Practicing Law in the Era of 3rd-Party Litigation Funding

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When Benjamin Franklin said: “the only sure things in life are death and taxes” he probably never envisioned something like third-party litigation funding. If he had, he may have added “or a permanent business model.” The trend is for this phenomenon to increase significantly, as lawsuits become more expensive and as plaintiffs seek help in fighting large corporations defended by global law firms.

The advent and growth of third-party litigation funding has added a distinct variable to the world of civil litigation, and has and will continue to change the calculus for many corporations and their defense counsel as to the tipping point between settling or pursuing a case to a court decision.

Law firm clients on the defense side, even if they win, must absorb tremendous costs in defending their products, patents, business ideas and global contracts. Plaintiffs looking to win on cases, some that are "bet-the-house” litigations, are partnering with financial corporations and funding companies who see big returns on investments.

History

Third-party litigation funding is commonly defined as funding by an outside party of a plaintiff's litigation costs and personal expenses to sustain them in what can be, and often is, a long, drawn-out time period between the filing of a lawsuit and a decision or settlement. It is commonly used in large, class action law suits.

The U.S. Chamber Institute for Legal Reform (ILR) described it as “investing” in litigation, with companies including Burford Capital Ltd. and Juridica Capital Management as “hedge funds” that front money to plaintiff lawyers in hopes of a large settlement and a hefty share of any financial awards. It originated in Australia in the early 1990s, and grew in popularity; by the early 2000s it took hold in the United Kingdom and elsewhere in the European Union.

Positions

Third-party litigation funding proponents argue that the practice allows for a greater chance for justice for plaintiffs who generally do not have the deep pockets to retain effective counsel and sustain it over the life of a lawsuit.

From a public relations perspective, this seems appealing to many who see monolithic corporations and their high-priced counsel as bullies stepping on the throats of the people who don’t have the means to fight back. But is it really?

What about the companies that supply third-party litigation funding? Are they really in it mostly for magnanimous purposes, or are they purely profit-driven entities that see the funding as simply an investment with a huge upside, and view the merits of a case as secondary?

A December 2016 article at antitrustsource.com, “Emerging Issues in Third-Party Litigation Funding: What Antitrust Lawyers Need to Know,” points out the appeal of TPLF to the funding companies in antitrust actions. Among them are:

- The cases are handled by “experienced and high specialized legal teams”;

- The dollar level of the claims is “sufficiently high to attract third-party funding”;
- The financial viability of an action can be enhanced if the plaintiff firms file class actions and assemble groups of claimants where there are a large number of victims.

Indeed, a March 2017 article in The American Lawyer reported that New York and London-based Buford Capital has done very well as a TLPF company. The company scored record profits in 2016 of more than $163 million, a 75 percent increase from the previous year, and more than three times its earnings in 2012. Buford bought out its biggest competitor, Chicago-based Gretchen Keller, in December 2016.

The ILR has been a vocal critic of third-party funding and lists four main reasons why it opposes the practice.

- It can increase the volume of litigation as more funding leads to more litigation;
- It prolongs litigation by encouraging plaintiffs to reject reasonable settlements;
- It can undercut the plaintiff’s control of litigation as the funders' inherent self-interest in a large settlement compels them to take control of the legal strategy;
- It can create ethical conflicts, as third-party funders have “no ethical obligations to safeguard the interest of the claimants.” This could create a conflict for plaintiff’ lawyers between acting in the interest of their clients or in the interest of the funder financing the firm.

ILR president Lisa A. Rickard offered a compelling case in an article in The Recorder in January 2017. Rickard pointed out that third-party funders companies are “investors first and foremost,” who fund lawsuits on “the present value of their expected return.”

She goes on to point out that the merits of a case are secondary because the investment may be worthwhile even if the chances of a large return are small. Why? Because third-party funding companies can spread the risk of any one investment over a large portfolio of cases.

As Rickard wrote: “TPLF providers have higher risk appetites than most contingency-fee attorneys and will be more willing to back claims of questionable merit.”

This sounds eerily similar to the subprime loan crisis, which arose when questionable mortgage loans were packaged into mortgage-backed securities and collateralized debt obligations and sold on Wall Street. Investment firms calculated that a default of a few loans would be compensated by the success of the other loans in the package. History has shown that did not work out well.

As Rickard noted, and as we are all familiar with, the *Chevron v. Donziger* case was one of the most egregious examples of third-party litigation funding chicanery. In the book Law of the Jungle, senior Bloomberg Businessweek writer Paul Barrett outlines how a young, smart, idealistic, Harvard-educated lawyer, Steve Donziger, joined a team of plaintiffs attorneys suing Texaco on behalf of indigenous Indians in Ecuador who had suffered many ailments and deaths because of Texaco’s decades of oil drilling on their lands.

Chevron bought Texaco and the old wells, believing that they had purchased them free and clear without the liabilities, and refused to settle. Donziger decided to start a crusade and fight Chevron by himself. He generated a great deal of publicity, and got a plaintiffs litigation funding firm to give him millions to fight Chevron.

Burford Capital provided $4 million to finance the Lago Agrio environmental contamination lawsuit in Ecuador. The lawsuit was of questionable merit, but resulted in an $18 billion judgment in an Ecuadorian court (later reduced to $9.5 billion) against Chevron in 2011.

In March 2014, the U.S. District Court for the Southern District of New York ruled that the Ecuadorian judgement resulted from fraud and racketeering. Judge Kaplan found that Donziger and his team of plaintiffs lawyers, in complete disregard of the law, bribed a judge who had issued a judgment against Chevron.

In August 2016, the decision was unanimously affirmed by the United States Court of Appeals for the Second Circuit. Donziger was found to have violated the federal Racketeer Influenced and Corrupt Organizations Act, commonly known by its acronym RICO.

