May 20, 2024

The Honorable Nathan Hecht
Chief Justice
The Supreme Court of Texas
P.O. Box 12248
Austin, Texas 78701

Dear Chief Justice Hecht:

On November 8, 2022, the Texas Civil Justice League respectfully requested you refer the issue of third-party litigation funding (TPLF) to the Supreme Court Advisory Committee for promulgation of an amendment to the Texas Rules of Civil Procedure establishing a framework for discovery and disclosure of TPLF agreements under appropriate circumstances. Our correspondence today serves as an addendum to that request and is intended to provide the committee with the history of action (or inaction) in the Texas Legislature on this topic.

We believe the notion of "lawsuit lending" (at various times also known as "lawsuit loan," "consumer lawsuit lending," "alternative litigation financing," "lawsuit advance funding" and "third party litigation funding") was first brought to the Texas Legislature's attention in 2005. At the time, the focus was on small dollar loans made to individual consumers using the proceeds of the lawsuit or settlement as collateral. The practice was akin to a plaintiff's counsel fronting his client small dollar loans to pay for living expenses prior to a resolution of a lawsuit or settlement.

In 2005 (79th Legislative Session), HB 2987 was filed by Representative Joe Nixon (R-Houston) which prohibited usurious interest rates on lawsuit loans. The bill passed the House, was picked up by Senator Ken Armbrister (D-Victoria), passed the Senate Business & Commerce Committee, but was never recognized on the Senate floor for debate. The bill language and history can be found at: https://www.capitol.state.tx.us/BillLookup/History.aspx?LegSess=79R&Bill=HB2987. The House Research Organization report can be found at: https://hro.house.texas.gov/pdf/ba79R/HB2987.PDF

We are unaware of any legislative activity on this topic between the 79th and 82nd Legislative Sessions (2005-2011).

The issue reappeared in 2012, during the 82nd legislative interim, when the House Judiciary and Civil Jurisprudence Committee was given the following interim charge (#5) regarding Alternative Litigation Financing:

Study the public policy implications of lawsuit lending and its effects on the civil justice system.

Chairman Tryon Lewis (R-Odessa) held a hearing on the topic on April 18, 2012. A primer on the topic was prepared by the Texas Civil Justice League and the Texas Association of Defense Counsel (TADC) testified. For your convenience, we are attaching both the primer and the testimony. The committee made the following conclusion in its report:

This committee affirms that "consumer lending" serves a legitimate need in the Texas economy. While the committee believes that reasonable regulations may be appropriate, it makes no specific recommendation regarding the regulation of consumer lending and believes that no compelling reason to prohibit the practice has been offered. Regarding "Lawsuit Finance," it is the committee's opinion that companies engaged in lawsuit finance should have to disclose their financial arrangements with attorneys, and their financial interest in lawsuits. There should be limits on this discovery; for instance, attorneys should not be able to determine opposing counsel's legal strategy through discovery. This should still fall under the attorney/client privilege. But, because of the unique circumstances behind these types of cases, there should be exceptions to the attorney/client privilege when these types of investors become involved in a lawsuit. Plaintiffs deserve to know when a third party has an interest in their lawsuit and what that interest is, as does the defendant and opposing counsel.

The full report can be found at (beginning on page 23):
https://house.texas.gov/_media/pdf/committees/reports/82interim/House-Committee-on-Judiciary-and-Civil-Jurisprudence-Interim-Report-2012.pdf

During the 83rd Regular Session (2013), Representative Doug Miller (R-New Braunfels) and Senator Joan Huffman (R-Houston) filed HB 1595 and SB 927, respectively. The house bill was heard in the House Judiciary and Civil Jurisprudence Committee on March 18, 2013, and a committee substitute was voted out on May 5, 2013, but never voted out of the House Calendars Committee. This bill required full licensure of litigation funding entities and was prescriptive in terms of the provisions of financing agreements. The bill language can be found at:
https://www.capitol.state.tx.us/tlodocs/83R/billtext/pdf/HB01595H.pdf#navpanes=0

In 2015, 84th Legislative Session, Senator Kevin Eltife (R-Tyler) and Representative Tan Parker (R-Flower Mound) filed SB 1282 and HB 3094, respectively, an omnibus bill relating to the regulation of consumer credit transactions and the regulation of the Office of the Consumer Credit Commissioner.
https://www.capitol.state.tx.us/tlodocs/84R/billtext/pdf/SB01282H.pdf#navpanes=0

SB 1282 passed the Senate and was referred to the House Investments & Financial Institutions Committee. Then-Representative (now-State Senator) Phil King (R-Weatherford) added an amendment in committee that proposed to authorize the Office of Consumer Credit Commissioner to regulate the industry and impose an annual cap on the industry's interest rate to

36% (the industry was pushing a measure that would have capped their interest rate at 100%). The bill was ultimately killed in the House in the final days of the 84th legislative session.

No legislative action was pursued in the 85th Legislative Session (2017).

Beginning in 2017, the use of what we now refer to as "third party litigation funding" emerged in full force. Instead of small dollar "loans" to consumers, the funding shifted to private investment in civil litigation in exchange for a portion of a settlement, judgment or some agreed value above the amount loaned to the claimant. By its very nature, TPLF injects unknown third parties into matters whose only interest is increasing the return on their investment. These third-party funders are sophisticated investors like venture capital firms or hedge funds, both in the United States, and abroad. The federal General Accounting Office (GAO) reports $3.2 billion in assets were under litigation funding in 2022 alone.

In 2019, during the 86th Legislative session, Senator Pat Fallon (R-Frisco) and Representative Matt Krause (R-Haslet) filed SB 1567 and HB 2096, respectively. These bills did require disclosure of a litigation financing agreement but did not regulate interest rates or any aspects of the practice of litigation funding. After significant pushback from politically conservative public-interest groups and law firms who use third-party financing in issue-oriented lawsuits, the bill authors declined to pursue the legislation.

No legislative action was pursued in the 87th Legislative Session (2021).

As mentioned before, in November of 2022, the Texas Civil Justice League requested this issue be referred to the Supreme Court Advisory Committee for rulemaking. For reference, that letter is attached.

No legislative action was pursued in the 88th Legislative Session (2023).

Recently, the existence of third-party intervention in lawsuits has also gotten the attention of the plaintiff's bar. First and foremost, these funders are not attorneys and arguably fall under the auspice of the unauthorized practice of law. While they may not be arguing in the courtroom, they are clearly influencing litigation decisions including when to settle and for what amount. As one lawsuit lender admitted, "We make it harder and more expensive to settle cases." (J, Gershman, "Lawsuit Funding, Long Hidden in the Shadows, Faces Calls for More Sunlight," *Wall Street Journal*, March 21, 2018, at wsj.com (quoting Allison Chock with Bentham IMF).

Moreover, third party lawsuit lending is impacting the amounts ultimately received by the injured party. As most representation of litigation on the plaintiff's side is supported by contingency fee arrangements, the coupling of another percentage fee arrangement on top of the lawyer's clearly reduces the amount ultimately recovered by the plaintiff. In some instances, the injured party ends up receiving less than the funder. A study conducted by Swiss Re Institute found civil cases involving third-party funders took 15 months longer to settle than cases where none was present. And, while longer cases might sometimes lead to greater rewards, these rewards are rarely passed on to the claimant, as cases involving third-party funders leave claimants with 12 percent less in take-home settlement funds. This inequity seems contrary to public policy.

