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BETTING ON TORT SUITS AFTER THE EVENT: FROM CHAMPERTY TO INSURANCE

Anthony J. Sebok*

INTRODUCTION

The common law today permits third parties unrelated to litigation to provide material support to parties involved in litigation in exchange for something of value contingent on the outcome of the litigation.¹ This practice is called champerty, and it is a species of maintenance, which is the support of litigation by a stranger.² Although once forbidden, champerty is now legal in the United Kingdom.³ In the United States, the permissibility of champerty varies from state to state, with sixteen states permitting the practice explicitly and another twelve permitting it implicitly.⁴

Technically speaking, the bargain struck between two parties in champerty is not an assignment. It is the partial assignment of the proceeds of litigation in which the property interest of the funder is by definition contingent on an uncertain event happening in the future—that is, the positive resolution of a lawsuit by either judgment or settlement. The “chose in action” remains in the hands of the original

* Professor of Law, Benjamin N. Cardozo School of Law. I would like to thank Professor Stephan Landsman for giving me the opportunity to present my views on litigation finance to the Clifford Symposium, as well as Tom Baker, Mark Geistfeld, Myriam Gilles, John Goldberg, Adam Scales, Cathy Sharkey, and Ben Zipursky for their comments.


². See generally Max Radin, Maintenance by Champerty, 24 Calif. L. Rev. 48 (1936).

³. In the U.K., third-party funding of litigation was unlawful until 1967. The Criminal Law Act of 1967 § 14(1) abolished criminal and tortious liability for maintenance and champerty. See Rachael Mulheron & Peter Cashman, Third-Party Funding of Litigation: A Changing Landscape, 27 Civ. Just. Q. 312, 318 (2008). Section 14(2) provided, however, that such abolition “shall not affect any rule of that law as to the cases in which a contract is to be treated as contrary to public policy or otherwise illegal.” Id. at 318–19.

⁴. See Sebok, supra note 1, (manuscript at 54). Some states, such as Connecticut and Colorado, started permitting third-party investment in the early nineteenth century, while others, such as Georgia, still prohibit it by statute. Id. (manuscript at 40, 60, 70).
party who suffered the wrong upon which the lawsuit is based.\textsuperscript{5} Nor does champerty have anything to do with lending, despite the confusion of some courts on this point (and the careless use of the term “non-recourse lending” by some litigation investment companies to describe champerty).\textsuperscript{6}

There is a long tradition of hostility towards champerty in the common law. In Book IV of the \textit{Commentaries}, in a discussion of wrongs against the public, Blackstone denounced maintenance as “an offence against public justice, as it keeps alive strife and contention, and perverts the remedial process of the law into an engine of oppression.”\textsuperscript{7} Champerty was the most odious form of maintenance and was “a practice so much abhorred by our law, that it is one main reason why a \textit{chose} in action, or thing of which one [has] the right but not the possession, is not assignable at common law; because no man should purchase any pretence to sue in another’s right.”\textsuperscript{8}

In a recent article, I tried to reconstruct the Blackstonian response because it lives on and has been repeated with some frequency by modern courts and critics of champerty.\textsuperscript{9} In that article, I identified three possible arguments for opposing champerty (as well as all forms of maintenance and assignment): (1) the argument from history, (2) the argument from corrective justice, and (3) the prudential argument. The argument from history is that, because the prohibition on third-party involvement in litigation has been part of the “Western legal tradition” since Roman law, modern courts should assume that—barring compelling reasons to the contrary—the common law cannot accommodate practices like champerty.\textsuperscript{10} This argument from history is doubly flawed. First, it is not clear why history alone should dictate the interpretation of the common law.\textsuperscript{11} Second, the historical story is

\begin{itemize}
\item \textsuperscript{5} See W. S. Holdsworth, \textit{The History of the Treatment of Choses in Action by the Common Law}, 33 \textit{Harv. L. Rev.} 997, 998 (1920).
\item \textsuperscript{7} 4 \textit{William Blackstone, Commentaries *135} (1902).
\item \textsuperscript{8} \textit{Id.}
\item \textsuperscript{9} See Sebok, \textit{supra} note 1, (manuscript at 72–77).
\item \textsuperscript{11} As Justice Holmes said in \textit{The Path of the Law},

It is revolting to have no better reason for a rule of law than that so it was laid down in the time of Henry IV. It is still more revolting if the grounds upon which it was laid
not as clear as some would have it; soon after Blackstone wrote his comments, American courts were endorsing a liberal approach to the very practices he condemned. 12

The argument from corrective justice is that since the obligation created by a wrongdoing in private law must be satisfied by the wrongdoer paying only the person she wronged, and only if the demand for payment is not tainted by a third-party's aid or instigation, almost all forms of maintenance and assignment are incompatible with private law theory, properly conceived. While some corrective justice theorists might be drawn to this argument, I offer an interpretation of corrective justice (one heavily influenced by Benjamin Zipursky's recourse theory) that is compatible with a robust market in litigation. 13

