# Third Party Litigation Funding

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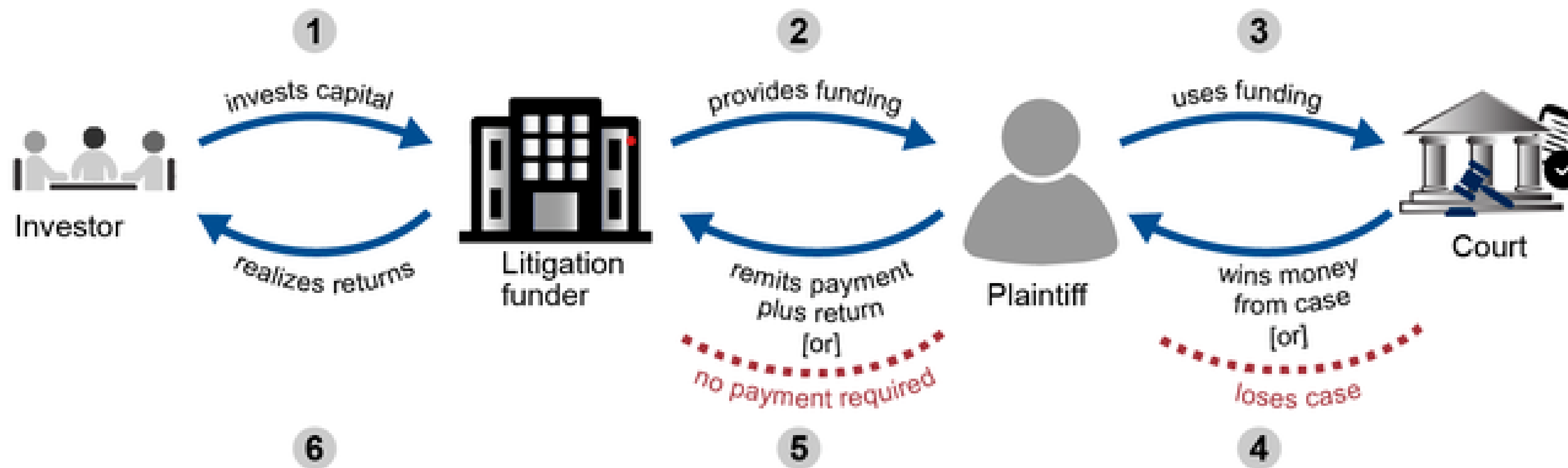
# What is third party litigation funding?

- An agreement between a third party lender and a claimant in which the lender purchases and the claimant assigns the lender a right to receive an amount from the potential proceeds of a settlement, judgment, or verdict obtained from the claimant's legal claim.
- General 4 main components:
  1. A money advance
  2. provided by a third-party
  3. in exchange for proceeds from claimant’s recovery
  4. payable back at the time of recovery, if the claimant is successful in recovering.
- “Non-recourse transaction”
- Consumer vs. Commercial

# Who funds it?

- Private Institutions who specialize in TPLF
- Hedge funds
- Wealthy Investors



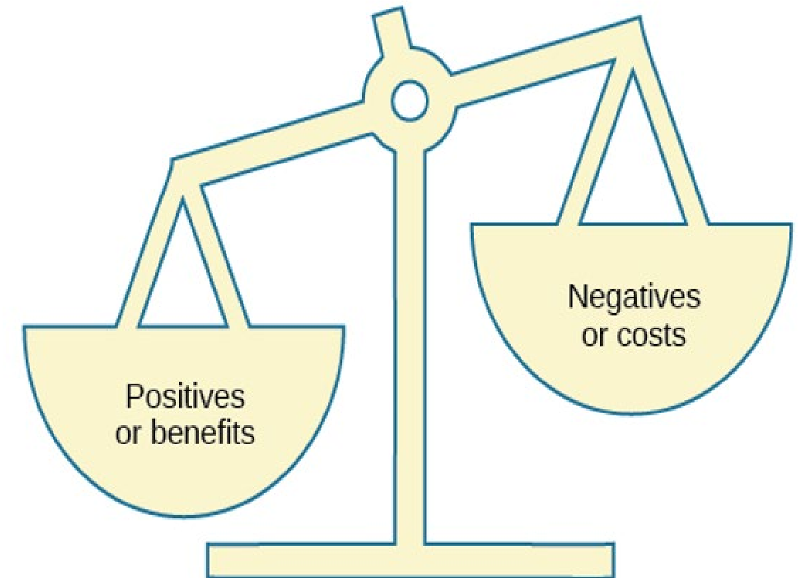
# Who Borrows?