Finally, the possibility of foreign adversaries using TPLF may threaten U.S. national and economic security. A 2022 letter from Sen. John Kennedy (R.-La.) to Chief Justice of the United States John Roberts and U.S. Attorney General Merrick Garland highlights this very concern, recognizing that "few safeguards exist in any form of law, rule, or regulation to prevent foreign adversaries from participating in civil litigation as an undisclosed third-party in our country's federal courtrooms." *(https://www.kennedy.senate.gov/public/pressreleases?ID=1FBC312C-94B8-409B-B0A3-859A9F35B9F5).* Sen. Kennedy warns that "[m]erely 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." (*see id*). Examples include prolonged litigation affecting U.S. competition or the economy or access to confidential trade secret information for state purposes. Judges and parties have a right to know whether non-related interests are driving the litigation, and a mandatory disclosure rule would effectuate that right.

In conclusion, we hope you find this legislative history useful as the Supreme Court Advisory Committee deliberates on this topic. If we can be of further assistance, please do not hesitate to ask.

Sincerely,

Lisa Kaufman

Lisa Kaufman
General Counsel

TEXAS CIVIL JUSTICE LEAGUE

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November 8, 2022

The Honorable Nathan Hecht
Chief Justice
The Supreme Court of Texas
P.O. Box 12248
Austin, Texas 78711

Dear Chief Justice Hecht:

In the last 20 years, the growing prevalence of third-party litigation funding (TPLF) has sparked a national debate over the extent to which TPLF agreements should be disclosed, discoverable, or otherwise regulated by the state. In view of the rapid growth of the TPLF industry, it seems likely that the debate will only intensify. On one hand, proponents seek legislative or judicial action either legitimizing their business or keeping other people's noses out of it. On the other, opponents seek with equal conviction to heavily regulate the industry or at minimum mandate disclosure of TPLF agreements to all parties in the litigation.

To date, two states, Wisconsin and West Virginia, have enacted mandatory disclosure statutes. Some federal district courts have adopted rules requiring disclosure of TPLF agreements to the court, including the Districts of Delaware and New Jersey, and the Northern District of California. More limited disclosure requirements have been adopted in at least two federal MDL cases, while more generally a number of other federal district and appellate courts have local rules that require disclosure of entities with a financial interest in the outcome of the litigation. Case law in the federal system is somewhat split, with some courts requiring disclosure when specific conditions are met and others denying discovery of TPLF agreements as either irrelevant or protected by attorney work product privilege.[1] Numerous state legal ethics opinions have weighed in on the relation between TPLF and various ethical rules, and the American Bar Association House of Delegates has recently issued "best practices" guidelines to assist attorneys and third-party funders in navigating the potential legal and ethical pitfalls of TPLF agreements.[2] No uniform standards exist to guide federal and state courts in determining if, when, to whom, and to what extent TPLF agreements should be disclosed.

This debate has come to the Texas Legislature as well, most recently in the form of H.B. 2096 and S.B. 1567, which were filed during the 2019 legislative session.

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[1] See Mark Behrens, Katie Jackson, and Cary Silverman, "Third-Party Litigation Funding: State and Federal Disclosure Rules and Case Law," May 11, 2022. https://shb.com, last visited July 31, 2022.

[2] See "ABA Outlines Best Practices for Third-Party Litigation Funding." https://www.americanbar.org/groups.business_law/publications/committee_newsletters/consumer/2020/202011/thid-party, last visited August 31, 2022.

This proposal directed the Supreme Court to adopt a rule mandating disclosure of TPLF agreements to all parties in a civil action. Although the legislation did not progress beyond the committee stage, we anticipate that something like it may again be introduced in the future as more states take or consider similar action.

That is why, on behalf of the members of the Texas Civil Justice League, we are asking you to refer the issue to the Supreme Court Advisory Committee for promulgation of an amendment to the Texas Rules of Civil Procedure establishing a framework for disclosure and discovery of TPLF agreements under appropriate circumstances. We understand and appreciate that sharp disagreement exists among members of the civil trial bar, the business community, the TPLF industry, and other stakeholders regarding both the threshold question of whether the existence of such agreements should be disclosed at all and, if so, just how much information should be provided. The SCAC, with its broad representation of the civil trial plaintiff's and defense bar, the judiciary, and in-house counsel, is the ideal forum for making policy in this area.

As for TCJL, we support mandatory disclosure of the existence of third-party funding agreements for both consumer and commercial litigation to all parties in the litigation. In our view, a disclosure statement should include: (1) the name, address, and place of formation of the third-party funder; (2) whether any third-party funder's approval is necessary for litigation or settlement decisions in the action, and, if the answer is yes, the nature of the terms and conditions of such approval; and (3) a brief description of the type of funding provided and whether any attorney's fees that may be awarded in the matter will be subject to assignment to the third-party funder.[3] A disclosure statement of this nature would put the court and parties on notice a funding company's interest in the outcome of the case without intruding into the realm of attorney work product, litigation strategy, or the specific amount of funding involved. It would also help illuminate whether certain third-party funding arrangements violate Rule 5.04 of the Texas Disciplinary Rules or Professional Conduct.

If it is the case that a TPLF agreement confers authority on the provider to make or participate in litigation or settlement decisions or to receive an assigned share of attorney's fees, a party could make a discovery request for more information, including the agreement itself, provided that such request meets the relevancy and other requirements of the existing rules. This may well be a rare case, given that to our knowledge most TPLF providers disclaim any involvement in managing or influencing litigation or settlement strategy (although we are not sure of the extent to which fee-splitting between lawyers and non-lawyers may be occurring).

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[3] This proposal closely tracks the Standing Order Regarding Third-Party Litigation Funding Arrangements issued by the Chief Judge of the United States District Court for Delaware. https://ded.uscourts.gov/sites/ded/files/Standing%20Regarding%20RegardingThird-Party%20Litigation%20Funding.pdf, last visited July 31, 2022.

But if such influence does exist, the court and other parties should have the tools to assess whether further disclosure should be compelled if it is relevant to identifying potential conflicts-of-interest and protecting the court's and attorneys' respective duties to the judicial system and the litigants they serve.

Thank you for your continued commitment to maintaining a fair, efficient, and transparent civil justice system. We deeply appreciate all you have done on behalf of the citizens of our state.

Sincerely,

George Christian

George Christian
Senior Counsel

Alternative Litigation Financing

Testimony to the Texas House Committee on Judiciary & Civil Jurisprudence

TEXAS CIVIL JUSTICE LEAGUE *APRIL 18, 2012*

Background: What is ALF?

