RESPONSE OF THE UNITED STATES OF AMERICA TO THE SECOND STUDY COMMISSION QUESTIONNAIRE 2019

By the Honorable Allyson K. Duncan
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By way of introduction, I thought some background might be helpful. These survey responses address general concepts in civil litigation financing in United States courts. As you know, the United States has a federal system of government in which federal and state court systems have different sources of authority and different jurisdiction.

Federal courts are courts of limited jurisdiction, hearing disputes arising out of federal law, and those involving citizens of different states where the amount in controversy exceeds a certain sum. Procedures in federal courts are governed by the Federal Rules of Civil Procedure (the "FRCP").

State courts are courts of general jurisdiction. They have primary responsibility over matters of common law, or judge-made rules of precedent, governing such basic areas of civil life as tort and contract. They also have primary jurisdiction over claims arising under state statutes. State courts have their own procedural rules, although in certain respects they sometimes mirror the FRCP. For instance, federal courts allow class actions, in which one named plaintiff represents a class of similarly situated individuals. Many states have parallel procedures.

Because responses to these questions might depend on the specific court system hearing a dispute, these responses focus on general concepts in American jurisprudence while highlighting avenues for additional research, rather than purporting to provide a comprehensive survey.

1. Who incurs the costs of civil litigation in your jurisdiction?

a. The American Rule

Civil litigation funding in the United States is governed by the so-called "American Rule." This is the default rule applied in both federal and state court that provides that each litigant pays his own attorneys' fees, regardless of the outcome.[1] This rule aims to protect parties by allowing each to litigate without fear that they will need to pay the other party's fees if unsuccessful. In this respect, the American Rule is seen as more favorable to plaintiffs than the "English Rule," under which the losing party pays the costs of the prevailing party.[2]

b. Exceptions

There are both common law and statutory exceptions to the American rule. Common law exceptions include equitable rules intended to prevent abuse through "bad faith, obduracy, or other misconduct."[3]

Statutory exceptions to the American Rule--arising out of federal or state statutes--tend to award attorneys' fees to prevailing plaintiffs bringing certain types of suits deemed

[1] *See Booking.com B.V. v. United States Patent and Trademark Office*, 915 F.3d 171, 188 (4th Cir. 2019).

[2] Theodore Eisenberg & Geoffrey P. Miller, *The English Versus the American Rule on Attorney Fees: An Empirical Study of Public Company Contracts*, 98 CORNELL L. REV. 327, 329 (2013).

[3] William A. Harrington, LL.B, Annotation, *Award of counsel fees to prevailing party based on adversary's bad faith, obduracy, or other misconduct*, 31 A.L.R. Fed. 833 (2018).

to vindicate a particular public interest. For example, the Magnuson-Moss Warranty Act--a federal statute that allows certain plaintiffs in suits involving warranties on consumer products to recover costs, expenses, and attorneys' fees--applies only to claims resulting from misleading warranty information on consumer products.[4] State statutory exceptions similarly apply in limited circumstances. For example, California's Consumers Legal Remedies Act allows consumers to recover attorneys' fees in suits resulting from false advertising and other unfair business practices.[5] A Massachusetts law provides reasonable attorneys' fees in certain landlord-tenant disputes if the landlord is in violation of the law and subsequently loses the case.[6]

2. Are there problems pertaining to civil litigation funding in your jurisdiction?

a. Costs

The costs of litigation in the U.S. are very high, which creates several problems. They limit access to justice, keeping plaintiffs with meritorious but low-value claims out of the courts. They also facilitate abuse by allowing parties to use the cost of prosecuting or defending a lawsuit as a weapon.

There are procedural aspects of our litigation that contribute to these high litigation costs. The most significant one is the broad use of discovery. Although recently amended in an effort to address the problem, the FRCP historically allowed parties to aggressively

[4]Magnuson-Moss Warranty Act, Pub. L. No. 93–637, 88 Stat. 2183 (1975).

[5]Consumers Legal Remedies Act, California Civil Code § 1780 (2010).

