



1212 New York Ave. NW
Suite 900
Washington, D.C. 20005
202-525-5717

Free Markets. Real Solutions.
www.rstreet.org

Testimony from:

Jerry Theodorou, Director, Finance, Insurance and Trade Program, R Street Institute

The Assembly Financial Institutions and Insurance Committee

January 11, 2023

Chair and members of the committee:

My name is Jerry Theodorou. I am the director of the Finance, Insurance and Trade program at the R Street Institute (“R Street”). R Street is a nonprofit, nonpartisan public policy research organization whose mission is to engage in policy research and outreach to promote free markets and limited, effective government. Prior to joining R Street in 2021, my background included 12 years of employment as a property and casualty insurance industry analyst, focusing on liability insurance lines such as commercial automobile liability insurance, medical professional liability insurance, general liability insurance and workers’ compensation insurance.

I have written extensively on tort trends and on the impact of liability awards on the economy, on insurance buyers, and on insurance and reinsurance providers. My most recent study on tort trends explored social inflation, which is the increase in liability loss severity above and beyond economic inflation.¹ In the study, third-party litigation funding, or TPLF, was identified as a key driver of social inflation. I have also written a separate article about TPLF.²

What Is Litigation Funding?

TPLF is the phenomenon whereby outside investors—mainly institutional investors such as hedge funds, pension funds, endowments, family offices and sovereign wealth funds—provide capital to law firms (mainly to plaintiff firms) to finance litigation. The American Bar Association, which refers to the practice as “alternative litigation finance,” or ALF, defines it as “the funding of litigation activities by entities other than the parties themselves, their counsel, or other entities with a preexisting contractual relationship with one of the parties, such as an indemnitor or a liability insurer.”³

The Litigation Funding Marketplace

The litigation funding marketplace consists of two types of providers: personal (or consumer) litigation funders and commercial litigation funders. Personal litigation funders provide pre-settlement cash advances to parties presenting claims for medical and other expenses in the course of a lawsuit. The



1212 New York Ave. NW
Suite 900
Washington, D.C. 20005
202-525-5717

Free Markets. Real Solutions.
www.rstreet.org

amounts are relatively low and typically do not exceed five digits. If the lawsuit is successful, the funder is entitled to receive a portion of the proceeds. The recipient of the advance is required to pay interest on the advance, sometimes at high double-digit rates that exceed state usury laws.⁴

In contrast to personal litigation funding, commercial litigation funding usually entails investment in complex cases against large corporations. The cases typically involve allegations of patent infringement, intellectual property theft and product liability damage. Investments in commercial litigation funding may be directed to individual lawsuits, or they may support the financing of a law firm's entire portfolio of outstanding litigation. According to litigation finance firm Westfleet Advisors' most recent report on the litigation finance industry, the average size of single-funded commercial suits is \$3.5 million and for portfolio investments, it is \$8.5 million.⁵

Westfleet's report estimates the size of the litigation funding market at \$12.4 billion in assets under management in 2021, up from \$11.3 billion in 2020, with 47 active funders.⁶

Arguments for and Against Litigation Funding

Opinions are divided as to whether litigation funding is a benefit or a blight. Its supporters are primarily litigation funders, who argue that it enhances access to justice. Its detractors, chiefly representing business interests, maintain that it violates legal and ethical standards and profits from unrelated parties' litigation.

In my research, I found that there are five main arguments advanced by supporters of litigation finance:

- TPLF facilitates access to justice that claimants would not otherwise have. It helps the "little guy" by leveling the playing field and corrects the imbalance that favors powerful, entrenched defense interests.
- TPLF providers do not influence the course of litigation.
- Use of TPLF is a private matter and should only be disclosed ex parte.
- The economic terms of TPLF agreements represent protected information and should not be disclosed.
- A global campaign of disinformation exists to attack the idea of commercial legal finance and the individual providers of it.⁷

On the opposite spectrum, opponents of litigation finance advance four main arguments:

- **Disclosure.** There should be disclosure of TPLF arrangements. If insurance coverage is discoverable in court, and it is, according to a federal Rule of Civil Procedure, the existence of TPLF should be discoverable as well. Rule (26(a)) states that the existence of insurance, the identity of insurers and copies of insurance policies are discoverable.
- **Influence.** Funders do control or influence matters they fund. It stands to reason that a party with a financial interest in a proceeding should wish to help shape its outcome. A rare example of a revealed



1212 New York Ave. NW
Suite 900
Washington, D.C. 20005
202-525-5717

Free Markets. Real Solutions.
www.rstreet.org

TPLF firm's agreement is one involving Therium, which allowed the funder to receive traditionally privileged attorney-client information, thereby assuring that plaintiff counsel would inform Therium of any developments in the case.

