EPISODE #26

Litigation Funding

TOTAL Run time: 25:32 minutes

Givonna: Litigation funding is a service by which a third party to a lawsuit provides funding to allow a claimant or their lawyer to pursue litigation. This practice has steadily increased in recent years and is currently a $15 billion market. While each individual firm is free to decide whether to participate in matters involving litigation financing, we at ALAS believe it is essential that those who do are fully aware of both the intricacies of litigation funding agreements, and the complex ethical issues raised by them. I'm Givonna Long, and you're listening to the Portable Ethics Lawyer. Joining me today is Lucian Pera, a litigation partner at Adams and Reese who focuses on legal ethics and lawyer regulation. Today, we'll discuss the ethical issues associated with litigation funding agreements and Lucian will provide some insights on how to tackle these issues and avoid some of the landmines associated with these deals. And I must say, I am excited about this conversation. Lucian, welcome.

Lucian: Thanks, it's great to be with you Givonna.

Givonna: So glad you're here. So let's get started by you giving an overview of Litigation Finance for the listeners who aren't familiar with the term and its use in the legal industry?

Lucian: Absolutely. Basically it's money provided by some third party, usually a, somebody in the commercial business of providing that money these days, a funder, a litigation funder, to either a claimant who's making some kind of claim or a law firm that is bringing the claim. Usually it's to cover expenses, litigation expenses, traditionally, even just ordinary litigation expenses. Now it has expanded to be available to cover

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fees or a part of fees. It also can even cover operating expenses. And it's all well and good, if you've got a wonderful plaintiff's case on a great contingency and everybody's got skin in the game, you think you're gonna win big time. If the client doesn't survive operationally, then it's gonna be a problem. So it can cover all those things. Usually it's what they call nonrecourse, which for purposes for this purpose means no payment.

You don't have to pay the money back unless there's a recovery. So that's basically the world, I guess. Should we talk for a minute about how the world divides up into the different kinds of funding?

Givonna: That sounds great.

Lucian. You mentioned $15 billion, which is a staggering number. I think that's really a number mostly associated with commercial funding. Think, you know, big claims. You know, some company is driven out of business allegedly by another company and the victim wants to sue for a billion dollars or whatever, commercial claims. That's one kind of hemisphere of the market. The other hemisphere of the market, which is considerably smaller, I think, is about plaintiff's personal injury loans. And then there's this part of those worlds that kind of straddles each, like there's millions and millions of dollars that go into marketing for mass torts, and that's funding to firms, really, not to the mass tort plaintiffs. And so it's commercial in the sense that it's to fund the law firm's pursuit of the claims marketing wise and intake and all that. So that's really kind of in both worlds.

Givonna: We talked about $15 billion. Why is litigation funding such a hot topic now?

Lucian: I think the reason we're talking about it, ALAS has talked about it from time to time, and it's increasingly important, I think, to ALAS firms. I mean, you know, I'm with an ALAS firm. I've been with an ALAS firm my whole career, so I, I'm a member and I understand, you know what, what we do. It's more important today for ALAS firms and for big law generally, because it has allowed a bunch of firms, including a number of ALAS firms, to do cases, to handle cases they could never have handled before. Because either number one, it reduces the risk of a contingent fee, and many of our firms are just not contingent fee firms.

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Another function it serves is purely economic or financial. Almost all firms are, you know, cash businesses. We empty the till at the end of the year, so just like it sometime requires an active will to fund a new office that's gonna take, you know, several million dollars and not gonna pay off for two years. It's just as hard to fund a, a case, a big plaintiff's case, that's gonna cost $2 million and it's gonna stretch over two years because the partners in year one are not the partners in year three. So both of those things are true for big law. And by the way, no question, over the last 10 or 20 years, ALAS member firms and big law firms have built practices around litigation funding in ways that didn't exist 10 or 20 years ago for those reasons.

Givonna: With this increasing amount of litigation funding, have there also been an increase in the number of frivolous lawsuits?