Finally, the prudential argument is that the development of a market in litigation—especially in champerty—will harm society either by encouraging an increase in frivolous litigation or creating litigation in general, whether frivolous or not. The prudential argument would be the greatest threat to champerty if it were proven true. So far, efforts to prove it have been unimpressive. 14 The fear that a market in champerty will result in lawsuits that are more likely to be frivolous than otherwise goes back to Blackstone, who, as we saw above, worried that third-party investors would turn lawsuits into "engines of oppression." 15 The fear seems far-fetched given that third-party investors operate under the same constraints as self-financing plaintiffs or lawyers who finance their clients' suits under the system of the contingency fee. 16 The fear that a market in champerty might increase the total amount of non-frivolous litigation seems to be as unpersuasive as
the argument from history: as many scholars have pointed out, society might benefit from more well-grounded lawsuits being filed.\textsuperscript{17}

In this Article, I will not refer back to the three arguments above. I want to explore a fourth argument that I did not discuss in my previous article on third-party investment in litigation. The argument is that third-party investment is bad (or ought to be looked upon with skepticism by the courts) because it is a form of gambling. This argument has appeared in a few judicial opinions in the United States, and it represents an interesting, albeit unpersuasive, line of attack. This Article will consider the accuracy of the characterization of champerty as a form of gambling (or speculation) and the force of the critique.

II. \textit{Is Champerty Gambling?}

Some courts have held that champerty is illegal because it is speculation that violates state law. What these courts mean by the word “speculation” is not clear, but a typical usage can be found in a 2003 decision by the Ohio Supreme Court: “[A] lawsuit is not an investment vehicle. Speculating in lawsuits is prohibited by Ohio law. An intermeddler is not permitted to gorge upon the fruits of litigation.”\textsuperscript{18} Sometimes, courts have meant the word “speculation” as a synonym for “harassing.”\textsuperscript{19} This is easily seen when one considers that the earliest form of maintenance in the United States was the contingency fee. Courts expressed a fear that the privileges inherent in the prosecution of a civil action—to demand that the other side sit for deposition, appear in courts, and retain (expensive) counsel—might lead lawyers to take a portion of the lawsuits of others in exchange for their services.\textsuperscript{20} For this reason, an Ohio court refused to permit the assignment of a disputed parcel of land to an attorney who promised that if he succeeded in winning back the land, he would return half of the property back to the assignor:


\textsuperscript{20} See, e.g., Reece v. Kyle, 49 Ohio St. 475, 483–85 (Ohio 1892).
A prospect of obtaining a large amount of property as consideration for professional services, and the risk of an inconsiderable bill of cost, form a strong temptation to speculation in lawsuits. It may induce men to purchase the right of instituting suits on trifling pretenses, for the purpose of forcing defendants to injurious and ruinous compromises as the most effectual means of purchasing peace.21

Yet, the real fear here was not speculation qua gambling, but something else—that if a lawyer "owned" part of a lawsuit, he would invest more of his time than a case merited for no other reason than to drive a defendant into an unjust settlement. When it came to "lawyer champerty," the real concern was not gambling. For example, when confronted with a case of a contingent fee taken on behalf of an "out of state indigent" with a genuine case who wanted to contest a will, the Tennessee Supreme Court permitted the champerty despite noting that nothing is more pernicious to the security of the community, nor anything more injurious to that character, for dignity, integrity, and purity, so indispensable in members of the bar, than the indulgence of a gambling spirit which would lead them, for contingent and possible advantage, to agitate society in the prosecution of doubtful, pretended, or obsolete claims.22

More typical of the courts that have linked champerty and gambling are a handful of recent decisions such as Echeverria v. Estate of Lindner,23 Lingel v. Olbin,24 and Wilson v. Harris.25 The Echeverria court held that a "non-recourse" loan between a commercial funder and a litigant who had received money pending the resolution of his suit under New York's "scaffold law" was either a loan (because liability under New York's Labor Law § 240 is no-fault) or "legalized gambling."26 The Lingel court noted that one of the reasons why third parties ought to be barred from any form of investment in litigation—whether champerty or assignment—was to prevent the introduction of the "vice" of speculation into contracts concerning lawsuits.27

Wilson is perhaps the most interesting of these modern cases because it is the only case in which the court used its state's legislative prohibition on gambling to strike down a champerty contract.28 While

22. Moore v. Trs. of Campbell Acad., 17 Tenn. 115, 118 (9 Yer. 1836).
27. Lingel, 8 P.3d at 1167.
28. See Wilson, 688 So. 2d at 268–70.
the facts of the dispute may have uniquely slanted against the champertor, this case is significant because the effect of the holding was to end litigation investment in Alabama. Wilson, the champertor, gave Harris, a "family friend," $4,749 in exchange for 33\% of a wrongful death suit that was under appeal.\textsuperscript{29} The jury awarded Harris $4 million.\textsuperscript{30} The court probably could have found alternative grounds to void the contract, but instead reached into Alabama's prohibition on wagering:

Section 8–1–150, Ala. Code 1975, provides that "[a]ll contracts founded in whole or part on a gambling consideration are void." In \textit{Thornhill v. O'Rear}, 108 Ala. 299, 19 So. 382 (1896), our supreme court observed that a gambling contract involves a wager and, defining "wager," the court stated:

A wager is nothing more than a bet, 'by which two parties agree that a certain sum of money, or other thing should be paid or delivered to one of them on the happening or not happening of an uncertain event.'