In his interim charges to House committees, Speaker Joe Straus has asked the Committee on Judiciary & Civil Jurisprudence to "study the public policy implications of lawsuit lending and its effects on the civil justice system." This charge responds to a growing national debate in the legal community regarding ethical questions raised by alternative litigation financing ("ALF"). ALF, also referred to as third-party litigation financing, is a practice in which investors provide funding to a litigant, usually in the form of a non-recourse loan, in return for a monetary interest in the outcome of the litigation. Currently, most ALF arrangements involve claimants, but nothing precludes defense financing as well. Its use in the United States thus far, however, appears limited primarily to litigation involving unsophisticated claimants in the mass tort arena, where settlements of bundled claims can produce significant returns to investors. It does not appear that any publicly-held entities have yet engaged in ALF in the US, though the changing economics of legal practice have sparked interest in equity investments in law firms (a more indirect form of ALF). One may reasonably expect that if ALF becomes the norm in large-scale litigation, publicly-held entities, pension funds, mutual funds, venture capital firms, and other entities may well participate.

ALF originated in the United Kingdom and has spread to other common law jurisdictions, primarily Australia, New Zealand, and, more recently, the United States. Limitations on contingency fees and bar rules that permit fee sharing between attorneys and non-attorneys helped spur the creation of the ALF industry in the UK, where both publicly-held and private investment companies regularly invest in commercial and other litigation. According to the American Bar Association, ALF has become a feature of complex disputes between experienced parties with substantial, ongoing litigation in UK courts and supports both offensive and defensive claims.

Alarmed by the trend toward increased use of ALF, late last year the American Bar Association Commission on Ethics 20/20 formed a working group to solicit comments from interested parties respecting the ethical implications of "investor-owned" litigation and the status of so-called ALF suppliers, the individuals or entities that buy shares in lawsuits. The ABA Commission's request for comments included an extensive memorandum discussing the relevant common law and disciplinary rules. Our analysis also includes the specific Texas statutory provisions, disciplinary rules, and case law that are pertinent to ALF arrangements.

The Common Law Background

For centuries the common law has developed specific legal doctrines designed to protect litigants from third-party financial interests gaining control of their claims and defenses. These doctrines include:

- Maintenance—malicious or officious intermeddling with a suit that does not belong to one, by assisting either party with money or otherwise to prosecute or defend; something done which tends to obstruct a court of justice or is against good policy in tending to promote unnecessary litigation and is performed under a bad motive.
- Champerty—a bargain by a stranger with a party to a suit, by which such third person undertakes to carry on the litigation at his own cost and risk, in consideration of receiving, if successful, a part of the proceeds or subject sought to be recovered.
- Barratry—the practice of exciting groundless legal proceedings (also referred to as "common barratry").

The Texas Supreme Court has held that Texas does not recognize the English common law doctrine of maintenance, champerty, and common barratry. In Harriet W. Bentinck v. Joseph Franklin and Galveston City Company, 38 Tex. 458 (1873), the court ruled:

> *Whether the English statutes prohibiting common barratry, maintenance and champerty have ever come to be regarded as a part of the common law of*

England, even in that country, we think, is somewhat doubtful. They have certainly not been so considered by the courts of this country, unless in the State of New York, which would be regarded as an exception to the rule. The English statutes, if not in terms, have been in principle adopted by the Legislatures of some of the States; but neither of the statutes passed in the reign of Edward I. nor Edward III., nor has that of 8 Elizabeth, c. 2; 12 George I., c. 29; nor 32 Henry VIII., c. 9, ever been adopted by the Legislature of Texas.

If, then, they have not become a part of the common law of England, they form no part of our system.

It is more than probable that the political power of our State has never regarded the principle contained in the English statutes as necessary or applicable to the condition of our people. A law which would prevent the officious intermeddling in the suits of others, in no way concerning parties so interfering, might be a salutary law in any State or community; but it cannot be denied that cases often present themselves to the profession in which a good man may do a service to humanity by espousing the cause of the weak against the strong.

The offense of common barratry is a species of immorality against which no law is necessary to warn the American profession.

The reasons which led to the enactment of 32 Henry VIII. do not exist in this country. In a country where all the lands embraced in what was once three kingdoms are owned by about eleven thousand persons, who form a strong landed aristocracy, such a statute as that of 32 Henry VIII. might serve to keep the land titles within these aristocratic limits; but in this country we have land for the millions; and if a lawyer helps his client to recover lands from the possession of another, and even takes a part of the land for his fee, if the right of his client is clear to the land, we are unable to see any immorality or breach of professioal ethics in the transaction. Yet it would certainly be very wrong for attorneys to become mere jobbers and speculators, to hunt up rotten titles and ferment litigation.

As indicated in the Bentinck opinion, the usual context for the common law defense of maintenance, champerty, and common barratry was in a dispute between an attorney and client over a fee agreement in which the attorney received a portion of the client's land in an action for the recovery of the client's real property. The origins of the defense lay in the preservation of feudal tenures, hence the court's holding that Texas' adoption of the common law of England did not include those parts of the common law inapplicable to the republic.

The Statutory Background: Barratry

Texas has long recognized the criminal offense of barratry. The offense existed at common law, and the Legislature codified it in the 1879 Revised Penal Code. The Legislature has included barratry in each revision of the Penal Code since 1879, and the current statute (last amended in 2009) is §38.12, Penal Code. The statutory offense of barratry is more narrowly circumscribed than the common law doctrine. A person commits barratry if, with intent to obtain an economic benefit the person:

(1) knowingly institutes a suit or claim that the person has not been authorized to pursue;

(2) solicits employment, either in person or by telephone, for himself or for another;

(3) pays, gives, or advances or offers to pay, give, or advance to a prospective client money or anything of value to obtain employment as a professional from the prospective client;

(4) pays or gives or offers to pay or give a person money or anything of value to solicit employment;

(5) pays or gives or offers to pay or give a family member of a prospective client money or anything of value to solicit employment; or

(6) accepts or agrees to accept money or anything of value to solicit employment.

The statute further prohibits a person from knowingly financing the commission of barratry, investing funds the person knows or believes are intended to further barratry, or knowingly accepting employment as a professional from an illegal solicitation of employment.

Barratry is a third degree felony in Texas. The statute does not apply to conduct authorized by the Texas Disciplinary Rules of Professional Conduct or a court rule. The statute also creates a separate offense of solicitation of professional employment, applying broadly to attorneys and health care providers, but classifies the offense as a Class A misdemeanor (unless it involves a repeat offender, in which case the offense is likewise a third degree felony).

Sec. 82.065, Government Code, governs contingent fee contracts and civil remedies for violations of state law and the Disciplinary Rules related to barratry. It requires a contingent fee contract for legal services to be in writing and signed by the attorney and client. It further allows the client to void the contract if it was procured as a result of conduct violating the laws of this state or the Texas Disciplinary Rules of Conduct regarding barratry by attorneys or other persons (see discussion below). During the 2011 session, the Legislature amended §82.065 to allow an attorney who was paid or owed fees or expenses under a contract voided under this section to recover fees and expenses based on a quantum meruit theory, if the client does not prove that the attorney committed barratry or had actual knowledge, before undertaking the representation, that the contract was procured as a result of barratry by another person. To recover the attorney must have reported the misconduct as required by the Disciplinary Rules, unless another person already reported the conduct or the attorney reasonably believes that reporting would substantially prejudice the client's interest.

The 2011 Legislature also added a new civil cause of action for barratry. A client who brings a civil action to void a contract for legal services procured as a result of barratry may recover all fees and expenses paid under the contract, fees and expenses paid to any other person under the contract (less fees and expenses based on quantum meruit), actual damages, and attorney's fees. A person improperly solicited for a contract for legal services may also file a civil action, even though the person did not enter into the contract that violates the law or disciplinary rules. If successful, the person may recover a penalty of $10,000, actual damages, and attorney's fees.

