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OTHER PEOPLE'S Money

THE RISE OF LITIGATION FINANCE COMPANIES RAISES LEGAL AND ETHICAL CONCERNS

By Mary Ellen Egan

Quarterly earnings calls can be stressful—especially if a business has bad or underwhelming news to disclose. Between upset shareholders and skeptical reporters firing off questions and scrutinizing numbers, CEOs would be forgiven if they conducted this four-times-per-year ritual with a full bottle of scotch next to their speakerphone.

Burford Capital, however, has had no need for such feelings of dread.

Its earnings calls, as of late, seem to contain nothing but good news. Founded in 2009 by Christopher Bogart, a former litigation associate at Cravath, Swaine & Moore and former general counsel at Time Warner Inc.; and Jonathan Molot, a former lawyer at Cleary Gottlieb Steen & Hamilton and a senior adviser in the Department of Treasury at the start of the Obama administration, the litigation financing company has become the largest such firm in the world.

Burford, which has been traded on the London Stock Exchange since its inception, currently has $3.3 billion in its coffers to invest in legal matters. In the first half of 2018, the company reported that income was at $205.2 million, a 17 percent increase compared to the first half of 2017. Meanwhile, the company has expanded, buying up Gerchen Keller, a Chicago-based litigation finance firm, for $160 million in 2016.

Gerchen Keller founders Adam Gerchen, Ashley Keller and Travis Lenker, who have since founded a plaintiffs-side litigation firm, declined to be interviewed.

In an October Burford study, the company surveyed 495 lawyers, general counsel and partners in the United States, the U.K. and Australia and found that more than three-quarters of them believe that litigation finance is a growing and important part of the business of law. The study also found that 70 percent of those who had not used it before are likely to in the next two years, while 42 percent of law firms surveyed see litigation finance as a way of remaining competitive in the marketplace.

"We have a suite of ways that we help law firms and the corporate clients of law firms," says David Perla, managing director at Burford who joined in May after eight years of being in charge of legal outsourcing providers Pangea3 and two years as president of Bloomberg BNA's Legal Division/Bloomberg Law. "For firms, it's a business development tool. They'll ask us to educate their clients about the benefits of applying for capital to monetize their existing legal assets."

Burford Capital founders Jonathan Molot (left) and Christopher Bogart

At its essence, litigation financing is third-party funding of legal cases. Legal financing companies provide a nonrecourse cash advance to litigants—usually plaintiffs—in exchange for a percentage of the judgment or settlement. It is not considered a loan but rather a form of asset purchase or venture capital. If, for example, the financier invests $200,000 and the case settles for 10 times that,

PHOTOS BY SHUTTERSTOCK; FRED R. CONRAD/THE NEW YORK TIMES/REDUX

the finance firm gets back its initial $200,000, as well as a percentage—anywhere between 10 and 30 percent—of the settlement money. If a plaintiff loses, the financing firm does not get paid.

Proponents of litigation funding say it levels the litigation playing field, benefits companies and firms by allowing them to free up capital for core business purposes, and reduces the risks for firms and their clients to settle for less than what their cases are worth.

Critics, on the other hand, contend that litigation funding disrupts the legal process by bringing in an outside party that can potentially exert control, encourages the filing of frivolous suits, and gives plaintiffs attorneys an unfair advantage in settlement talks.

"There's been an increasing demand for litigation funding by both firms and clients in the last couple of years," says Eric Robinson, a shareholder at Stevens & Lee in its New York City office and co-chair of the firm's litigation finance and alternative funding group. "Some firms don't want to risk the contingency fee model, but that may change if a client is willing to consider a litigation funder."

KEEP THE CASH FLOWING

Litigation funding started in Australia and the United Kingdom in the mid-1990s and entered the U.S. commercial market in the mid-2000s. It is now a multibillion-dollar global industry with a dozen commercial litigation funding companies in the U.S. market.

Financing is conducted on a single-case basis or on a portfolio of suits.