- **Attorney-Client Privilege.** TPLF raises legal ethical concerns. Plaintiffs' attorneys owe a duty to their plaintiffs, but also owe a contractual duty to funders. This can lead to their failing to comply with their duty of independent judgment regarding choice of expert witness, for example.
- **Fee-Sharing.** One of the model rules for professional conduct of the American Bar Association (504(c)) stipulates that "a lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services." Fee sharing or fee splitting violates this rule.⁸

The issue that has gotten the most attention in the debate between litigation funding's supporters and detractors is disclosure. Supporters of litigation argue that the existence and terms of funding are confidential; opponents maintain that parties in a legal dispute have a right to know if third parties are investing in the outcome of their lawsuits.

The Way Forward

Disclosure is the best response to prevent potential deleterious consequences of litigation funding. Federal rules and civil procedures should be modified to allow TPLF transparency. An example of action taken to achieve this aim includes the September 2022 letter by the Institute for Legal Reform and Lawyers for Civil Justice to the Advisory Committee on Civil Rules asking the committee to amend Rule 16(c)(2) to prompt judges to consider inquiring about investments in their cases from non-parties whose existence has not been disclosed.⁹ If this measure is implemented, judges could better manage their cases and make more informed decisions without compromising their judicial discretion.

Disclosure and transparency in litigation are a boon, not a bane. Litigation is intended to right wrongs and promote justice. In the interest of fairness for the existence of parties financing litigation and their arrangements with litigants, arrangements should be disclosed, not veiled in secrecy. We believe that legislation in New Jersey impacting litigation funding should require plaintiffs to disclose financial backing from investors who are not parties to the litigation.

Thank you for your time,

Jerry Theodorou
Director, Finance, Insurance and Trade Program
R Street Institute
jtheodorou@rstreet.org



1212 New York Ave. NW
Suite 900
Washington, D.C. 20005
202-525-5717

Free Markets. Real Solutions.
www.rstreet.org

¹ Jerry Theodorou, “The Scourge of Social Inflation,” *R Street Policy Study* No. 247, December 2021.
<https://www.rstreet.org/wp-content/uploads/2021/12/RSTREET247.pdf>.

² Jerry Theodorou, “Litigation Funding: Competing Mythologies,” R Street Institute, Oct. 14, 2022.
<https://www.rstreet.org/2022/10/14/litigation-funding-competing-mythologies>.

³ Lev E. Breydo, “Alternative Litigation Finance: Leveraging Legal Analytics to Navigate the World’s Largest Unstructured Data Set,” American Bar Association, September 2020.
https://www.americanbar.org/groups/business_law/publications/blt/2020/09/alt-litigation-finance;

⁴ Irina Fan et al., “US litigation funding and social inflation: The rising costs of legal liability,” Swiss Re Institute, December 2021. <https://www.swissre.com/dam/jcr:7435a896-5f4b-463b-a1e6-7d4ec17db556/swiss-re-institute-expertise-publication-us-litigation-funding-and-social-inflation-december2021.pdf>.

⁵ “2021 Litigation Finance Market Report,” *The WestFleet Insider*, March 2022.
<https://www.westfleetadvisors.com/wp-content/uploads/2022/03/WestfleetInsider-2021-Litigation-Finance-Market-Report.pdf>.

⁶ *Ibid.*

⁷ Theodorou. <https://www.rstreet.org/2022/10/14/litigation-funding-competing-mythologies>.

⁸ *Ibid.*

⁹ “Rules Suggestion to the Advisory Committee on Civil Rules: An Important but Rarely Asked Question: Amending Rule 16(c)(2) to Prompt Judges to Consider Inquiring about Financial Interests Created by Third-Party Litigation Funding,” Lawyers for Civil Justice and the U.S. Chamber of Commerce Institute for Legal Reform, Sept. 8, 2022.
https://www.uscourts.gov/sites/default/files/22-cv-m_suggestion_from_lcj_and_ilr_-_rule_16c2_0.pdf.