[6]MASS. ANN. LAWS ch. 186, § 14 (1991).

seek evidence from one another. This tactic would drive up costs and pressure the less well-financed party to settle regardless of the merits of his claim.

b. Alternatives

The high cost of litigation has also encouraged parties to avoid the courts altogether. For instance, the United States looks favorably on arbitration, and all federal courts have a mandatory mediation program. While alternative dispute resolution ("ADR") is often perceived to be a lower-cost alternative to litigation, that isn't necessarily true. The nature of the dispute, the amount in controversy, the litigants' resources, and the arbitrator's fees may drive up ADR costs as well. Compulsory arbitration may also have a pernicious effect on the ability of plaintiffs to recover damages. The terms of compulsory arbitration provisions in consumer contracts, for example, routinely preclude plaintiffs from seeking to bring a class action, as discussed below.

3. What resources, if any, are available to litigants in order to address financing litigation issues in your jurisdiction?

a. Class Actions

Attempts have been made to reduce litigation costs and increase access for claimants of limited means. Certain procedural mechanisms encourage private parties or the courts to consolidate overlapping disputes for more efficient resolution. One such procedural mechanism is the class action lawsuit. This allows a small group of plaintiffs to bring a civil suit on behalf of a much larger group of people who have similar claims against the defendant.[7] Class actions can involve hundreds or thousands of plaintiffs.[8] Allowing an individual or group to represent the class and bring a lawsuit on behalf of all class members ensures that each individual litigant does not have to bear the costs of litigating very similar claims. Importantly, class counsel generally receives payment from damages awarded to the class--typically fifteen to twenty percent--meaning that plaintiffs are not required to front any litigation costs and do not pay any fees unless the suit is successful.

Class actions have, however, created problems. The potential for a crushing verdict in a class claim may force a defendant to settle in an action with relatively little merit.

b. Multi-District Litigation

Many of these same considerations apply to multi-district litigation, another procedural mechanism to resolve overlapping proceedings more efficiently. Multi-district litigation is a mechanism by which the courts themselves, rather than plaintiffs' attorneys, consolidate for pre-trial proceedings hundreds or thousands of individual lawsuits that are based on the same misconduct by a defendant. Although multi-district litigations are tools that the courts employ, they have many similarities to class action lawsuits: they provide aggregate resolution of essentially similar legal issues affecting large numbers of people, reduce the burden on individuals to litigate their own cases, and enhance the predictability

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[7]Rule 23 of the Federal Rules of Civil Procedure provides the framework for class action lawsuits. *See* Fed. R. Civ. P. 23.

[8]*See Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 550 (2007) (involving a class of plaintiffs consisting of all "subscribers of local telephone and/or internet services from 1996 to present").

of the legal system by providing a single judge the authority and expertise to resolve common issues.

c. Contingency Fees

A long-standing tool for tort victims is the contingency-fee arrangement, which provides that an attorney will receive a percentage of the victim's recovery, usually a third, and nothing if the suit fails. Contingency fee arrangements allow plaintiffs with limited resources but meritorious and valuable claims to prosecute them.

d. Third-Party Funding

Third-party litigation funding is another private solution to cost barriers.[9] Third-party litigation funding entities primarily engage in three types of third-party litigation funding: (1) consumer funding--providing loans or cash advances to plaintiffs in low-value cases in exchange for reimbursement plus a financing fee; (2) direct loans to plaintiffs' lawyers and law firms that are secured by the assets of the firm; and (3) investment in commercial claims, which involves third-party funders providing capital directly to businesses or their outside counsel to finance the costs of litigating against other businesses. Since 2016, dozens of third-party litigation funding entities in the United States raised an estimated $1.75 billion to invest in litigation.[10] Third-party funding will be discussed in greater detail later.

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[9] Third-party litigation funding is not limited to a particular type of funder or a particular type of claim. Large and small investors fund a range of different types of claims including breach of contract, antitrust violations, intellectual property, and more.