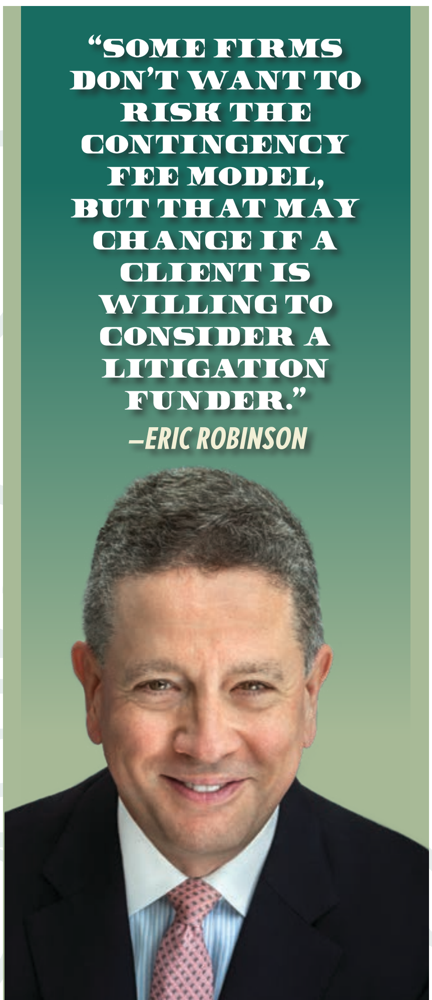

PHOTO COURTESY OF BURFORD CAPITAL; PHOTO BY FRANK VERONSKY PHOTOGRAPHY

Portfolio financing provides law firms with a large chunk of money in exchange for returns tied to a pool of cases.

Litigation financing is used for a variety of purposes. For individual plaintiffs, particularly those involved in personal injury lawsuits, the money can come in the form of cash advances to pay for such things as medical expenses or attorney fees. Advances tend to run between $2,500 and $7,500.

Meanwhile, for law firms and companies, it can be used for litigation or arbitration costs such as attorney fees, expert witness and court fees, or as working capital to cover such costs as salaries, rents and other business expenses. For individuals and companies, the money also can be used to provide cash flow during the period after a judgment has been issued and before the settlement or verdict money has come in.

That cash flow can be a lifeline—especially for law firms, allowing them greater flexibility with their caseloads. "A good piece of strong litigation is an asset; it can pay for itself or other costs," says Allison Chock, the Los Angeles-based chief investment officer at Bentham IMF, which provides litigation finance to plaintiffs and law firms in the United States and for international arbitration.

Chock says litigation finance can allow clients to hire counsels who don't normally take cases on a contingency basis. And it also enables firms to take on more contingency or hybrid fee cases than they ordinarily would because the firm is not carrying 100 percent of the risk throughout the case. "At a high-end contingency firm, you can only do a certain number at a time; otherwise the expense could bankrupt your firm," she says.

Founded in 2001 in Australia, Bentham is the second-largest litigation funding company in the world, with $200 million dedicated to funding U.S. matters and another $106 million for legal funding in other jurisdictions around the world. The company entered the U.S. market in 2011 and currently has U.S. offices in New York, Los Angeles, San Francisco and Houston.

"Our company is made up of almost exclusively lawyers, including even some of our marketing personnel. Our CMO is a former litigator, as is our marketing manager in LA," says Chock, a former litigation associate at Latham & Watkins and partner at litigation-only boutique firm Hennigan, Bennett & Dorman, which later merged with McKool Smith. "When a case comes in, we will do our due diligence—collection risks, how solid is the case, etc., and then based on our evaluation, we will decide what terms will be offered."

Chock says Bentham does mostly single-case financing. "We've worked hand in hand with contingency lawyers and more traditional hourly firms that want to do more of these types of cases," she says.

In the majority of instances, however, firms are coming to them on behalf of their clients. "There's been an uptick in interest from big law firms in the last two years," she says. "They wouldn't have done this five years ago, but clients are now demanding this. They want law firms to take on some of the risk." She says Bentham's largest, single-case investment so far is a $40 million advance on a trade secrets and breach of contract judgment that's currently on appeal.

Perla of Burford, meanwhile, compares his company to a financial institution. "Burford is a public balance sheet, much like an investment bank," Perla says. "Everything we do is nonrecourse, and we only make money if the client is successful."

According to him, the firm applies a forensic level of due diligence on a case-by-case basis to vet the legal validity of each case and the likelihood that the suit will be successful. Perla says of the 1,500 inbound requests for capital in 2017, the firm only funded 60 requests.

WHO'S THE BOSS?

Critics, however, have argued that litigation funding is rife with ethical conflicts and potentially illegal behavior. One of the oft-cited concerns about litigation funding is that it will create a deluge of frivolous lawsuits.