- The individual claimant/consumer
- Plaintiffs' firms
  - But keep in mind Rule 5.4 of Professional Conduct!

# Plaintiffs and third party litigation funding

**Benefits**

- Access to justice
- Levels the playing field
- Ability to monetize claims
- Access to medical care that may not have been affordable otherwise
- Ability to cover living expenses while awaiting the completion of litigation
- Little risk in advancing non-meritorious claims
- Plaintiff's can withstand defense delay tactics as they are not facing financial distress
- Ability to transfer risk to a third party

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# Plaintiffs and third party litigation funding

**Cons**

- HIPAA/confidentiality issues
- Expensive
- 3rd party influence over decisions
- May deter settlement
- Potential conflicts of interest between attorney and client
- Vulnerability of consumers

# Third party litigation funding disclosure regulations

- In the U.S., there are no federal rules that explicitly require the disclosure of TPLF funders.
- Federal Legislation & Congressional Oversight: Between 2017 and 2021, members of Congress repeatedly introduced a TPLF disclosure bill, “The Litigation Funding Transparency Act.” It did not pass.
- In September 2023, the House Oversight Committee held a hearing entitled, “Unsuitable Litigation: Oversight of Third-Party Litigation Funding.” At that hearing, Johnson & Johnson Assistant General Counsel Aviva Wein testified that “the outside money and control fueling modern-day mass tort litigation have little to do with vindicating rights or compensating purportedly aggrieved consumers.”
- Ms. Wein concluded, “Today, the primary beneficiaries of our mass tort regime are the attorneys and their investors. The losers are the courts, American businesses, consumers and allegedly aggrieved claimants.”
- Senators Joe Manchin and John Kennedy have introduced a new bill addressing TPLF, the “Protecting Our Courts from Foreign Manipulation Act,” The House bill, H.R. 5488, is sponsored by the new Speaker, Mike Johnson. This legislation, however, is limited to requiring disclosure of foreign persons or entities, and banning sovereign wealth funds and foreign governments from funding litigation.

# Proposed disclosure regulations in New York

- **April 2024:** Counsel to the New York State Office of Court Administration, David Naconti, sent out a Memorandum stating that the Administrative Board of the Courts was seeking public comment on proposed amendments to Sections 202.67 and 207.38 of the Uniform Civil Rules for the Supreme Court and County Court (22 NYCRR §§ 202.67 & 207.38), that would require disclosure of information relating to litigation financing agreements in certain circumstances.

# A look around the world

## AUSTRALIA

- TPLF was invented in Australia more than two decades ago & drove an explosion of class action litigation in the country.
- September 2021: Attorney General Michaelia Cash and Treasurer Josh Frydenberg announced a draft law regulating TPLF in class actions. The proposed legislation would restrict the fees for class action lawyers and funders to a maximum of 30% of any total payout, give courts the power to approve and adjust funding agreements, and require funders to be licensed. The proposal would also require each plaintiff to consent to participate in the class action and to the funder's terms, creating an opt-in system for funded class actions. The bill successfully passed the Australian House of Representatives in 2021, but did not pass the Senate.
- No efforts have been made to reignite the bill. There is presently no legislation in Australia that limits the fees that funders can charge as payment for the risks undertaken in funding the litigation.
- Outside of government regulation, the courts have a supervisory role in the approval of funded class action settlements. Australian courts can exercise equitable jurisdiction to set aside litigation funding agreements.

