Economics and the Litigation Funding Industry: How Much Justice Can You Afford?

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> At Columbia Law School, I got the impression that litigation was a quest for the Holy Grail of truth. Nobody told me that it was also a financial contest, and that in order to succeed, either you or your client must have the economic staying power to weather the stormy seas of litigation. Since the average plaintiff in a tort case does not have the money or the staying power to enter the arena against a giant opponent, it is the entrepreneur-lawyer who must supply these requisites, and must furnish the services of an organization for which the plaintiffs themselves could not afford to pay. This is the exact opposite of the defense situation, where the defendant corporations and their insurance companies dwarf the economic power of the law firms who work for them on a non-contingent basis.[1]

I. INTRODUCTION

A. The Litigation Funding Business

The following pages delineate the litigation funding business, burgeoning since the 1990's. That field of business increasingly attracts entrepreneurs competing to fill a hitherto-vacant niche in America's economy. The multiplicity of these enterprises displays an extensive array of litigation funding methods. These diverse companies, more and more, impress their mark on the practice of law.

Each litigation funding company can reap the benefits of the portfolio means of investing. That is to say, investor funds can simultaneously be directed to multiple lawsuits. A varied portfolio promotes a more even flow of investor profits and losses. This facilitates long-range stability and predictability of returns. The litigation funding company's long-term experience earns it an expertise in appraising lawsuits. Such expertise is denied the individual plaintiff. These advantages - the portfolio investment approach, and the specialized expertise advantage - long since have

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1. STUART M. SPEISER, LAWSUIT 560 (1980).

been invoked by plaintiffs' tort attorneys.

The emergence of the litigation funding industry has been hailed by some commentators as a boon to the impoverished. The needy would otherwise be incapable of asserting their legal rights in the halls of justice. Contrariwise, other critics condemn this upstart industry as a menace to business. These critics deem it a threat to the independence of the legal profession. The dawning of 2002 must witness continuing controversy over this fresh element in the litigation equation.

B. The Economic Perspective

Any reluctance of the judiciary to speak in the language of economics does not demonstrate that judge-made rules are not premised upon efficiency.[2] People intuitively apply economic principles.[3] They practice economics unconsciously.[4]

The use of simplifying assumptions[5] applies to all problems analyzed by economics.[6] Wherein lies the art of economics? That art lies in identifying

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2. *See* WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF TORT LAW 22-23 (1987).

3. *See id*. at 23.

4. *See id*.

5. *See* A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 4 (2d ed. 1989).

> In order to facilitate mathematical formulation and exposition, neoclassical economic theory routinely adopts what appear to be, and often are, from both a physical and a psychological standpoint, highly unrealistic assumptions: that individuals and firms are rational maximizers, that information is costless, that the demand curves of individual firms are infinitely elastic, that inputs and outputs are infinitely divisible, that cost and revenue schedules are mathematically regular, and so forth. The unrealism of the assumptions sometimes drives a wedge between economic theory and the economic system that the theory is purporting to describe and explain.

R. POSNER, OVERCOMING LAW 428 (1995).

6. *See* POLINSKY, *supra* note 5, at 4. Gregory Scott Crespi notes:

> Austrian economics shares with its neoclassical competitor the characteristic of being a "theoretical" approach to understanding phenomena. By this I mean simply that both approaches are based upon the use of simplified logical models of individual human behavior and social interaction that selectively abstract from much of the richness and complexity of actual events.
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> Austrians and neoclassicists differ, of course, in their views as to which aspects of the world can be abstracted from without vitiating the relevance of the models for explanatory or predictive purposes.

Gregory Scott Crespi, *Exploring the Complicationist Gambit: An Austrian Ap-*

those assumptions which adequately simplify an issue. Such identification is the better way to grasp major features of an issue.[7]

Herein will be defined the economic assumptions underpinning such litigation issues as: the contingent fee in the United States; the conditional fee arrangement in the United Kingdom; the respective English Rule and American Rule for meeting the costs of adversarial proceedings; and the proposed sale of causes of action. Analysis of each of these issues throws into relief for 2002 the economic dimensions of the newborn litigation funding industry.

II. THE CONTINGENT FEE IN THE U.S.

A. The Contingent Fee Today

The contingent fee relationship is a contract between a client and her lawyer whereby the attorney's fee is determined by the outcome of the suit.[8] Such agreements can assume many variants.[9] Generally, a plaintiff's lawyer collects a percentage of the proceeds of the case (whether by trial, or settlement);[10] she takes nothing should the case be lost or dropped.[11] The plaintiff's lawyer gets a third of any award in a majority

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proach to the Economic Analysis of Law, 73 NOTRE DAME L. REV. 315, 323 (1998).

7. *See* POLINSKY, *supra* note 5, at 4.

8. *See* Daniel L. Rubinfeld & Suzanne Schotchmer, *Contingent Fees*, *in* 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 415 (Peter Newman ed. 1998).

9. *See id*.

10. *See* THOMAS J. MICELI, ECONOMICS OF THE LAW 193 (1997).

11. *See id*. Stuart M. Speiser notes:

> Managing tort litigation is something like producing a show or a movie, where the producer packages the enterprise and pays all the actors, writers, directors, and technicians. Tort lawyers perform similar functions as they prepare their client's case for trial, but there are major differences. Producers commonly finance their capital risk by selling equity, obtaining bank loans, and selling auxiliary rights, such as record albums and publications. They can also offer tax benefits to those who want to assume the risks of the enterprise. Usually the producers wind up with a large percentage of ownership although they have invested little or no money of their own. No such gravy train is available to the tort lawyers. They must finance everything themselves. Once launched, the play or film runs on in theaters and on television, whereas the trial is a one-shot performance which must pay its own way on the day that it goes to the jury. Though films and plays are considered very risky in-

of the states.[12] However, in some states the proportion depends on whether the case is tried or settled.[13] A judge can, *sua sponte*, revise elements of a contingent fee contract that appear unfair to the client.[14]

Nothing in the American practice of law has surprised foreign attorneys more than America's general approval of the contingent fee.[15] Most American tort plaintiffs file suit under a contingent fee arrangement.[16] In personal injury, the contingent fee arrangement has nearly been the universal financing method.[17] Most nations ban the contingent fee,[18] including many common law as well as civil law systems[19] (the conditional fee arrangement instituted in England in 1995 is a variant of the contingent fee system).[20]

B. Beneficiaries of the Contingent Fee

1. The Plaintiff Class

By the late nineteenth century, attorneys had started to assume cases on a contingent fee basis.[21] Few issues cut so deeply into professional concerns and social mores in urbanizing, industrializing America as did the contingent fee.[22] The contingent fee was a necessary financial inducement toward delivering legal assistance to victims of personal injuries.[23] That arrangement rendered it possible for a wealthy corporation to be sued by a

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> vestments and most of them return little or nothing to their backers, there is still a ready market for equity offered by experienced producers. However, no such financing or tax shelter advantages are available to plaintiff's tort lawyers, no matter how experienced or successful they may be.

SPEISER, *supra* note 1, at 560-61.

12. *See* MICELI, *supra* note 10, at 193.
13. *See id*.
14. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 569 (4th ed. 1992).
15. *See* MARTIN MAYER, THE LAWYERS 24 (1967).
16. *See* MICELI, *supra* note 10, at 170.
17. *See* MAYER, *supra* note 15, at 255.
18. *See* POSNER, *supra* note 14, at 568.
19. *See* Rubinfeld & Schotchmer, *supra* note 8, at 415.
20. *See id*. at 416.
21. *See* LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 422 (1973).
22. *See* JEROLD S. AUERBACH, UNEQUAL JUSTICE: LAWYERS AND SOCIAL CHANGE IN MODERN AMERICA 44 (1976). This work by Professor Jerold S. Auerbach has been fashioned a "classic book." GERRY SPENCE, WITH JUSTICE FOR NONE: DESTROYING AN AMERICAN MYTH 45 (1989).
23. *See* AUERBACH, *supra* note 22, at 45.

poor person[24] (or, in any case, by an illiquid or risk-adverse one).[25]

2. The Plaintiffs' Bar

The contingent fee not merely assured counsel for those otherwise too poor to afford any.[26] It also furnished cases to attorneys devoid of the law firm ties, and social contacts, which attract business retainers.[27] Assume an environment of thousands of lawyers with a bleak outlook for steady employment. The inevitable result is that clients with increasingly weaker cases can team with attorneys willing to represent them for contingent fees.[28] Sometimes a youthful lawyer just opening her practice is well ad-

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24. *See* FRIEDMAN, *supra* note 21, at 423.