The agreement here was that Harris would pay Wilson a sum of money upon the happening of an uncertain event over which neither party had control—Harris's recovery of damages after her personal injury lawsuit survived the appellate process.\textsuperscript{31}

On the other hand, in another recent case, \textit{Odell v. Legal Bucks}, a North Carolina court looked to its state statutes concerning gambling and came to the conclusion that champerty was not gambling.\textsuperscript{32} Odell, who had filed a personal injury suit arising from a car accident, took $4,200 from a commercial litigation funder, Legal Bucks, and signed a contract that promised to give Legal Bucks a portion of her award or settlement from the suit if there was an award or settlement.\textsuperscript{33} The amount that she would give Legal Bucks depended primarily on how much time elapsed between the receipt of the money by Odell from Legal Bucks, but under the contract, the amount could not exceed 325\% of the advance—no matter how long it took for Odell to resolve her case.\textsuperscript{34} In the end, Odell settled her case for $18,000 and Legal Bucks claimed that she owed them $9,582.\textsuperscript{35} Odell refused to pay Legal Bucks more than the statutory interest in North Carolina, which is 16\% \textit{per annum}.\textsuperscript{36}

\textsuperscript{29. Id. at 266–68.}
\textsuperscript{30. Id. at 266.}
\textsuperscript{31. Id. at 268 (alteration in original) (citation omitted).}
\textsuperscript{33. Id. at 770.}
\textsuperscript{34. Id. at 770–71.}
\textsuperscript{35. Id. at 771.}
\textsuperscript{36. Id.}
The court rejected all of Odell's arguments, including the argument that the contract between her and Legal Bucks was void because it was an illegal gambling contract. The court reasoned that Odell and Legal Bucks had made neither a "bet" nor a "wager":

N.C. Gen.Stat. § 16-1, in defining illegal gaming contracts, provides:

All wagers, bets or stakes made to depend upon any race, or upon any gaming by lot or chance, or upon any lot, chance, casualty or unknown or contingent event whatever, shall be unlawful; and all contracts, judgments, conveyances and assurances for and on account of any money or property, or thing in action, so wagered, bet or staked, or to repay, or to secure any money, or property, or thing in action, lent or advanced for the purpose of such wagering, betting, or staking as aforesaid, shall be void.

... [F]or an agreement to constitute a "bet," there must be both a winning party and a losing party. In the Agreement at issue in the current case, however, both Plaintiff and Defendants desired the same outcome of the uncertain event: that Plaintiff recover a large sum of money in her personal injury claim. All parties to the Agreement stood to gain if Plaintiff recovered an amount equal to or greater than the sum of the principal of the advance plus the accrued interest. Likewise, all parties to the Agreement stood to lose if Plaintiff recovered less than the amount she owed to Defendants.

A "wager," as defined above, requires that neither party to the wager have any interest in the contingent event at issue. It is true that Defendants had no independent interest in the outcome of Plaintiff's personal injury claim. However, it is equally clear that Plaintiff did have an independent interest in the outcome of her personal injury claim. The outcome of Plaintiff's personal injury claim would not only define Plaintiff's legal rights and obligations under the Agreement with Defendants, but would also define her legal rights with respect to the other parties to the automobile accident giving rise to her claim.

Obviously, one of the problems with evaluating the argument that champerty is gambling is the possibility of multiple definitions of gambling. The Model Anti-Gambling Act—adopted in 1952 and declared obsolete in 1984 by the National Conference of Commissioners on Uniform State Laws—reflects the views of the American Bar Association Commission on Organized Crime, which are instructive in under-

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37. Id. at 773.
38. Id. at 772–73. The court relied upon the definition of "bet" and "wager" found in 38 Am. Jur. 2d Gambling § 3 (2010) because North Carolina courts had not previously defined these terms for the purposes of N.C. Gen. Stat. § 16-1.
standing and interpreting the meaning of some statutory provisions in various state laws. The Act defines "gambling" as

risking any money, credit, deposit, or other thing of value for gain contingent in whole or in part upon lot, chance or the operation of a gambling device, but does not include: bonafide contests of skill, speed, strength or endurance in which awards are made only to entrants or the owners of entries; bonafide business transactions which are valid under the law of contracts . . . .39

The North Carolina definition of a wager presupposes two people basing a contract on the contingent result of an event in which they have nothing at stake other than the sum named in the contract. Two people who wager on a coin tossed by a third-party have nothing at stake in the outcome of the coin toss other than the wager between themselves. But this seems like an overly restrictive definition of a wager. If Bob has applied for a grant from the Ford Foundation, his wager with Ben over whether he receives the grant is still a wager even though Bob is very interested not only in winning the wager with Ben but in getting the grant from the Ford Foundation. Furthermore, I am not sure that I agree with the North Carolina definition of a bet, or at least the way that definition was interpreted in the Odell case. I agree with the court that "for an agreement to constitute a 'bet,' there must be both a winning party and a losing party."40 I am not sure why Odell was not the losing party in her bet with Legal Bucks. The bet was that if she secured a positive outcome from her lawsuit (anything greater than $0 net her attorney's fees), she had to pay Legal Bucks the first $9,582. It is true that that she might have been happy to lose this bet if the outcome from her suit was greater than $9,582 (net her attorney's fees) but that seems irrelevant from the fact that whether she had to pay Legal Bucks at all was contingent on the outcome of her suit.

