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Third-party litigation funding in US enters mainstream, leading to calls for reform

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Third-party litigation funding in the US has entered the mainstream. Investor groups are pouring unprecedented sums of money into financing litigation in the world's largest litigation market. In recent years, well-heeled investors such as pension funds and university endowments "have collectively pumped more than a billion dollars in the sector", according to a May 2016 Wall Street Journal article.

Third-party litigation funders front money to plaintiffs' law firms in exchange for an agreed-upon cut of any settlement or money judgment. Investors are attracted by the prospect of hefty returns that are not tied to economic or market conditions.

Commercial litigation funding began in Australia, made its way to the UK and Europe, and arrived in the US within the past decade. The practice has taken off in recent years with the loosening of longstanding common law doctrines on maintenance, champerty and barratry that prohibited the outside financing of litigation.

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Litigation funders view lawsuits as assets, just like any other receivables. Burford Capital LLC's 2015 Annual Report explains: "It may seem strange to think of litigation in that way, but if one strips away the drama and the collateral dynamics associated with the litigation process, a litigation claim is nothing more than an effort to get money to change hands". Burford is a publicly traded global finance firm focused on litigation funding.

Along with the growth of third-party litigation funding in general, there is a trend in the US for larger investment firms to move away from financing individual cases in favour of investments in pools of cases. In January, Burford Capital announced a $100m investment in a portfolio of cases at a large global law firm. In March, Burford reported that it had exceeded $627m in commitments across 54 different litigation investments. Gerchen Keller Capital LLC, a private fund based in Chicago, has $1.4bn under management, from which it has deployed $700m into 75 investments, many of which are portfolio deals, according to a recent announcement.

Proponents of third-party litigation funding, such as litigation funder Bentham IMF, claim that the practice "evens the playing field between large, well-financed litigants who are quite used to fighting in court, and individuals or small to mid-sized companies, who are often inexperienced at fighting legal battles and may find themselves easily outgunned". On the other hand, business and civil justice organisations, such as the US Chamber Institute for Legal Reform, believe that third-party litigation funding may lead to the filing of speculative, potentially high-yield lawsuits, because litigation funders absorb some of the risk in litigation and can spread it across a portfolio of cases and among investors. Additionally, a funder's presence can unreasonably prolong cases and frustrate settlements.

Another trend in the US is that startups are entering the market to finance cases that are not large enough for the more traditional litigation funders to consider. Some are using a crowdfunding-like model that allows accredited individuals to shop among cases pre-screened by the finance firm and contribute as little as $2500 in the hopes of obtaining a payout if the case settles or produces a favourable judgment. This approach by firms including Lexshares, Inc, Trial Funder Inc, Mighty Group, Inc, Invest4Justice and Legalist seems to be catching on. Invest4Justice has received pledges exceeding $3.2m since it was founded in early 2014. Mighty Group has reportedly helped fund over 1000 lawsuits in its short existence.

The US Chamber Institute for Legal Reform, American Insurance Association, American Tort Reform Association, National Association of Manufacturers and Lawyers for Civil Justice (a partnership of leading corporate counsel and defence bar practitioners) have urged the blue ribbon committee that develops procedural rules for the US federal courts to require the disclosure of third-party litigation funding at the outset of a lawsuit. The groups believe that courts should know if their efforts to settle cases may be complicated by an entity that is not in the room. Courts also might be more open to defendants' requests for cost-shifting in cases involving burdensome discovery if they are aware that there is not a wide disparity in each side's ability to pay. Where sanctions are appropriate for misconduct, courts need to know about the presence of a third-party in the litigation to determine how to impose sanctions or other costs. Disclosure also would help courts assess the adequacy of representation in putative class actions, where courts must examine the resources that counsel will commit to the class.

The judiciary in general may be receptive to calls for disclosure of third-party litigation funding. In a 2014 survey of 357 federal and state judges nationwide, with an average experience of over 17 years on the bench, almost two-thirds said they would prefer to know if litigation funding is being employed in cases before them. Two-thirds of the judges surveyed also reported that they believe the practice of litigation funding is not acceptable and will increase the number of lawsuits. The study was conducted for the Law and Economics Center at George Mason University's law school just outside of Washington, DC.

So far, the federal Advisory Committee on Civil Rules has taken a 'wait and see' approach. In the meantime, the US Chamber Institute for Legal Reform is urging federal judges in individual cases, particularly those managing multi-district litigations, to enter case management orders providing for the disclosure of third-party litigation funding. This would improve justice in those courts and give the Advisory Committee the data it needs to determine how best to bring third-party litigation funding into the open. ■