

Litigation Funding: Tipping the Scales from Justice for Litigants to Profits for Investors*

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Litigation funding is a burgeoning multi-billion-dollar industry that has disrupted the insurance and legal industries. Third-party litigation funding (TPLF) is a practice in which independent parties, typically hedge funds or investment firms, provide non-recourse financial

support to assist plaintiffs pursuing litigation in exchange for a sizable portion of any settlement or verdict.

This arrangement allows litigation funders to collaborate with plaintiffs' lawyers as to litigation strategy. The entire practice operates largely in secret, and there is little transparency. The use of TPLF arrangements in several high-profile litigation matters such as Hulk Hogan's lawsuit against Gawker, the NFL concussion cases, and the #MeToo claims has gained a great deal of media attention, thereby exposing many aspects of these furtive TPLF practices. With that, numerous concerns regarding the practice have emerged.

How It Works

Litigation funders research and identify cases that are likely to yield large awards and work with law firms or plaintiffs' lawyers to pay the litigation costs in exchange for a share of the outcome. Like traditional investment practices, TPLFs invest capital in litigation as a mechanism to diversify investment portfolios to reduce risk and stabilize returns by expanding investment opportunities into the legal sector, which has traditionally been an untapped market. The returns on those TPLF investments can pay handsome rewards, especially in high-stakes cases.

There are two types of litigation funding:

- In the individual plaintiff model, the funder advances money to a plaintiff and then charges interest that can exceed the initial loan value.
- In the second model, the funder advances money to a plaintiff or a law firm for either a particular case or a portfolio of cases in exchange for a portion of the settlement or verdict. These payments are made on a non-recourse basis, meaning that if the plaintiff does not recover in the litigation, then the funder will not get paid. In effect, the non-recourse nature of funding agreements resembles contingency fee arrangements.

In addition to funding individual actions, TPLFs engage in "portfolio funding," a practice in which funders invest in multiple cases in different practice areas at a single law firm, which gives them an interest in the outcome of an entire portfolio of lawsuits. Portfolio funding only amplifies concerns. Essentially, it is analogous to buying ownership over a law firm, presenting conflicts of interest issues, and prioritizing profit maximization. It can jeopardize a law firm's duties to individual clients in favor of meeting the objectives of the firm's financier.

TPLFs have been touted as a mechanism to increase access to justice for plaintiffs who otherwise would be unable to pursue legal action against wealthy or powerful adversaries. Despite this perceived benefit, numerous concerns have emerged regarding TPLF practices as a few of the funding arrangements have become public.

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Impact on the Legal Industry – Rise in Frivolous Lawsuits, Conflicts of Interest

Among the slew of concerns is that TPLFs are fueling an increase in frivolous lawsuits and driving up jury verdicts. TPLFs face very little personal risk in their litigation investments, which is believed to incentivize funders to invest in voluminous lawsuits even when the claims are frivolous in the hope that businesses will opt for a quick settlement, rather than incur the high cost of defense.

Funding also can be used to shape case law. By investing heavily in litigation, funders can target certain areas of law and influence outcomes with the goal of changing precedent. Funders can do this by outspending their adversaries and hiring premiere litigation experts to testify at trial and present Hollywood-quality visual exhibits and high-tech computer animations for the jury.

Funders have the resources to fund mock trials to sharpen trial presentations. On the flip side, funders can invest in litigation with the objective of preventing the development of precedent adverse to their own interests. It is not difficult to imagine the number of ways TPLF can be used to manipulate the legal system.

Strategic Influence over Litigation

One of the most troubling aspects of these funding arrangements is the lack of transparency. Funding agreements with law firms and plaintiffs' lawyers are entered into without any disclosure to the judges, defendants, or sometimes the plaintiffs (particularly in class actions), who often are unaware of a third party with a stake in the outcome. Litigation funding agreements may have terms that give funders significant control over key elements of the litigation, including the right to provide input on settlement demands and overtures as well as the management of litigation expenses.

When TPLFs fund multiple related cases, they have an interest in gaining strategic influence over the litigation process and outcome in ways that align with their own financial interests rather than the interests of justice. TPLFs gain control by provisions in the funding agreements that give them the right to select the lawyer and the expert witnesses, and to direct any settlement discussions even if it is to the detriment of the plaintiff.