The U.S. Chamber of Commerce has been particularly vocal on this front, fearing that businesses will be awash in specious lawsuits and/or forced to settle frivolous suits to avoid having to pay to litigate them. On its Institute for Legal Reform website, the chamber argues that "more litigation funding means more litigation," and that funding "can undercut a plaintiff's control of litigation."

"CLIENTS ARE NOW DEMANDING THIS. THEY WANT LAW FIRMS TO TAKE ON SOME OF THE RISK."

—ALLISON CHOCK

PHOTO COURTESY OF BENTHAM IMF

"The people who rail against us, the ones that say we are gambling or drumming up business, overlook the fact that we only take on cases we can win," Perla says. "Because of the way that we carefully vet cases on either a single-case or portfolio basis, we are actually creating efficiency in the [legal] system."

Robinson, who advises Stevens & Lee's clients about the benefits and potential pitfalls of litigation financing, concurs. "The big funders are sophisticated and vet claims carefully. As a result, they weed out the weak claims that shouldn't be brought. In that sense, they're having a positive effect on the market," he says.

Meanwhile, in February 2017, the Consumer Financial Protection Bureau and the New York attorney general sued RD Legal, one of the largest consumer litigation financing firms, over allegations that it scammed 9/11 first responders and NFL concussion victims out of millions of dollars by luring them into costly settlement payouts while disguising the terms of the advance agreements.

In its court papers, RD Legal has claimed that the structure of the CFPB is unconstitutional while maintaining that it has done nothing wrong. "Far from engaging in the 'deceptive and abusive' practices alleged in this lawsuit, the RD entities provide customers the information necessary to make informed decisions about whether to sell their settlement proceeds," RD Legal said in its motion to dismiss. "The RD entities even encourage customers—in bold type in every contract, above the signature line—to consult with an attorney and other professionals who can assist in

Pablo Fajardo (left), a lawyer representing the Ecuadorean indigenous communities suing U.S. oil giant Chevron for billions of dollars in damages for pollution, speaks during a press conference in Quito on Sept. 20, 2017. Fajardo said they had decided to withdraw legal action brought in Brazil.

RODRIGO BUENDIA/AFP/GETTY IMAGES

determining if the transaction fulfills the customers' financial needs."

In June, the U.S. District Court for the Southern District of New York agreed with RD Legal as to the unconstitutionality of the CFPB and dismissed the claims brought by that bureau. However, it upheld the claims brought by the New York attorney general and allowed those to proceed.

Meanwhile, in March, the *New York Time*s reported that federal prosecutors are looking into consumer litigation financing firms for, among other things, high interest rates. According to the *Times*, prosecutors are looking into whether the financial arrangements between cash-advance firms and lawyers constituted illegal kickbacks.

John Beisner, the Washington, D.C.-based leader of Skadden, Arps, Slate, Meagher & Flom's mass torts, insurance and consumer litigation group, says litigation financing firms might not file a single meritless suit. But portfolio financing could allow some flawed suits to make it into the courts.

"Back in the day, funders said, 'We'd be crazy to invest in a frivolous lawsuit.' And I said that they could spread risk on a portfolio basis. If you're a plaintiffs lawyer, why not spread risk around cases? If one or two ships come in, you've covered all of your bases," says Beisner, who represents the U.S. Chamber of Commerce. But he adds that the opinions stated in this piece are his own.

One of the biggest tension points between proponents and critics of litigation financing is the potential for interference by the third-party funder, either by dictating legal strategy or pressuring attorneys over settlement amounts.

"Funders say, 'We don't have any control,' but some get to pick the counsel, and most get notified about settlement offers," Beisner says. "They are certainly exercising influence."

Critics such as Beisner point to Burford Capital's involvement in the long-running Chevron case. The Chevron Corp. was being sued by a group of Ecuadorean villagers who claimed that the oil giant polluted their land.

In a civil RICO case against Steven Donziger, the lawyer for the villagers, court documents revealed that Burford, in a confidential presentation to the plaintiffs, was concerned about an "unnaturally low" settlement and asked them not to settle for less than $900 million without Burford's consent. And if plaintiffs settled for less than that, Burford wanted to be compensated for $900 million anyway.

That presentation, however, predated the actual agreement signed by the plaintiffs attorneys including Patton Boggs (now Squire Patton Boggs) and Donziger, who stipulated that if they settled for less than $1 billion, Burford would be compensated as if the settlement was $1 billion. Additionally, if Burford invested $15 million, it would receive 5.5 percent of any recovery.