Before we examine the consequences of adopting a more relaxed definition of gambling along the lines of that suggested by either the Model Anti-Gambling Act or Alabama's state law, it is important to recognize that champery could escape any suggestion that it was any form of gambling if it were to present itself as essentially a form of investment in the lawsuit of another. The motivation for this definitional move is simple—if the paradigm example of gambling is a contract with another to make the terms of the payoff contingent on events over which one has no control, then to the extent that both parties to the contract can stress their control over the outcome, the

40. Odell, 665 S.E.2d at 773.
more likely that the contract will be viewed as an investment rather than a wager.

Courts allowed this same definitional move when they drew a distinction between "speculation" and gambling in the late nineteenth century futures markets. In the early years of the development of the commodities markets, it was an open question whether the contracts traded on these exchanges were anything other than gambling contracts.\(^1\) This question was categorically answered in the negative by Justice Holmes in *Board of Trade of Chicago v. Christie Grain & Stock Co.*\(^2\) As Joshua Tate has pointed out, the road to Justice Holmes's conclusion was paved by numerous courts drawing finer and finer distinctions between gambling—which was very much on the minds of the public authorities at the time—and financial speculation—which was a relatively new activity into which the courts projected a number of value judgments.\(^3\) For example, *Kirkpatrick & Lyons v. Bonsall* involved an 1870 futures contract to sell 5,000 barrels of oil during the first six months of 1871 at a specified price.\(^4\) The court argued that

> [w]e must not confound gambling, whether it be in corporation stocks or merchandise, with what is commonly termed speculation. Merchants speculate upon the future prices of that in which they deal, and buy and sell accordingly. *In other words they think of and weigh, that is speculate upon, the probabilities of the coming market, and act upon this outlook into the future, in their business transactions; and in this they often exhibit high mental grasp, and great knowledge of business, and of the affairs of the world... But when ventures are made upon the turn of prices alone, with no bona fide intent to deal in the article, but merely to risk the difference between the rise and fall of the price at a given time, the case is changed.... Then the bargain represents not a transfer of property, but a mere stake or wager upon its future price.*\(^5\)

The court was clearly impressed with the idea that the class of persons who speculate (as opposed to gamble) were businessmen; the businessmen had an interest in the market in which they made the contingent contracts, even if they had no intention of actually taking possession of the things to which the contingent contracts (the fu-

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3. See Tate, *supra* note 41, at 98.
5. Id. at 158 (emphasis added).
tures) referred. Beyond this, the courts have not made much progress since the late nineteenth century. As one commentator noted,

The common law has defined “speculation” neither clearly nor uniformly. . . . Those courts attempting to define “speculation” have failed to establish a uniform definition. . . .

Although courts have failed to define “speculation” clearly, they have distinguished between “speculation” and gambling. While gambling focuses on abstract chance, courts and commentators consider speculation to be a subset of investment.46

Suggesting speculation is not gambling when the risk-taker has an interest in the market or activity in which he or she invests could—if taken to its extreme—save champerty only by placing it on the horns of a dilemma. In theory, one option available to someone who would like to invest in litigation is to take an assignment of the lawsuit. The history of prohibitions on the assignment of “chooses in action” parallels the history of champerty; as we have seen above, it was precisely out of a fear of champerty that, according to Blackstone, the law prohibited assignment as well.47 Since the nineteenth century, assignment has been permitted in almost all choses of action except “personal torts” such as personal injury, some forms of professional malpractice, and defamation.48

Consequently, the courts have been ever more vigilant to prevent lesser forms of assignment by means of “intermeddling” through champerty—that is, taking over a lawsuit not by becoming the party in interest but by taking over some, if not all, of the major incidents of control over the conduct of the lawsuit in addition to a contingent payment if the lawsuit pays out a positive amount.49 At minimum, intermeddling means something more than that the maintainer has made suggestions which the party litigating the case has followed; in the context of champerty, intermeddling must mean that the investor has bought the right to make certain decisions about the litigation from the party bringing the suit along with a share of the contingent outcome. The degree of control the investor obtained by contract can extend over a spectrum ranging from relatively minor control (e.g.,

46. Michael T. Johnson, Note, Speculating on the Efficacy of “Speculation”: An Analysis of the Prudent Person’s Slipperiest Term of Art in Light of Modern Portfolio Theory, 48 STAN. L. REV. 419, 427–28 (1996) (quoting BENJAMIN GRAHAM & DAVID L. DODD, SECURITY ANALYSIS: PRINCIPLES AND TECHNIQUE 43 (3d ed. 1951) (“'Gambling' represents the creation of risks not previously existing—e.g., race-track betting—whereas 'speculation' applies to the taking of risks that are implicit in a situation and so must be taken by someone.” (alteration in original))).

47. The underlying evil that both assignment and maintenance represented to the common law is not easy to summarize. See Sebok, supra note 1, §§ II, III.