# A look around the world

## ENGLAND

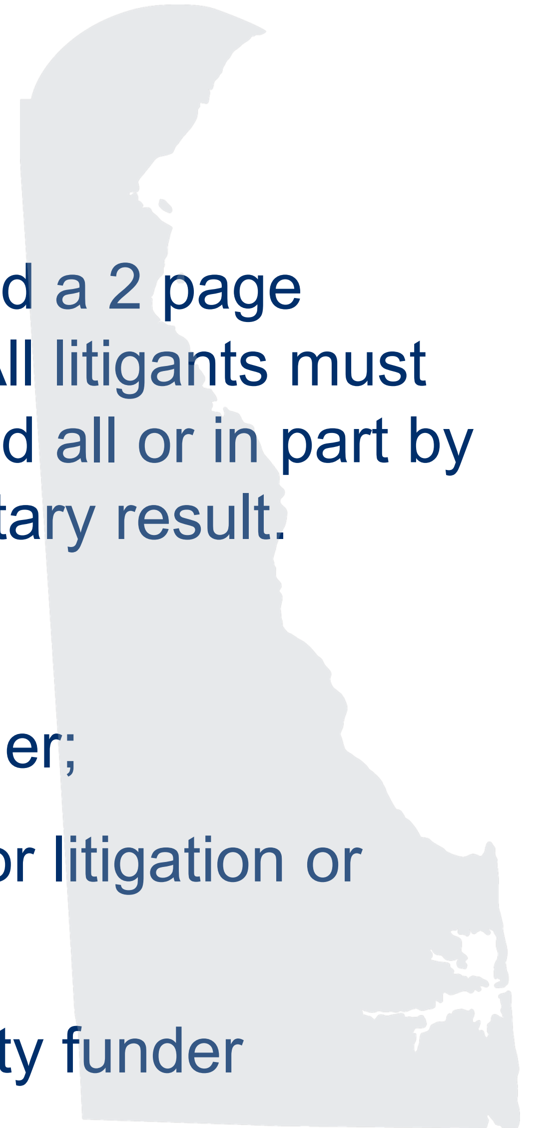
- The government has not specifically regulated the TPLF industry in England, however, there is a form of self-regulation.
- England and Wales have an independent body charged by the Ministry of Justice with delivering self-regulation of litigation funding. The association administers a voluntary code of conduct to be observed by funders that are members of the association. The code sets out standards of practice and behavior, such as capital adequacy requirements and limitations on the funder's ability to terminate a funding.

# A look around the world

## CANADA

- TPLF agreements must be disclosed to the court in class actions and insolvency matters, where TPLF arrangements are subject to court approval. One report stated that, where funding is disclosed and approved, courts have protected commercial details and allowed defendants to view only a redacted version of the agreement.

# Disclosure requirements by state: to tell or not to tell, that is the question



## Delaware

- Chief Judge Connelly of the U.S. District of Delaware issued a 2 page standing order requiring disclosure of TPLF agreements. All litigants must disclose whether attorney fees and expenses are being paid all or in part by a 3rd party in exchange for either a monetary or non-monetary result.
- The standing order also requires the disclosure of:
  - Name, address, and place of formation of third party funder;
  - Whether the third party funder's approval is "necessary for litigation or settlement discussions in the action"; and
  - A description of the financial interest held by the third party funder

# Disclosure requirements by state: to tell or not to tell, that is the question

## New Jersey

- The U.S. District Court for the District of New Jersey adopted a local rule in June 2021 that requires all parties to file a statement with the court within 30 days of filing an initial pleading or the case being transferred to the court, including removal from state court, when any person or entity that is not a party is providing funding for some or all of the attorneys' fees and expenses for the litigation on a non-recourse basis in exchange for

  (1) a contingent financial interest based upon the results of the litigation; or,

  (2) a nonmonetary result that is not in the nature of a personal or bank loan, or insurance.

- The statement must identify:

  (1) the funder

  (2) whether the funder's approval is necessary for litigation or settlement decisions, and, if so, the nature of the terms and conditions relating to that approval; and,

  (3) briefly describe the funder's financial interest.

- The order also provides that the parties may "seek additional discovery of the terms of any such agreement upon a showing of good cause that the non-party has authority to make material litigation decisions or settlement decisions, the interests of parties or the class (if applicable) are not being promoted or protected, or conflicts of interest exist, or such other disclosure is necessary to any issue in the case."

# Disclosure requirements by state: to tell or not to tell, that is the question

## Montana

- Governor Greg Gianforte signed into law SB 269, which requires disclosing TPLF agreements in all civil cases before Montana courts.
- In addition to requiring disclosure of the litigation agreements, the law also requires the following:
  - requires litigation funders to register with the Montana Secretary of State.
  - makes litigation funders jointly liable for costs
  - established a 25% cap on the amount that a funder may receive or recover from any judgment, award, settlement, verdicts, or other form of monetary relief obtained from the lawsuit

# Disclosure requirements by state: to tell or not to tell, that is the question

## Wisconsin

- 2018: became the first state to statutorily require automatic disclosure of "any agreement under which any person, other than an attorney permitted to charge a contingent fee representing a party, has a right to receive compensation that is contingent on and sourced from any proceeds of the civil action, by settlement, judgment, or otherwise".
- This was true in *all* state court civil cases—not just in complex litigation or class actions.

# Disclosure requirements by state: to tell or not to tell, that is the question

Over the past several years, some states have taken steps to regulate TPLF, focusing primarily on consumer protection type issues.