The Ethical Background: Barratry, Conflict of Interest, Client Confidentiality, Fee Arrangements, Independent Judgment

(1) Barratry. There are a number of ethical rules that may apply to ALF arrangements under certain circumstances. Rule 7.03, Texas Disciplinary Rules of Professional Conduct, broadly parallel the criminal and civil statutes proscribing barratry. It reads as follows:

(a) A lawyer shall not by in-person contact, or by regulated telephone or other electronic contact as defined in paragraph (f), seek professional employment concerning a matter arising out of a particular occurrence or event, or series of occurrences or events, from a prospective client or nonclient who has not sought the lawyer's advice regarding employment or with whom the lawyer has no family or past or present attorney-client relationship when a significant motive for the lawyer's doing so is the lawyer's pecuniary gain. Notwithstanding the provisions of this paragraph, a lawyer for a qualified nonprofit organization may communicate with the organization's members for the purpose of educating the members to understand the law, to recognize legal problems, to make intelligent selection of counsel, or to use legal services. In those situations where in-person or telephone or other electronic contact is permitted by this paragraph, a lawyer shall not have such a contact with a prospective client if:

(1) the communication involves coercion, duress, fraud, overreaching, intimidation, undue influence, or harassment;

(2) the communication contains information prohibited by Rule 7.02(a) ; or

(3) the communication contains a false, fraudulent, misleading, deceptive, or unfair statement or claim.

(b) A lawyer shall not pay, give, or offer to pay or give anything of value to a person not licensed to practice law for soliciting prospective clients for, or referring clients or prospective clients to, any lawyer or firm, except that a lawyer may pay reasonable fees for advertising and public relations services rendered in accordance with this Rule and may pay the usual charges of a lawyer referral service that meets the requirements of Occupational Code Title 5, Subtitle B, Chapter 952.

(2) Champerty and Maintenance. The old common law doctrines of champerty and maintenance, though not recognized by judicial decision, are carried forward in part in the Texas Disciplinary Rules of Professional Conduct as well. Rule 1.08 prohibits certain transactions that may compromise the lawyer's duty of fidelity to the client. It includes a provision barring a lawyer from accepting compensation for representing a client from a person other than the client unless:

(1) the client consents;

(2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and

(3) information relating to representation of a client is protected as required by Rule 1.05.

The rule states further that a lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:

(1) acquire a lien granted by law to secure the lawyer's fee or expenses; and

(2) contract in a civil case with a client for a contingent fee that is permissible under Rule 1.04.

As stated by the comment to the rule:

This Rule embodies the traditional general precept that lawyers are prohibited from acquiring a proprietary interest in the subject matter of litigation. This general precept, which has its basis in common law champerty and maintenance, is subject to specific exceptions

developed in decisional law and continued in these Rules, such as the exception for contingent fees set forth in Rule 1.04 and the exception for certain advances of the costs of litigation set forth in paragraph (d). A special instance arises when a lawyer proposes to incur litigation or other expenses with an entity in which the lawyer has a pecuniary interest. A lawyer should not incur such expenses unless the client has entered into a written agreement complying with paragraph (a) that contains a full disclosure of the nature and amount of the possible expenses and the relationship between the lawyer and the other entity involved.

More generally, Rule 1.06 bars a lawyer from representing a person if the representation "reasonably appears to be or become adversely limited by the lawyer's or law firm's responsibilities to another client or to a third person or by the lawyer's or law firm's own interests." A lawyer may, however, proceed with the representation if the lawyer reasonably believes the client's representation will not be materially affected and each affected client consents to the representation after full disclosure.

(3) Fees; Client Confidentiality; Professional Independence. The terms of a particular ALF arrangement may also raise ethical issues with respect to the fees charged by the lawyer, the confidentiality of client information, and the professional independence of the lawyer.

- A lawyer must charge a "reasonable" fee. Specifically, a lawyer may not "enter into an arrangement for, charge, or collect an illegal fee or unconscionable fee. A fee is unconscionable if a competent lawyer could not form a reasonable belief that the fee is reasonable."

- A lawyer may not disclose confidential client information to a third party or use client confidential information to the disadvantage of the client, except under extreme circumstances or if the client consents to the disclosure.

- A lawyer may not allow a person who pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment on behalf of the client. Moreover, a lawyer shall not practice with or in any form of business that is authorized to practice law for a profit if a nonlawyer owns any interest in the business or has the right to direct or control the professional judgment of the lawyer.

Potential Legal and Ethical Issues with ALF

Within this framework of statutes and disciplinary rules, ALF raises a complex and interlocking set of legal and ethical issues. As identified by the ABA Commission on Ethics 20/20, these issues may be summarized as follows:

- Confidentiality and Privilege. In order to evaluate a case for possible investment, an ALF supplier may ask an attorney for information protected by attorney-client or work product privilege. As discussed above, Rule 1.05 broadly prohibits the disclosure of any confidential or privileged client communication without the express consent of the client. Such information may include, for example, the lawyer's assessment of the client's case and the likelihood of the client prevailing. Moreover, even if the client consents to the disclosure of confidential information to an ALF supplier and therefore waives privilege (if the communication is indeed privileged), the privilege may not be reasserted against any other party to or interest in the suit. In that event, the lawyer might likewise run afoul of Rule 1.05(b)(2), which bars the lawyer from using the client's confidential information to the client's disadvantage without consultation with and consent of the client. Thus, it would appear that if a lawyer wishes to seek an ALF arrangement with respect to a client, the lawyer must obtain the client's consent for both the disclosure of information necessary to secure the ALF contract and the possible consequences of the disclosure of the information in the litigation itself. This may not be completely known at an early stage in the lawsuit, however, creating a potentially difficult ethical issue that could materially affect the client's prospects for a successful outcome.

- Professional Independence. As we have seen, an attorney owes an ethical duty to his or her client to represent zealously the client's interests and to exercise independent professional judgment on behalf of the client. The presence of a third party with a potentially significant interest in the outcome of the lawsuit raises the possibility of conflicts between the client's desires, the attorney's evaluation of the client's best interests, and the financial interest of the ALF supplier. It is conceivable that the ALF supplier may even attempt to influence, directly or indirectly, the lawyer's handling of the case. Moreover, an attorney who both represents the client and invests in an ALF supplier that finances the suit faces the potential for conflicts between the client's interest and the attorney's financial interest. Consequently, a Texas lawyer seeking an ALF arrangement will have to consider Rules 1.06 (conflict between the lawyer's and client's interest), 1.08 (the lawyer's acceptance of payment for legal services by a person other than the client, and 5.04 (professional independence of the lawyer).

