non-union federal class action filings, including securities actions, fell back to its 1997 level.

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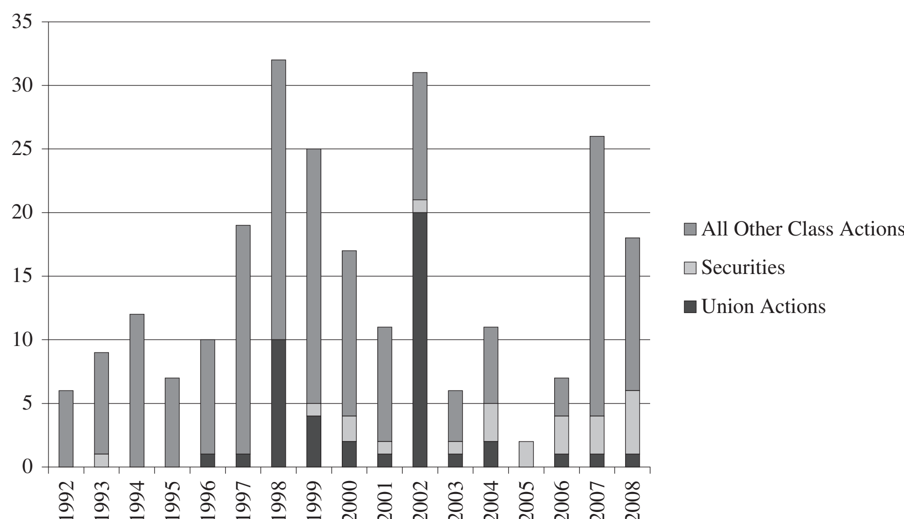
111. *Id.* at 14 tbl. 3, 18 tbl. 6.

112. The securities class action filings data in Figure 2 are from GREG HOUSTON ET AL., NERA ECON. CONSULTING, TRENDS IN AUSTRALIAN SECURITIES CLASS ACTIONS: 1 JANUARY 1993 – 31 DECEMBER 2009, at 4 fig. 1 (2010), *available at* http://www.nera.com/nera-files/PUB_Recent_Trends_Australia_0510.pdf. I have adjusted Morabito's data to include these filings but Figure 2 is a bit of a "mash-up" because I have put together two different datasets that were created by different analysts and the reporting years are not entirely comparable.

FIGURE 2: DIVISION OF CLASS ACTION FILINGS, BY CASE TYPE[113]



As in the United States, Australian attorneys sometimes file multiple competing class actions related to the same dispute, of which only one may produce a class-wide resolution. Morabito reports that the 249 federal class action filings from 1992 to 2008 were associated with only 169 separate legal disputes.[114] Although each of the competing actions may be associated with some litigation activity, the presence of competing actions suggests that the filings data give a somewhat inflated picture of the number of litigated class lawsuits in Australia during the period.

Morabito's database was truncated just about the time when lawsuits arising out of the global financial crisis began to emerge. King & Wood Mallesons, a corporate defense firm, publishes an annual report on class action litigation in Australia that provides information about developments since 2009.[115] According to Mallesons, there were six significant securities class action settlements in 2012, with a total value of just under AUD $500 million.[116] Further, among the highlights of class action developments in Australia over the past several years has been "the replacement of individuals (effectively straw men) by 'so-

113. *See* MORABITO, *supra* note 109, at 14 tbl. 3, 18 tbl. 6; *see also* HOUSTON ET AL., *supra* note 112, at 4 fig. 1.

114. MORABITO, *supra* note 109, at 4.

115. KING & WOOD MALLESONS, CLASS ACTIONS IN AUSTRALIA: THE YEAR IN REVIEW 2012 (2013), *available at* http://www.mallesons.com/Documents/Class_Actions_in_Australia-The_Year_in_Review_2012.pdf.

116. *Id.* at 9 tbl. 1.

phisticated' investors as the lead plaintiff in class proceedings."[117] In other words, the typical lead plaintiff in financial class actions is now an institutional investor, rather than an individual consumer or shareholder.

The absolute numbers shown in Figures 1 and 2, and the small percentage of the federal court caseload they represented in each year of the study period, challenge the suggestion that third-party litigation financing contributed to a substantial rise in general civil litigation in Australia. In their unpublished 2009 paper Abrams and Chen estimate that third-party funding has increased litigation overall by 16.5%.[118] Abrams and Chen assert that funding a few hundred commercial claims, including class actions that constitute less than 1% of all federal filings, could lead to a 16% increase in civil litigation generally, which is difficult to believe.[119] Whatever the benefits and drawbacks of third-party litigation financing in Australia, the sky is not falling there.

