



Law, Finance, and Capital Markets

A RAND INSTITUTE FOR CIVIL JUSTICE PROGRAM

This PDF document was made available from www.rand.org as a public service of the RAND Corporation.

[Jump down to document](#) ▼

The RAND Corporation is a nonprofit research organization providing objective analysis and effective solutions that address the challenges facing the public and private sectors around the world.

Support RAND

[Purchase this document](#)

[Browse Books & Publications](#)

[Make a charitable contribution](#)

For More Information

Visit RAND at www.rand.org

Explore the [RAND Law, Finance, and Capital Markets Program](#)

View [document details](#)

Limited Electronic Distribution Rights

This document and trademark(s) contained herein are protected by law as indicated in a notice appearing later in this work. This electronic representation of RAND intellectual property is provided for non-commercial use only. Unauthorized posting of RAND PDFs to a non-RAND Web site is prohibited. RAND PDFs are protected under copyright law. Permission is required from RAND to reproduce, or reuse in another form, any of our research documents for commercial use. For information on reprint and linking permissions, please see [RAND Permissions](#).

THE ARTS
CHILD POLICY
CIVIL JUSTICE
EDUCATION
ENERGY AND ENVIRONMENT
HEALTH AND HEALTH CARE
INTERNATIONAL AFFAIRS
NATIONAL SECURITY
POPULATION AND AGING
PUBLIC SAFETY
SCIENCE AND TECHNOLOGY
SUBSTANCE ABUSE
TERRORISM AND
HOMELAND SECURITY
TRANSPORTATION AND
INFRASTRUCTURE
WORKFORCE AND WORKPLACE

This product is part of the RAND Corporation occasional paper series. RAND occasional papers may include an informed perspective on a timely policy issue, a discussion of new research methodologies, essays, a paper presented at a conference, a conference summary, or a summary of work in progress. All RAND occasional papers undergo rigorous peer review to ensure that they meet high standards for research quality and objectivity.

OCCASIONAL PAPER

Alternative Litigation Financing in the United States

Issues, Knowns, and Unknowns

Steven Garber



This paper is a product of the RAND Institute for Civil Justice Law, Finance, and Capital Markets Program. Financial support was provided by Juridica Investments Limited, a supplier of one type of alternative litigation financing discussed and analyzed here. Additional financial support was provided by the Kauffman-RAND Institute for Entrepreneurship Public Policy.

Library of Congress Cataloging-in-Publication Data

Garber, Steven, 1950-

Alternative litigation financing in the United States : issues, knowns, and unknowns / Steven Garber.

p. cm.

Includes bibliographical references.

ISBN 978-0-8330-4990-2 (pbk. : alk. paper)

1. Costs (Law)—United States. 2. Practice of law—Economic aspects—United States.
3. Lawyers--Fees—United States. 4. Law and economics—United States. I. Title.

KF8995.G37 2010

347.73'77—dc22

2010017529

The RAND Corporation is a nonprofit research organization providing objective analysis and effective solutions that address the challenges facing the public and private sectors around the world. RAND's publications do not necessarily reflect the opinions of its research clients and sponsors.

RAND® is a registered trademark.

Cover image courtesy of Aggressive Entertainment/iStockphoto

© Copyright 2010 RAND Corporation

Permission is given to duplicate this document for personal use only, as long as it is unaltered and complete. Copies may not be duplicated for commercial purposes. Unauthorized posting of RAND documents to a non-RAND website is prohibited. RAND documents are protected under copyright law. For information on reprint and linking permissions, please visit the RAND permissions page (<http://www.rand.org/publications/permissions.html>).

Published 2010 by the RAND Corporation

1776 Main Street, P.O. Box 2138, Santa Monica, CA 90407-2138

1200 South Hayes Street, Arlington, VA 22202-5050

4570 Fifth Avenue, Suite 600, Pittsburgh, PA 15213-2665

RAND URL: <http://www.rand.org>

To order RAND documents or to obtain additional information, contact

Distribution Services: Telephone: (310) 451-7002;

Fax: (310) 451-6915; Email: order@rand.org

Summary

Provision of capital by nontraditional sources to support litigation activity in the United States has received considerable attention of late from journalists, researchers, and policy advocates. This phenomenon is often referred to as *third-party financing* of litigation. This term, however, mischaracterizes the phenomenon in the United States because, viewing the plaintiff and the defendant as the first two parties, it has become common for there to be at least a third, and often a fourth, party involved in financing litigation activity. Specifically, in almost all personal-injury lawsuits brought by individuals and many lawsuits brought by businesses, plaintiffs' efforts are financed by contingency-fee lawyers who pay expenses during the course of a lawsuit and are reimbursed for expenses only if the plaintiff receives a recovery. In addition, in many lawsuits, much (and sometimes all) of defendants' legal costs are paid by an insurer under "duty to defend" arrangements. Thus, in this paper I propose and use the term *alternative litigation financing* (ALF) to describe the phenomenon under study, namely, litigation financing by entities other than plaintiffs, defendants, their lawyers, or defendants' insurers.

Although ALF is fairly new in the United States, some have already called for banning or heavily regulating it. Very little is known, however, about current ALF activity and its effects, and even less about how ALF activity and ALF markets will evolve in the near and longer terms. A main purpose of this paper is to provide policymakers with information that could help them make socially advantageous decisions about ALF in the next five to ten years. Several kinds of state-level policymaking institutions—bar associations, courts, legislatures, and state attorneys general—could play important roles in how ALF develops in the United States. The other main purpose of the paper is to provide researchers with background and ideas that could help them contribute to the effort to develop information that could help policymakers make wise decisions.