48. See id.

49. See infra text accompanying notes 50–53.
control over what documents the funder can see) to almost complete control (e.g., control over selection of counsel or veto power over settlement). At some point, the control assumed by the funder by contract verges on full control over the lawsuit, and full control of the lawsuit collapses the distinction between maintenance and assignment.50 Once the maintainer assumes full control of the lawsuit, she really is an assignee and the contract that brought her control of the lawsuit is properly a contract on assignment—not maintenance.51 Following these objections, several courts also prohibit champerty in order to place restrictions on the intermeddling in legal claims, particularly when the intermeddler is a stranger.52 In Florida, for example, intermeddling means "offering unnecessary and unwanted advice or services; meddlesome, [especially] in a highhanded or overbearing way."53

The dilemma is, therefore, that the more disinterested in the suit in which a champertor invests, the more likely her contingent reward upon the successful resolution of the suit will be deemed gambling. The more interested in the suit the champertor becomes (short of taking an assignment in the suit and replacing the original claimant), the more likely that a court will find champerty against public policy because it is a form of impermissible intermeddling.

50. See, for example, State Bar of Michigan, Ethics Opinion RI-321 (June 29, 2000), which described a litigation funding agreement offered in Michigan by a Nevada-based funder and contained the following conditions: (1) the funder had the right to order the litigant to replace the lawyer currently handling the case; (2) the funder had the right to order the litigant to refuse any settlement; (3) the litigant promised to continue the case "under all circumstances"; and (4) the funder had the right to inspect any document in the litigant's (or his attorney's) possession regardless of the effect that the inspection might have on the potential waiver of attorney-client privilege. The committee offered the opinion that no lawyer could recommend this agreement to a client because it made the funder "in real terms" a "client" in the case "with a co-equal, if not superior, decision making role" to the litigant receiving the funding. Id.

51. See Am. Optical Co. v. Curtiss, 56 F.R.D. 26, 32 (S.D.N.Y. 1971) (holding that an agreement which limited the litigant's control over whether to sue at all violated Federal Rule of Civil Procedure 17(a), which requires the moving party to be the "real party in interest").

52. See Johnson v. Wright, 682 N.W.2d 671, 678 (Minn. Ct. App. 2004) (noting that because the loan agreement was dependant on the outcome of the plaintiff's lawsuit, the funder "effectively intermeddled and speculated in [the plaintiff's] litigation and its outcome"); Moffett v. Commerce Trust Co., 283 S.W.2d 591 (Mo. 1955) (defining maintenance as "an officious intermeddling in a suit which in no way belongs to one, by maintaining or assisting either party, with money or otherwise, to prosecute or defend it" (quoting 10 AM. JUR. 549 (1937)))); St. Search Partners, L.P. v. Ricon Int'l, L.L.C., No. 04C-09-191-PLA, 2006 Del. Super. LEXIS 200, at *12–13 (Del. Super. Ct. May 12, 2006).

III. IS CHAMPERTY INSURANCE?

A. Champerty and the “Insurable Interest” Test

The minimal test for gambling endorsed by Alabama—that whenever “two parties agree that a certain sum of money, or other thing should be paid or delivered to one of them on the happening or not happening of an uncertain event”—has the virtue of simplicity. It focuses on the fortuity of the reward enjoyed by the recipient of the reward—that is to say, the lack of control of the recipient over whether the outcome will come about. Of course, this definition itself fails to fully capture the real world of champerty because the party taking the funding does have some control over the outcome upon which the contingent reward depends. Even the plaintiff in Wilson v. Harris had some control over whether her appeal would succeed, although most of the control she could have exercised would have made a difference before the funder had “invested” his $4,749. Certainly, in the typical case of litigation finance such as Odell, the party receiving the money can make a large difference in the existence and scale of a contingent recovery.

As Professor Tom Baker has pointed out, the mere fact that one party can affect the occurrence of a contingent outcome does not helpfully distinguish gambling from, for example, insurance. In On the Genealogy of Moral Hazard, Baker observed that the emerging insurance markets of the nineteenth century developed the distinction between “physical” hazards and “moral” hazards. The former category referred to risks inherent in nature and over which the insured had no control, while the latter referred to “people and situations. The people were those whose character suggested that they were unusually susceptible to the temptation that insurance can create, and the situations were those that heightened that temptation.” As Baker noted, to the extent that actuarial science could predict the probability of these people and situations generating a loss as a result of falling prey to the temptation contained in the moral hazard, the insurance industry could, in theory, price insurance while taking into account moral hazards. Baker’s article chronicled the attempts by

56. Id. at 250.
57. Id. at 252.
the insurance industry and observers to use the concept of moral hazard to police the content of insurance policies and the very meaning of the term insurance:

Despite the similarity between moral and physical hazards, nineteenth-century insurers treated moral and physical hazards in one remarkably different way. Except in the extreme case, the answer to most physical hazards was a higher premium rate, not a refusal to insure. . . .

With moral hazard, in contrast, refusal to insure was the first resort. Unlike the applicant who presented a greater-than-usual physical hazard, the applicant who presented a greater-than-usual moral hazard could not obtain insurance at a higher price.58

Insurance that attempted to underwrite moral hazards was denounced for many reasons. One of the most important reasons, as Baker and others have noted, is that these policies were seen as a form of gambling.59 The problem is that the line demarcating gambling and insurance kept moving: at one time even life insurance that underwrote “natural” hazards was outlawed as gambling. Life insurance was initially viewed as gambling and was prohibited in several European countries during the sixteenth and seventeenth centuries.60 To stop such gambling, insurance contracts in which there was no “insurable interest” were considered wagers and were unenforceable at law.61 The requirement of an insurable interest lessened and eventually eliminated resistance to life insurance.62 By the nineteenth cen-

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who ran afoul of the underwriter’s or adjuster’s moral hazard ranking? After all, if suicides, weddings, and crime observed the regularities of dice games, why not carelessness? Insuring people thought more likely to be careless (or even arsonists or thieves) may, in effect, load the dice, but that simply changes the odds, not the fact that the dice will produce predictable results over the long run. All that is required to keep the game afloat is the collection of a higher premium from the morally hazardous.