25. *See* POSNER, *supra* note 14, at 569. Stuart M. Speiser notes:

> Tort lawyers cannot amass any fortunes comparable to those of fried chicken entrepreneurs, real estate developers, oil drillers, entertainers, professional athletes, and dozens of other groups whose income is accepted as part of our free enterprise system, even though most of them do not undertake the degree of public service or responsibility that every tort lawyer assumes. There does not seem to be any public resentment about the contingent fees of real estate brokers, who regularly take a large percentage bite out of the largest investment most people ever make. Real estate brokerage commissions take much more out of our gross national product than do contingent fees of tort lawyers. Brokers need little professional training, and in some instances they do no more than to insert newspaper advertisements that the homeowners themselves could compose. Yet their billions in annual commissions are not questioned, since they perform a useful service that is partly self-liquidating because its cost is built into the structure of the real estate market. There is little or no price competition among real estate brokers, though there is among tort lawyers. The public must either pay the fees established by brokerage groups or sell their house themselves.

SPEISER, *supra* note 1, at 572.

26. *See* AUERBACH, *supra* note 22, at 48.

27. *See id*.

28. *See* RICHARD NEELY, THE PRODUCT LIABILITY MESS: HOW BUSINESS CAN BE RESCUED FROM THE POLITICS OF STATE COURTS 22 (1988). Stuart M. Speiser notes:

> Because of the risks of tort litigation, it is usually the last choice of the star law students who have alternative job offers. In order to compensate for these risks, tort cases are supposed to produce a higher hourly income than other legal work; but even if the tort firm is successful, it is difficult to accumulate the working capital needed to keep a large organization running between collections. There is no way of raising capital for such an organization except from the lawyers themselves. Like most plaintiff's tort lawyers, I started out with virtually no capital of my own. Had I been sitting on a large pile of capital, then the last thing I would probably have invested it in

vised to discover a plaintiff whom she can represent on a contingent fee basis even when that client's case is vulnerable.[29] Nothing plunged the legal elite into deeper despair than did contingent fees, and the proliferation of negligence attorneys whose practices hinged on them.[30]

C. The Economics of the Contingent Fee

The contingent fee was condemned for transforming the attorney into a partner in the plaintiff's claim.[31] It does, in effect, make the attorney a party to her client's lawsuit.[32] There are three parties in interest: the plaintiff, the plaintiff's attorney, and the defendant.[33]

1. The Lawyer as Banker

To some degree, the plaintiff's attorney under the contingent fee system serves as her client's banker.[34] She must put up most of the suit's resources.[35] Why?

A plaintiff with a legal claim thereby owns an asset.[36] Yet it is sometimes impossible to borrow against a legal claim.[37] Banks and other lending institutions might find it expensive to estimate the probability that the claim can be vindicated in court.[38] Also, these institutions can be risk-averse due to governmental regulation.[39] In addition, numerous legal claims, such as personal injury claims deriving from an accident, are unassignable, and therefore worthless as collateral.[40]

2. The Lawyer as Inquisitor

Fortunately, through specialization the contingent fee attorney can estimate risks more precisely than can a conventional lender.[41] Her method

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was a self-perpetuating sponge such as a plaintiff's tort firm.

SPEISER, *supra* note 1, at 568.

29. *See* GORDON TULLOCK, TRIALS ON TRIAL: THE PURE THEORY OF LEGAL PROCEDURE 109 (1980).

30. *See* AUERBACH, *supra* note 22, at 45.

31. *See id*.

32. *See* MAYER, *supra* note 15, at 24.

33. *See* TULLOCK, *supra* note 29, at 106.

34. *See id*.

35. *See id*. at 108.

36. *See* POSNER, *supra* note 14, at 567.

37. *See id*.

38. *See id*.

39. *See id*.

40. *See id*.

41. *See id*.

of investigating the potential case is inquisitorial.[42] Since she will invest her own resources in the case (and forfeit them should she err), she will weigh the case more carefully than will the more impartial judges and jurors later on.[43]

3. The Lawyer as Portfolio Manager

There are other risk-minimizing advantages associated with the contingent fee system. That system comports with the portfolio approach to lawsuit investing. As law and economics guru Judge Richard A. Posner of the United States Court of Appeals for the Seventh Circuit stated: "Risk is reduced because the lawyer specializing in contingent fee matters can pool many claims and thereby minimize the variance of the returns."[44]

4. The Size of the Contingent Fee

The contingent fee must exceed a fee charged for the same services being billed on an as-performed basis.[45] The banker-lawyer is remunerated for not only the dollar equivalent of her services, but for her underlying *loan* thereof.[46] The implicit interest rate is high since the default risk (that is, the loss of the case) greatly surpasses that of conventional loans.[47]

5. The Contingent Fee and the Floodgates of Litigation

The thrust of the contingent fee variable is to impel such plaintiffs to become more reluctant to settle than hourly fee plaintiffs.[48] It commonly is charged that the contingent fee system invites frivolous suits. These charges appear plausible, where plaintiffs are not responsible for their legal fees upon defeat.[49]

Nevertheless, such criticism overlooks the aforementioned inquisitorial function of the plaintiff's banker-lawyer.[50] Actually, a larger proportion of frivolous suits are filed under the hourly fee system.[51] This is because higher contingent fee settlement amounts pressure defendants not to settle; in turn, this defendant-resistance deters would-be plaintiffs from filing frivolously.[52] Total *litigation costs* actually can be lower thanks to the

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42. *See* TULLOCK, *supra* note 29, at 107.
43. *See id*. "For where your treasure is, there will your heart be also." *Mathew* 6:21. *Luke* 12:34 (King James).
44. POSNER, *supra* note 14, at 567.
45. *See id*.
46. *See id*.
47. *See id*.
48. *See* MICELI, *supra* note 10, at 170, 195.
49. *See id*. at 192.
50. *See id*.
51. *See id*. at 195.
52. *See id*. at 194-95.

contingent fee.[53]

It is charged that the contingent fee system promotes *more litigation* than does the hourly fee system.[54] Nonetheless, were the contingent fee barred, the filing of some legitimate causes of action on the part of the low-income parties would be deterred.[55] It may be argued that hourly fees sustain too little litigation.[56]

And what is the English variant of the contingent fee?

III. THE CONDITIONAL FEE ARRANGEMENT IN THE U.K.

Until 1967, contingent fee agreements in England and Wales were, under the common law crime of maintenance, illegal.[57] Pre-1995, any contingent fee agreement whereby an attorney's reward varied with the outcome of her case remained proscribed by the rules of professional conduct, and were unenforceable against her client.[58] Nevertheless, since that date attorneys there have been permitted to offer to plaintiffs a conditional fee arrangement, in addition to the choice of fees charged on an hourly basis.[59]

Should her case be lost, the attorney absorbs all of the plaintiff's ex-

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53. *See id*. at 195.

54. *See* MICELI, *supra* note 10, at 196. Stuart M. Speiser notes:

> Judges and most jurors are aware that tort cases are handled on a contingent fee basis. Jurors usually allow for the fact that the plaintiff will not get all the money - that they must add something to cover fees and expenses. Judges reviewing awards take this into consideration, and so do insurance companies and defense lawyers when they make settlement offers. Thus there is no public outlay for the huge apparatus that now exists for the public's benefit: the facilities maintained by plaintiff's lawyers. Nobody has to pay anything until these facilities have been used and have benefited the user; and when the tort lawyer's fees are paid, they reflect the exact value of the facilities to the beneficiaries. How many other facilities of this nature do we have? Health care? Financial advice? Accounting? Government services? All of those services must be paid for regardless of results, and many are heavily subsidized by tax dollars, as are our huge industrial concerns.

SPEISER, *supra* note 1, at 569-70.

55. *See* MICELI, *supra* note 10, at 196.

56. *See id*.

57. *See* Hugh Gravelle, *Conditional Fees in Britain*, *in* 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 382 (Peter Newman ed. 1998).