Lucian: There's no evidence of that. If you talk to the U.S. Chamber of Commerce, which is the arch foe of litigation funding in every one of its forms, they suggest that, they contend that, but they've never come up with any proof. If you think about it for a few minutes, it's not, it's not hard to understand. I mean, investors who put their own money at risk, because after all they get nothing, if there's no recovery, they're gonna be more hardheaded than plaintiffs, than claimants. They're gonna be more hardheaded even than lawyers and law firms about wanting to get their money back. And so they're gonna vet claims in a very different and more rigorous way. But I, I don't think there's any evidence of that.

Givonna: Well, now let's turn to the ethical issues. Because we know there are some. What are some of the ethical issues associated with these litigation funding arrangements?

Lucian: Well, I think there are a number, there are two big ones. One that's really, it shouldn't be an issue and one that is an issue that you need to work through. The one that really isn't an issue typically is fee sharing. Obviously, you can't pay back litigation funding on any basis that amounts to fee sharing. The market over the last, I've been working in this market, since 1998, and over time the market has adapted to our view about fee sharing. And so typically, except in Arizona, Arizona's a different place because you can fee share there. But nevertheless, everywhere else in the country you

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typically see funding deals that are drawn up on the basis of repayment of the or no repayment if there's no recovery and repayment if there is a recovery based on a return of the funds and often some multiple of the funds.

Don't be deceived if you read an agreement, a funding agreement, and you get to about page three where they've got what they call the funding waterfall and says how the money gets paid back; because you will see, and many of them at a certain, you know, until a certain amount of recoveries made, you know, X percent goes to funder, X percent goes to law firm. Well if that's all it says, that's fee sharing. But what you'll often see is you reach the end of the waterfall and you have a provision that says, in no event shall, you know, more than three x three, a multiple three be paid back. That means then that all that waterfall stuff is about timing. So that's fee sharing. And there's probably, there's more. We could talk for an hour about fee sharing, but, mostly fee sharing is something you have to be careful about, but with a reputable funder, you're not gonna have an issue with.

The other big one is confidentiality. It is, I think the big issue. Any trial lawyer, whether they've had anything to do with litigation funding ever before, will have these questions. The key thing to understand about litigation funding and confidentiality is waiver. It's interesting to me, many lawyers don't understand that the way waiver works for attorney-client privilege and for work product is quite different. For attorney-client privilege on the one hand, you all under, everybody understands that, you know, if you admit a third party into the conversation or if they, if you willingly, voluntarily provide an attorney-client privilege communication to a third party, a stranger, then it's waived. It just is, it's done. You know, it's sort of easy to wave in that sense, alright?

Work product doesn't work that way. Work product only waiver only occurs when you do something that substantially increases the likelihood of it falling into the hands of an opponent. So, for example, an NDA, which you will see in every litigation funding arrangement before it's even begun to be discussed, an NDA, which says, I'm gonna provide you my work product, but you agree, you agree to keep it secret; that avoids waiver almost uniformly. And so that distinction is important because what funders need,

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and this is the key point on confidentiality, what funders need is enough information to vet the claim, to know what's going on with the claim to protect their rights. Okay?

So, never give them anything that's only protected by privilege. I typically draft that into funding agreements and usually it's already in the ones I've seen. And, and on the other hand, can you share with them more product? Yes, you can. You wanna be judicious. Often in a funding agreement it'll say what information you're gonna provide or your client's gonna provide. I like being specific, but nevertheless, as long as it's work product and there's a good solid confidentiality agreement, you're good. One last thing on confidentiality, which is, I do think, you know, if a law firm is getting funded on a client matter, for example, then you want the client as a lawyer, you want the client to consent to your sharing that information, even though they are not a party to the funding agreement. So those are the two big things, confidentiality and featuring. There are others, but those are the two big ones.

Givonna: What about control? So a lot of people think that control is probably an issue that comes up in these litigation funding agreements?

