Connecticut Debate Association

January 12, 2019

Guilford High School, Warde High School and Wilton High School

Resolved: Third parties should not be permitted to invest in lawsuits.

Note: This packet is intentionally shorter than usual, 6 pages rather than 10.

The Ethics of Investing in Another's Lawsuit

The New York Times, Room for Debate, May 27, 2016

The disclosure that Peter Thiel, co-founder of PayPal, spent about $10 million to help the wrestler Hulk Hogan sue Gawker Media apparently because a Gawker blog outed him as gay years ago revealed for many the lucrative practice of investors paying for litigation in which they are not involved.

While Thiel's motives were not profit driven, most investors seek a cut of any final judgment or settlement. Should third parties be allowed to invest in lawsuits or does that unduly influence them?

This Is Casino Litigation, Where We All Lose

Lisa A. Rickard, president of the United States Chamber of Commerce Institute for Legal Reform.

Thanks to Hulk Hogan and the Silicon Valley billionaire Peter Thiel, Americans are learning about the growing trend of investing in other peoples' lawsuits.

The case sheds light on this fast-growing industry of hedge funds, lawyers and other profiteers investing in third-party litigation financing. Even if Thiel may not be making any financial gain from Hogan's suit against Gawker, the financiers who pay the costs of litigation in third-party cases, do so in return for a percentage of a judgment or settlement.

This practice is a cancerous growth on our civil justice system, turning our courts into profit centers, increasing the number of lawsuits in our already over-sued society, shifting control of lawsuit decisions toward funders rather than litigants, and reducing settlement dollars for truly deserving victims. And all of this is occurring out of view of the public, the courts and the regulators.

Thiel's financing of the Gawker case was disclosed after the fact, but there is no obligation in any court to make known the presence of third-party funding. This matters, because outside financing can have a major influence on the case itself. Should a defendant fight in court or settle, and if so for how much? And might these decisions be made with the funder's bottom line in mind, rather than what is right for the litigants?

And the court's awareness of funding in a case can impact the outcome. Will a jury's decision -- or its determined damages -- be different knowing a chunk of the award goes to a third party? Would a judge handle a case differently, if he or she were aware of a funder with ample cash behind the scenes?

Litigation funders claim they only invest in legitimate lawsuits, but the reality is they'll invest in many cases because virtually all settle. Therefore, they can take unmeritorious cases and spread the risk across a broad portfolio of litigation.

There's no question that third party litigation financing offers big financial returns from other peoples' lawsuits. But should we really be turning our courts into casinos?

Third-Party Litigation Finance Promotes Justice and Deters Wrongdoing

Anthony Sebok, is a professor of law at Benjamin N. Cardozo Law School. He also advises Burford, a litigation investment company, on ethics issues.

The main reason to permit third-party funding of litigation is that there is no reason, other than irrational prejudice, to prohibit it, and the state should only prohibit conduct if it has a rational basis for doing so. Another reason to permit third-party funding of litigation is that it may occasionally help promote justice, or deter future wrongdoing, or bring needed compensation to deserving victims.

Clearly, third-party litigation funding sometimes promotes justice. NAACP v. Button (1961) is remembered today as a major civil rights case that stopped Virginia from preventing civil rights groups from helping local victims of racial discrimination, but it was also, technically, about third-party litigation funding, since the law the Supreme Court struck down was a law against anyone paying another person's legal expenses if they were "not a party and in which it had no pecuniary right or liability." This law – prohibiting what is known as "maintenance" and "champerty" had been applied selectively against civil rights groups and was struck down by the Supreme Court where it interfered with political speech.

Third-party litigation finance has helped Miller UK, a family-owned business that laid off 300 of its 400 employees when Caterpillar pulled out of a contract after it used its relationship to learn the secrets of the Miller product design. Miller proved its allegation and received $74 million in damages from a jury in Illinois – and could only have done so because of third-party litigation financing. Indeed, this type of financing has helped countless small personal injury litigants outlast the delaying tactics of insurance company lawyers and secure more of the compensation that they were due.