58. *See id*.

59. *See id*. at 383.

penses.[60] Should the case be won, or should the plaintiff accept a settlement offer, the plaintiff delivers to her attorney her hourly fee in addition to a markup.[61] The latter cannot exceed 100 percent.[62] Under English cost-shifting rules, if a case is conducted under a conditional fee agreement, a defendant becomes liable solely for those actual costs incurred by the plaintiff's attorney, and not for this markup.[63]

Victorious plaintiffs pay their attorneys' markup from the court award or settlement.[64] Numerous conditional fee arrangements restrict the fee payable upon victory to a maximum of 25 percent of the proceeds.[65] This eliminates the risk that a plaintiff must pay all of her winnings (or even more) to her attorney.[66]

Should a plaintiff lose, she need not reimburse her attorney, but must meet the defendant's expenses.[67] A plaintiff bringing a case under a conditional fee agreement can insure against bearing the defendant's costs, and hence risk no loss from an unsuccessful case beyond her insurance premium.[68] Conditional fee arrangements are limited to certain cases. These are insolvency cases, personal injury cases, cases before the European Commission, and cases before the European Court of Human Rights.[69]

Obviously, the traditional hourly fee arrangement spreads risks poorly: all expense and proceeds risks impinge upon the client.[70] A conditional fee agreement, accompanied by insurance against cost shifting in failed cases, lifts all cost risk from the client's shoulders.[71] Yet conditional fee arrangements leave a risk-averse plaintiff carrying more of the award or settlement risk than does the contingent fee contract.[72]

The conditional fee agreement is permissible in the United States.[73] Apparently, it goes unutilized here.[74] This signals that the conditional fee agreement is less efficient, insofar as the client and her attorney are concerned, than is the contingent fee contract.[75] In England, the American-style contract whereby an attorney collects a share of any court award or

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60. *See id*.
61. *See id*.
62. *See id*.
63 *See* Gravelle, *supra* note 57, at 383.
64. *See id*.
65. *See id*.
66. *See id*.
67. *See id*.
68. *See id*.
69. *See* Gravelle, *supra* note 57, at 383.
70. *See id*.
71. *See id*.
72. *See id*. at 384.
73. *See id*. at 385.
74. *See id*.
75. *See* Gravelle, *supra* note 57, at 385.

settlement should her case be won continues to be contrary to professional practice rules.[76] They remain legally unenforceable.[77]

What other English practice informatively contrasts with U.S. practice?

IV. THE ENGLISH RULE AND THE AMERICAN RULE

A. The English Rule

Long in vogue in England has been a system for paying the expenses of adversarial proceedings (the cost-shifting process referred to in Section III).[78] Once a decision has been rendered in a civil suit, the legal expenses of the victor ordinarily are paid by the loser.[79] Under England's cost-shifting rules, between 65 percent and 80 percent of the expenses of the victorious litigant are absorbed by her defeated counterpart.[80] Presumably, each adversary enjoys some probability of prevailing, and an inverse chance of meeting both of the parties' legal fees.[81]

An additional complication has been the requirement that the barrister collect her fee in advance.[82] This meant that the poor found themselves unable to bring an action.[83] This requirement might have been aimed at reducing the amount of litigation.[84] The British approach reduces the number of cases brought to trial.[85] It entails some incentive for a pretrial settlement.[86]

B. The American Rule

The American Rule directs each party to pay her own fees regardless of which litigant has prevailed.[87] It not only applies to most types of federal litigation, but also is prominent in all states outside Alaska.[88] Never has there been any concerted effort by businesses to revise this system.[89] Plaintiffs write off numerous legitimate minor claims because it costs too

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76. *See id*. at 383.
77. *See id*.
78. *See* TULLOCK, *supra* note 29, at 109.
79. *See id*.
80. *See* Gravelle, *supra* note 57, at 383.
81. *See* TULLOCK, *supra* note 29, at 110.
82. *See id*. at 110-11.
83. *See id*. at 111.
84. *See id*.
85. *See* WERNER Z. HIRSCH, LAW AND ECONOMICS: AN INTRODUCTORY ANALYSIS 213 (3d ed. 1999).
86. *See id*.
87. *See id*. at 212.
88. *See id*.
89. *See* NEELY, *supra* note 28, at 23 n.1.

much to go to court.[90] Business recoils from being stuck with judgments and the opposing parties' attorneys' fees as well.[91]

C. The English Rule Plus the Contingent Fee

1. The Hirsch Thinking

In view of the foregoing, Werner Z. Hirsch, the noted scholar of law and economics at the University of California at Los Angeles, opines:

> A further and rather forward-looking reform would add to the American contingency fee system the British system whereby the losing litigant pays all legal costs. Then the losing lawyer would not only have no compensation for his own time, but would have to pay his opponent's costs as well. The presence of American contingency fees put the American market to work in dispensing civil justice. Britain's cost and award setting system prevents the market from being a travesty – one in which lawyers win exorbitantly and lose painlessly.[92]

2. The Posner Thinking

On the other hand, Posner acknowledges that the loser-pays rule renders weak cases less attractive to file, and it leaves the strong cases less attractive to defend.[93] However, this loser-pays rule might diminish the settlement rate.[94] Optimists will be hopeful over recovering their fees where recovery will not take place through a settlement.[95] In addition, this optimism produces an enhanced incentive to sue.[96]

Posner proposed that the loser-pays rule constitutes a partial substitute for the contingent fee[97] that is nearly absent from England.[98] Yet the emphatic Posner is less receptive than is Hirsch to the option of harnessing the loser-pays rule with the contingent fee:

> Without contingent fees it is difficult for individuals and small firms to finance civil litigation. The loser-pays rule provides a partial substitute. It facilitates the bringing at least of strong cases, because in such cases the lawyer for the plaintiff has a reasonable probability of being paid his fee by the defendant, so that the lawyer's fee will not eat into the plaintiff's winnings.

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90. *See id*.
91 *See id*.
92. HIRSCH, *supra* note 85, at 214.
93. *See* RICHARD A. POSNER, LAW AND LEGAL THEORY IN ENGLAND AND AMERICA 71 (1996).
94. *See id*.
95. *See id*.
96. *See id*.
97 *See id*. at 72.
98. *See id*. at viii.

> But if contingent-fee contracts are permitted yet the loser-pays rule is retained, litigation may explode. For as I just noted, the loser-pays rule may increase the rate of litigation, and so may multiply the effect of contingent-fee financing of litigation. It is not surprising that most of the world's legal systems have both the loser-pays rule *and* a rule against contingent fees.[99]

How else, to borrow Posner's terms, can a legal system promote the bringing at least of strong cases?

V. THE SALE OF CAUSES OF ACTION

A. The Upside of Barratry

Most states now prohibit the assignment of personal injury tort claims.[100] They premise their prohibition either on the theory that those actions alone which survive can be assigned (and that personal injury claims do not survive), or on their professed fear of maintenance, of champerty, and of barratry.[101] Maintenance exists when a person without interest in her suit assists a litigant.[102] Champerty means maintenance as well as the agreement to share in the lawsuit's proceeds.[103] Attorneys or law firms in the United States (and abroad) cannot purchase unmatured liability rights.[104]

Barratry signifies repeated maintenance (or champerty).[105] But consider the crime of barratry. Were the judicial system both inexpensive and accurate, anyone instigating lawsuits would truly engage in a public service.[106] She should be reasonably reimbursed for this contribution[107] (and attorneys might present the obvious such public servants).[108] Only insofar as the legal system proves both costly and inaccurate does this behavior

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99. POSNER, LAW AND LEGAL THEORY IN ENGLAND AND AMERICA, *supra* note 93, at 72 (emphasis in original). On the other hand, whereas Posner here fancies the loser-pays rule a "partial substitute" for the contingent fee, scholar of law and economics Professor Thomas J. Miceli propounds that in a sense the contingent fee (whereby the plaintiff avoids paying legal fees if she *loses*) reverses the English Rule (under which a plaintiff eludes payment of legal fees if she *wins*). *See* MICELI, *supra* note 10, at 192.

100. *See* Marc J. Shukaitis, *A Market in Personal Injury Tort Claims*, 16 J. LEGAL STUD. 329, 330 (1987).

101. *See id*.