Burford ultimately invested just $4 million and later sold its stake. In February 2011, the plaintiffs were awarded $18.2 billion from Ecuador courts. However, the company refused to pay, accusing plaintiffs and their lawyers of engaging in fraud. Burford also accused Donziger and others of fraudulent inducement and terminated its relationship with the plaintiffs in September 2011.

Burford released a joint statement with Chevron in April 2013 renouncing any claims to the litigation. U.S. courts have ruled for Chevron, rejecting attempts by the Ecuadorean plaintiffs to collect the judgment. Donziger, meanwhile, has been suspended from the practice of law in Washington, D.C., and New York.

"That's the problem [with litigation funding]—the settlement isn't dictated by the strength or weakness of the case, but by the investors," Beisner says.

"When we invest, we have no control over strategy or settlement," says Perla of Burford. "The only influence we have, in terms of settlement, is when we decide to invest and the return we have on it."

Chock of Bentham also says claims about undue influence on the part of funders are completely unfounded. "In the U.S., that's not the case. The client and firm are in control, and no reputable funder would try to influence strategy," she says.

In regard to settlement matters, Chock says in single cases, funders have the right to be informed of any settlement discussion, but "the client is ultimately in control." In fact, she says if they had been allowed to offer legal advice, in some instances, the plaintiffs would have won larger settlements. "We've had situations that if they had followed our advice, they would have done much better," she says.

Lisa Miller, principal at the Lex Law Corp. and a civil litigator in California and New York who consults on ethics and third-party funder issues, says when it comes to issues of funding and control, lawyers have to set clear guidelines from the get-go about independence of thought and action. "Attorneys are going to be wading into a Wild West," she says. "And they need to make sure the ethics wall is firmly in place."

MATTER OF DISCLOSURE

One of the hotly debated topics around litigation funding is the question of disclosure: Should plaintiffs be compelled to reveal that their work is being underwritten, in part, by a third party?

Those in favor of disclosure point out that under the Federal Rules of Civil Procedure, defendants are required to disclose information about their insurance coverage at the outset of their case.

"Defendants are saying, 'Look, federal judges require that all insurance contacts should be revealed—how much money there is, how much money they can spend on litigation, etc. This is totally one-sided. Why shouldn't outside funding be revealed, as well?' " Beisner says.

Not surprisingly, funders oppose forced disclosure. "Opponents want to analogize it to liability insurance, but this is not the same thing," Chock says. She says disclosure of litigation funding prejudices claimants and will result in costly "discovery sideshows" that unnecessarily burden claimants and courts in a way that rarely arises in insurance coverage disclosures.

To Chock, the whole thing smacks of a fishing expedition. "Disclosure is the first step," Chock says. "What defendants are truly after is a discovery sideshow, targeting the financial wherewithal of the claimant, and worse, trying to learn of weaknesses in the claims that may have been identified by the funding professionals. I used to be a defense lawyer, so I'd want to know that stuff, too. But why is that fair?"

"THE WHOLE IDEA OF THE ARRANGEMENT IS A CONCERN BECAUSE OF THE ETHICS RULE THAT SAYS THAT AN ATTORNEY CAN'T SHARE THEIR FEES WITH A NONATTORNEY."

—JOHN BEISNER

PHOTO COURTESY OF SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP

Regardless, forced disclosure about litigation financing may be around the corner. In April, Wisconsin passed a bill requiring disclosure for all litigation funding arrangements—consumer and commercial. It was the first state to pass such a law.

And in May, three Republican U.S. senators introduced the Litigation Funding Transparency Act of 2018. The bill seeks to mandate disclosure of the existence of litigation funding agreements and details of the agreements in any federal class action or multidistrict litigation case.

Critics such as Beisner say the unique structures of class actions and MDLs mandate disclosure. "When litigation funding started, we all thought class action funding would never happen. The attorneys can't agree to give you money—the class members would have to agree," he says.

The way funders get around this, he says, is the attorney in a class action agrees to give up a part of their contingency fee to litigate that matter. "The whole idea of the arrangement is a concern because of the ethics rule that says that an attorney can't share their fees with a nonattorney," he says.