- Conflicts of Interest. A client may seek his or her attorney's advice when deciding whether to pursue or accept ALF for a particular claim. If the attorney advises the client to agree to an ALF supplier acquiring an interest in the litigation and the client subsequently enters into a contract with a supplier, the attorney may then have a duty to inform the ALF supplier (in addition to the client) of material adverse developments in the litigation. A question therefore arises as to whether the client should seek an independent opinion regarding the advisability of ALF in this particular instance. Texas Disciplinary Rules 1.05 and 1.06 may be pertinent here, since a conflict may be created by both the terms of the ALF contract itself and the lawyer's personal financial interest in securing ALF for the claim. Rule 1.08 may also come into play, since an ALF agreement could be construed as a business transaction with the client. In that event, the lawyer must fully disclose the details of the arrangement, allow the client to seek independent legal counsel, and obtain the client's written consent to the ALF agreement.

- Fees. Most ALF agreements are structured as non-recourse loans that are repaid solely from the eventual settlement or judgment in the litigation. But other types of fees or payments may be contractually arranged, including finder's fees for attorneys who refer clients to an ALF supplier or non-contingent legal fees. The ethical issues here involve whether the payment of substantial finder's fees by ALF suppliers may constitute barratry and whether and under what circumstances the attorney must disclose to the client fees paid by the ALF supplier. These circumstances might invoke Texas Disciplinary Rules 1.08 (prohibited transactions) and 7.03 (prohibited solicitations and payments), as well as the criminal and civil liabilities discussed above. Moreover, the high interest rates common to ALF arrangements may rise to the level of an unconscionable fee under Texas Disciplinary Rule 1.04, as well as create the potential for usurious interest charges in the event the claimant prevails in the suit and the loan is repaid from the proceeds (if, as discussed below, the ALF agreement may be construed as a loan subject to interest rate limitations).

- Withdrawal. ALF contracts may limit the ability of the client to terminate the attorney's representation or of the attorney to withdraw from the litigation. If the ALF supplier has the power to approve or veto termination or withdrawal or the hiring of substitute counsel, both the client's right to discharge the lawyer and the lawyer's ethical duty to withdraw from or terminate the representation under certain circumstances may be compromised.

Numerous lawyers, firms, ALF suppliers, and national legal interest groups, including the American Tort Reform Association, the Institute for Legal Reform of the U.S. Chamber of Commerce, and the American Insurance Association, filed comments with the working group. While much of the content of these responses is repetitive, the primary arguments in favor of and opposed to ALF can briefly be characterized as follows:

ARGUMENTS IN SUPPORT OF ALF

(1) the availability of litigation financing for trial attorneys and their clients allows greater access to the judicial system while safeguarding both the attorney's ethical obligations and the client's interests;

(2) a significant amount of litigation is already funded by third parties, such as financial institutions that lend money to lawyers to finance their practices, insurers through subrogation, and contingency fee arrangements in a growing variety of contexts—ALF is no different;

(3) the ethical questions raised by ALF do not vary in kind from those arising under other financing arrangements and that the ABA Model Rules and most states' rules of professional conduct adequately address conflicts of interest, attorney-client and work product privilege, and other issues.

ARGUMENTS IN OPPOSITION TO ALF

(1) the expansion of ALF will encourage the proliferation of litigation with no offsetting public policy benefits;

(2) ALF causes irreparable harm to the U.S. system of justice by turning litigation into a marketable commodity and courts into investment instruments;

(3) by its very nature ALF introduces third party financial interests into the attorney-client relationship, producing insoluble conflicts of interest and threatening the lawyer's duty of confidentiality and loyalty to the client.

Buyer Beware: Is ALF "Legal Loan-Sharking"?

According to a January 17, 2011 article published in The New York Times, loans to consumers from ALF suppliers can resemble the kind of high-interest loans usually associated with unregulated lenders. In fact, the Attorney General of the State of Colorado has filed suit against two ALF suppliers for violations of Colorado lending laws. In an effort to avoid regulation, ALF suppliers have banded together to persuade state legislatures to pass model legislation sanctioning alternative litigation finance. Thus far, Maine, Ohio, and Nebraska have enacted such legislation, and it has been introduced in several more, including New York, Illinois, and Maryland.

Even some plaintiff's lawyers, however, worry that ALF suppliers take advantage of vulnerable consumers. "It takes advantage of the meek, the weak and the ignorant," according to New York plaintiff's attorney Robert Genis. "It is legal loan-sharking." Mr. Genis is referring to cases like Ernesto Kho's. Injured in a 2004 auto accident, Kho borrowed $10,500 from ALF supplier Cambridge Management Group. When Kho's lawsuit settled for $75,000, Cambridge dipped into the proceeds for $35,939, more than three times the principal amount of the loan. In another case, a Brooklyn man injured by police borrowed $4,000 from LawBuck$ to pursue a civil rights claim against the city. When a jury awarded him $350,000, LawBuck$ claimed that the claimant owed them $116,000. A Brooklyn trial judge considering whether to enforce the litigation finance agreement is quoted as saying, "This is usurious, and if not usurious, it's unconscionable."

Although ALF suppliers say the risk of losing money on these loans is far more significant than in the standard credit market, the facts appear otherwise. According to The New York Times, ALF suppliers look for mass litigation, such as the Vioxx cases, with fairly predictable payouts. They further prescreen potential clients to cherry pick only the best claims and limit their liability to 10-20% of the amount they project the claimant will collect. In the absence of any disclosure or transparency, it is impossible to judge whether ALF suppliers' claims that they lose money on a substantial number of loans are justified. In fact, courts in Michigan, New York, and North Carolina have determined that plaintiffs may not be obligated to repay litigation loans that carry usurious rates of interest. One ALF supplier told the Times that "[W]e don't want judges to shine a light on us," so it only invests in claims expected to settle before trial.

In 2005 the Texas Legislature considered subjecting ALF contracts to the state's usury laws. H.B. 2987 prohibited lenders from charging usurious rates of interest in violation of §302.001, Finance Code, which limits the annual rate of interest a lender may charge. If an ALF agreement resulted in an interest rate exceeding the limitation, it would be subject to the financial and other penalties prescribed by Chapter 305, Finance Code. The bill did not apply to contracts entered into between a lawyer and a client for purposes of compensating the lawyer for providing legal services. The bill passed the House and cleared Senate committee, but was not considered by the Senate.

Another ALF Model: Financing the attorneys not the clients

Founded in 1998, Augusta Capital is the leading provider of customized capital solutions to the nation's elite law firms. Augusta accommodates a wide variety of law firm models, ranging from full service firms to litigation boutiques. Our extensive industry experience makes Augusta a valuable capital partner for firms seeking to manage their contingency fee practices more effectively.

Augusta specializes in providing nonrecourse financing for complex contingency fee cases—an ideal tool for the financial management of contingency fee practices. Augusta's financial solutions provide firms with a prudent hedge to manage individual case concentrations, which often occur in the firm's best cases, as well as a source of liquidity with repayment obligations that coincide with the firm's recoveries. Tailored to the unique demands of each firm's practice, Augusta's solutions give our clients valuable advantages in today's competitive marketplace.

Headquartered in Nashville, Tennessee, Augusta Capital, L.L.C. provides financing directly to attorneys and law firms specializing in complex contingent-fee litigation. According to Augusta Capital's comments to the ABA Commission on Ethics 20/20, a typical financing agreement works as follows:

- Pursuant to Augusta Capital's funding model, Augusta Capital agrees to provide litigation funding typically on an ongoing basis to the lawyer in an amount that equals a set percentage of normal litigation expenses (e.g., expert fees, deposition costs, counsel's travel expenses) incurred by that lawyer in pursuing the case. As an example, if the lawyer incurs in a given month $50,000 in normal litigation expenses for a case that qualifies for funding under Augusta Capital's contract and the contract calls for Augusta Capital to fund 50% of normal litigation expenses, then Augusta Capital will provide funding to the lawyer serving to reimburse the lawyer for 50% of that amount, or $25,000.