102. *See id*. at 330 n.1.

103. *See id*.

104. *See* Robert Cooter, *Liability Rights as Contingent Claims*, *in* 2 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 575, 577 (Peter Newman ed. 1998).

105. *See* Shukaitis, *supra* note 100, at 330 n.1.

106. *See* TULLOCK, *supra* note 29, at 109.

107. *See id*.

108. *See id*.

become undesirable socially.[109]

B. A Market in Legal Claims

There is difficulty inhering in the contingent fee, which one finds in all situations of joint ownership.[110] In effect, her contingent fee contract renders the attorney a co-tenant of the property represented by her plaintiff's cause of action.[111] Each owner may sense insufficient incentive to exploit her own right, since a portion of her endeavors to do so accrues to her co-tenant.[112] This less defines a rationale for the regulation of contingent fees than it constitutes a reason to allow the outright sale of legal claims.[113]

The American legal system forbids the transferability of unresolved tort claims,[114] albeit contract claims can be assigned.[115] This failure leaves the populace a millenium behind the legal state of the art of this matter[116] that developed in medieval Iceland.[117]

Competitive exchange affords a promising remedy for inefficient tort laws.[118] Regardless of the initial allocation by law of liability rights, exchange in (at least) a complete set of perfectly competitive markets allocates liability rights efficiently.[119]

Different individuals place different values on those risks triggering liability.[120] It is these divergent valuations that generate gains via trade.[121] To realize these gains, a potential victim might sell the right to collect damages to another who values it more.[122] Prospective injurers could pay others to carry liability (if they can do so at less expense).[123]

Such markets, if perfectly competitive, would attain equilibrium when each right was held by the party most valuing it, and each duty to pay damages was held by the party meeting it at minimal cost.[124] Such equi-

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109. *See id*.

110. *See* POSNER, *supra* note 14, at 568.

111. *See id*.

112. *See id*.

113. *See id*.

114. *See* DAVID D. FRIEDMAN, LAW'S ORDER: WHAT ECONOMICS HAS TO DO WITH LAW AND WHY IT MATTERS 266 (2000).

115. *See* POSNER, *supra* note 14, at 568.

116. *See* FRIEDMAN, *supra* note 114, at 266.

117. *See id*. at 263-67.

118. *See* Cooter, *supra* note 104, at 575.

119. *See id*. at 577. A liability right is the right of a victim to receive compensation from her injurer. It combines a victim's rights and injurer's liability. *See id*. at 575.

120. *See id*.

121. *See id*.

122. *See id*.

123. *See* Cooter, *supra* note 104, at 575.

124. *See id*.

librium proves Pareto-efficient[125] respecting the allocation of both matured and un-matured liability rights.[126]

As an example of the transfer of matured liability rights, an accident victim suing her injurer typically retains her attorney on a contingent fee basis.[127] As an additional example of the transfer of an unmatured liability right, a customer buying medical insurance typically assigns (via a contractual subrogation clause)[128] to her insurer any right to be compensated for medical expenses triggered by accidents.[129] For the sake of efficiency, the law should facilitate a competitive market for liability rights,[130] rather than impeding exchange therein.[131]

It presumably would be the less wealthy potential plaintiff who would sell her prospective cause of action to a more potent party.[132] What such an original plaintiff might command for her suit must hinge upon the ultimate payoff from the defendant as discounted by the uncertainty of collection.[133] In a sufficiently difficult case, the victim might need to hand over her case gratis, or even to subsidize the prosecution thereof.[134]

This final option could emerge because what the victim nets is deterrence.[135] The victim, through exercise of this last option, evidences that a future defendant who injures her can be forced to suffer damages, even should it not be that victim who collects them.[136] The more probable the lawsuit, the heavier the deterrent impact of any legal principle the suit enforces.[137] Thereby, potential defendants become less likely to risk the proscribed behavior that might engender a suit.[138] Any overall burdens imposed on the tort system by the assignment of claims should be more than overbalanced by these enhanced payoffs from deterrence (as well as compensation) offered by a rule of the free alienation of claims.[139]

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125. *See* POLINSKY, *supra* note 5, at 7 n.4 (stating "[a] situation is said to be Pareto efficient or Pareto optimal if there is no change from that situation that can make someone better off without making someone else worse off").

126. *See* Cooter, *supra* note 104, at 575.

127. *See id*.

128. Subrogation has been endorsed for various contexts. *See, e.g.*, George Steven Swan, *Subrogation in Life Insurance*, 48 INS. COUNSEL J. 634 (1981).

129. *See* Cooter, *supra* note 104, at 575.

130. *See id*.

131. *See id*.

132. *See* FRIEDMAN, *supra* note 114, at 265.

133. *See id*.

134. *See id*. at 265-66.

135. *See id*. at 266.

136. *See id*.

137. *See* POSNER, *supra* note 14, at 569.

138. *See id*.

139. *See id*.

C. Tort Claims Market Practicalities

A tort victim aiming at compensation from her tortfeasor is often in a very weak bargaining position.[140] She might immediately require funds to meet medical bills, cover living expenses, and replace lost wages.[141] Those parties most needing compensation at once - the poor - are the least likely to carry insurance.[142]

Meanwhile, the typical tortfeasor prefers to delay any settlement.[143] Payment in the future costs the tortfeasor less than would a payment at once.[144] Throughout the interim, a defendant-tortfeasor can invest the money.[145]

The market in tort claims would elevate the amount of compensation to the plaintiff nearer to the anticipated court judgment.[146] A monopsony provides a buyer with an impressive bargaining power.[147] The claims market would evaporate the monopsony advantage of the tortfeasor of 2001.[148] Instead of bargaining with her single, intransigent tortfeasor, the tort victim simply could auction her claim to the most ardent of many potential purchasers.[149] Those prospective tort claim purchasers could inform potential plaintiffs regarding their legal rights.[150] As it is, many tort victims fail to pursue valid claims merely due to their ignorance of their right to compensation.[151]

Under the anti-market status quo, a lawyer hired for an hourly fee collects more money the *longer* she works.[152] The tort victim is unable to monitor her lawyer's efforts.[153] Also, the lawyer hired for a contingent fee stands to gain only a proportion of any recovery through her additional efforts, yet absorbs the cost of the entire additional time dedicated to the case; her incentive is to put in *fewer* hours than her client desires.[154]

The tort claims market could resolve both of these conflict of interest problems.[155] A claim purchase is analogous to a one hundred percent con-

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140. *See* Shukaitis, *supra* note 100, at 334.
141. *See id*.
142. *See id*. at 334 n.34.
143. *See id*. at 335.
144. *See id*.
145. *See id*. at 335 n.37.
146. *See* Shukaitis, *supra* note 100, at 336.
147. *See id*. at 335 n.36.
148. *See id*. at 336.
149. *See id*.
150. *See id*. at 337-38.
151. *See id*. at 337.
152. *See* Shukaitis, *supra* note 100, at 338-39.
153. *See id*. at 339.
154. *See id*.
155. *See id*. at 339-40.

tingent fee contract.[156] The claims purchaser obtains a lawyer. Unlike most tort victims, such a purchaser would have the expertise to supervise efficiently an hourly fee attorney.[157]

To be sure, recovery in a personal injury suit results not solely from lawyer input, but also from the cooperation of the tort victim. Once such a victim auctions away her stake in a claim, she feels correspondingly less incentive to appear sympathetic before a jury. Purchasers of claims might pay the purchase price in installments, contingent upon the sellers' cooperation.[158] It is a commonplace in the economic analysis of law that "a continuing outlook of interaction is [a] prerequisite to sustaine[d] cooperation."[159]

The objection that a market in tort claims might engender nuisance suits is a coherent one.[160] In a costless judicial system, a defendant assailed with a groundless suit never would settle.[161] The expense of actual litigation entails a weighty incentive for defendants to settle even groundless suits.[162] Nonetheless, civil procedure reforms might relieve such a threat: selection of venue could be restricted; discovery rules could be tightened; and a loser-pays rule could be applied.[163]

The objection that unsophisticated tort victims must be protected from their own unwise decisions to sell claims is possible.[164] However, a buyer's behavior is constrained through other potential buyers' purchase price competition.[165] After all, even if just one purchaser was attracted to a claim, that buyer still must deliver to the tort victim more than the settlement offer of the tortfeasor (or of that tortfeasor's insurer).[166] In addition, since, presumably, most claims purchased would be settled, the purchaser could be required to file a court statement of the purchase price and of the settlement amount.[167] The court would always wield the power to void unconscionable assignments [168] and allot a portion of any judgment to the tort victim.[169]

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156. *See id*. at 340.