Lucian: There's a little part of the story and a big part of the story. The big part of the story is that over again, the last 20 years, mostly because of champerty concerns and no, we don't wanna talk about champerty. It's too early in the morning to talk about champerty. Anyway, we, if we were live, we could give prizes to anyone in the audience who could explain what champerty is, and we could keep the prizes. In any event, under champerty law, somebody who's often called an officious inter meddler, a stranger to the litigation, is putting money in the litigation to, to pursue it. But you avoid pretty, you avoid a lot of concerns about champerty if the outside funder doesn't have any control. If they keep a complete arm's length distance.

That has driven a lot of the market in terms of not wanting to have control. The other thing, of course, it's just like your bank lender. I mean, the bank does not want to run your law firm if they're loaning you money. They do not. They do not wanna lend a liability suit, et cetera. So there are all these different drivers. So generally speaking, the market does not want or permit generally, the law generally is not thought to permit control by the funder. Now there's several things on that point. That's the sort of

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narrower issue. So, the, first of all, you as a lawyer, if you're getting funding, obviously you can't let a funder dictate how you handle the case, period. Full stop. So control, forget it. Secondly, you know, even if the client is getting funded, there are real limits. You've got to honor the client's decision-making. So, the funder typically cannot have control over settlement decisions. Now, as soon as I say that, if anybody really wants to press the envelope on that or discuss this for another 30 minutes or so, they can call me.

But the there's in the Sysco Burford dispute, I'll just drop a footnote in the Sysco Burford dispute, which you can pull up online and talk about, I don't know that we have time to talk about it. There was some very interesting discussion about New York law and in a very unique circumstance, what the arbitrators seem to have concluded is that yes, in some instances you can give over as a funded party control to a funder. And I think the closest analogy you might think about is insurance contracts. I mean, there are many insurance contracts that give over to the insurer: the right to settle claims. There is a good bit of law that varies from one type of claim to another about your ability to, for example, assign a claim and such as that. Some you simply can't assign.

So it's a complex set of legal rules, but the bottom line is that funders by and large don't want control. They're willing to completely disclaim control. I think you as a lawyer want to have them do that, and if you get anywhere near some other view of the world, then you wanna think seriously about it.

Givonna: That all makes sense. What type of conflict situations can arise when litigation funding agreements happen?

Lucian: Number one, I think most conflicts issues for lawyers can be addressed upfront on a business basis. That is to say if the no matter whether it's client claimant funding or law firm funding, if you align the interests, you align the interest of the lawyer and the funded party, whether lawyer or not, and the funder, if you align their interests, then the possibility of conflicts is reduced. In fact, in my opinion, the possibility of conflicts in a, where the, the deal properly aligns those interests is less than it is for a law firm that is funding it out of its own pocket. Now, that said, sure they can happen and often they happen when the case doesn't go as expected.

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What we, one funder and I used to call the not so good recovery. You, you get to a point you say, you know, we had high hopes for this case, but it's not a $10 million case. It's a million-and-a-half-dollar case. And suddenly your expenses loom larger than they, you thought they would. Your fee is, you know, smaller than you thought they would, and the funder and everybody's crowding each other out. Yes, that can create conflicts. Yes. But what the key way is to deal with them up front. And usually the way it works is that everybody's got skin in the game. Meaning. I don't think, I don't know that the law firm really wants to, if it gets funding, be completely outta the game in terms of having risks themselves. They need some risk to keep things, keep the game honest, so to speak.

There are some cases where conflicts are more difficult and you wanna talk with client, for example, where you're looking for not just money. Let's assume there's some injunctive relief. Because that can change things, right? Because the funder, their interests and the party's interests might be different if, you know, all the funder cares about is the money part and all the client cares about is the injunction. So there's some cases where it's much more difficult to align interests up upfront.

Givonna: So I do wanna focus on something you mentioned a couple times. You mentioned if the law firm is entering into the agreement with the funder versus if the client does. I want to talk about that. So what are some ways to structure these deals and what are the ethical implications of those arrangements?