Forward Trends

The *Chevron v. Donziger* case and its aftermath are emblematic of what appears to be an increase in litigation as a consequence of third-party funding. It can be argued that this new paradigm in funding emboldens plaintiff attorneys and their firms to pursue questionable cases.

And why not? If the plaintiffs firms can fund their fees and expenses throughout their entire litigation portfolio with someone else's money, they will often push ahead where they may not have before.

This resembles the commercial real estate boom of the late 1980s and early 1990s, when developers went ahead with projects purely on speculation (without any tenants lined up) because they were fully funded with Japanese money. In the real estate world, this was known as not having any "skin in the game." You can draw an analogy to the nexus between TPLF companies and plaintiffs law firms.

There is empirical evidence this is happening, and not just in the U.S. As noted earlier, third-party litigation funding had its genesis in Australia. Although somewhat dated, the ILR cites a study done in Australia by NERA Economic Consulting titled "Trends in Australian Securities Class Action," covering 1993 to 2009 inclusively.

The study concluded that third-party litigation funding was a primary catalyst in the increase in securities class action suits in Australia over that period of time. It would not be farfetched to surmise that the increase in those suits has continued since 2009.

The question of transparency regarding the involvement of TPLF companies has come more to the forefront over the past year or so, as many judges have shown their displeasure over the lack of full disclosure of TPLF in cases that come before them.

Reuters reporter Alison Frankel wrote in a July 2016 blog post about a judge's ruling that Cigna could seek monetary damages in a long-running case involving a 1990s Liberian judgement. And in November 2015, the Colorado Supreme Court added a regulatory aspect to TPLF when it affirmed a decision (Oasis Legal Finance Group LLC v. Coffman) of the Colorado Court of Appeals that TPLF firms are subject to state lending regulations.

Most recently, there has been movement in the U.K. regarding disclosure of TPLF. In early June, the Royal Bank of Scotland “successfully obtained orders forcing claimants to disclose the identity of their funders,” according to an article in The Law Society Gazette. In addition, the British Parliament is apparently taking an interest in TPLF as a possible component of a review of legal aid in the U.K.

Lord Faulks, a conservative member of Parliament and former Minister of State for the Ministry of Justice, penned an op-ed published in early June in The Times of London titled “Litigation funders are a growing threat to our justice system.”

In his piece, Faulks states that “U.K. litigation funders have increased their global assets under management by more than 740 percent” since 2009. He calls for increased regulatory safeguards.

Third-party litigation funding is climbing in other parts of Europe as well, for a good reason. In a November 2016 article in the D&O Diary, attorney and author Kevin M. LaCroix points out that these countries, unlike the U.S., have a “loser pays” model that requires an “unsuccessful litigant to pay its own and its adversary’s fees and expenses.”

Therefore, TPLF means that plaintiff firms no longer fear taking on cases outside of the U.S. The Volkswagen case, where in which the company pled guilty earlier this year to selling diesel vehicles with software designed to cheat on U.S. emissions tests, is a perfect example.

Defendant Counsel Responses
Based on what has transpired over the past few years, the TPLF paradigm and its impact on litigation are not passing phenomena. TPLF is growing in the U.S. and abroad, especially in large civil cases, and shows no signs of abating. A poll taken at the 16th Annual Legal Malpractice and Risk Management Conference in March during one panel discussion found that 35 percent of the attendees said they had participated in a case where the plaintiff received third party funding.

That figure may not seem significant, but, according to an article by Bloomberg BNA writer Joan C. Rogers, a 2016 study by the aforementioned Burford Capital found that the percentage of U.S. lawyers saying that their firms used litigation finance grew from “seven percent in 2013 to 11 percent in 2014 and to 28 percent in 2015.” That increase over a multi-year period is significant.

What should be the strategy for law firms defending companies in class action suits? Whether through their own experience or through some sophisticated financial analysis algorithms, they will have to figure out at what point and at what cost their clients choose whether to pursue a defense or seek a settlement.

Defense counsel and their corporate clients should pay heed to the words of the old Kenny Rogers song “The Gambler.” “Know when to hold ‘em; and know when to fold ‘em; know when to walk away; and know when to run.”

Summation
As a result of the rise of TPLF, defense counsel is at a crossroads when it comes to formulating its strategy and deciding where the tipping point is between settling a class action suit and pursuing it to a trial conclusion. The situation is even more complicated because laws regarding TPLF vary by state. The rise of international class action lawsuits subject to the laws of the countries where the suits are filed complicate matters further.

Yet another challenge is that, despite decisions such as that of the Colorado Supreme Court in 2015, transparency is still wanting in TPLF. The Volkswagen case alluded to earlier is emblematic.

Kit Chellel points out in an excellent article in Bloomberg Markets how, after the news broke of the emissions test cheating, CalPERS, which had a large position in Volkswagen stock, was able to join in the class action suit against Volkswagen because of TPLF. In this case, funding was provided by Elliott Management, a $28 billion hedge fund based in New York.

The ILR's website section covering TPLF is a wonderful source for looking at the latest trends at home and abroad. There are no easy answers or silver bullets that will solve this problem. But in dealing with this issue defense counsel should at least do the following:

- Find out at the very beginning of litigation whether or not a plaintiff is backed by TPLF;
- Analyze the merits of a plaintiff's case at the outset and advise the client openly, and honestly, as to the chances of winning the case and at what point to settle.

I close this assessment as I opened, with a quote from Benjamin Franklin. At the signing of the Declaration of Independence, he advised his fellow signers of the need to stay united, and was purported to have said the following: "We must all hang together or most assuredly we will all hang separately." That's good advice for defense counsel who face the growth of third-party litigation funding.

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