157. *See id*.

158. *See* Shukaitis, *supra* note 100, at 340.

159. George Steven Swan, *The Economics of the Retaliatory Discharge Public Policy Action*, 9 ST. LOUIS U. PUB. L. REV. 605, 611 (1990) (citing R. AXELROD, THE EVOLUTION OF COOPERATION 16 (1984)).

160. *See* Shukaitis, *supra* 101, at 342.

161. *See id*.

162. *See id*.

163. *See id*. at 343 n.66.

164. *See id*. at 346.

165. *See id*. at 347.

166. *See* Shukaitis, *supra* note 100, at 347.

167. *See id*. at 347, n.80.

168. *See id*. at 347.

169. *See id*.

The objection might arise that the free alienation of personal injury actions would increase the volume of civil litigation.[170] Indeed, a larger fraction of claims would be pursued. Still, the enhanced efficiency of the system should (via deterrence) decrease tortious activity.[171] These dual effects might cancel one another.

An objection could be made that personal injury tort claims are so strictly personal that society ought not countenance their sale.[172] On the other hand, human injuries and pain are not on the block.[173] Nothing would be vended beyond the right to compensation for those injuries endured already.[174] There is a minuscule basic distinction between the tort victim's proposed sale of her claim, and the settlement of her claim with the tortfeasor.[175]

The case for a market in tort claims is weighty. At least comparably defensible would seem to be a no more sharp departure from American litigation tradition: the litigation funding industry.

VI. THE LITIGATION FUNDING INDUSTRY

A. The Advent of the Litigation Funding Company

1. Litigation Funding Companies Toot Their Own Horn

Lawyers scanning the American bar's professional press in 2001 witnessed the reply to the emphatic question: "Are the scales of justice *tilted* against your clients?"[176] That response was dispatched from so stately an address as The John Marshall Law School Building (in Atlanta) by ExpertFunding.com:

> ExpertFunding.com has the answer; we are legal and financial professionals who are committed to the belief that our justice system operates most effectively when external financial pressures are removed from the equation. It is our experience that far too often, the scales of justice are tilted in favor of the large, well-funded defendant. Many plaintiffs with legitimate claims are forced to either forego their cases or accept minimal settlement offers because of the cost of litigation. ExpertFunding.com is the industry leader in providing a variety of *non-recourse* funding solutions to litigants and their legal counsel. We help attorneys and plaintiffs with PENDING cases and pressing financial litigation needs by supplying venture capital-like financing for various types of litigation. . . .

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170. *See id*. at 343.
171. *See id*.
172. *See* Shukaitis, *supra* note 100, at 344-45.
173. *See id*. at 346.
174. *See id*.
175. *See id*. at 346.
176. Advertisement, NAT'L L.J., Jan. 8, 2001, at B15.

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> *This form of funding is not a loan, as there are no closing costs or installment payments due, nor is interest accrued*. If the case is ultimately lost at trial or over turned on appeal, the client is not obligated to reimburse us. If you or your clients find yourself seeking the justice you deserve and could benefit from our funding services, please contact us or visit our web site.[177]

The state bar members are also advised of the availability of litigation funding companies. The Ohio State Bar Association is alerted to the presence of the Litigation Finance Corporation.[178] The Louisiana Bar is kept posted on the merits of the Pan American Funding Corporation.[179] Litigation funding companies seem omnipresent.[180]

2. Law Firms, Large and Small

Normally, if plaintiffs' lawyers accept clients on a contingent fee basis, the attorneys cover litigation expenses by drawing upon their firms' general operating account, or their line of credit at a bank.[181] That plaintiffs' lawyers (hired on a contingent fee basis) borrow funds from banks to finance lawsuits is a longtime practice.[182] In major cases, wherein legal ex-

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177. *Id*. (emphasis in original) *available at* <http://www.expertfunding.com.html>.

178. *See* Advertisement, 74 O.S.B.A. REPORT, Feb. 12, 2001, at 162; *available in* <http://www.lit-finance.com.html>.

179. *See* Pan American Funding Corporation, Advertisement, 48 LA. BAR J., 114 (2000) *available at* <http://www.panamfunding.com.html>; Pan American Funding Corporation, based in Kenner, Louisiana, keeps an office in Gainesville, Florida. *See also* Adam Miller, *Legal Shylocks? State Officials, Florida Bar Taking a Closer Look at Litigation Funding Companies*, MIAMI DAILY BUS. REV. Jan. 19, 2001, at B1, B4. Atlanta lawyers are solicited by Darwin Financial Group, Inc. *See* Advertisement, FULTON COUNTY DAILY REPORT, Apr. 10, 2001 at 12. Darwin Financial Group, Inc., can be reached at <darwinfinancial@hotmail.com.

180. Not to be overlooked, for example, is Capital Transaction Group of Southern Pines, N.C. *See also* Adam Miller, *Rolling the Dice*, MIAMI DAILY. BUS. REV. July 14, 2000, at A9.

181. *See id*.

182. *See id*. Stuart M. Speiser notes:

> Plaintiff's tort lawyers are small businessmen, subject to all of the disadvantages of that status, plus a few that are unique. There is practically no business credit available to them. There are no tax breaks, not even substantial depreciation or investment tax credits, which other small businessmen benefit from. Other businesses of our size are able to get some capital from banks, or to sell stock to the public, or to get assistance from government agencies. But no such help is available to us. If you think that tort practice is a gravy train, go to your bank and try to borrow money against a tort case. No bank will lend money to a tort lawyer beyond the personal assets that the

penses reach hundreds of thousands of dollars, borrower-law firms frequently put up their own assets to secure their loans to meet litigation costs.[183] "[The] smaller, less affluent firms are more likely to go this route."[184]

However, President Charles Agee of Augusta Capital (in Memphis) recounts that law firms of every size have sought financing from Augusta Capital.[185] The litigation funding companies purchase a stake in a lawsuit's result, instead of lending money at interest to the attorney (or directly to her plaintiff-client).[186] Upon a final judgment (or a settlement), payout for the litigation funding company derives, generally, from the lawyer's share if the funds were utilized for legal expenses, and from the client's share if the money was utilized for personal expenses.[187] Boosters of the litigation funding industry posit that it differs very little from the contingent fee arrangement whereby an attorney files suit in exchange for a claim against the damage award (or settlement).[188]

B. Litigation Funding Company Styles

Hundreds of litigation funding companies sprouted nationwide in the late twentieth century.[189] They afford plaintiffs upfront cash.[190] Many of these companies are owned and operated by lawyers.[191] For instance, Advanced Settlement Funding was inaugurated in 1999 by attorney Al J. Cone of Ocala and two friends.[192]

> lawyer can put up as security, because the bank cannot step in and finish up the job if something happens to the lawyer.
>
> This creates constant pressure on the proprietors of tort firms to maintain their personal assets in highly liquid form, since they may need them on short notice to keep their practice going. Thus, they are deprived of the opportunity to make equity and real estate investments, which other lawyers are free to engage in without fear of tying up funds needed for law firm capital. This heavy financial penalty is never discussed publicly, but it is one of the reasons why the profits of a successful tort practice must be higher than those of lawyers paid by the hour.

SPEISER, *supra* note 1, at 568-69.

183. *See* Miller, *supra* note 180 at A9.

184. *Id*.

185. *See id*. at A10.

186. *See id*. at A9.

187. *See id*. at A10.

188. *See* Richard B. Schmitt, *A Las Vegas Lender Tests Odds in Court – And Forms an Industry*, WALL ST. J., Sept. 15, 2000, at A1.

189. *See* Miller, *supra* note 180, at A9.

190. *See id*.

191. *See id*.

192. *See id*. at A10. Mr. Cone is a solo personal injury attorney. *See* Miller, *supra* note 179, at B4.