While Chock says she is "vehemently opposed" to mandated disclosure, she says it might make sense for certain class actions and MDLs, depending on how they're handled. She points to the way Judge Dan Polster of the U.S. District Court for the Northern District of Ohio handled litigation funding disclosure in the multidistrict opioid litigation.

Polster ordered the litigants to reveal their litigation financing agreements to the court—not to opposing parties. He also required that counsel and the funder sign statements that funding wouldn't give the lender any influence over litigation strategy or settlement decisions, or undermine counsel's independence.

THE ROAD AHEAD

While certain aspects of litigation funding might continue to be debated and contested, funders think their future is bright.

"I think we've just scratched the surface," Perla says. According to him, Burford is moving into providing business solutions for law firms, as well as exploring the private equity model to provide firms alternative solutions to the cash partnership problem.

For example, a law firm might spin off its administrative back office and other nonlawyer-related tasks as a separate business structure owned by the partners. Then the law firm would pay the operations entity for its work on behalf of the firm. The spin-off service would be a source of permanent equity for the partners.

Stevens & Lee shareholder Robinson says he's seeing increased demand in the intellectual property space. "A patent owner might have a meritorious claim—they can prove patent infringement—but might not have the resources to explore a suit.

Bringing in a funder can help in these kinds of cases," Robinson says.

He also predicts the litigation funding model will empower clients in fee negotiations. "I think it has the potential to be transformative," Robinson says. "It could, particularly for sophisticated business litigants, offer another route to negotiate price with their lawyers."

Clients could conceivably negotiate a percentage of a fee upfront and risk the difference based on the result, he says. Adding litigation financing as an alternative to billable hours could "eventually let a client that's frustrated with the risks it takes in an hourly engagement have a solid idea about acceptable price on the front side, along with the risk that its lawyer might share with it," he adds.

Robinson and others predict that demand for litigation financing—particularly on the part of clients—will continue to grow. "It's exciting for them because it keeps capital in their pockets," he says. "It also can allow a litigant to engage a lawyer that might be priced beyond its usual budget and give the lawyer more freedom to prove the client's claims."

The rise of artificial intelligence has led to additional opportunities for litigation financing firms. LexShares, a litigation funding firm founded in 2014 with offices in Boston and New York City, has developed a proprietary platform that scours federal and some state court filings for potential investment leads.

Called "Diamond Mine," the technology searches dockets for keywords such as "breach of contract." It downloads cases, converts them into raw text and then applies a 17-point scoring system to determine a baseline of investment opportunity.

If a case looks promising, the company reaches out to litigants to gauge their interest in financing. If they're interested, LexShares attorneys assess the claim's validity and determine whether it's a good candidate for financing. The majority of LexShares' investments are about $1 million.

According to the company, in the first half of 2018, Diamond Mine identified 436 cases that led to litigants seeking financing of more than $540 million, but the firm only invested in 20 of the 436.

San Francisco-based Legalist is another litigation financing company using technology to find potential clients. It was founded in 2016 by two Harvard University dropouts who developed an analytics tool that constantly monitored courts and livestreamed the data. "It made the data readable to lawyers, so we thought they would pay us for the data to help better assess their own cases," says co-founder Eva Shang.

While the technology didn't take hold with lawyers, it earned Shang and her co-founder, Christian Haigh, a spot in the vaunted incubator startup Y Combinator, where the duo first learned about litigation financing.

Today, the duo's algorithm uses court documents to make underwriting decisions by looking at data points, such as the time it takes similar cases to be resolved and how many cases in a specific jurisdiction settle. Once a case has been identified and a litigant has agreed to pursue financing, the sole Legalist attorney vets the case. As of press time, Legalist says it's vetting additonal lawyers to join the company.

"We're a technology company that wants to fight the injustices of the legal system," Shang says. "We fund commercial cases in the lower range—the real David vs. Goliath cases, not the Goliath vs. Goliath ones."

Ultimately, Miller of the Lex Law Corp. urges clients and law firms to educate themselves about the benefits and potential problems with legal funding. "I don't think [litigation funding] is a bad thing; it's just not well understood," she says. "In litigation, the last thing you want is more trouble. It's already expensive and exhausting." ■

"WE FUND COMMER-CIAL CASES IN THE LOWER RANGE—THE REAL DAVID VS. GOLIATH CASES, NOT THE GOLIATH VS. GOLIATH ONES."

—EVA SHANG

PHOTO COURTESY OF LEGALIST