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December 21, 2016

Year in Review: 2016 Cases Will Not Hinder Litigation Funding

By John Harabedian

2016 was the year of the outlier. Undoubtedly, this was due to one of the most surprising presidential elections in history, but also because of the assortment of notable legal decisions relating to litigation funding. Many of these decisions had attorneys and commentators alike wondering whether courts were systematically tightening their grip on the litigation funding industry, with an ultimate eye towards deterrence or even eventual extinction. But when viewed more closely, the handful of seemingly detrimental cases that dominated the legal wires in 2016 represented nothing more than a series of outliers, the effects of which should have little to no effect on the historic growth and future sustainability of litigation funding.

In August, the legal blogosphere was **abuzz** when a federal district court in *Gbarabe v. Chevron*, No. 14-cv-00173, 2016 WL 4154849 (N.D. Cal. Aug. 5, 2016) compelled a class action plaintiff to produce his confidential litigation funding agreement to the defendant. While many wondered whether *Gbarabe* would signify a turning point where more courts would compel the same or similar disclosures from plaintiffs receiving litigation funding, the answer thus far has been "no." Given the peculiar facts of that case, this comes as no surprise. Because plaintiff's counsel conceded the funding agreement was relevant to the question of class certification and, moreover, failed to assert that the document was privileged, the court had little choice but to grant defendant's request. This contrasted with the opposite decision in *Kaplan v. S.A.C. Capital Advisors,* No. 12-cv-9350 VM knr, 2015. As it is unlikely other courts will not confront such circumstances, there is a high probability *Gbarabe* will remain a case relevant unto itself.

In September, not long after *Gbarabe*, the Delaware Chancery Court in ***Judy v. Preferred Communication Systems*, Consol. C.A. No. 4662-VCL**, ruled that a third-party litigation financier, Preferred Spectrum Investments (PSI), lacked standing to seek an award from the court to recover its attorney fees and expenses under Delaware's common benefit doctrine because PSI was neither plaintiff nor plaintiff's counsel. Like *Gbarabe*, at first blush this seemed like an affront to all potential litigation funders, but there are many facets of this case that cage its effects on the market.

First, and most notably, PSI did not have a formal funding agreement with the plaintiff and provided the funding "gratuitously." PSI did so because its ultimate goal was to take over the defendant company, not seek a return on its advanced fees and costs. If PSI had entered into a formal agreement with plaintiff, the court appeared receptive to the idea of PSI, or a funder similarly situated, obtaining a fee award. *Id.* at 34 ("PSI could have entered into an agreement with [plaintiff] that would have contemplated some form of repayment, including potentially a repayment that would be funded by a court-ordered fee award."). This is consistent with Delaware's historical protection of litigation funding arrangements, as we have previously **discussed**.

Second, and relatedly, because litigation funders almost always enter into funding agreements with their clients, they have not needed to rely on the common benefit doctrine to get paid their return. PSI's attempt to get compensated through the common benefit doctrine therefore appears to be a misguided venture by an inexperienced funder, the likes of which will probably never happen again: "Litigation financiers do not need the common benefit doctrine to give them an incentive to finance litigation. They provide financing for the same reason that any lender loans money: to obtain a risk-adjusted return under the terms of a bargained-for agreement." *Id.* As such, *Judy* should not be viewed as any change in Delaware law as it relates to litigation funding.

If *Gbarabe* and *Judy* were not enough to give litigation funders pause, around this same time, courts in Pennsylvania and New York reminded us that the seemingly extinct and ancient doctrine of champerty was seemingly alive and well. In *WFIC v. Labarre*, 2016 WL 4769436 (Pa. Super. Sept. 13, 2016) and *Justinian Capital SPC v. WestLB AG*, 2016 N.Y. Slip Op. 07047, — N.E.3d — (Oct. 27, 2016), the respective courts found that the underlying agreements upon which each plaintiff was basing its claims were champertous, and accordingly dismissed plaintiffs' claims. But each case presented unique facts that often never arise in a typical litigation funding arrangement, which temper any potential reverberations.

Labarre involved an attorney bringing an unjust enrichment claim against litigation funders who helped finance his former client's case. After the underlying case was resolved, certain funders were paid back their investments by the former client, but the attorney, who had been previously discharged by the former client, was paid nothing. The court found the fee agreement between the attorney and former client champertous because it explicitly required that the litigation funders would be paid out of the attorney's contingency fee, rather than directly by the former client, which amounted to fee-splitting. *Id.* at *5.

In the unusual facts of *Justinian Capital*, German bank Deutsche Pfandbriefbank AG (DPAG) suffered a significant investment loss by purchasing notes managed and sponsored by a government-owned German bank WestLB. DPAG sought to sue WestLB to recover its losses, but because DPAG received significant support from the German government, and because the German government partially owned WestLB, DPAG feared that a direct lawsuit would lead to further negative repercussions for the company. To avoid this, DPAG assigned the devalued notes through a non-binding purchase agreement to Justinian Capital, a shell company based in the Cayman Islands, and Justinian brought DPAG's claims against WestLB. Identifying the obvious, that the notes changed hands for the "sole purpose of bringing litigation," the court found the acquisition to be champertous pursuant to New York's Judiciary Law §489 (concerning purchasing or taking assignments of bonds or promissory notes) and dismissed Justinian Capital's claims. *Id.* at *4.

As we **previously** noted, there are many lessons to be learned from *Labarre*, and the same goes for *Justinian Capital*. But the main takeaway is that parties should not shy away from pursuing litigation funding, even in the few states where champerty remains a defense, so long as they are acting in good faith and partnering with experienced litigation funders who can steer them away from these potential legal pitfalls. As *Labarre* teaches, parties to a litigation funding agreement should ensure that the contract is governed by the law of a state, such as California, where a champerty defense does not exist. Even courts in Pennsylvania have **recently** upheld such choice of law provisions to reject a champerty defense. And like *Judy*, *Justinian Capital* should serve as a stark reminder that litigation funding arrangements should not be utilized to "hide the ball" from the courts. On the contrary, they should serve the sole purpose of allowing harmed claimants to advance their meritorious claims when they otherwise could not. Accordingly, claimants looking to utilize litigation funding should be the real parties in interest, and should always enter into a formal funding agreement to protect both themselves and the funder from any potential negative consequences as the case progresses.

If this advice is heeded, 2017 should be much less eventful on the litigation funding legal decision front.

John Harabedian *is legal counsel in the Los Angeles office of litigation funding firm Bentham IMF, where he conducts due diligence on potential investments and provides legal advice to Bentham. He is a former prosecutor in the Los Angeles County District Attorney's Office and prior to that, he represented both plaintiffs and defendants in commercial and securities litigation in private practice at an AmLaw100 firm.*