Id. (quoting Horace Binney, Address 393 (1950)).

58. Id. at 253.

59. Id. at 257 (citing VIVIANA A. ROTMAN ZELIZER, MORALS AND MARKETS: THE DEVELOPMENT OF LIFE INSURANCE IN THE UNITED STATES 72 (1979) on nineteenth-century resistance to the life insurance industry).

60. See SHEPARD B. CLOUGH, A CENTURY OF AMERICAN LIFE INSURANCE: A HISTORY OF THE MUTUAL LIFE INSURANCE COMPANY OF NEW YORK, 1843–1943, at 20 (1946); ZELIZER, supra note 59, at 33.

61. The roots of the insurable interest doctrine and the origins of modern insurance are intertwined. A version of the insurable interest doctrine first arose in England in a 1774 statute responding to perceived excesses by early insurers combined with widespread religious aversion to the concept of gambling on the lives of others.


62. Baker, supra note 55, at 257 n.83 ("[T]he passage of the Gambling Act of 1774, which prohibited wagering policies, represented the first attempt to sunder activities that had previ-
tury, efforts to draw crisp lines between gambling and insurance were unraveling:

[I]nsurance writers often relied on difficult-to-maintain intent distinctions (for example, insurers seek protection against losses, gamblers seek gains) or subterfuge (for example, equating life insurance and savings plans). On close analysis, these efforts are not particularly persuasive . . . . Insurance and gambling are not only difficult to separate historically, they are also difficult to separate analytically. . . . In the end, the strategy of the insurance men was to separate insurance and gambling institutionally: Whatever “gambling” was, it was not something that “insurance” institutions would do.53

The lesson from the nineteenth century is that the distinction between insurance and gambling, like the distinction between speculation and gambling, cannot be established by a priori definitions.64 It is clear that the insurance contracts overlap to some extent with the definition of wagering set out by the Alabama courts and the Model Anti-Gambling Act: money is paid on the occasion of an uncertain event. As one of Baker’s nineteenth-century sources argued,

Insurance is, in reality, nothing more than a wager, for the underwriter who insures at one per cent, receives one dollar to return one hundred upon the contingency of a certain event; and it is precisely the same in its operation as if he had bet a wager of ninety-nine dollars to one that the property does not burn, or that a certain event does not happen. . . . But, in a moral point of view, it should be considered entirely different. The character of an act is determined by its spirit, intention, and consequences. An individual that insures a bona fide interest, does it with a different intention than he who obtains a policy upon property in which he has no interest; for the latter hopes to make a gain, the former to protect himself from loss . . . .65

63. Id. at 258 (emphasis added) (citations omitted).
64. As one commentator has noted,

Probability theory, on which modern insurance was based, had been developed in the seventeenth century at the behest of professional gamblers, and it had not lost its link to gambling devices such as dice and lotteries. . . . Life insurance was berated “as a ‘speculation repugnant to the law of God and man’ that turned life into ‘an article of merchandise’” and through which “man was not only ‘betting against his God,’ but, even worse, usurping His divine functions of protection.”


The distinction between wagers that are "insurance" and other wagers that might be better described as gambling (or speculation) is functional. As Baker put it, the distinction is based on the motive behind the wager: "[I]nsurers seek protection against losses, gamblers seek gains." 66

A "moralized" conception of insurance, if carried forward, does help explain why champerty is not insurance and might therefore be classified as gambling or speculation. The moralized definition—which putatively focuses on the motive of the party making the wager—really seems to distinguish between insurance and gambling on the basis that insurance deals with an existing risk while a wager creates a risk. 67 This definition anchors the wager on the desire of the insured to preserve her status quo, not to gain from the vagaries of fortune. The person who takes out fire insurance on her house presumably prefers her house over the check from the fire insurance company; her state of affairs ex ante to the fire is her "first best" position (house minus the cost of the premium), while her state of affairs ex post the fire is a marginally "second best" position (cash equivalent of the house minus the cost of the premium and transaction costs). 68 The reason that insurers claim to insist on the "insurable interest" condition in life insurance is an extension of this line of reasoning: insurance must be in some way connected to the protection of an interest already enjoyed or held by the insured. 69 This is what George Savage, quoted by Baker above, meant when he said that insurance should only be extended to protect someone against the loss of a "bona fide interest." 70

Many commentators and scholars have complained that the conventional "moralized" definition of insurable interest as bona fide interest is ad hoc and inconsistent. 71 Attempts to provide a purely economic