The result is plaintiffs are less likely to settle quickly or for lower amounts. They are positioned and incentivized to make egregious demands even if it takes longer to resolve the case. This is because an increased settlement means increased profits for the funder who will take a portion of the settlement proceeds.

Sysco v. Burford Capital

Sysco v. Burford Capital is a prime example of a TPLF interfering with and preventing a litigant from accepting a reasonable settlement at the expense of the litigants. The dispute illustrates the conflict of interest between funders and litigants and the significant control given to litigation funders through funding arrangements.

Sysco, a major food distributor, initiated antitrust lawsuits against several meat suppliers using \$140 million in litigation funding from Burford Capital. When Sysco sought settlement of its antitrust claims, Burford objected. Sysco then filed a lawsuit against Burford for preventing it from accepting a settlement and prolonging the litigation for greater financial gains. Burford sought to substitute itself as the plaintiff in the Sysco antitrust lawsuits to assume control over Sysco's legal claims.

Litigation funding makes it possible for plaintiffs' firms to engage in expensive litigation tactics. For example, plaintiffs can engage consultants to orchestrate negative media campaigns surrounding the litigation. This may compel a corporate defendant to salvage its reputation and opt for early resolution despite having meritorious defenses. If the corporate defendant opts to go to trial rather than settle, the negative media attention will potentially have tainted the jury. Either way, there is damage to the corporate defendant's reputation.

Bollea v. Gawker Media

In addition, the practice can conceal the true motivations behind a lawsuit as seen in *Bollea v. Gawker Media*. In 2012, Terry Gene Bollea, better known as Hulk Hogan, sued Gawker Media for invasion of privacy after Gawker published excerpts from a private video. In 2016, a Florida jury awarded Hogan \$140 million in damages. The verdict eventually led to Gawker having to file bankruptcy.

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After the trial, it was revealed that Peter Thiel, a Silicon Valley billionaire and co-founder of PayPal, secretly funded Hogan's legal battle against Gawker. Thiel had a personal vendetta against Gawker, stemming from its 2007 article that outed him as gay without his consent. Thiel's funding revealed how wealthy individuals can influence legal outcomes by bankrolling lawsuits and weaponizing the legal system against their adversaries.

Threat to National Security

The primary leaders in voicing concerns over TPLF practices have been insurers, legal professionals, and policymakers, but the impact of these practices reaches far beyond these entities. A growing area of concern is the threat that a foreign power could potentially use TPLFs to destabilize U.S. markets and key sectors of the economy, or to influence the outcome of litigation involving divisive or political issues to align with their own strategic interests.

The few TPLF agreements that have been disclosed show that funders have access to evidence and discovery used in the litigation. By taking control of high-stakes litigation, foreign adversaries may gain access to sensitive and confidential data such as proprietary information regarding technology or intellectual property and allowing it to come out in a lawsuit.

In another possible scenario, a foreign adversary could use TPLFs to hold U.S. corporations in costly litigation to gain a competitive advantage for foreign competitors. Every dollar that is put toward litigation is money that companies could be putting into hiring additional workforce, maintaining their current workers, innovating new products, investing in research and development, and expanding the business. Not to mention the opportunity cost that companies incur in man-hours lost to defending lawsuits or the reputational damage to their business.

Economic Cost to Consumer Households

Jury awards continue to trend toward higher verdicts, a phenomenon that is attributed in part to litigation funding. The U.S. Chamber of Commerce said in a recent report that the number of verdicts for more than \$100 million reached a record in 2023, up nearly 400 percent from

2013. By driving larger verdicts, TLPF practices contribute to increased tort expenses initially borne by businesses, but then passed on to U.S. consumers in the form of higher prices for goods and services.

Higher tort costs also affect the availability and cost of insurance for businesses. As investor-funded litigation increases, so do the litigation defense costs incurred by corporate defendants and their insurers, resulting in increased premiums for insurance policies. Businesses eventually push these expenses on to their consumers.

