Bloomberg BNA

ABA/BNA
Lawyers' Manual on Professional Conduct™

Litigation Funding

Litigation Funding on Rise In Big Civil Cases, Panel Says

Third-party litigation funding is on the upswing, particularly in big civil cases. Law firms or their clients can arrange for millions of dollars in funding for legal fees and expenses to help weather litigation that could be protracted but ultimately produces large recoveries.

However, most lawyers haven't yet used litigation funding, so they're wondering about its legality and propriety, and how the funding process works.

Also, insurance companies are concerned that defense costs may go up and cases may be harder to settle when funders are secretly injecting money into large cases and might be pulling the strings.

These issues were front and center March 2 during the 16th Annual Legal Malpractice and Risk Management Conference, as an insurance company manager and a litigation funding executive squared off during a panel discussion on ''Winning the Arms Race in Big Civil Cases—the Upside and Downside of Litigation Finance.''

The attendees—mostly defense lawyers and insurance industry representatives—got an inside look at how cases get funded at one of the major players in the field, and what the insurance industry thinks about third party litigation financing.

Also, a lawyer who has represented law firms in litigation funding summarized its current legal status.

Growing in United States. In a poll during the session, only about one third (35 percent) of the attendees said they'd been involved in a case where the plaintiff received third party funding.

That number may be going up. The percentage of U.S. lawyers who say their firm used litigation finance grew from 7 percent in 2013 to 11 percent in 2014, and then to 28 percent in 2015, according to a report from legal financing firm Burford Capital.

Panel moderator J. Richard Supple Jr. noted that litigation financing is well established outside the United States. There's a mature market in the United Kingdom, Australia, and South Africa, and slightly less mature markets in several other European countries, he said.

Supple is a partner in Hinshaw and Culbertson LLP's New York office and represents lawyers in litigation matters, including funding agreements.

Gawker Case Isn't Typical. Litigation finance became cocktail-party chatter last year when news broke that Silicon Valley tech entrepreneur Peter Thiel was bankrolling former professional wrestler Hulk Hogan's sex-tape lawsuit against Gawker Media as revenge for a Gawker article about Thiel.

However, the largest financers—the publicly traded Bentham and Burford—tend to focus on large commercial cases with the hope of big returns, Supple noted.

Supple said that some major players have left the market, underscoring that it's a risky business. On the other hand, well-established entities from overseas are coming into the U.S. market, as are hedge funds, he said.

Moreover, crowdfunding is now being used to finance cases. Supple mentioned TrialFunder, which uses proprietary computer models to let people invest modest amounts in lawsuits.

One Funder's Process. Bentham focuses exclusively on large investments in the commercial litigation market rather than funding in the consumer market, and it doesn't fund individual class actions or malpractice cases against attorneys, according to panelist James A. Batson.

Batson is investment manager and legal counsel in Bentham IMF's New York office. He represented the plaintiff in *Zubulake v. UBS Warburg*, a case widely regarded as redefining parties' e-discovery obligations in litigation.

Inquiries about litigation funding typically come from lawyers who are trying to work out an alternative fee arrangement with their client, Batson said. He noted there's often a disconnect between a law firm's willingness to take on risk in litigation versus the client's appetite for risk.

Batson said he initially wants to hear only basic information, such as the particular court, the potential damages, and the law firm's budget, with no disclosure of client information. We'll send out a nondisclosure agreement right away if we're interested, he said.

In the next stage Bentham gets additional information, including the identity of the lawyers and parties. If we like the case after an initial look, we prepare a term sheet that's nonbinding but provides an exclusivity period, Batson said.

Batson said that during the due diligence period, he prepares a detailed funding agreement and makes a presentation to an investment committee. If it approves the funding, then Bentham's role becomes one of monitoring, he said.

Two Types of Arrangements. Batson said all of Bentham's litigation financing is nonrecourse funding in which any return comes solely from proceeds in the case. He described two different types of funding arrangements.

One involves funding to the client in a single case. In a classic scenario, Bentham will pay 50 percent of the client's legal fees in exchange for 20 percent of any recovery. The law firm agrees to defer the other 50 percent of its fees in exchange for also receiving a 20 percent interest in the recovery. Thus, the client pays only the out-of-pocket costs and retains 60 percent of any recovery.

Batson noted that variations are possible if the client won't bear the out-of-pocket expenses or the law firm wants funding for a higher percentage of its fees. In some cases Bentham might pay the expenses or a larger share of the fees in exchange for a higher share of the recovery. But it's more difficult to get approval for that type of arrangement, Batson said. ''We like the client to have skin in the game,'' he said.

A second approach is portfolio funding, in which Bentham provides a law firm with capital against a basket of at least three cases that the firm has taken on a contingent fee basis. If one case isn't successful, Bentham's payment comes from the next case. The obligation is nonrecourse in the event all of the cases are unsuccessful or don't generate enough, Batson said.

Batson said this arrangement doesn't violate the prohibition in Rule 5.4 against sharing fees with nonlawyers because Bentham isn't taking a percentage of the law firm's contingent fee. Portfolio funding is analogous to getting a bank line of credit that's secured by contingent recoveries, he said.

Question of Control. ''We make definitively clear that we exercise no control over the litigation,'' Batson said.

He said Bentham can't dictate whether certain motions are filed, who the client's counsel is, or whether the client accepts a settlement offer.

''In my opinion, our role is less than the insurance company's role often is in the litigation,'' Batson said. The rights of the insurer to influence how the case is litigated in some instances are greater than the rights that we have, he said.

Batson said there are certain requirements for keeping Bentham informed and for what happens if the client changes counsel midstream. Bentham can't stop the client from changing counsel but can stop funding if it objects to the change, he said.