But I don't think that the fate of third-party litigation funding should rise or fall depending on whether the government thinks it makes the world a better place. We don't hold most economic activity to that standard. People want to do it, and it doesn't hurt anyone – so why not allow it?

The argument that it hurts defendants is ridiculous. Of course defendants don't like it. But they don't like it because they don't like being sued. (Who does?)

The fact that the money for a lawyer comes from someone other than the person named on a caption of a legal document does not change the facts of the lawsuit. It doesn't make the facts stronger or weaker. It doesn't change the law. All it does is make it more likely that it will see a courtroom, and that the defendant will be judged for what he or she did. And that is reason alone to allow it to happen.

Legal financing

From Wikipedia, the free encyclopedia

Legal financing (also known as litigation financing, professional funding, settlement funding, third-party funding, legal funding, lawsuit loans and, in England and Wales, litigation funding) is the mechanism or process through which litigants (and even law firms) can finance their litigation or other legal costs through a third party funding company.

Similar to legal defense funds, legal financing companies provide money for lawsuits but are more often used by those without strong financial resources. Furthermore, legal financing is more likely to be used by plaintiffs, whereas legal defense funds are more likely to be used by defendants. Money obtained from legal financing companies can be used for any purpose, whether for litigation or for personal matters. On the other hand, money obtained through legal defense funds are solely used to fund litigation and legal costs.

…

Legal financing companies normally provide money in the form of a lump sum payment, and generally, no specific account is established for the litigant. If the case proceeds to trial and the litigant loses, the third party funding company receives nothing and loses the money they have invested in the case.[1] In other words, if the litigant loses, he does not have to repay the money. In addition, litigants generally do not have to pay monthly fees after obtaining legal financing. Instead, no payments of any kind are made until the case settles or judgment is obtained, which could occur months or years after legal funding is received. Accordingly, to qualify for funding with a legal financing company, a litigant's case must have sufficient merit that the company deems its investment in the case to be worth the risk.

In tort litigation, legal financing is most commonly sought in personal injury cases, but may also be sought for commercial disputes, civil rights cases, and workers' compensation cases.[2]

History

While Third Party Litigation Funding is not a new concept, it is relatively new to the United States and has its roots in the old English principles of champerty and maintenance. Some U.S. states still prohibit or materially limit champerty and other allow it with some restrictions.[3]

Little financial assistance is available from traditional sources to help injured plaintiffs cover the cost of litigation or pay their personal expenses while a case remains pending. Plaintiffs may turn to credit cards and personal loans to cover litigation fees, attorneys' fees, court filings, personal finances, and living expense shortfalls while they wait for litigation to be resolved. The obligation to repay that debt is not affected by the outcome of the plaintiff's lawsuit.

In many jurisdictions, and throughout the United States, attorney rules of ethics preclude an attorney from advancing money in the form of loans to their clients.[4][5]

The introduction of legal financing provides qualified plaintiffs with a means of paying the cost of litigation and their personal expenses, without having to resort to traditional borrowing.

Qualification for litigation financing

Legal funding companies do not provide legal advice to applicants, nor do they provide referrals to attorneys. Thus, to qualify for legal financing a plaintiff must have already hired an attorney. To apply for legal financing, the plaintiff must complete an application form and provide supporting documents.[6]

As legal financing companies only recover their investment if the plaintiff recovers money from the funded lawsuit, the merits of the plaintiff's case must be strong, meaning that the plaintiff has a strong argument that the defendant is liable for the damages claimed in the lawsuit. The defendant in the case (the person or company being sued) must also have the ability to pay a judgment, whether by virtue of its own financial strength or through insurance coverage. The injured party's attorney must also agree to the legal financing and generally must to sign an agreement consenting to the legal financing.