66. See Baker, supra note 55, at 258.
67. See Richard E. Speidel & Ian Ayres, Studies in Contract Law 612 (6th ed. 2003) (claiming that those insured seek insurance "to compensate them for the possible occurrence of an existing risk" while "[g]amblers by their contracts create the risk at issue").
69. See Baker, supra note 55, at 259 ("[T]he common law 'insurable interest' requirement (which was one solution to the temptation aspect of the moral hazard problem) declared that insurance policies sold to people who lacked an 'insurable interest' were voidable 'wagering' policies.").
70. Savage, supra note 65, at 160.
71. For a review of the centuries of criticism, see Jacob Loshin, Note, Insurance Law's Hapless Busybody: A Case Against the Insurable Interest Requirement, 117 Yale L.J. 474, 483–89 (2007) ("In both life and property insurance, therefore, the definition of insurable interest is erratic, ambiguous, and inconsistent.").
definition of insurable interest are more promising, but have also been criticized for being empty.\textsuperscript{72} I will not hazard entering this debate, except to say that, to the extent that a “bona fide” interest includes any “economic interest in the safety or preservation of property from loss, destruction or pecuniary damage,” then I would argue that the champerty contract can be seen as an insurance contract.\textsuperscript{73}

What is the “insurable interest” in a champerty contract? At first glance, it might seem as if the “investor” in a lawsuit is the opposite of a party seeking insurance. She is a stranger to the lawsuit and has nothing at stake unless she chooses to make the wager. But, as Jonathan Molot has pointed out (albeit in a different context), litigation investment can serve as a form of insurance.\textsuperscript{74} In Molot’s model, a firm that faces a litigation risk (e.g., a liability) would ideally have liability insurance that protected it from the cost of liability (“before the event” insurance, or BTE). However, what if the firm did not have BTE insurance or its BTE insurance was inadequate? In theory, it could purchase “after the event” (ATE) liability insurance by assigning its potential liability to another party at a price that reflected a discount to the expected cost of the liability.\textsuperscript{75} Much of Molot’s article tries to explain how a market in ATE liability insurance could develop, the details of which are not relevant to this Article.\textsuperscript{76}

I would like to suggest that the much more common form of champerty, which already exists in the United States and United Kingdom markets, is also a form of insurance. Under the conventional plaintiff-side champerty contract, a party who has filed a lawsuit which has not yet been reduced to judgment “sells” a portion of that contingent return to the champertor. One way of viewing the litigant’s interest in the lawsuit is that it concerns (in Baker’s words) a potential gain, or the recovery of damages from the defendant. But the plaintiff in a

\textsuperscript{72} See Speidel & Ayres, supra note 67, at 612; see also Thomas Lee Hazen, Disparate Regulatory Schemes for Parallel Activities: Securities Regulation, Derivatives Regulation, Gambling, and Insurance, 24 ANN. REV. BANKING & FIN. L. 375, 422 (2005).

Professors Speidel and Ayres, among others, attempt to distinguish between insurance and gambling on the basis that insurance deals with an existing risk while a wager creates a risk. This does not appear to be a satisfactory distinction. The wager simply adds economic consequences for the parties to the wager, much as a derivatives contract on the price of a commodity provides a parallel economic consequence for the speculator.

\textsuperscript{Id.} (footnote omitted).

\textsuperscript{73} N.Y. INS. LAW § 3401 (McKinney 2007); see also, e.g., CAL. INS. CODE §§ 280–384 (West 2005).

\textsuperscript{74} See Molot, supra note 17, at 367.

\textsuperscript{75} See id. at 377.

\textsuperscript{76} See id. at 378–90. The most daunting questions are whether the insurer can (1) price the risk and (2) achieve any discount to the expected cost of the liability by taking on the risk from the firm. See id.
lawsuit is not seeking to realize a gain; she is trying to repair a loss. If this is correct, then we can see her lawsuit as a risk that is symmetrical to the risk of liability faced by the opponent she is suing. Under this analysis, the focus should not be on the champertor (the investor) but on the rightholder who sells part of her suit to the investor. The right way of seeing “champerty as insurance” is to see that the champerty contract permits the rightholder to purchase a very special kind of insurance. I will try to illustrate what I mean in the following paragraph.

Before the accident that gave rise to the suit into which the champertor invested, the litigant (L) was uninjured. Assume L had a welfare of 100 before the accident. After the accident that gave rise to her injury, her welfare was decreased by some amount; in this example, let us assume the amount of the decrease is 20. Upon deciding to sue the person whom she reasonably believes wrongfully injured her, L’s welfare is now 80 plus the expected value of her suit. The expected value of her suit is less than 20 (unless punitive damages and legal expenses are awarded), so her welfare after the accident and before the resolution of her suit is $80 + (20p - F)$ where $p$ is the probability of recovering her wrongful losses and $F$ is the amount of any legal fees L will have to pay in order to recover her wrongful losses. Assuming that L has a non-frivolous lawsuit worth 20, she faces a risk of no recovery and a risk of less than full recovery. In the same way that an investor could remove the risk of a future liability from a defendant by “purchasing” that risk, an investor could remove the risk that L will receive no compensation for her wrongful loss by “purchasing” that risk from her. Therefore, the champerty contract is an “arrangement for transferring and distributing risk” where the risk is the failure of the legal system to provide in part (or in whole) the redress of wrongful losses. It is a form of insurance.