Lucian: Well, those are the two key ones. Yeah. I mean, one is that the funding is for the benefit of, and, and the agreement is between the client and or the claimant and the funder. And the other classic one is between the, the, the law firm and the funder. Of course, sometimes the funding agreement is with the claimant for the purpose of paying the fees of the lawyer. So that's, you know, pretty much, you know, that's very similar, right, in the sense that both have skin in the game. I do think one thing we haven't talked about that comes up in that context that's important is do you; assume I'm an ALAS member firm and I have one of my partners say, I got the world's best plaintiff's, antitrust case, and we got, we're gonna go get some, we wanna go get some funding for it. And so the question is, well, does the firm advise the client when the client is seeking funding?

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Givonna: That’s a big one.

Lucian: I think that's a big one. I think there are numerous reasons to, well, to not do it. Now, can you back completely out of that and have them hire other council help? Yes. As a practical matter though, the firm is gonna have to be involved in some ways, but I think you wanna be very clear about what your role is. Are you going to agree with the client you will not advise on funding. If you do, do you have the confidence?

You know, most of the high-end plaintiff's lawyers who handle these kind of cases, they're smarter than hell. But most of the ones I've met are not smarter than hell as transactional lawyers. And so maybe the answer, if you wanna take that on is to say, okay, we got, you know, Jimbo over here who is the trial lawyer, he's got, he's the big antitrust guy. Fine, he tells us a great name, but we're gonna get Sally because Sally has done a bunch of deals that are real significant that look a little like this. Sally's job is to advise the client on the funding negotiation. Even with that, there still is some risk because of course the firm has a different interest in that transaction. It can be done, it is done, but it's, you need to think of it as a risk.

Givonna: So if a firm wants to structure the deal where the firm is making the deal with the litigation funder, any suggestions on how they could structure those deals?

Lucian: I see a lot of structures, but I am not the transaction guy. I mean, what I really do recommend to firms that call me about, like, they say, well, we've seen this deal and they tell us this and that, and we're worried about ethics, and I say, no, no, it's if you do it right, it's not an ethics issue. Okay, so my job is not done completely. But mostly what I think they need is, they need, I think an advisor that is, frankly, the ones I, I, there are one or two that I've worked with who I think the world of, and they are, uh, they are, that's their business is advising clients on getting funding. They will take a deal to market. They will negotiate with the funder. They know what is market. The other thing I think that's helpful is a lawyer who really has done the transactional side of those deals. There are several that are just, you know, there are two or three that are the best in the country. And hiring somebody like that is money well spent and, and that's what I recommend.

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So structure is something that ought to be negotiated carefully by people who know what in the world they're doing. I could give you some, give somebody some rough advice on that, but that's not my gig usually. Right.

Givonna: I do want to, before we end just talk a little bit about some of the decisions that are out there that affect options for structuring, like the New York Bar opinion from 2018.

There is the, you know, ABA best practices for third-party and litigation funding amongst others. So, how do those decisions kind of affect the options for a structure.

Lucian: Well, I'm, I'm chuckling because the New York City Bar opinion, and I believe, although the authorship is anonymous, I believe I know who wrote it. And I love the city actually. Actually, I'm, although I'm a member of the Tennessee Bar and the Arizona Bar, I'm a member of the City Bar of New York for various reasons. So I respect them and their ethics folks are very good, but that opinion is wrong. It's just wrong, wrong, wrong. I could spend, you know, the next hour telling you why, but the bottom line is, is it's not consistent with New York law. If it were true, then I don't know if you could pay your FedEx bill without it being fee sharing, because any fee that depends upon your receipt of fees, like, every expense, but I mean, it's a really, really broad reading that is just wrong and flies in the face of New York law.