Additional qualification or approval factors may include the total amount of damages sought, a sufficient potential margin of recovery to justify the investment, the background of the applicant, and laws of the applicant's place of residence.[7] Some legal financing companies limit their investment to specific types of lawsuits, such as a personal injury claim or commercial litigation.[8]

Benefits

Lawsuits are expensive and may progress slowly, over a period of many months or years.[9] During that time, many plaintiffs may feel considerable financial pressure, and may need money to pay the costs of litigation, as well as the costs of supporting themselves. When obtained during the course of tort litigation, legal financing may help a plaintiff who has immediate needs, such as medical care, and cannot afford to wait until the litigation concludes to obtain money. A severely injured plaintiff might have significant personal expenses due to disability or loss of income and may face significant personal and medical debt, and as a result may feel considerable pressure to enter into an early settlement.[5] A defendant may recognize a plaintiff's financial need and offer a low settlement in anticipation that the plaintiff will not be able to afford continued litigation.

The desperate situation of plaintiffs is reflected in a finding by the American Legal Finance Association, an industry group for legal financing companies, that over 62% of funds provided to plaintiffs are used to stop a foreclosure or an eviction action.[10]

Criticisms

One concern about litigation funding is that it is costly to the plaintiff, and may take a very large chunk out of plaintiff's eventual settlement or verdict. After paying attorney fees and the amount owed to the legal financing company, the plaintiff may receive little or no additional money beyond any amount received from the advance.[2]

There is some concern that, if widely adopted, litigation finance could prolong litigation and reduce the frequency of settlements of civil lawsuits.[11] A study of civil lawsuits published in the Journal of Empirical Legal Studies found that between 80% and 92% of cases settle.[12] The study found that most plaintiffs who decided to pass up a settlement offer and proceed to trial ended up recovering less money than if they had accepted the settlement offer.[12]

The legal financing industry has come under fire from critics for actual and potential legal and ethical violations.[9] For example, some companies have been found to violate state usury laws (laws against unreasonably high interest rates), champerty laws (laws prohibiting third parties from furthering a lawsuit for an interest in the recovery), or to require action by the applicant's lawyer that might be unethical under state rules of professional conduct.[13]

A major criticism of litigation funding is that its cost is disproportionate to the risk accepted by litigation finance companies.[2] As lenders thoroughly evaluate claims before they agree to provide financing, they have a very high likelihood of recovering their fee at the conclusion of the plaintiff's case, and further limit potential losses by providing financing in amounts that are relatively small as compared to the plaintiff's anticipated recovery.[2]

In June 2011, the New York City Bar Association addressed some of the ethical issues raised by lawsuit financing in an ethics opinion about third-party non-recourse legal funding. It concluded that with due care a lawyer could help a client obtain legal financing, and that non-recourse litigation financing “provides to some claimants a valuable means for paying the costs of pursuing a legal claim, or even sustaining basic living expenses until a settlement or judgment is obtained.”[13] Many lawyers advise clients to pursue legal financing only as a last resort, when other forms of financing are not available.[2][12]

United States

Legal financing is a fairly recent phenomenon in the United States, beginning in or around 1997.[18] Litigation funding is available in most U.S. jurisdictions. Litigation funding is most commonly sought in personal injury cases, but may also be sought for commercial disputes, civil rights cases, and workers' compensation cases. The amount of money that plaintiffs receive through legal financing varies widely, but often is around 10 to 15 percent of the expected value of judgment or settlement of their lawsuit.[2] Some companies allow individuals to request additional funding at a later date. The amount of money available depends on the policies of the financing company and the characteristics of the plaintiff's lawsuit.

Investing in litigation: Second-hand suits, Fat returns for those who help companies take legal action

The Economist, Apr 6th 2013 | NEW YORK

COMPANIES need to make the best returns on the assets they have in hand. But what if a company does not know that it has them, or whether it can use them? In some cases a lawsuit could be a valuable earner. A technology company in liquidation might have a patent-infringement suit that the bankruptcy's administrators lack the time to pursue. There may be money to be made by suing a joint-venture partner, but the prospect of a costly case dissuades managers from going to court.