Although Cone bristles over the phrase "litigation funding," Advanced Settlement Funding delivers money directly to plaintiffs either pretrial, or post-verdict during appeal.[193] The negotiated minority percentage of any judgment or settlement collected by Advanced Settlement Funding varies with the risks of the lawsuit.[194] The funds are devoted solely to the clients' personal expenses not legal costs.[195] The transaction is independent of the plaintiff's attorney.[196]

Indeed, each company boasts its own style in delivering funds. Some (unlike Advanced Settlement Funding) advance money to a plaintiff's attorney, and others give it to the plaintiff herself.[197] Some funders collect a flat dollar sum; others negotiate a percentage of any final award or settlement.[198] Some funders require their monies be dedicated only to personal expenses (for example, medical bills, or mortgage payments); others require that their funds be allocated solely to litigation costs (for example, filing fees, or deposition expenses).[199]

A majority of the litigation funding companies are small.[200] They typically advance a maximum of $20,000 to individual plaintiffs.[201] One example is Capital Transaction Group. It provides up to $20,000 for not yet-appealed personal injury lawsuits.[202]

A number of the smaller funding companies serve as feeder offices to the larger ones.[203] Compare this smaller litigation company gatekeeper role to the contingent fee situation. In the latter circumstances, a would-be plaintiff can retain an initial gatekeeper attorney. Her job is to obtain a second, more highly qualified lawyer.[204]

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193. *See* Miller, *supra* note 180, at A10.

194. *See id*.

195. *See id*.

196. *See id*.

197. *See id*. at A9.

198. *See id*. at A10.

199. *See* Miller, *supra* note 180, at A10.

200. *See id*. A9.

201. *See id*.

202. *See id*. at A11.

203. *See id*. at A9. "The Krassmers could either invest in litigation loans themselves or become the middlemen who study promising lawsuits and find suitable investors . . . ." Sharon Harvey Rosenberg, *The Brokers: Hollywood Couple Works with Litigation Funders*, MIAMI DAILY BUS. REV. July 14, 2000, at A11.

204. *See* TULLOCK, *supra* note 29, at 107.

> Today, most serious tort cases are referred to the specialist by family or business lawyers, so that the tort lawyer's client is actually a very sophisticated lawyer. Such lawyers will not refer these cases if the specialists had not established a track record for adding much more to the client's net recovery than they take out of the case.

The heftier firms (for example, ExpertFunding.com of Atlanta, LawFinance Group of San Francisco, or Plaintiff Support Services, of Gertzville N.Y.) occasionally advance clients hundreds of thousands of dollars.[205] A number of the larger litigation funding companies invest in just 10 percent of the applications received from lawyers and plaintiffs.[206] Their aim in reviewing the pros and cons of these applications is to identify winners 75 percent of the time.[207]

Lawsuit Funding Partners of Las Vegas has operated since 1998.[208] It provides funds for personal injury plaintiffs up to a total of $100,000; maximums fluctuate with the strength of the respective lawsuits.[209] It affords funds at either the pretrial stage, or after its plaintiff has attained a judgment, yet still faces challenges at the appellate level.[210] Meanwhile, LawFinance Group funds only those plaintiffs who have triumphed at the trial level and confront appeals.[211]

C. The Expansion Of The Litigation Funding Industry

Since its launch in the mid 1990's, LawFinance Group has opened offices in Boston, New York, and Los Angeles.[212] It now is expanding into the Southeast.[213] Recently it funded its initial cases in Florida.[214] LawFinance Group now finances cases in approximately thirty states.[215]

Perry Walton (who lacks formal legal training) conducts seminars with entrepreneurs.[216] He shares his business plan for the litigation funding

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SPEISER, *supra* note 1, at 569.

205. *See*, Miller, *supra* note 180,at A9; *Cf.* Advertisement, TRIAL, Apr. 2001, at 33.

206. *See* Miller, *supra* note 180, at A10.

207. *See id*.

208. *See id*. at A9.

209. *See id*.

210. *See id*.

211. *See id*. at A10.

212. *See* Miller, *supra* note 180, at A10.

213. *See id*.

214. *See id*.

215. *See id*.

216. *See* Schmitt, *supra* note 188, at A1.

> The way to keep up with the law is to attend seminars sponsored by professional organizations, and every time a lawyer goes to such an out-of-town seminar for five days, it costs about a thousand dollars. These seminars are for work and not play; classes usually meet six hours a day, and attendees are expected to read a heap of printed material. The ancillary value of such meetings is that a lawyer makes friends whom he or she can call on the telephone for a five-minute consultation. The smarter and more experienced lawyers often serve at no charge to enhance the competence of the slower and less experienced lawyers. Specialists give

industry.[217] It was largely Mr. Walton who discovered the litigation financing company market niche.[218]

Walton, through his Future Settlement Funding Corporation, has trained 400 persons in this field.[219] Some have paid up to $12,400 for a two-day seminar. Therein, Walton dispenses tips on networking and marketing.[220] Along with his course, Walton has offered a service assisting with incorporation in Nevada to those desiring to inaugurate their own businesses.[221]

Perhaps coincidentally, Nevada enforces no ceiling on consumer debt interest rates.[222] Walton avers that usury laws do not apply to the litigation funding company, Resolution Settlement Corporation, he runs in Las Vegas.[223] Perry argues this is because his loans constitute contingent obligations.[224] They are contingent because they need not be repaid should the plaintiff lose.[225] Walton charges clients up to fifteen percent monthly in interest on their outstanding balances.[226] His usury theory has not been challenged before a judge.[227]

VII. THE LITIGATION FUNDING PORTFOLIO

A. The Investment Diversification Principle

Peter L. Bernstein has authored eight books concerning economics and finance.[228] In 2001, *Investment Advisor* dubbed him perhaps America's preeminent financial historian.[229]

1. A Little Diversification Goes a Long Way

Variance of return means the statistical measurement of how broadly re-

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> other lawyers advice for free when they can do so 'off the top of their heads' in return for fee generating work in cases where the specialist must take over and perform direct services.

RICHARD NEELY, WHY COURTS DON'T WORK 213 (1983).

217. *See* Schmitt, *supra* note 188, at A1.

218. *See id*.

219. *See id*. at A12.

220. *See id*.

221. *See id*.

222. *See id*. at A12.

223. *See* Schmitt, *supra* note 188, at A1.

224. *See id*.

225. *See id*.

226. *See id*.

227. *See id*. On the other hand, attorney Andy Price of the Florida Department of Banking and Finance says that litigation funding company interest rates could violate Florida usury law. *See* Miller, *supra* note 179, at B4.

228. *See* Andrew Gluck, *Are Equities Riskier Than You Assume?*, DOW JONES INVESTMENT ADVISOR, Jan. 2001, at 28, 30.

229. *See id*.

turns to an asset swing above and below their average.[230] Diversification means the combination of investments which react divergently to the economic environment.[231] The attractiveness of diversification is explained through the mathematics of diversification.[232] The return on a diversified portfolio equals the average of the rate of return on its constituent holdings.[233] Bernstein explains that diversification depends more upon how individual assets perform relative to one another than upon the absolute number of assets owned.[234]

Statisticians invoke the term covariance to signify the degree of parallelism between the returns of any two securities.[235] The riskiness of a portfolio is a function of the covariance of the portfolio's elements, not of the average riskiness of those several investments.[236] Negative covariance is unnecessary to the achievement of the risk reduction from diversification.[237] Anything short of perfect positive covariance still potentially minimizes risk.[238]

A little diversification goes far to diminish stock market investment volatility.[239] The portfolio comprised of only fifteen stocks (chosen randomly) is but 5 percent more variable than a portfolio of a hundred stocks (selected at random). Amassing a portfolio of approximately twenty well-diversified and equal-sized U.S. stocks slices total risk by some 70 percent.[240]

On the other hand, a 2001 study published in the *Journal of Finance* delivered more disquieting news, finding that aggregate stock market volatility remained quite stable through time. Yet volatility at the firm level has waxed; hence, correlations among individual stock returns has waned.[241]

Shrinking correlations among stocks imply that the benefits from portfolio diversification have grown through the post-1960 era. The conven-

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230. *See* PAUL L. BERNSTEIN, AGAINST THE GODS: THE REMARKABLE STORY OF RISK 252 (1996).