In a study conducted by the U.S. Chamber of Commerce Institute for Legal Reform in 2020, using the estimated insurable cost paid in the U.S. tort system, found that tort costs in 2020 totaled \$443 billion or 2.1 percent of U.S. gross domestic product broken down as follows: \$229 billion in general and commercial liabilities, \$196.5 billion in automobile accident claims, and \$17.5 billion in medical liability claims. To give these figures perspective, the Institute for Legal Reform estimates these tort costs boil down to \$3,621 on average per household, with these figures varying from state to state. The highest total tort costs per household in 2020 were New York (\$5,408), Florida (\$5,065), New Jersey (\$5,059), California (\$4,599), and Georgia (\$4,157).

Current Regulatory Landscape

Without transparency, it is unknown how much and to what extent litigation funding is being used to exploit the U.S. legal system. The calls for transparency are growing and several state legislatures have responded by enacting or considering legislation to regulate litigation funding.

These states have in recent years enacted laws to respond to the calls for regulating TPLFs:

- **Montana** signed into law Senate Bill 269 (May 2, 2023), which requires disclosure of TPLF agreements in civil cases, requires TPLFs to register with the Montana Secretary of State, makes litigation funders jointly liable for costs, and establishes a 25 percent cap on the amount a TPLF can recover from any lawsuit.

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- **Indiana** passed House Bill 1160 (March 13, 2024), which mandates funding agreements are subject to discovery, restricts funder control of litigation, and prohibits funders from accessing proprietary data.
- **West Virginia** Senate Bill 850 (April 23, 2024) amends and expands existing laws initially enacted in 2019, requiring registration with the state's attorney general, and disclosure of the terms of the funding agreement regardless of whether it is requested in discovery.
- **Louisiana** Senate Bill 355 (August 1, 2024) limits foreign litigation funding, prohibits funders from controlling or manipulating litigation, ensures plaintiffs are aware of any outside influences on their cases, and makes litigation finance agreements subject to discovery in civil cases.

Several other states have proposed similar laws to require transparency. Florida House Bill 1179 (2024), if passed, would require disclosure of funding, restrict funder control of litigation, and prohibit investors from recovering more than the litigant. Kansas House Bill 2510 (2024), if passed, would require disclosure of third-party litigation funding agreements.

Calls for regulation of TPLF practices also are happening at the federal level. In 2019, a proposed amendment to Federal Rule of Civil Procedure 26(a)(1)(A), seeking mandatory disclosures of any TPLFs, failed to pass. In 2024, Congressman Darrell Issa (R-CA) introduced the Litigation Transparency Act of 2024 to mandate litigants to disclose anyone who has the right to receive any contingency payment on the outcome of the litigation as well as to provide a copy of any litigation funding agreement.

The reoccurring theme in these calls for setting parameters for TPLF is the need for transparency. Proposed solutions almost uniformly call for mandatory disclosures of TPLF arrangements, including the identity of funders and the contractual terms of the funding arrangement. Some of the proposed regulations include amending the ABA Model Rules to explicitly address TPLF issues and regulating the TPLF industry by implementing licensing requirements, placing caps on funder returns, and prohibiting funder control over legal strategy. As more and more regulations

are implemented, TPLF will become more transparent and the unsustainable negative impact it is having on the legal landscape should eventually wane.

Maryan Alexander, Esq., represents clients and insurers in state and federal court in complex civil litigation matters, including commercial disputes, accountant professional liability, premises liability, products liability, toxic torts and other general casualty claims. She has defended at trial large financial institutions, property management companies, and local and foreign product manufacturers and distributors in matters involving allegations of negligence, violations of consumer protection acts, fraud/misrepresentation, and breach of contract and warranties. Maryan was one of 20 nominated finalists who successfully completed Wilson Elser's rigorous Mock Trial Invitational through which our most successful trial lawyers impart their knowledge to those destined to join their ranks.

Maryan was seconded to the legal department of a large financial institution during which time she handled regulatory, operational and transactional matters, including the negotiation of insurance and optional product marketing and servicing agreements, and advising on third-party risk management and regulatory compliance. Through this secondment, Maryan developed a unique understanding of the regulatory environment surrounding financial institutions and insurance companies, as well as the internal structure and processes unique to the financial and insurance industries.

Recognized for her written communications skills and precision in drafting motions, Maryan also is adept at researching complex issues and providing insightful periodic updates and analysis to clients. She is valued for her focus on identifying cost-effective resolutions for clients.

Before attending law school, Maryan pursued a career in online journalism/financial news and multimedia with Washingtonpost.Newsweek Interactive.