Enter "third-party funders". These outside investors offer to pay for a lawsuit, in exchange for a share of the payout: from 30% to 60%. Some lawyers work on contingency ("no win, no fee") arrangements, but others cannot shoulder the risk. So third-party funders may get involved.

Returns are impressive enough to have drawn in both hedge funds and traditional financial companies. Allianz, a German insurer, built a profitable lawsuit-funding unit before running into conflicts of interest with suits aimed at its insurance customers. It closed shop. Credit Suisse built and then spun off its litigation-finance unit, now called Parabellum (the Latin for "prepare for war".)

The potential profits can be seen in the results of three public companies that specialise in funding litigation: Burford and Juridica, both listed in London but focusing on America, and IMF, the first public litigation funder, based in Australia. Juridica, which released results on March 15th, made $38m in cash profits on $256m under investment. Juridica concentrates on monetising court wins and settlements, and immediately returning the cash to shareholders. Last year it offered the highest dividend yield on London's AIM market, which specialises in smaller companies.

The biggest risk, says Richard Fields, Juridica's founder and chief executive, is not the quality of cases. He says the company invested in 30 of some 1,200 it considered, and has profited from all that have been concluded. The risk is timing: courts' gears grind slowly before suddenly producing results, so cashflow is "lumpy".

Burford, though a year younger, is bigger than Juridica, and funds a wide spectrum of cases. It boasts a 61% net return on invested capital in 2012. Christopher Bogart, its co-founder and boss, says that chief financial officers understand when he describes lawsuits as assets: "I'm not talking about doing anything different with litigation than they're talking about doing with photocopiers and aeroplanes."

Some worry that funding others' lawsuits is unethical. A common-law prohibition against "maintenance" and "champerty" used to forbid outsiders from meddling in lawsuits or taking cuts from judgments. But such rules have loosened. Lord Jackson, a former judge asked in 2009 by the British government to review civil-law costs, has praised outside funding.

America, with its astronomical legal costs, has other worries. Robert Weber, IBM's general counsel, wrote in February that third-party funding was "the latest gimmick in a headlong rush to degrade legal professionalism". America's Chamber of Commerce, a business lobby, fears that funding will encourage junk lawsuits. But John Peysner of the University of Lincoln sees "no evidence at all" to justify such concerns. Steven Garber, an economist at RAND, a think-tank, says the economics of filing low-merit cases make little sense. The best business is in unlocking good cases that otherwise might not be filed, rather than in funding a slew of uncertain ones in the hope that some are settled for their "nuisance value", or that a few big wins pay for the rest.

For now, demand for outside funding outstrips supply. The global litigation-finance industry is probably worth more than $1 billion today. But only a small part of all litigation is funded by outsiders. That proportion looks likely to grow.

IBM GC Says: Beware Of Lenders Offering To Finance Your Lawsuit

Forbes, Bob Weber of IBM, Feb 12, 2013

This is a guest post by Robert C. Weber, IBM general counsel and senior vice president of legal and regulatory affairs. The views expressed are his.

Always be on high alert when someone tries to sell you a fix to a problem you didn't know you had.

This is the advice I'd ask you to keep front and center as you think about the newest gimmick in the headlong rush to degrade legal professionalism and to increase the lottery mentality of our court system. The gimmick is so-called "third party litigation financing," a seemingly benign term that camouflages a real risk to clients, our court system and to lawyer professionalism itself. I've seen enough to know that this isn't needed, that it tends to introduce a gambling mentality into our court process, and it creates an environment ripe for the promotion of the interests of lawyers over those of the client. With these three strikes, this new gimmick should be ruled out of our court system without delay.