231. HARRY BROWNE, WHY THE BEST-LAID INVESTMENT PLANS USUALLY GO WRONG 499 (1987).

232. *See* BERNSTEIN, *supra* note 231, at 253.

233. *See id*.

234. *See* PAUL L. BERNSTEIN, CAPITAL IDEAS: THE IMPROBABLE ORIGINS OF MODERN WALL STREET 50 (1992).

235. *See* BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET: A LIFE CYCLE GUIDE TO PERSONAL INVESTING 209 n. (1999).

236. *See* BERNSTEIN, *supra* note 234, at 54.

237. *See* MALKIEL, *supra* note 235, at 210-11.

238. *See id*. at 211.

239. *See* BERNSTEIN, *supra* note 234, at 54.

240. *See* MALKIEL, *supra* note 235, at 212.

241. John Y Campbell, et al., *Have Individual Stocks Become More Volatile? An Empirical Exploration of Idiosyncratic Risk*, 56 J. FIN. 1, 23-25 (2001). *Cf.* Jonathan Clements, *Why 15 Stocks Just Aren't Enough*, WALL ST. J., Mar. 13, 2001 at C1.

tional rule of thumb is that a portfolio of just twenty stocks meets a major fraction of the entire benefit in diversification. But the growth in idiosyncratic risk through time has increased the total of randomly chosen stocks necessary to win a comparatively complete portfolio diversification. Such a portfolio in 2001 requires nearly fifty stocks.[242]

2. The CAPM Premise

The most powerful framework with which to grasp the pricing of shares is the Capital Asset Pricing Model (CAPM).[243] A central premise of CAPM is that risk-adverse investors who practice optimal diversification (to stabilize returns) dominate the market.[244]

The numerical description of systematic risk is called beta.[245] Systematic risk captures the reaction of separate stocks (or of a portfolio) to general market swings.[246] Systematic risk cannot be eliminated by diversification.[247] CAPM declares that it is solely this systematic component that counts toward enhanced payoffs to investors,[248] since the solitary risk for which investors should reap compensation is risk which cannot be diversified away.[249] Unsystematic risk carries little or no impact upon stock value.[250] Consistently with CAPM, the market delivers no premium for an investor's shouldering an unneeded burden through failure to diversify adequately.[251]

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242. *See id*.

243. *See* HENDRICK S. HOUTHAKKER & PETER J. WILLIAMSON, THE ECONOMICS OF FINANCIAL MARKETS 150 (1996).

244. *See id*. at 151.

245. *See* MALKIEL, *supra* note 235, at 221. Beta is used to express the volatility of a mutual fund as well as of any one stock. Prof. Craig L. Israelson defines beta:

> A measure of the volatility of a fund relative to a benchmark index. A beta of 1.00 indicates that a fund has volatility equivalent to its market benchmark index (e.g., S&P 500, Russell 2000, etc.). A beta coefficient of 1.10 indicates a fund's monthly returns are 10% more volatile than its benchmark. A very low beta may not indicate that a fund has low volatility, it may simply be due to a very low correlation between that fund and its benchmark index….

Craig L. Israelson, *Alpha Beta Soup*, FIN. PLAN, Jan. 2001, at 59, 60.

246. *See* MALKIEL, *supra* note 235, at 221.

247. *See id*. at 222.

248. *See id*. at 224.

249. *See id*. at 235.

250. *See* BERNSTEIN, *supra* note 234, at 190.

251. *See* HOUTHAKKER & WILLIAMSON, *supra* note 243, at 153.

B. A Litigation Funding Company's Portfolio

Nevertheless, diversification, which is common (not universal) in capital management, is distinctly uncommon in the labor market.[252] Attorneys invest considerable time and money to join their profession.[253] Such a vocation is not risk-free, but it is unusual for someone to qualify herself for a second occupation in case her first choice is unprofitable.[254] A small practice actually lies at the boundary between the labor market and the capital market.[255] Choosing a profession is tantamount to going into a small business.[256]

In 1999, Bill and Patty Krassner of Hollywood, Florida, responded to a Future Settlement Funding advertisement in *USA Today*.[257] Paying $10,000 for a three- day seminar, they were taught the basics of the litigation funding industry.[258] The Krassners set up shop as Specialty Funding and Recovery.[259] They typically lend or arrange loans to plaintiffs in sums ranging from $3,000 to $5,000.[260] It typically requires six months to two years for one of their cases to conclude.[261] Ordinarily, the Krassners look to reap 10 to 25 percent of the profits on every loan they arrange.[262]

Recall the economic importance of a diversified portfolio of cases to a plaintiffs' law firm operating on a contingent fee basis as discussed earlier in Section II. The Krassners' portfolio encompasses twenty to thirty cases.[263] Mr. Walton's Resolution Settlement Corporation has invested in scores of lawsuits nationally.[264] Its portfolio is rapidly swelling.[265] And

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252. *See id*.

253. *See id*.

254. *See id*. This is not to deny the realistic opportunity for simultaneous preparation for two professions. *See, e.g.,* George Steven Swan, *Legal Education and Financial Planning: Preparation for the Multidisciplinary Practice Future*, 23 CAMPBELL L. REV. 1, 18-31 (2000). *Cf.* Raymond Fazzi, *Disenchanted with the Law: Some Lawyers Find Being a Financial Advisor Is More Satisfying*, FIN. ADVISOR, Jan. 2001, at 59. "[W]orkers and consumers also engage in portfolio management. Workers often develop a variety of skills (or keep their skills general and therefore applicable to many different work environments) and engage in a variety of activities." DWIGHT R. LEE & RICHARD B. MCKENZIE, FAILURE AND PROGRESS: THE BRIGHT SIDE OF THE DISMAL SCIENCE, 39 (1993).

255. *See* HOUTHAKKER & WILLIAMSON, *supra* note 243, at 153.

256. *See* Speiser, *supra* note 182.

257. *See* Rosenberg, *supra* note 203, at A11.

258. *See id*.

259. *See id*.

260. *See id*.

261. *See id*.

262. *See id*.

263. *See* Rosenberg, *supra* note 203, at A11.

264. *See* Schmitt, *supra* note 188, at A1.

265. *See id*.

Lawsuit Funding Partners funds approximately 250 cases annually.[266] President of Lawsuit Funding Partners, Bob Sandler,[267] reports: "I've got firms now that will send me four, five, six cases a week."[268]

C. A Tort Claims Portfolio

The portfolio principle, and the notion generally of the litigation funding company's portfolio, were combined and more concisely applied to a market for purchased tort claims by Marc J. Shukaitis. Shukaitis found:

> A tort claim would . . . be worth more to a market purchaser than to the victim because a purchaser would hold a diversified portfolio of claims. A diversified portfolio would include many (perhaps a dozen or more) claims from different victims that would be presented in different courts using different legal theories. Such a diversified portfolio of tort claims would be worth more than the sum of the expected monetary values of the individual claims because diversification would reduce some of the risk associated with claims. A purchaser of a diversified portfolio would eliminate the "unsystematic" risk associated with claims and would thus discount his purchase price of a claim only for "systematic" risk. The diversified portfolio holder could thus pay the tort victim more than the victim's valuation of the claim, which would be reduced for both systematic and unsystematic risk.
>
> Collecting a diversified portfolio would be to some extent inconsistent with increasing value through expertise. The purchaser of the claims would therefore be required to trade off expertise against diversification. This trade-off exists in all separate markets and there is no reason to believe that professional purchasers of tort claims would be less able to make this trade than are, say, professional managers of mutual funds. A tort victim should be able to receive greater compensation from a market purchaser than from the tortfeasor if the market purchaser is an expert in the sort of claim that the victim has. For example, a purchaser might specialize in automobile accident claims or in airplane crash claims in much the same way some law firms specialize in particular types of claims. The claim will be worth more to the expert (who will thus be willing to pay more for the claim) because his knowledge or experience allows him to value the claim more precisely and to recover a larger judgment in court. A purchaser might also have his own legal staff, which could reduce the costs to him of litigating a claim. The net effect of a well-functioning market would be to raise the compensation received by a tort victim toward the expected value of the claim discounted at a market interest rate appropriate for the riskiness of a diversified portfolio

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266. *See* Miller, *supra* note 180, at A10.

267. *Id*. at A9.