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117. *Id.* at 7.

118. *See* BEISNER ET AL., *supra* note 5, at 9. The U.S. Chamber of Commerce relied on Abrams and Chen's unpublished 2009 paper in its report.

119. The 16.5% figure Beisner et al. attribute to Abrams and Chen's 2009 analysis does not appear in Abrams and Chen's 2012 paper, although the abstract for this more recent paper states "we find some evidence that third party funding corresponds to an increase in litigation and court caseloads." Abrams & Chen, *supra* note 86, at 1. The claim that third-party litigation funding has increased litigation is downplayed further in a brief description of the research by Abrams. *See* David S. Abrams, *Third-Party Litigation Funding*, REGULATION, Winter 2011–2012, at 3.

The estimates in Abrams and Chen's 2012 paper are based on econometric analysis. The regression coefficients measuring the effect of litigation funding on the number of filings are not statistically significant although coefficients for some variables associated with court processing of cases are. The model appears to combine data drawn from IMF, which invests almost exclusively in federal litigation, and Australian government judicial administration data, which include state and federal court cases. As in the United States, the number of state court filings far outweigh the number of federal court cases. The process through which funding federal commercial litigation (including class actions) would increase state civil case filings (including in states that do not offer a class action procedure) is unclear. Moreover, Abrams and Chen's econometric model rests on the assumption that absent third-party litigation financing, criminal and civil caseloads should rise or fall together across (state) jurisdictions and across time. There is no theoretical or empirical basis for this assumption. In the United States, from 2001–2010 state court criminal case filings rose 8% and civil case filings rose 20%. RICHARD Y. SCHAUFFLER ET AL., NAT'L CTR. FOR STATE COURTS, EXAMINING THE WORK OF STATE COURTS: AN ANALYSIS OF 2010 STATE COURT CASELOADS 2, 8 (2012). Meanwhile, in the federal courts, criminal case filings rose 22% and civil case filings rose 11%. ADMIN. OFFICE OF THE U.S. COURTS, FEDERAL JUDICIAL CASELOAD STATISTICS: MARCH 31, 2010, JUDICIAL CASELOAD INDICATORS, *available at* http://www.uscourts.gov/Viewer.aspx?doc=/uscourts/Statistics/FederalJudicialCaseloadStatistics/2010/front/IndicatorsMar10.pdf. Civil and criminal caseloads in the United States reflect different behavioral dynamics and legal policies; there is no reason to believe that the same is not true for Australia.

V. Conclusion: Will the Sky Fall If Third-Party Litigation Funders Invest in U.S. Class Actions?

The United States, of course, is not Australia—virtually all U.S. state and federal courts permit class actions, damages class actions are litigated on an opt-out basis, discovery is more generous than in other jurisdictions, class actions may be tried to juries that may award punitive damages (although they rarely do), and plaintiff class counsel generally are awarded fees proportional to the damages they obtain for class members. However, the legal fee regime in the United States is significantly different from the regime that prevailed in Australia at the time the Australian federal class action procedure was enacted into law and that still prevails there today. In theory, if and when third-party litigation investors enter the class action market in the United States, the number of class actions might increase, there might be more competition among plaintiff firms to serve as class counsel, a greater fraction of class claims might proceed to certification, and settlement values might rise. However, in the face of U.S. Supreme Court jurisprudence raising pleading and certification standards—and endorsing corporate efforts to preclude any type of class proceeding by incorporating mandatory arbitration clauses in a host of consumer, small business, and employment contracts—these outcomes seem unlikely any time soon.

In the Henny-penny story, having persuaded herself that the sky is falling when she was hit by a single acorn, Henny-penny gathers her barnyard companions together and they run off to see the king to share the news and seek his protection. Along the way the animals meet Foxy-woxy who persuades them that he knows the best path to the king's palace and then leads them instead into his lair, where he eats all of them. Neither anecdotal evidence of third-party litigation investors' strategies in the United States, nor contemporary U.S. class action jurisprudence, nor empirical data on trends in Australian class actions, suggest that the sky will fall any time soon should third-party litigation financing migrate to the class action domain in the United States. The animals in the barnyard should be wary of following Henny-penny off to see the king, lest they encounter Foxy-woxy on the way.