Litigation financing is a "cure" looking for a disease. Those who advocate for more of it in the U.S. typically argue that it helps ensure equal access to the justice system. And they often cite the emergence of litigation financing in countries like Australia and the United Kingdom to support this position. That misses the point entirely. In Australia and the United Kingdom, loser-pays rules and prohibitions on contingency fees created a gap in the availability of legal services. Here in the U.S., we have no such problem. Our contingency fee system fills that gap, and does so consistent with well-established rules and ethical traditions. As a result, would-be litigants in the U.S. already have access to excellent lawyers who they could not otherwise afford on their own. And while contingency fees do little to incentivize lawyers to pursue cases that would result in important injunctive relief without a significant monetary payment (such as certain varieties of public interest cases), third-party financing is no better solution. The bottom line is that the contingency fee system already solves the one problem litigation financing addresses, and does so in a manner that avoids the worst excesses.

There is no shortage of lawyers willing to take on a contingency fee case with a reasonable chance of success and the possibility of significant recovery. But when the potential recovery on a dubious theory is substantial (either because of pressures to settle or because there is a very small chance of a very large recovery), most lawyers will hesitate before fronting litigation costs. They do so both because of their ethical obligation not to bring frivolous suits, and because they are loath to use their own limited resources to finance cases where the probability of recovery is low.

This is where the lottery mentality of litigation financing wreaks havoc. Third-party financers operate under an entirely different set of incentives that will often make such high-risk/high-return cases attractive. The typical financer has multiple investors and investments, bringing with them a greater ability to spread both financing and risk. As a result, these investors see much more value in taking on a very big risk that carries with it the slim possibility of a very big return – even when (indeed, especially when) doing so means financing lawsuits that would not otherwise be brought. And ethical considerations play no part in that calculus; the investor simply crunches the numbers. This is nothing more than calculated gambling. Perhaps then it should come as no surprise that Las Vegas is viewed as a hub of litigation funding, or that one of the chief proponents of litigation funding in the U.K. is famous for casino investments. The U.S. court system and the legal profession deserve better.

Unfortunately, particularly in the challenging economic environment facing law firms today, many attorneys have become willing participants in this degradation of the profession. As lawyers rush to this perceived opportunity to find new sources of funding for themselves, the attorney-client relationship risks being lost in the shuffle. Third-party financing agreements routinely include conditions that the financer be apprised of developments in the case, even when those developments might be privileged or involve disclosure of work product. Some investors demand a say in choice of counsel, the right to participate in strategic decisions, or the power to veto settlement offers. Whose interest is the attorney representing in these arrangements? The client's? Her own? The financier's? And when they conflict?

It is bad enough that these arrangements allow an outsider to intrude so profoundly on matters that have always been left to the attorney and the client. That the outsider has an exclusively financial interest that may differ from the client's interests only makes matters worse. Part of what makes the attorney-client relationship unique is the attorney's ethical obligation to put his client's interests first and pursue those interests zealously as an officer of the court. An outside investor has no comparable duty; indeed, there is a competing duty to maximize return for the investor's investors.

While client and investor interests may align in some situations, in many others they will not – such as when the client wants to take a settlement that the investor views as providing an insufficient return on its investment. In that context, third-party financing arrangements will prolong litigation to satisfy the investor's expectations or demands, even when an early settlement offer is the client's best option. The opposite dynamic can also come into play when the outside investor values an early and sure payout over a more comprehensive victory that would truly vindicate the client's interests. Either way, the lawyer serves the investor's interest and the client is the loser. As always, he who pays the bills makes the rules. Not surprisingly, in countries where third-party financing is prevalent, lawyers prioritize developing ongoing relationships with investment firms, rather than with their actual clients. Thus, I fear the end result of allowing third-party financing to flourish is a slow but steady shift away from the traditional understanding of law as a profession toward a conception of law as just another money-making venture, where the investors inevitably call the shots.

As it should in a self-regulated profession, it falls to lawyers to stop this trend while we still can. I hope we do so soon. Otherwise, we risk forfeiting the professional and client-driven reputation we worked so hard to earn.

