September 11, 2023

The Honorable James Comer
Chair
Committee on Oversight and Accountability
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Jamie Raskin
Ranking Member
Committee on Oversight and Accountability
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Comer, Ranking Member Raskin and members of the Committee:

Thank you for your decision to hold a hearing on Sept. 13, 2023, titled “Unsuitable Litigation: Oversight of Third-Party Litigation Funding.” My name is Jerry Theodorou. I am the director of the R Street Institute’s Finance, Insurance and Trade program. The growth of third-party litigation funding activity is of interest for my insurance-focused research because my work on social inflation (growth in insurer loss costs for reasons beyond rising consumer price index) identifies third-party litigation funding as a meaningful factor contributing to a secular trend toward ever-higher judgements and settlements in civil litigation, something that may stoke higher general liability insurance losses.¹

Litigation funding refers to the practice of third parties investing in lawsuits to which they are not parties. Among leading scholars of litigation finance, University of Iowa law professor Maya Steinitz has written that “both proponents and opponents of this newly emergent phenomenon agree that it is the most

important civil justice development of this era.” Proponents argue that litigation funding helps level the playing field, enabling access to courts for plaintiffs and plaintiff attorneys who would otherwise not have access to sufficient finances to pursue litigation. Opponents of litigation funding maintain the practice violates fundamental legal ethics issues; is responsible for inflating the size of court awards; and is motivated purely by financial considerations, as it operates in the dark. Before concluding whether litigation funding is a boon or a bane for our civil law system and the economy, we must understand its workings. Unfortunately, however, litigation funding firms typically refrain from disclosing details of their agreements. As sunlight is the best disinfectant, we hope that my comments will help shed some light and lead to sound policymaking.

According to a recent Government Accountability Office (GAO) report, litigation finance (n.b. the terms litigation finance and litigation funding are used interchangeably) gained a foothold in the U.S. around 2010. Since then the litigation finance industry has grown significantly, with new funders in the market according to an oft-cited report produced annually by Westfleet, a major player in the litigation funding field. Its magnitude is, however, not known definitively. Litigation Finance Journal states that litigation finance’s market size is unknown because “the answer is dependent on an element of transparency not currently inherent in the industry itself.” In an attempt to quantify the litigation insurance marketplace, the GAO report drew on the Westfleet report, which identified 47 active commercial litigation funders. The GAO cites Westfleet’s finding that assets under management of litigation finance firms grew from $11.3 billion to $13.5 billion from 2020 to 2022.

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3 Ibid.
Litigation Finance History

Although litigation finance emerged on the U.S. legal scene circa 2010, the practice of litigation financing is centuries old. Prior to its current manifestation, litigation financing was known as “champerty.” Throughout its history, champerty has been looked upon unfavorably as an unseemly and reprehensible practice. The 18th-century jurist William Blackstone wrote in his *Commentaries on the Laws of England* that third parties who become financially involved in litigation are "pests of civil society … officiously interfering in other men's quarrels," (emphasis added). In a mid-19th-century U.S. case, champerty was found to be "odious in the eyes of the law." 8

The influential 14th edition of the Encyclopedia Britannica, published in 1938, declares that in the United States, “champerty as defined by the common law [is] still generally criminal.” 9 Because champerty, as defined historically, may have included contingency fee arrangements—and because contingency fees have become standard practice—prohibitions against champerty have been removed in many states.

Contemporary reference works continue to define litigation funding negatively. For example, Black’s Law Dictionary defines maintenance, a practice akin to champerty, as an “officious intermeddling in a lawsuit by a non-party by maintaining, supporting or assisting either party, with money or otherwise, to prosecute or defend the litigation.” 10 Webster’s New World Dictionary defines champerty as “an act or proceeding by which a person who is not concerned in a lawsuit makes a bargain with one of the litigants to help maintain the costs of the suit in return for a share of any proceeds: illegal in most states.” 11

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Through our review of the literature on third-party litigation finance, we have identified several red flags surrounding the practice of third-party litigation funding:

1. Ethical concerns
2. Absence of disclosure
3. Support of patent trolls
4. Recent scandals
5. National security implications

Legal Ethical Considerations

The main legal ethical challenge to litigation funding is its potential to infringe upon attorney-client privilege. Attorneys have a duty of loyalty to their clients. Attorney-client privilege protects communication between the attorney and the client, who is party to the lawsuit. If privileged communications are divulged to a third party, such as a litigation funder, there is a conflict of interest, and the privilege is lost. Prior to funders making an investment in a suit, it stands to reason they will want to know as much as possible about the case to judge whether they might have a reasonable chance of success. This may involve the litigant providing non-public information to the funder. Whether this is allowable varies from state to state.

A second legal ethical consideration is whether a funding arrangement interferes with the attorney’s duty of independent judgment. Lawyers have an obligation not to be influenced in their legal strategy by individuals or entities not party to the litigation. If the plaintiff’s attorney is influenced by a litigation funder who attempts to steer legal strategy in a way that alters the attorney’s, the duty of independent judgment is compromised.