To further these goals, I synthesize and interpret publicly available information from many sources, such as descriptive and analytical articles about ALF, websites of ALF suppliers and law firms, and literature on contingency-fee lawyers, the economics of U.S. civil litigation, access to justice for civil litigants, and corporate law firms. Much of the analysis is conceptual, but empirically grounded, and applies standard perspectives from microeconomics. The discussion and analyses also benefit greatly from 17 semistructured interviews I conducted with participants in ALF markets, attorneys at law firms and corporations, and experts on the objectives and management of corporate law firms and corporate legal departments.

The paper considers economic, legal, and ethical issues related to ALF in the United States. The author is an economist, not a lawyer or philosopher. To aid readers who are particularly interested in legal issues, I provide cites to what appears to be useful recent literature.

In Section 2, I argue that the policy debate and much of the writing about ALF is confusing because of failure to appreciate five crucial distinctions, namely, distinctions between

- legal ethics and social morality
- ethical and instrumental policy considerations
- different forms of ALF
- the effects of ALF in the near and longer terms
- activities that are intrinsic to ALF and activities that might accompany ALF.

In Section 3, I provide—to the extent that available information allows—a description of ALF activity in the United States as of early 2010. There are three fairly active segments of the U.S. ALF industry, all of them providing support for plaintiff-side efforts. These three segments—on which my analyses focus—involve the following:

- consumer legal funding (non-recourse loans) to individual, usually personal-injury, plaintiffs
- loans and lines of credit for plaintiffs' law firms
- investments in commercial (business against business) lawsuits.

As repeatedly illustrated in Sections 5 and 6, these three types of ALF differ in several ways that are relevant to their social (including economic) effects.

I consider in Section 4 whether policymakers should focus on ethical considerations, as some have advocated, on the grounds that ALF is “unethical” and, therefore, just shouldn't be allowed. Here I distinguish between legal ethics, as exemplified by laws governing lawyers and the American Bar Association's (ABA's) *Model Rules of Professional Conduct*, and morality, as that term is understood by moral philosophers and intuitively by many others. Regarding legal ethics, I briefly discuss laws and professional rules that might proscribe ALF in some jurisdictions (maintenance and champerty) and laws and rules that might limit ALF-related activities in some jurisdictions (pertaining to intermeddling, fee splitting with nonlawyers, and unintentional waiver of attorney-client and work-product privileges). I conclude that in some states laws and professional rules and uncertainty about their application by courts in ALF contexts could deter some forms of ALF entirely, substantially constrain activities related to ALF, or increase costs of ALF. Regarding social morality, I argue—using access to justice and property rights as examples of moral principles—that there is no compelling argument for *either allowing or banning* ALF.

Sections 5 and 6 make up the heart of the paper and apply microeconomic principles to explore likely effects of ALF on outcomes of social concern. Section 5 focuses on the present and the near future (five to ten years, say) and discusses the plausibility of various claims about the effects of ALF on litigation as well as potential effects that have not received much attention. Specifically, I consider the potential effects of ALF on the quantity and quality of civil litigation, the likelihood and timing of settlements, the fairness of settlements, and the transaction costs of litigation. In many instances, I conclude and illustrate that these effects are likely to differ substantially across the three active segments of the ALF industry. I also comment on special issues raised by class-action and patent-infringement litigation.

In Section 6, I argue that the longer-term effects of ALF might properly dominate policy assessments, and, for that reason, I consider how the markets for ALF may grow and evolve

over the longer term. I comment briefly on the potential longer-term effects of ALF on fairness to plaintiffs and defendants and then focus on the social goal of economic efficiency. That discussion highlights the potential for competition to promote economic efficiency, points out what seem to me to be key challenges for markets to achieve nearly efficient outcomes, and discusses possibilities for market developments—such as the emergence of brokers and the development and wide diffusion of expertise in case evaluation—to address those challenges.

The concluding section focuses on lessons for policymakers for the next five to ten years or so. In my view, the key lessons for the short term are as follows:

- Do not accept uncritically arguments about ethics compelling anything about ALF policy.
- Always keep in mind that the economic effects of ALF almost surely differ substantially across the three active segments, as well as across new segments that may emerge based on other business models of ALF suppliers.
- Be doubtful about any claims about “effects of ALF” that purportedly apply broadly over various types of ALF.
- Be skeptical of one-size-fits-all policy prescriptions, because context matters, and it seems implausible, for example, that policies affecting all kinds of ALF will be broadly effective in promoting social objectives.
- Be wary of claims about the effects of ALF in other countries providing simple lessons for the United States, because the effects of ALF—and, indeed, forms of ALF—in other countries (such as Australia and the United Kingdom) reflect to large degrees institutional features of legal rules abroad that differ from those in the United States, such as not allowing lawyers to work under contingency-fee agreements and requiring the losing side to pay the winning side’s legal expenses.
- Because of massive uncertainties about even recent effects of ALF, and more importantly, future effects of ALF, policymakers might best limit their interventions in ALF activity to “robust” policies—policies whose outcomes are likely to be satisfactory, or at least not too unsatisfactory, no matter what the truth is pertaining to these massive uncertainties.

I conclude by suggesting and discussing two key characteristics of robust policy in the present context. These are (1) *light-handedness* (avoiding policies that could fundamentally impede development of effective competition in ALF markets) and (2) *precision* (avoiding policies that apply more broadly than necessary to alleviate problems that are viewed as too pressing to wait to see whether market developments will alleviate them).