

OPINION: 3rd-Party Litigation Funding Needs Transparency

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Investors are pumping unprecedented sums of money into financing litigation, lured by the prospect of payoffs untethered to economic or market conditions. Litigation funders make money gambling on other people's lawsuits; they front money to plaintiffs' law firms in exchange for an agreed-upon cut of any settlement or money judgment. The practice has taken off in recent years with the loosening of common law doctrines, such as champerty, that long prohibited the outside financing of litigation.

Legal Claims As Assets

To litigation funders, a lawsuit is more than a dispute; it is an asset, just like any other receivable. As Burford Capital LLC acknowledged in its 2015 annual report, "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.

Money Pours In

Commercial litigation funding began in Australia, made its way to the United Kingdom and Europe, and arrived in the United States within the past decade. 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. A July 2016 ABA Journal article reported that "business is booming" for litigation funders.

One trend is the movement away from financing individual cases in favor of investments in pools of cases. For example, in January, Burford Capital announced a \$100 million investment in a portfolio of cases at a large global law firm. In March, Burford reported that it had exceeded \$627 million in commitments across 54 different litigation investments. Chicago-based Gerchen Keller Capital LLC, a private fund, recently announced that it has \$1.4 billion under management, from which it has deployed \$700 million into 75 investments, many of which are portfolio deals.

Another trend 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 crowdfundinglike model that allows ordinary accredited investors to shop among cases prevetted by the finance firm and contribute as little



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as \$2,500 in the hopes of obtaining a payout if the case settles or produces a favorable judgment. This approach by firms such as Lexshares Inc., Trial Funder Inc., Mighty Group Inc., Invest4Justice and Legalist, seems to be catching on. Invest4Justice has received pledges exceeding \$3.2 million since it was founded in early 2014. Mighty Group has reportedly helped fund over 1,000 lawsuits in its short existence.

Problems Inherent in TPLF

Proponents of third-party litigation funding (TPLF) assert that the practice promotes access to justice and levels the playing field by providing plaintiffs with the resources to go the distance. But the practice can fuel the filing of weak or meritless claims. Funders are willing to speculate on such cases if the case will prove cheaper for a business to settle than to spend exorbitant sums to litigate, even if the business has valid defenses. Litigation funding can also lead to speculative, potentially high-yield cases being brought because of the trend towards funding groups of cases, even entire law firm litigation portfolios. The law firm can offload some of its risk onto a third party that can, in turn, spread that risk across a portfolio of cases and among investors, including in the mix cases that are of low merit.

Further, the funder's presence can unreasonably prolong cases and frustrate settlements. If a party is obligated to pay some of its settlement to a funder, that party may have a strong incentive to reject an otherwise reasonable offer and hold out for more money. By the same token, the litigation funder may exert influence in settlement negotiations as a result of the measure of control it acquires by providing risk capital. For instance, litigation funder BenthamIMF's code of best practices for its U.S. operations appears to anticipate such involvement, noting that the "Claimant, counsel, and the Funder shall consult in good faith as to the appropriate course of action to take in connection with all settlement demands and offers." A lawyer's ability to remain in control of a case may be particularly questionable when a litigation funder has invested in a large group of that law firm's cases or perhaps the firm's entire litigation practice.

Disclosure Needed

So far, the litigation funding industry has operated "in a relative vacuum of disclosure and without regulation," notes the American Lawyer.

Courts trying to settle cases may be unaware that their efforts may be complicated by an entity that is not even in the room. Courts also may be rejecting defendants' calls for cost-shifting in cases involving burdensome discovery based on the erroneous belief that there is 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. For example, in July 2016, a Philadelphia federal court excoriated the "outrageous behavior" of a group of financier backers behind an attempt to enforce a Liberian judgment against Cigna.

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. In August 2016, this need led a San Francisco federal judge to grant a motion by Chevron to compel a plaintiff to reveal the identity of litigation funders behind a proposed class action involving a gas explosion off the coast of Nigeria.

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.

The U.S. Chamber Institute for Legal Reform and others have urged the Advisory Committee on Civil Rules to adopt an amendment to Rule 26(a)(1)(A) of the Federal Rules of Civil Procedure that would require disclosure of third-party litigation funding at the outset of a lawsuit. So far, the committee has taken a "wait and see" approach. The Catch-22 is that, because third-party funding of lawsuits occurs in secrecy, the proof needed to support reform is elusive.

Federal judges in individual cases, particularly those managing multidistrict litigations, have the power to bring about transparency regarding the presence of third-party litigation funders in their courts. They should make all case management orders provide 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 sunlight.

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