[10] SEAN THOMPSON, DAI WAI CHIN FEMAN, & AARON KATZ, THE THIRD PARTY LITIGATION FUNDING LAW REVIEW 196 (Leslie Perrin ed., 2d ed. 2018).

e. Public Service Organizations

Other solutions, like fee shifting statutes discussed above, or legal aid and pro bono organizations, may help impecunious litigants bring meritorious cases. However, most organizations providing these services operate under severe capacity constraints, meaning they can only take on a limited caseload, and have to screen either for the severity of a litigant's poverty, or the salience of their claim for the organization's mission.

For instance, for a small number of indigent individuals, state legal aid organizations provide free legal services, alleviating the financial burden of litigation. In 1974, the U.S. Congress created the Legal Services Corporation, which provides federal funding to civil legal aid services, thereby allowing them to hire more staff and provide services to more clients. Organizations that provide pro bono legal services, like the American Civil Liberties Union and the National Association for the Advancement of Colored Peoples' Legal Defense and Education Fund, are another resource to help impecunious litigants find representation. These programs, however, are still limited in their reach; the availability of attorneys and eligibility of litigants for legal aid programs varies by program and state, leaving many without representation.

4. Are litigation funding agreements permitted in your jurisdiction?

See response to question 5.

5. If so, how are such agreements regulated or otherwise controlled?

The permissibility of litigation funding agreements and the extent to which they are permitted varies by jurisdiction in the United States. As such, we address questions 4 and

5 together. Litigation funding agreements are governed by three areas of law: a) the common law doctrines of maintenance, champerty, and barratry place limitations on third-party provision of financial assistance to litigants; b) state usury laws governing debtor-creditor arrangements limit interest rates; c) lastly, rules of legal ethics place limitations on what attorneys may do with fees and costs.

a. The common law doctrines of maintenance, champerty, and barratry are the most common limitations on litigation financing agreements. Maintenance refers to the act of helping to prosecute a suit. Champerty refers to maintaining a suit in return for financial interest in the outcome. And barratry refers to the continuing practice of maintenance or champerty. These forms of litigation financing have traditionally been prohibited. However, the national trend has been toward limiting the reach of these doctrines and allowing for more third-party financing. Some states have held that they did not ever incorporate the common law doctrines, while others have expressly abolished them.[11]

b. Another statutory limitation on third-party financing is found in usury laws. These regulations govern the amount of interest that can be charged on a loan. When litigation financing agreements are treated like loans, state laws against usury will limit the rate of interest that can be charged to borrowers.

[11]See Lisa Bench Nieuwveld, *Third Party Funding – Maintenance and Champerty – Where is it Thriving?*, KLUWER ARBITRATION BLOG (Nov. 7, 2011), http://arbitrationblog.kluwerarbitration.com/2011/11/07/third-party-funding-maintenance-and-champerty-where-is-it-thriving.

c. Attorney ethics rules also affect litigation funding agreements. Rule 5.4(a) of the ABA's Model Rules of Professional Conduct provides that a lawyer or a law firm shall not share legal fees with a nonlawyer other than in certain limited circumstances. These circumstances do not include third party financing. In a 2018 advisory opinion, the Professional Ethics Committee of the New York City Bar Association stated that certain agreements between law firms and funders violate Rule 5.4's prohibition on fee sharing. No court or other bar association has yet addressed this issue; however, many commentators agree with the NYC Bar Association's interpretation.

Some organizations have pushed for more regulation of third-party financing in the United States.[12] A proposed amendment to the FRCP, which would require full disclosure of third-party funding agreements in civil actions, has garnered public support from the general counsels and chief legal officers from Google, Verizon, AT&T and other corporations. The push for transparency in litigation financing has been occurring at the state level as well. In 2018, Wisconsin became the first state to require disclosure of third-party funding even if not requested in discovery. Other states are expected to follow suit.

[12] Risto Pribisich, *Maintenance, Champerty and Usury: Ethical Issues of Alternative Litigation Financing* (ABA Presentation 2015).