

# Litigation Funding Needs Regulating To Meet Ethics Standards

By **Deborah Winokur** (March 21, 2024)

According to the U.S. Chamber of Commerce Institute for Legal Reform,[1] third-party litigation funding is a multibillion-dollar industry globally with \$13 billion in assets under management in the U.S. alone.

On the consumer side, funders provide loans to litigants for living and possibly litigation expenses while their lawsuits are pending. The loans are generally nonrecourse, but funders are paid before plaintiffs receive any recovery and can reduce recovery by 40% or more depending on the success of the contingent case.



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Even with the potential for exploitation, third-party litigation funding can serve a welfare-enhancing function by providing litigants with access to capital without incurring debt.[2] Further, having a ready cash flow for living expenses puts litigants in a stronger bargaining position with regard to settlement discussions.

Multiple cases, however, have arisen that have exposed some of the pitfalls involved when an unsophisticated consumer of legal services engages with a third-party litigation funder.

In one instance recently, a plaintiff has secured a substantial settlement only to find that the actual recovery was significantly reduced due to repayments to a third-party litigation funder. These types of surprises are never a good way to wrap up a case and, with increased recurrence, are highlighting a growing need for professional oversight.

In January, for example, Sean Murtaugh, the plaintiff in an underlying workers compensation case sued his former lawyer, Robert S. Goggin, III, and a litigation funding outfit under the civil Racketeer Influenced and Corrupt Organizations Act claiming that the pair colluded to shift high-interest loans for legal representation to the plaintiff.[3]

Murtaugh, a lineman working for Amtrak, claims he was injured while installing a feeder arm on a pole while he was in an aerial work platform within proximity of a cell tower. He claims that the exposure to the energy fields from the antenna caused him to have long-term neurological symptoms.

Shortly after the exposure, Murtaugh retained the services of a law firm. Pending the outcome of his case, Murtaugh received financial assistance for his living expenses from the litigation funder.

Upon settling the case, he received a settlement amount that subtracted the sums received for living expenses along with high-interest loans used to fund the legal representation, including payments to expert witnesses and deposition fees. The Murtaugh case is currently working its way through the legal system and the defendants have not issued public comment.

Given the uneven bargaining position and the potential that a party may be easily exploited immediately following an accident or injury, it is time that states consider regulating consumer legal funding.

Third-party litigation funding is not specifically regulated under federal law. Currently, a small minority of states, namely, Maine, Oklahoma and Vermont regulate consumer legal funding in some fashion. Pointedly, Pennsylvania, where the Murtaugh case is pending does not.

Another roughly dozen states are considering proposals that contain consumer protective measures, such as requiring litigation funders to register with the state, recommending that an attorney review the funding agreement prior to the potential litigant entering into the contract, and providing transparent information about the funding amount and interest rate.

Key provisions of pending proposals prohibit funders from offering or accepting commissions for referrals, charging excessive interest rates and fees, or having any role in making strategic decisions with respect to the underlying civil matter.

Third-party litigation funding also intersects with core aspects of the attorney-client relationship. The agreements entered into between a potential litigant and the funder may contain terms that are fundamentally at odds with lawyers' responsibilities under the Rules of Professional Conduct.

It is essential that lawyers advocate within their bar organizations and to their local representatives for commonsense consumer protection measures that protect the welfare of potential litigants while also promoting consistency with the rules.

### **Protection of Clients**

Many of the Rules of Professional Conduct are aimed at protecting vulnerable clients. Perhaps none more so than Model Rule 7.3, which prohibits a lawyer from personally soliciting a client unless the client is a lawyer, a personal contact of the soliciting lawyer, or someone who routinely uses legal services for business purposes. According to Explanatory Comment [2], the rationale for the rule is a concern for "overreaching."

The comment explains that a "person may already feel overwhelmed by the circumstances giving rise to the need for legal services, may find it difficult to fully evaluate all available alternatives with reasoned judgement and appropriate self-interest."

This rationale is equally applicable to third-party funders. In the Murtaugh case, potential plaintiffs can find themselves without the financial wherewithal for their medical bills or are out of work, amid an unanticipated crisis. At such a critically vulnerable time, regulation of the funding industry to avoid exploitation is a must.

### **Attorney-Client Relationship and Professional Independence**

At the outset, Model Rule 1.1 clarifies that a legal relationship is between an attorney and client. As such, Model Rule 1.2 contains the absolute requirement that a lawyer abide by a client's decision concerning settlement of a case. Model Rule 1.4 underscores the critical importance of a client meaningfully participating in a representation.

If a lawyer is beholden to a third-party litigation funder who has the authority to direct the representation, the relationship among the lawyer, client and funder becomes conflated, and there is a high degree of risk that a lawyer will not be able to act consistently within the duties under the rules.

Further, professional independence is one of the fundamental underpinnings of legal

practice in the U.S. The rules prohibit sharing of legal fees with nonlawyers. Explanatory Comment [2] to Rule 4.4 "expresses traditional limitations on permitting a third party to direct or regulate the lawyer's professional judgment in rendering legal services."

The rules also prohibit a third party from paying for the representation of a client unless the client consents and the third party agrees not to interfere with the lawyer's independence or professional judgment.

To avoid a morass wherein a client and a litigation funder agree to terms that are incompatible with a lawyer's duty to remain independent, it is essential that any regulations include specific clarifying provisions consistent with the rules.

These provisions should state explicitly that a client maintains the sole and ultimate authority on whether, and under what terms, to settle a case, and that a litigation funder may not share a legal fee with a lawyer.

## **Conclusion**

The preamble to the rules implores lawyers to seek to improve the law and promote access to the legal system. Litigation funders have access to critical capital that potential litigants may need to advance their legal claims. Without litigation funding, consumers in need may be completely shut out of the legal system.

Given the tension between the need for access to funding and the need for consumer regulation, reform in this area should be balanced and flexible.

There must be sensitivity to the growing legal funding industry and regulation must not be so restrictive that it will render litigation funding not commercially viable. Ultimately, implementing appropriate regulation to drive out predatory and deceptive practices from the industry is critical for all parties engaged in the pursuit of justice.

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[1] <https://instituteforlegalreform.com/what-you-need-to-know-about-third-party-litigation-funding/>.

[2] <https://via.library.depaul.edu/cgi/viewcontent.cgi?article=1009&context=law-review>.

[3] Sean Murtaugh v. Robert S. Goggin, III, Esq., E.D. Pa., 2:2024cv-00026 (1/3/24).