B. Champerty and Moral Hazard

As many commentators have noted, the scholastic debate over the concept of an insurable interest is often overwhelmed by the more practical problem of minimizing the risk of moral hazard wrecking the insurance market. The moral hazard concern of insurance is that an insured will be overly insured and will therefore be able to profit from an event, thereby either choosing to bring that event about or taking

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77. Keeton’s classic definition of insurance is an “arrangement for transferring and distributing risks.” ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW: A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES, AND COMMERCIAL PRACTICES 3 (student ed. 1988).
78. See Loshin, supra note 71, at 478–79 n.10 (collecting sources).
less than socially efficient steps to protect against that event's occurrence. Professor Catherine Sharkey has noted, both in her article and in commentary on this Article, that the conceptual problem of fitting champerty into insurance might be usefully analyzed by adopting a functional approach which asks to what extent the shifting of the plaintiff's risk of receiving "no redress" after an accident might produce a moral hazard.

Sharkey's observation is helpful, and in this context, we can usefully contrast champerty contracts with insurance contracts for punitive damages. Sharkey noted that there may have been credible reasons for courts and insurance companies to resist the insurability of punitive damages, citing George Priest's classic 1988 article for that proposition. It is worth noting, albeit for different reasons, that courts in the nineteenth century had strong intuitions against permitting insurance for punitive damages in ways which are similar to social resistance to champerty contracts. But as Sharkey argued, by adopting Priest's own account of what can count as an insurable interest, an argument could be made that punitive damages as they have now developed should be insurable:

Simply stated, two related conditions must be met in order for a risk to be insurable. First, the losses must be probabilistic: "A loss that is certain to occur in some particular period cannot be insured against; one can only accumulate savings before the loss occurs or after the loss is suffered to restore the previous economic position." Second, the ever-present problem of moral hazard must be restrained. Moral hazard describes the behavioral effects of insurance on the insured; thereby, if insurance lowers expected injury costs, the insured will proceed with risky activities, increasing the likelihood of injuries to others.

Sharkey's argument with regard to punitive damages is that—to the extent that they are now awarded to prevent under-deterrence involving cases of non-intentional wrongdoing—there is no reason to allow insurance companies to categorically disclaim their obligation to stand

79. See DeCespedes v. Prudence Mut. Cas. Co., 193 So. 2d 224, 226 (Fla. Dist. Ct. App. 1966) ("The insured must not be encouraged to use the coverage for profit as this intends to increase moral hazard and could ultimately undermine the whole concept of insurance."); Liberty Mut. Ins. Co. v. State Farm Auto. Ins. Co., 277 A.2d 603, 608 (Md. 1971) (describing insurance clauses as designed to protect insurers from moral hazard resulting from overinsurance); Baker, supra note 55, at 259; Loshin, supra note 71, at 488.
80. See Catherine M. Sharkey, Revisiting the Noninsurable Costs of Accidents, 64 Mo. L. Rev. 409 (2005).
81. Id. at 434–35 (citing George L. Priest, Insurability and Punitive Damages, 40 Ala. L. Rev. 1009 (1989)).
82. See id. at 420.
83. Id. at 434–35 (quoting Priest, supra note 81, at 1020 (footnotes omitted)).
behind their insureds when their insureds are found liable for punitive damages: "[R]isks of losses leading to punitive damages awards have become more probabilistic and less subject to insured moral hazard."84

Under the same general analysis, it would appear that champerty contracts should be permitted as insurance as well. Both of Priest's conditions are satisfied under these contracts. First, the loss is probabilistic: for someone seeking redress for a wrong that was done to her, the chance of recovery is never 1.0, but always a factor less than zero.85 Second, the ever-present problem of moral hazard is restrained. This is because champerty is not assignment. Because the rightholder is not assigning the entirety of her claim but only a portion, she still has an interest in the outcome of the suit, and therefore she is not indifferent after she sells a portion of her suit between the result for which she bought "insurance" (the lawsuit being won) and the alternative result (losing the lawsuit). That would not be the case had she assigned the lawsuit, but—although the law has not always been clear on this point—champerty is clearly not the same thing as assignment.86 There are other reasons besides financial self-interest for why the rightholder who sells to a champertor would prefer to avoid the risk against which she insured (the non-redress of her injury by the person who violated her right) such as the rightholder's natural desire for satisfaction; however, the material incentive alone should satisfy concerns over moral hazard.

IV. Conclusion

In this short Article, I have attempted to analyze one common criticism of champerty: that it is a form of gambling. This line of attack is not persuasive not because champerty may not satisfy the definition of wagering, but because, as I have argued, the fact that a contract conditions the award of money on the occurrence of an uncertain event tells us nothing about whether, as a functional matter, the contract serves a socially useful function. I have argued further that champerty can be seen as a form of "after the event" insurance for victims of wrongful losses. The next step in this analysis would be to compare the form

84. Id. at 437.
85. Courts sometimes make the mistake of assuming that pending litigation is a "sure thing" and therefore conclude that champertous contracts should be reclassified as loans. See, e.g., Rancman v. Interim Settlement Funding Corp., No. 20523, 2001 Ohio App. LEXIS 4818, at *8 (Ohio Ct. App. Oct. 31, 2001), aff'd on other grounds, 789 N.E.2d 217 (Ohio 2003). No case is a "sure thing" until reduced to judgment for numerous reasons, and even then the certainty of redress depends on the rightholder's ability to collect on the judgment.
86. See Sebok, supra note 1, (manuscript at 37).
and content of champertous investments with another well-developed market in “after the event” insurance in litigation: insurance for legal fees in the United Kingdom.\textsuperscript{87}