- The funding that Augusta Capital provides is entirely contingent—the lawyer is not obligated to repay any portion of the funding provided by Augusta Capital—nor to pay any fee to Augusta for the funding—for a particular case unless and until a recovery is made in that particular case. If, as to a particular case, no recovery is obtained, then the lawyer is not obligated to repay any portion of the funding provided by Augusta Capital for that particular case or any fee to Augusta. If a recovery is made in a case, the lawyer must repay the funding Augusta Capital provided in that particular case, plus a fee to Augusta Capital in an amount provided for under the terms of the funding agreement. Augusta's fee in a case where a recovery has been obtained is strictly a function of the amount of funding provided and usually, although not always, of the amount of time required to resolve the case. Typically, in a case involving complex litigation that resolves successfully three years after Augusta began providing funding, Augusta's fee equals approximately $1 for every $1 of funding to be repaid to Augusta Capital.

Augusta Capital's agreements purport to shield the attorney-client relationship from outside interference. They:

- require the attorney to maintain independent judgment;
- prohibit Augusta from exercising any control or influence over the attorney's decisions in the litigation;
- provide Augusta no recourse against the client if, in the event of recovery, the attorney does not repay the loan;
- prohibit the attorney from passing financing costs through to the client either directly or through a higher attorney's fee;
- provides that the attorney's obligation to repay the loan is not contingent on the attorney receiving any payment of attorney's fees out of the recovery;
- requires the attorney to obtain the written consent of the client to the attorney's funding agreement with Augusta; and
- requires the attorney to obtain the written consent of the client prior to communicating any confidential client information to Augusta and requires Augusta to enter into a confidentiality and non-disclosure agreement with the attorney with respect to any such communications.

Augusta asserts that its ALF arrangement with litigation counsel avoids the ethical pitfalls associated with direct financing of the client, particularly with respect to waiver of the attorney-client privilege and the protection of the lawyer's work product. They point to federal court decisions that protect the lawyer's work product even if it is disclosed to a third party, if the disclosure does not substantially increase the opportunity for potential adversaries to gain access to the information. Thus, courts have generally held that disclosure to non-adversarial parties does not waive work product protection.

Still, although the Augusta Capital financing agreements attempt to preserve the sanctity of the attorney-client relationship by funding the lawyer or the law firm, the question still remains whether a substantive distinction exists between ALF arrangements that finance the client and those that finance the client's lawyer. It would seem that the same ethical considerations are present in both instances, and that those considerations are intrinsic to the ALF structure itself. If that is the case, no contract provisions can eliminate or minimize the very real ethical concerns that may be compromised by ALF.

- For example, in a high-profile case stemming from the September 11, 2001 attacks, a plaintiffs' firm representing a class of Ground Zero first responders attempted to get a federal court to order the class plaintiffs to pay

$6 million of an $11 million interest charge the firm owed to an ALF supplier, Counsel Financial. Apparently, plaintiffs were never told about the ALF agreement or that they may be required to pay interest. The lawyers' interest payment request came in addition to $150 million in attorney's fees awarded in the settlement agreement between the parties. The judge denied the request, telling the plaintiffs' counsel, "In the context of $150 million, I believe you can absorb $6 million." Although we do not have access to the ALF contract between the firm and Counsel Financial in this case, it is reasonable to assume that many of the same safeguards found in the Augusta Capital contract may have been included here as well. In any event, the question is whether ALF agreements create fundamental ethical problems.

Texas Case Law: ALF agreements do not violate public policy

Two Texas courts of appeals have held that ALF agreements that do not violate public policy if they do not vest control over the litigation in uninterested third parties. In Anglo-Dutch Petroleum Int'l Inc. v. Smith and Anglo-Dutch Petroleum Int'l, Inc. v. Haskell, the 14th and 1st District Courts of Appeals in Houston agreed with a Houston trial court that a litigation funding agreement entered into between Anglo-Dutch Petroleum International and several investors was enforceable.

The underlying litigation arose from a dispute between Anglo-Dutch and Halliburton involving the development of an oil and gas field in Kazakhstan. Anglo-Dutch sought financing for its lawsuit against Halliburton and entered into several Claims Investment Agreements in which investors fronted litigation costs in return for a portion of Anglo-Dutch's recovery, if any. If it prevailed, Anglo-Dutch agreed to pay the investors (including Smith and Haskell) their initial investment, plus 85% of the initial investment, and an additional 85% for each year that passed from the date of the agreement to the time of Anglo-Dutch's recovery. The Agreements further stipulated that in the event of Anglo-Dutch's bankruptcy the investors' interests in any cash recovery would not be described as a debt or obligation of Anglo-Dutch. Instead, an assignment of cash recovery was attached to each agreement, providing each investor with a security interest in Anglo-Dutch's cash recovery, if any.

Ultimately, Anglo-Dutch received a $106 million award in the lawsuit, at which time Halliburton settled the case. Prior to settlement, Anglo-Dutch attempted to negotiate new terms with the litigation investors, lowering the amounts of their payments. Smith and Haskell refused to renegotiate ad filed suit against Anglo-Dutch. The trial court entered judgment awarding actual and exemplary damages, and attorney's fees, to the investors, finding that Anglo-Dutch committed fraud, breach of fiduciary duty, conversion, and breach of contract. The Courts of Appeals reversed the exemplary damages award, but upheld the judgment for actual damages and attorney's fees on the breach of contract theory.

In its appeal of the trial court's breach of contract finding, Anglo-Dutch alleged that the Claims Investment Agreements could not be enforced because: (1) the Agreements were usurious loans; (2) alternatively, if the Agreements were not loans, they were void, unregistered securities; and (3) the Agreements were unenforceable because they violated public policy. Both courts of appeals held that: (1) the Agreements did not meet the definition of a "loan" and, consequently, were not usurious transactions; (2) even if the Agreements could be considered securities, the sellers of the securities (Anglo-Dutch) rather than the purchasers (Smith and Haskell) have no standing to bring a claim based on the securities being unregistered; and (3) the Agreements did not violate public policy because they did not vest control over the litigation in uninterested parties.

The basis for the courts of appeals' ruling can be summarized as follows:

(1) A loan means "an advance of money that is made to or on behalf of an obligor, the principal amount of which the obligor has an obligation to pay the creditor. The courts determined, however, that the Claims Investment Agreements did not constitute loans under Texas law because Anglo-Dutch did not have an absolute obligation to repay the principal amount amounts that the investors invested. If Anglo-Dutch had not prevailed in its lawsuit against Halliburton, it would have had no obligation to pay the investors anything. As a matter of law, therefore, the agreements could not be usurious. Moreover, Anglo Dutch's "subjective intent" that the agreements were to be treated as loans does not change the terms of the agreements themselves. The agreements established a contingency under which certain amounts would be paid to the investors, but no absolute obligation. The courts of appeals distinguished trial court rulings from other states (New York, Ohio, and Michigan) holding litigation financing agreements to be usurious based on the virtual certainty of recovery (or in the Michigan case, the fact that a jury verdict had already been reached before the litigation financing agreement was made) in the underlying actions in those cases. In this case, the courts asserted, there was no such certainty but a true contingency. By the same token, Smith and Haskell cited other state court opinions from New Jersey, Florida, Montana, and Illinois that enforced litigation financing agreements on the basis that a contingent, nonrecourse investment agreement does not constitute a loan subject to the usury statutes.