In contrast, there's actually a city bar formal opinion from 2024 that is not quite the same subject, but it's on advising clients on their litigation funding agreements, which we just talked about. Lovely opinion. Just like all the city bar opinions, they're just normally are. It's lovely. Otherwise you mentioned the ABA, the litigation section published some best practices on litigation funding. It's, it's good. It's good. It's at a pretty high level, but it's worth pulling. I should mention shameless self-promotion on confidentiality, one of the litigation funding advisors and I have done a piece. Since 2018 that we've done, I think three versions and we're soon to be putting out a new one, pulling together all of the decisions on discovery of litigation funding agreements. There are about a little over a hundred at this point, and, and this is a concern. It's the number one concern any firm is gonna have when they think about a litigation. How does confidentiality work? So we've, we got the law for you on that if you ever need it.

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Givonna: There was an April 2024 proposed rule change. Do you have any insights that you can tell us about where that is right now?

Lucian: It's not going, it hasn't gone anywhere. The new, what you're talking about is in, in the wake of that 2018 city bar opinion from New York. That is, did I mention wrong? The city bar put out a different group, a task force, to come up or think about revisions. They did. They have a proposal to revise New York's 5.4.

It, to my knowledge, it hasn't gone anywhere. I don't think, frankly, most people think there's any need. If you, if you pulled every litigation funding agreement, you know, in the country right now, I don't know, but I'd be willing to bet a majority of them point to New York law. That opinion as wrong as it is, doesn't scare funders. Because they, they've read the law, they know what the law is, and so yeah, it'd be nice to fix New York 5.4, but it's not holding anybody back.

Givonna: One last thing in our time together. Question: do firms have to disclose these financing agreements. I'm sure many listeners wanna know, do they have to disclose these agreements that they make in a litigation matter?

Lucian: Broadly speaking, yes. And when you say disclose, I mean, there, there are two big categories. One is to your clients and the other is to, you know, the other side in litigation.

Givonna: Exactly.

Lucian: Okay, so let's talk about those separately quickly. One is to your clients. By and large, if you're funding as a firm, getting funding for a case or a set of cases, yeah. You, you gotta disclose to your client because you need client consent. You want client consent on disclosing anything confidential, certainly including work product. The second category of disclosure in the litigation to the opposing party or the court or whatever, there is a growing body of rules out there. They're, they're, they come from local court rules. The District of Delaware, for example, federal district, US District Court in Delaware, has some cases like this. Judge Connolly up there has imposed them. I think across the board, but they were driven by IP cases. Northern District of California has a disclosure rule on class actions. A number of the states that have adopted some

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kind of litigation funding legislation or reform has have imposed some kind of disclosure obligation. They vary. In fact, we're adding that to our article on confidentiality this year. We're in the midst of working on that. They are very different from one to the other in scope. So most of them would not require disclosure of the terms. Most of them would, that exists would require disclosure of the fact of funding. I think some of them certainly require disclosure of the funder. But they all vary.

And by the way, the scope of what is funding for this purpose is, also varies and is somewhat complex. There are people out there who take the position that it's federal rules, civil procedure, I think it's 7 the corporate disclosure requirements that are in every district. Some people take the position that those require, some of those require, disclosure of litigation funding.

I do not agree with that, but nevertheless, in a number of jurisdictions, there are some mandatory disclosure to your opponent kind of requirements. And you just need to, you know, as I say, your mileage may vary. You need to check what districts you're gonna be in and what the rules are there.

Givonna: You've given us a lot of very helpful information today, and with the increased popularity of litigation finance in commercial disputes, many firms will have, or they already have had to navigate any ethical pitfalls associated with these transactions.

So it's really important to understand the risks and rewards of these third-party funding agreements, and, you know, addressing it both with your clients and at your firm, adopting a policy that deals with all the aspects of funding and it'll really help firms navigate this, I would call dynamic economic opportunity

Lucian: But I would surely to God think that every firm ought to have a position policy, something that says anybody gonna get any litigation funding of any kind, or whatever, you know, gotta come to the firm, you know, and gotta have some kind of procedure to approve it. I mean, I just can't imagine, you know, one of our members doing that without a real approval process. But I guess it bears saying.

Givonna: Well, thank you so much for your time today.

Lucian: It's been a pleasure.

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Givonna: Until next time. I'm Givonna Long, and this is The Portable Ethics Lawyer.

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