A third legal ethical consideration raised by litigation funding relates to non-attorney ownership of law firms. Attorney Rule of Professional Conduct 5.4 bars non-attorneys from owning law firms and bars
lawyers or laws firms from sharing legal fees with a non-lawyer. This rule is considered crucial as it keeps lawyers independent in their legal advice. It also prohibits the possibility of non-lawyer owners who put financial gain above their duty of loyalty and duty of confidentiality to their clients. This restriction is similar to rules governing medical practices. To be sure, if medical practices were owned by private equity firms or hedge funds, there might be pressure to increase the practices’ revenues in ways that violate physicians’ duties to their patients.

Absence of Disclosure

The limited disclosure made by third-party litigation funders is the issue most often in the crosshairs of litigation funding’s opponents. They argue that defendants at trial are often required to furnish information about the insurance they carry. Insurance disclosure can help courts understand how damages are viewed in court. Similarly, if the existence of third-party funding were disclosed, the court might have a better understanding of the motivation of the litigants and their attorneys. According to legal scholar Michael Menapace, “the light of disclosure can help policymakers understand this [information on whether there is a third party funder] and prescribe remedies.

Support of Patent Trolls

Litigation funders maintain the types of litigation they are involved with include patent infringement and intellectual property cases. What is not mentioned, however, is that some litigation funding firms invest in

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Patent trolls, aka non-practicing entities (NPEs), are companies that produce no product or service. Their business model involves acquisition of unused or weak patents. Patent trolls target businesses that run the gamut from Main Street retailers to major U.S. manufacturers and technology companies. *Harvard Business Review* has estimated patent trolls annually cost U.S. businesses approximately $29 billion in direct out-of-pocket costs. This does not include the opportunity cost of not innovating, not investing and not hiring. The activity of patent trolls has been characterized as shakedown or extortion. Trolls that call themselves patent enforcement entities, some of which are involved with third-party litigation funders, send thousands of threatening letters demanding payment.

**Recent Scandals**

In 2017 the federal judiciary’s Advisory Committee on Civil Rules, responding to a request to require disclosure of litigation funding arrangements, found that “the benefits of disclosure are less clear” and that no specific examples were provided where litigation finance had a deleterious effect on the parties or the outcome of a case. The litigation funding industry has supported this position, along with the observation that, because litigation financing is becoming mainstream and there have been no scandals, there is no need for disclosure. However, recent revelations of litigation funding’s involvement in some unseemly business arrangements belie the notion that the industry is scandal-free.

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On Aug. 30, 2022, a lawsuit was filed against third-party litigation funding firms that financed Tom Girardi’s law firm Girardi Keese.\textsuperscript{21} Girardi Keese consumed $2 million from Boeing that was targeted for families of the 189 passengers and crew who perished in the 2018 Lion Air Flight 210 crash in Indonesia. In addition, Girardi misappropriated $41 million of the firm’s trust account to support a lavish lifestyle.

There were 682 claims on Girardi’s firm, amounting to $496 million. Litigation funders referred clients and funded Girardi’s cases in exchange for half of contingency fees collected.

In another tawdry recent case involving litigation funders, a staged accident scheme in New York valued at $31 million found litigation funder Adrian Alexander responsible for orchestrating a massive trip-and-fall scheme.\textsuperscript{22} This personal litigation racket involved at-risk, often homeless New Yorkers who Alexander recruited to pretend to fall down in potholes. Many of Alexander’s “patients” underwent unnecessary surgeries to maintain the insurance ruse. Patients’ legal and medical fees were paid by a litigation funding firm owned by Alexander.

**National Security Implications**

In October 2022, I wrote an article on litigation funding that pointed to potential national security threats from sovereign wealth funds of unfriendly countries investing in litigation funding.\textsuperscript{23} Three months later, in January 2023, Sen. John Kennedy (R-La.) sent a letter to Attorney General Merrick Garland “out of grave concern about the growing threat to national security from foreign entities funding litigation in our nation’s courts.”\textsuperscript{24} At least one litigation funder has disclosed in its annual report that an unidentified sovereign


The potential danger to national security, as articulated in Sen. Kennedy’s letter, is that “merely by financing litigation in the United States against influential individuals, corporations, or highly sensitive sectors, a foreign actor can advance its strategic interests in the shadows since few disclosure requirements exist in jurisdictions across our country.” Additionally, the U.S. Chamber of Commerce Institute for Legal Reform published a study on the national security implications of third-party litigation funding in November 2023.

**Conclusion**

Our review and analysis of third-party litigation funding trends find that the workings of the industry need to be better understood. To a large extent, litigation funding operates in the dark. It is not surprising that an industry that operates with dogged resistance to disclosure should be involved in supporting questionable practices like patent trolling and in activities that push against established legal ethical principles, such as the duties of loyalty and confidentiality. Litigation finance needs to be better understood in order for public policy to be made, whether at the federal or state levels, and I am pleased that this committee is endeavoring to do so with this hearing.

Thank you again for holding this important hearing and for your consideration of my views. Should you have any questions or wish to have further discussion, please do not hesitate to contact me.

Sincerely,

Jerry Theodorou

“/s/”

Director, Finance, Insurance and Trade

R Street Institute

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