(2) Anglo-Dutch argued that the Claims Investment Agreements constituted illegal, unregistered securities and thus void and unenforceable under state and federal law. In support of this argument, Anglo-Dutch argued that one of the investors, Law Funds, was engaged exclusively in the business of financing lawsuits and thus served more as a promoter rather than as an investor. The courts of appeals rejected this argument, holding that only the purchaser has standing to void an unregistered security under the Texas Securities Act.

(3) Anglo-Dutch argued that the Claims Investment Agreements should be void as against public policy because they are "champertous," encourage litigation, and give control over litigation to parties with only a financial interest in the outcome. It also argued public policy should bar agreements in which a third party promises to pay money to a plaintiff in a pending lawsuit in exchange for a cash payment or interest rate, that if the agreement were a loan, would exceed the maximum allowable interest rate under Texas law. The courts of appeals determined that while assignments of causes of action that tend to increase or distort litigation may violate public policy (e.g., Mary Carter agreements), the Claims Investment Agreements at issue did not. Anglo-Dutch presented no evidence that the agreements were indeed champertous, "preyed on financially desperate plaintiffs," or ceded any control over the Halliburton litigation to the investors.

(4) More importantly, the courts of appeals determined that litigation financing agreements do not necessarily increase or prolong litigation. They reasoned that investors only get paid out of the proceeds of the settlement or judgment, so they would have no interest in prolonging legal proceedings. Moreover, investors who are willing to front significant amounts of money may be assumed to have carefully considered the risks of a non-recourse agreement and thus are highly unlikely to fund a "frivolous" claim. The courts of appeals determined further that the structure of the Claims Investment Agreements may actually have encouraged settlement. They thus concluded that the agreements do not violate Texas public policy.

What Should Be Done?

There is broad disagreement in the legal community about what, if anything, should be done about ALF as a matter of public policy. On one end of the spectrum, opponents of ALF call for the prohibition of third party litigation financing altogether. On the other end, proponents of ALF argue that current rules of ethics are sufficient to regulate the industry and no additional statutory protections are necessary. Given the array of legal obligations and ethical duties that attach to the practice of law generally, most would agree that any public policy response to the real and perceived abuses of ALF must be carefully and deliberately considered to assure that the best interests of the client and the integrity of the judicial process are protected.

Ibid.
American Bar Association, ABA Commission on Ethics 20/20, *Issues Paper Concerning Lawyer's Involvement in Alternative Litigation Financing*, November 23, 2010, at 3.
Ibid.
Black's Law Dictionary, Rev. 4th Ed. (St. Paul, 1968), p. 1106.
Ibid, p. 292.
Ibid, p. 190.
Harriet W. Bentinck v. Joseph Franklin and Galveston City Company, 38 Tex. 458, 473 (1873).
V.T.C.A. Penal Code, §38.12(a).
V.T.C.A. Penal Code, §38.12(b).
V.T.C.A. Penal Code, §38.12(f).
V.T.C.A. Penal Code, §38.12(c).
V.T.C.A. Penal Code, §38.12(d), (g), (h).
V.T.C.A. Government Code, §82.065(a).
V.T.C.A. Government Code, §82.065(b).
Quantum meruit is a common law remedy whereby a person may recover the reasonable value of services rendered as dictated by law and reason, regardless of any agreement as to value or whether the services are rendered pursuant to a legal contract. See *Black's Law Dictionary*, Rev. 4th Ed. (St. Paul: West Publishing Co., 1968), at 1408.
V.T.C.A. Government Code, §82.065(c).
V.T.C.A. Government Code, §82.0651(a).
V.T.C.A. Government Code, §82.0651(b).
V.T.C.A. Government Code, §82.0651(c).
V.T.C.A. Government Code, §82.0651(d).
Rule 7.02(a) prohibits a lawyer from making or sponsoring a false or misleading communication about the qualifications or services of any lawyer or firm.
Texas Disciplinary Rules of Professional Conduct, Rule 1.08(e). Rule 1.05 generally protects confidential client information, including both privileged information and unprivileged information relating to the client.
Texas Disciplinary Rules, Rule 1.08(e).
Texas Disciplinary Rules, Rule 1.08, comment 7, Acquisition of Interest in Litigation.
Texas Disciplinary Rules, Rule 1.06(b)(2).
Texas Disciplinary Rules, Rule 1.06(c).
Texas Disciplinary Rules, Rule 1.04(a)
Texas Disciplinary Rules, Rule 1.05(b). A lawyer may reveal confidential information with the express consent or authority of the client, or when the lawyer has reason to believe it is necessary to comply with a court order, the Disciplinary Rules or other law; to establish a defense in a controversy with the client or to a criminal charge, civil claim, or disciplinary complaint; when the lawyer has reason to believe disclosure is necessary to prevent the client from committing a criminal or fraudulent act or to rectify the consequences of the client's criminal or fraudulent act in the commission of which the lawyer's services had been used. There are some additional exceptions for the disclosure of unprivileged client information. See Rule 1.05(c) and (d).
Texas Disciplinary Rules, Rule 5.04(c).
Texas Disciplinary Rules, Rule 5.04(d). It should also be noted that Rule 5.05 prohibits the unauthorized practice of law by a person who is not a member of the bar.
A number of state bar associations have opined that a lawyer who wishes to share information with an ALF supplier about the nature and value of the case must seek the client's informed consent prior to disclosure. *See* 2006 NC Eth. Op. 12, 2006 WL 6135364, at 1 (N.C. St. Bar Oct. 20, 2006); UT Eth. Op. 06-03, 2006 WL 3694077 (Utah St. Bar Dec. 8, 2006); FL Eth. Op. 00-3, 2002 WL 463991 (Fla. St. Bar Mar. 15, 2002); MI Eth. Op. RI-3-21, 2000 WL 33716933; PA Eth. Op. 95-128, 1995 WL 935642 (Pa. Bar Assn. Comm. Leg. Eth. Prof. Resp. Sept. 5, 1995).
ABA Commission on Ethics 20/20 Working Group on Alternative Litigation Financing, November 23, 2010, at 4-5; see also *Leader Technologies, Inc. v. Facebook, Inc.*, 719 F. Supp. 2d 373 (D. Del. 2010), in which the court ruled that that the attorney-client privilege was waived when the lawyer disclosed potentially privileged documents to an ALF supplier.
ABA Commission at 5-6.
ABA Commission at 6-7.
In the event of default, the lender of a non-recourse loan may only seek to satisfy the debt from the collateral. Because they do not allow a lender to recover from any other assets, they often carry higher interest rates than recourse loans.
ABA Commission at 7.
Ibid. See also Texas Disciplinary Rule of Professional Conduct 1.15, which specifies the conditions under which a lawyer must or may ethically withdraw from or terminate representation of the client. The most common situations in which a lawyer may be *required* to withdraw is when the lawyer may be called upon as a material witness against the client's interests, is discharged by the client with or without good cause, or continuing the representation would violate other applicable law or rules of professional conduct.
Binyamin Applebaum, "Lawsuit Loans Add New Risk for the Injured," *The New York Times*, http.www.nytimes.com/2011/01/17/business/17lawsuit.html?_r=1&pagewanted=print (accessed November 28, 2011).
William J. Gorta, "Bitten by lawsuit 'sharks'," *New York Post*, December 12, 2011.
Ibid.
H.B. No. 2987, Engrossed, 79th Tex.Leg. Reg. Session, 2005.
http://www.augustacapital.com/ (accessed November 28, 2011).
Response of Augusta Capital, LLC to Request for Comment: Issues Paper Concerning Lawyer's Involvement in Alternative Litigation Financing, February 7, 2011, Comments:
Alternative Litigation Financing Working Group Issues Paper, "Issues Paper Concerning Lawyer's Involvement in Alternative Litigation Financing," ABA Commission on Ethics 20/20 Working Group on Alternative Litigation Financing, pp. 15-18, at p. 16.
See, for example, *United States v. Stewart*, 287 F. Supp. 2d 461 (S.D.N.Y. 2003).
See Binyamin Applebaum, *Investors Put Money on Lawsuits to Get Payouts*, N.Y. Times (Nov. 14, 2010); Bruce Golding, *Judge rejects interest charges on Ground Zero settlements*, N.Y. Post (August 27, 2010).
Anglo-Dutch Petroleum Int'l Inc. v. Smith, 243 S.W.3d 776 (Tex.App. 2007); *Anglo-Dutch Petroleum Int'l Inc. v. Haskell*, 193 S.W.3d 87 (Tex.App. 2006).
See *Anglo-Dutch Petroleum Int'l Inc. v. Haskell*, 193 S.W.3d 87 (Tex.App. 2006) at 92.
See *Anglo-Dutch Petroleum Int'l Inc. v. Smith*, 243 S.W.3d 776 (Tex.App. 2007) at 782.
Haskell, supra at 96, quoting Tex. Fin. Code Ann. §301.002(a)(10) (Vernon Supp. 2005).
Haskell, supra at 97-98.
Haskell, supra at 102-03.
Haskell, supra at 103.
Haskell, supra at 104-05.