268. *Id*. at A10. Law Finance Group Inc., President Alan Zimmerman estimates his company's annual advances number "in the hundreds." Jean Hellwege, *David v. Goliath Revisited: Funding Companies Help Level the Litigation Playing Field*, TRIAL, May 2001, at 14, 16.

> of personal injury tort claims.[269]

Apprehend how, Shukaitis' tort claims portfolio squares with the recognition by Posner in Section II.C.3., of the pluses accruing to a portfolio of causes of action under the contingent fee system. The logic of each critic vindicates the litigation funding companies' exploitation of the portfolio approach to investment.

VIII. THE MIXED REACTION TO LITIGATION FUNDING COMPANIES

A. Voices Pro: The Open Arms Sector

Director of the Center for Ethics and Public Service at the University of Miami School of Law, Anthony V. Alfieri, worried during 2000: "The presence of third-party financing may palpably or subtly influence litigation strategy in ways that may be inimical to the best interest of a client."[270] Ethics counsel for the American Bar Association George Kuhlman, however, perceives no difficulty when third-party funding agreements are so structured that they do not impede the lawyer's independence.[271] Kuhlman compares these agreements with the purchase of an insurance policy:[272]

> Those seeking to acquire an interest in another's litigation don't acquire the right to control the legal strategy or intervene in the attorney's ability to make judgments. If the company does not involve itself in the legal strategy of the case, I would see no inherent conflict in the process.[273]

Kuhlman's insurance reference reminds one of medical insurance subrogation discussed in Section VB.

Florida Bar Professional Ethics Committee member Tim Chinaris is an associate dean and ethics professor at Florida Coastal School of Law.[274] Dean Chinaris believes that numerous clients with meritorious suits are compelled to settle their claims for too little reward because insurance companies (and other corporate defendants) boast the longer purse.[275] Chinaris contends that litigation funding can reinforce the non-affluent

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269. Shukaitis, *supra* note 100, at 336-37 (footnotes omitted).

270. Miller, *supra* note 180, at A11.

271. *See id*.

272. *See id*.

273. *Id*. "We don't like things that tempt [lawyers] to misbehave. But we hope there is not need to ban an activity in order to make sure no one does a bad thing." *Id*. (alteration in original).

274. *See* Miller, *supra* note 179, at B4.

275. *See id*.

plaintiff.[276]

B. Voices Con: The Resistance Movement

1. Bar Circles

A discordant voice within Florida's bar was raised during 2000 by Florida state Senator Walter G. "Skip" Campbell (of Tamarac).[277] Senator Campbell, a trial attorney, ardently resists bids to curb tort litigation.[278] Nonetheless, the Senator opposes litigation funding companies:

> I find [third-party litigation funding] unethical because you basically have lawyers selling a percentage of their contingency contract. . . . An attorney needs to have independence, and this opens the door to anything and everything.[279]

Senator Campbell is a partner in Krupnick, Campbell, Malone, Roselli, Buser, Slama, Hancock, McNelis, Liberman and McKee (of Fort Lauderdale).[280] Although he is constantly contacted by litigation funding companies, Campbell refuses ever to cooperate with them:[281] "What if an attorney wants to seek a settlement that is less than what the lending company is expecting . . . ? You could feasibly have non-lawyers putting pressure on an attorney to hold out for a larger settlement. Then you have a case of people practicing law without a license."[282]

Observe that Campbell's language focuses upon obstacles to the *lawyer*; "attorney needs to have independence";[283] "nonlawyer putting pressure on an attorney."[284] Pray: Where is the clients' lobby? The neat little trick lies in finding a *consumer* so dissatisfied with competition (litigation funding) as to demand protection for producers (protection of the attorneys' contingency contract).[285]

After all, no complaint has been filed with the Florida bar against litiga-

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276. *See id*.
277. *See* Miller *supra* note 180, at A21.
278. *See id*.
279. *Id*.
280. *See id*.
281. *See* Miller, *supra* note 180 and accompanying text.
282. *Id*.
283. *Id*.
284. *Id*.
285. George Steven Swan, *The Political Economy of Interprofessional Imperialism: The Bar and Multi-Disciplinary Practice, 1999-2001*, 24 J. LEGAL PROF. 151, 193-94 (2000) (referencing the organized bar's resistance to multidisciplinary practice).

tion funding companies.[286] The President of Lawsuit Funding Partners, Bob Sandler, promises to press ahead with support to plaintiffs until the passage of a law prohibiting it:[287] "I'm going to continue helping plaintiffs wherever I can."[288]

2. Business Circles

Relatively sharply alarmed over the possible impact upon the volume of litigation are business groups.[289] Jon Shebel is the President and Chief Executive of Associated Industries of Florida, the most energetic business lobby in Florida.[290] President Shebel is a long-term proponent of restrictive legislation against tort lawsuits.[291] Compatibly therewith, he also favors outlawing litigation funding companies.[292]

One such alternative could be passage of a Florida constitutional amendment regulating plaintiffs' attorneys' fees and, English Rule-style,[293] forcing plaintiffs to pay the defendants' expenses.[294] Business groups, numbering among them Associated Industries of Florida, bandy the idea of an initiative to that effect on 2002's election ballot.[295] Cui bono?

Anthony Downs, in Downs' *An Economic Theory of Democracy*,[296] incisively discerned that: "Every economic theory of government must assume that the governors carry out their social function primarily in order to attain their private ends."[297] The proximate beneficiaries of a legal shift like that advocated by the Associated Industries of Florida are not hard to find.

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286. *See* Miller, *supra* note 180, at A21.

287. *See id*.

288. *Id*.

289. *See id*.

290. *See id*. at A9. The Associated Industries of Florida has been deemed "the 800-pound gorilla." Christine Jordan Sexton, *Feeding Frenzy*, MIAMI DAILY BUS. REV., Mar. 30, 2001, at A8, A10.

291. *See* Miller, *supra* note 180, at A21.

292. *See* Miller, *supra* note 180 and accompanying text.

293. *See supra* Section IV.A.

294. *See* Miller, *supra* note 180, at A21.

295. *See id*.

296. ANTHONY DOWNS, AN ECONOMIC THEORY OF DEMOCRACY (1957).

297. *Id*. at 291. "The organizations of Post-Capitalist society all want things from the political power, the government. But they want things that are of benefit to them, that will enable them (at least in their opinion) better to do their own job, fit into their value system, or line their pockets." PETER F. DRUCKER, POST-CAPITALIST SOCIETY 102 (1994).

IX. CONCLUSION

The preceding discussion has analyzed facets of the longstanding use of the contingent fee in the United States. This analysis accompanied assessments of the conditional fee arrangement in the United Kingdom, and of the respective English Rule and American Rule for meeting the costs of adversarial proceedings. All three of these latter assessments have included references to the American-style contingent fee. Likewise, the contingent fee has been alluded to in the context of the proposed market in tort causes of action.

The contingent fee entails features making it (in any case partially) an economic precedent for the nascent litigation funding industry. In both the contingent fee context and litigation funding industry context, a funding party (the plaintiff's lawyer and the litigation funding company, respectively) can amass a portfolio of claims. Such a portfolio engenders an investment efficiency denied to those plaintiffs otherwise forced to fund their lawsuits themselves, severally.

Also, in both the contingent fee context and the litigation funding industry context, the prospective funding party can bring to the lawsuit-filing decision an expertise born of professional experience. Precisely such expertise is wanting in the isolated plaintiff. This expertise, too, constitutes an efficiency-enhancing variable. Potentially strong cases are the more likely to be litigated, and potentially weak cases are the more likely to be discarded.

It has been seen that litigation funding is a sunrise industry.[298] The litigation financing field blossoms with companies in a multitude of styles. This industry reproduces itself via the seminar mode of professional education. Both attorneys and laypersons leap aboard the bandwagon to share in the risks and rewards of equity in a litigation funding enterprise. But growls of discontent over these new developments rippled through the air even during 2000. Business and bar opponents of these companies will be heard from in 2002.

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298. Attorney-inquirers to the Office of Bar Counsel of the Massachusetts Bar Association ask whether an attorney can provide her client with information regarding loan companies specializing in loans to persons in their clients' circumstances. *See* Alice L. Hageman, *Neither a Borrower nor a Lender Be*, MASS. BAR ASS'N LAW J., Dec. 2000, at 2.