The agreement contains exit clauses that allow Bentham to get out if, for example, the litigation is no longer economically viable, Batson said. But then we're no longer longer entitled to our return, although we may recover our investment, he said.

That's a worst-case scenario for us, because our motivation is to achieve a positive recovery and get our return, Batson said.

Insurer Sees 'Potential for Abuse.' Sharing an insurer's perspective, panelist Matthew F. Probolus said litigation funding carries the ''potential for abuse.'' He's the E&O Portfolio Manager at Travelers Bond & Specialty Insurance in Hartford, Conn.

Insurers are concerned about whether there may be more frivolous cases and higher litigation costs, how much influence outside forces will have, how the funding arrangement will affect the decision to settle or try the case, and who has control of the litigation, Probolus said.

''This is an unregulated industry right now,'' Probolus said.

Batson pointed out, however, that Bentham is an established business and a public company.

He also said that ''if I start funding frivolous cases, I'll lose my job.'' Bentham actually passes on lots of cases, he said.

The availability of funding helps level the playing field, allowing good cases to go forward they otherwise couldn't, Batson said.

Who's Behind the Curtain? Three quarters of the attendees (75 percent) said the plaintiff should be required to disclose that it's receiving litigation funding. However, only one-fourth (25 percent) said the information shared with the funder should be subject to discovery.

Probolus said insurers want disclosure of litigation funding so they'll know who's behind the curtain. We want to see who's on the other side of the case and who else is involved, he said.

''The unknown for the insurance marketplace is a scary thing,'' he said. ''It's an issue of transparency to let everyone know who's at the table,'' Probolus said.

The U.S. Chamber of Commerce is asking for clear disclosure, and judges want to know too, he said.

Probolus noted that draft revisions to Federal Rule of Civil Procedure 26(a) would require this disclosure, as would the proposed Fairness in Class Action Litigation Act of 2017 (H.R. 985).

Prospect of Ancillary Litigation. The U.S. District Court for the Northern District of California recently adopted a rule that requires disclosure of litigation funding in class actions, Batson noted.

He said Bentham opposed a broader version that would have required disclosure in all civil cases because it could lead to ancillary litigation about what should and shouldn't be produced.

If funding has to be disclosed, then all of a sudden we get subpoenas, the client has to deal with it, we have to fight it, and maybe we get deposed, Bentham said.

Batson pointed out that that if laws or rules require all litigation funding to be disclosed, then the defendant will know which plaintiffs don't have litigation funding. That knowledge would give defendants a tactical advantage in cases where plaintiffs aren't being funded, he said.

But there are some cases when our clients want to disclose that they have litigation funding, because that can sometimes help produce settlement, Batson said.

On the other side, most law firms that are facing a plaintiff with litigation funding will want to try to get discovery about information shared with the funder or with other funders, he said.

Confidentiality Issues. Supple said the attorney-client privilege generally won't cover materials shared with the lender, but the work product doctrine may apply—provided that the funder and the disclosing party have executed a nondisclosure confidentiality agreement.

He cited *Miller UK Ltd. v. Caterpillar, Inc.*, 2014 BL 2019, 17 F. Supp.3d 711 (N.D. Ill. 2014), as a helpful case that explains the reasons for the differing levels of protection.

   ISSN 0740-4050

Batson said Bentham follows that approach. ''We don't want anything covered by the attorney-client privilege,'' he said.

However, Bentham will look at information covered by the work product doctrine, Batson said. That protection generally remains when it's shared with others as long as reasonable steps are taken to keep it out of the adversary's hands, he noted.

Is It Even Permitted? In polling during the session, slightly more than three-quarters of of the attendees (77 percent) said litigation funding should be permitted.

Batson said that when a firm is thinking about litigation funding or talking with a funder, it needs to consider first and foremost whether it's in a jurisdiction that restricts or forbids litigation funding.

Litigation funding is restricted wholly or partly in 20 states, Batson said. He mentioned Ohio, which he said has a great statute that protects consumers by setting out 10 required steps, and Georgia, which has a ''terribly restrictive statute.''

Supple said that court opinions are starting to acknowledge potential public policy benefits of litigation funding. As an example, he pointed to *Lawsuit Funding LLC v. Lessoff*, No. 650757/2012, 2013 BL 343470 (N.Y. Sup. Ct. N.Y. Cty. Dec. 4, 2013), which said public policy favors litigation financing because it ''allows lawsuits to be decided on their merits, and not based on which party has deeper pockets.''

Supple also said courts generally don't believe a funder's security interest violates the prohibition in Rule 5.4 against sharing fees with nonlawyers. He cited *Counsel Fin. Servs., LLC v. Leibowitz*, 2013 BL 199584 (Tex. Ct. App. July 25, 2013), for that proposition.

He suggested an ABA report, *Informational Report on Alternative Litigation Finance*, as a resource for lawyers looking for additional information on legal and ethical issues: The ABA Commission on Ethics 20/20 prepared the report in 2012 in the course of considering updates to the ABA Model Rules.

Medieval Doctrines. The defenses of champerty and maintenance are unlikely to succeed in the absence of unusual facts showing that the funder has taken an assignment of the action or assumed control over it, Supple said.

As an example, he cited *Charge Injection Techs. v. E.I. Dupont De Nemours & Co.*, No. N07C-12-134-JRJ, 2016 BL 73231 (Del. Super. Ct. Mar. 9, 2016).

However, some states still enforce the champerty doctrine in a way litigation funders might not like, Supple said.

Champerty is investing in another person's litigation in exchange for part of the recovery, and maintenance is supporting a lawsuit brought by another person who has no valid right to be litigating it.

By Joan C. Rogers

To contact the reporter on this story: Joan C. Rogers in Washington at jrogers@bna.com

To contact the editor responsible for this story: S. Ethan Bowers at sbowers@bna.com