TADC

THE TEXAS ASSOCIATION OF DEFENSE COUNSEL, INC

An Association of Personal Injury Defense, Civil Trial & Commercial Litigation Attorneys—Est. 1960

Written Testimony on behalf of the
Texas Association of Defense Counsel
Submitted for consideration to the
House Committee on Judiciary and Civil Jurisprudence

April 18, 2012

RE: Committee Interim Charge #5

Chairman Jackson, & members of the House Committee on Judiciary and Civil Jurisprudence, the Texas Association of Defense Counsel (TADC) is pleased to present the attached written testimony on Interim Charge #5, to study the public policy implications of lawsuit lending and its effects on the civil justice system, before the committee.

The TADC is a professional organization comprised of approximately 2000 members, all of whom are civil trial lawyers engaged primarily in the representation of clients other than personal injury plaintiffs. The practice areas of our members range from the traditional insurance defense practice to general tort and commercial litigation.

We appreciate the opportunity to provide testimony on this important issue. If we may be of any assistance or provide further information, please contact us.

Respectfully submitted,

Tom Ganucheau

Thomas E. Ganucheau, President

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Alternative Litigation Financing
Proposed Testimony to the Committee on Judiciary & Civil Jurisprudence by the Texas Association of Defense Counsel
April 18, 2012

To the Honorable Members of the House Judiciary & Civil Jurisprudence Committee:

Thank you for the opportunity to submit these comments on the committee's charge to "study the public policy implications of lawsuit lending and its effects on the civil justice system." Lawsuit lending, or "alternative litigation finance" (ALF), appears to be a growing trend in some parts of the country, and we are aware of several state legislatures, bar association ethics committees (including a task force of the American Bar Association), and state attorneys general are taking a close look at the subject to determine whether a public policy response is warranted.

Potential public policy approaches toward ALF take many forms and are being promoted by stakeholders with opposing interests in the issue. On one hand, ALF providers have advocated legislation in a number of states to legitimize the practice through the adoption of model legislation. We are aware of pro-ALF legislative efforts in Maine, Nebraska, Ohio, Nevada, Connecticut, Maryland, Indiana, and Tennessee, though there may be additional states to be added to this list. Proposed legislation generally establishes a regulatory framework that requires ALF providers to obtain a license, usually from the consumer finance agency in the state, and to subject themselves to some level of regulation. These proposals also require ALF contracts with consumers to itemize fees and charges, to limit the accrual of interest beyond a certain time, and to allow the consumer to rescind the contract within a certain period of time. Moreover, they prohibit an ALF provider from paying finder's fees to third parties and to refrain from any involvement in the litigation itself. Most of the ALF providers we are aware of likewise state in their contracts that they under no circumstances infringe on the ethical duties between the client and the client's lawyer, although we are unaware of how these arrangements work in practice.

On the other side of the issue, legislation has been introduced in a number of states, including Arizona, Indiana, Oklahoma, Illinois, and Rhode Island, to ban or limit ALF. These proposals have taken one of two approaches. For example, the Indiana proposal would prohibit ALF altogether. Proposals in the other states, however, would subject ALF to state consumer lending laws and limit the interest rates that can be charged. It should be noted that bringing ALF agreements under the purview of state consumer finance laws legitimizes the practice in the same manner as regulatory proposals, treating ALF as a loan agreement although under most state laws (including Texas'), ALF does not constitute a loan because there is no absolute duty of the borrower to repay the loan principal.

It appears to us that ALF raises a number of possible ethical issues, though it does not necessarily violate ethical precepts *per se*. As noted in the remarks submitted by the Texas Civil Justice League, both Houston courts of appeals have held that ALF arrangements do not violate public policy in the absence of specific unethical conduct. In other words, both courts held the parties (both of whom were represented by counsel) to their bargain. Among other things, these cases demonstrate that if both parties are represented by counsel and enter into an ALF agreement with their eyes open, the courts are not likely to disturb them. Even in a consumer context, it is likely in most cases that a plaintiff who seeks ALF is already represented by counsel, who will presumably advise the claimant on whether ALF is appropriate in the particular instance. We would suspect that plaintiff's counsel will consider this option very carefully in view of the potential liability for legal malpractice if the arrangement ends in an adverse result for the client.

Much of this remains speculative, however. A call to our membership to report on their experiences with litigation financing and any adverse impact on the handling or resolution of a case resulted in no reported experiences or issues of an ALF arrangement in Texas litigation. There is some evidence, however, that a few defense firms have been asked to examine the merits of using ALF to help finance expensive and complex commercial litigation and to provide advice to clients, but to our knowledge no ALF deals have actually been made. We are aware that an ALF provider has financed or is financing claims against a railroad in Texas, but our members are not involved in the case and can offer no insight on the effect ALF may be having on the litigation.

We will continue to study this issue and monitor our members' exposure to ALF arrangements.