Third Party Litigation Funding (TPLF)

US Chamber of Commerce, Institute for Legal Reform,

https://www.instituteforlegalreform.com/issues/third-party-litigation-funding , undated

Third party litigation funding, or TPLF, is the practice of hedge funds investing money in lawsuits in exchange for a percentage of the settlement or judgment. TPLF is a global financial industry. What started in Australia, has spread to four other continents including the UK, the United States, Canada, Europe, and Asia. The litigation funding industry operates in the shadows, making it difficult to gauge just how much impact it is having on lawsuits. However, at the end of 2017, Woodsford Litigation Funding's CEO told the Financial Times that worldwide £70 billion (or approx. $100 billion) was a reasonable estimate of the amount available to funders and firms.

Unlike other financial products, TPLF is not regulated anywhere in the world. This is problematic because litigation funding can have a material impact on the outcome of a case, and the involvement of third parties in litigation, solely for financial gain, presents numerous ethical issues and conflicts of interest.

For one, TPLF increases the volume of litigation. It is simple: more litigation funding means more litigation. For example, a study by NERA Economic Consulting found that the rise of TPLF is responsible for much of the exponential increase in securities class action litigation in Australia. Additionally the business strategy pursued by funders capitalizes on meritless litigation. Funding firms are increasingly utilizing a portfolio funding business model. This allows them to spread risk across a universe of diverse cases and take on cases that might be weak or dubious, but still hold the possibility of massive awards. The funder's portfolios may span across multiple, different law firms.

TPLF can unnecessarily prolong litigation. In the instance of a settlement or judgement of a class action, typically the funder is paid first, then the attorneys, followed by the lead plaintiff. What is left is divided among the remaining class members. Based on this payment structure, plaintiffs may be driven to reject an otherwise reasonable settlement offer. This prolonged litigation hurts defendants, who are forced to divert additional time and money from productive activity to defending litigation.

Compounding the length of litigation is the fact that funding arrangements tend to operate in secret. Thus defendants may not even be aware that a funder is involved in litigation against them and judges may not be privy to the fact that funding is being used in his or her courtroom.

In addition, TPLF can undercut a plaintiff's control of litigation. Funders have a major interest in the outcome of cases they invest in, so it is not unexpected that some funders seek to control a case's legal strategy, both indirectly and directly. In one patent case, a funder sued the plaintiff for settling for an amount lower than what the funder demanded. In the infamous Chevron case in Ecuador, the funding contract with the plaintiffs stipulated that the funder would have veto power over the choice of attorneys and receive priority in the disbursement of any monetary award. Arrangements such as these place the interests of outside investors ahead of the interests of the parties in court.

Finally, TPLF creates ethical conflicts. Lawyers have a fiduciary duty to act in the best interests of their clients, but an ethical conflict arises when funders are fronting the fees for the claimants' lawyers or when funders and law firms are structurally linked, or have portfolio arrangements. The lawyer-client duties can become secondary to the financial rewards pursued.

U.S. Reforms

Litigation funding is rapidly expanding in the United States and shows no signs of slowing down. A September 2017 survey by funder Burford Capital claims the use of litigation financing in the U.S. grew 414% between 2013 and 2016. An industry expanding that rapidly and amassing funds across the globe it can then reinvest in lawsuits in any jurisdiction needs transparency and to be brought out of the shadows.

Safeguards are necessary to counter the many problems associated with TPLF in the U.S. In the white paper Stopping the Sale on Lawsuits: A Proposal to Regulate Third-Party Investments in Litigation, ILR suggests the following reforms regulating TPLF:

Prohibiting investor control of cases;

Forbidding direct contracts between investors and lawyers that do not also include the client; ;

Banning law firm ownership of TPLF firms;

Prohibiting the use of TPLF in class actions; and;

Requiring disclosure of funding contracts in litigation.