- Indiana, Maine, Nebraska, Nevada, Oklahoma, Tennessee, Vermont, and West Virginia require some form of TPLF registration or licensure.
- Ohio mandates that funders disclose certain contractual terms and information to the consumer.
- Arkansas, Indiana, Nevada, Tennessee, and West Virginia have enacted laws regulating TPLF interest rates or fees.
- Colorado state's Supreme Court held, in part, that a TPLF company agreeing to advance money to tort plaintiffs in exchange for future litigation proceeds, is the equivalent of making a loan. Therefore, this is subject to regulation under Colorado's Uniform Consumer Credit Code.
- South Carolina's Department of Consumer Affairs issued a ruling that entities funding litigation in exchange for a portion of the recovery proceeds are providing loans, and therefore, are subject to compliance under South Carolina's laws governing lending.

# What about New York?

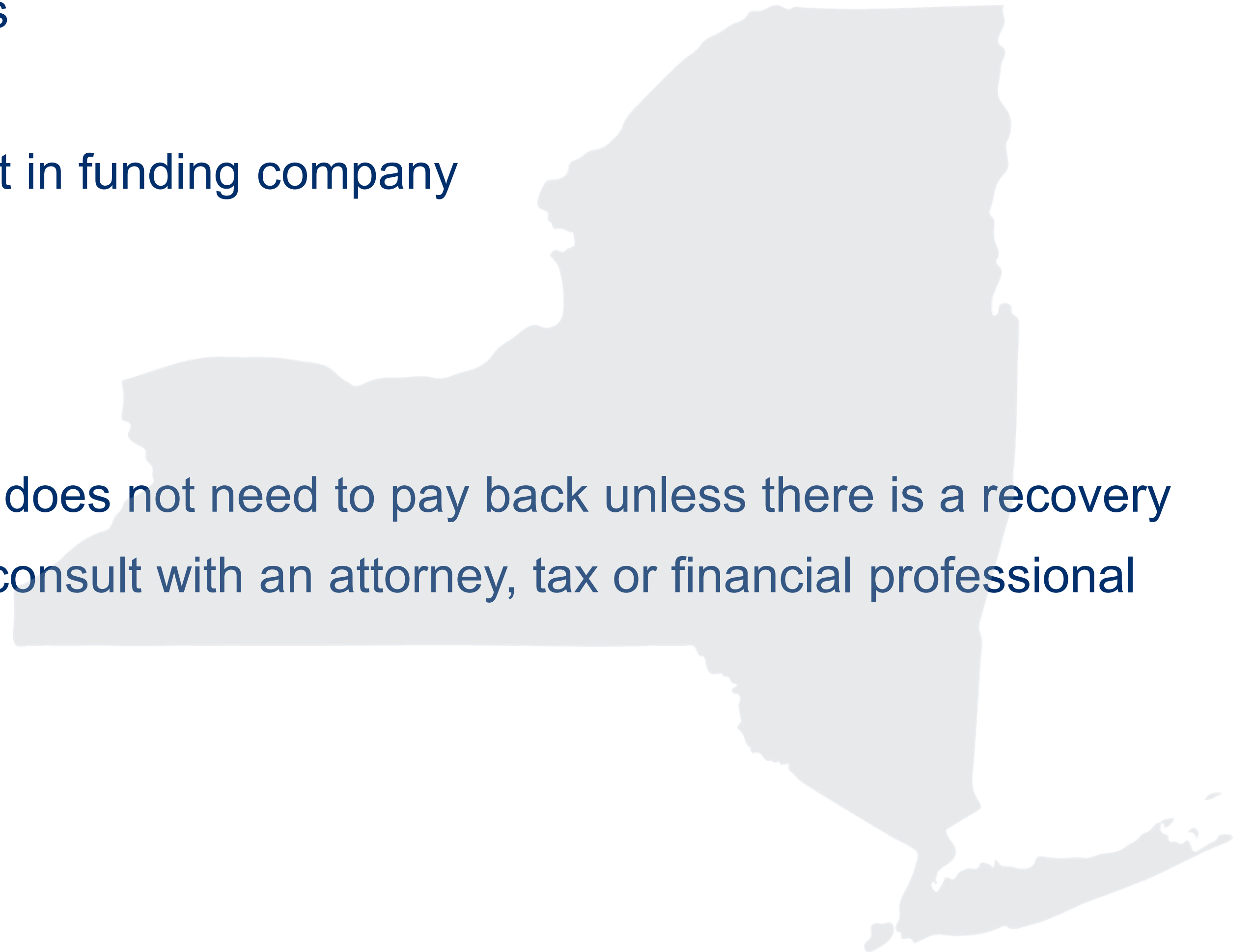
- In **New York**, there have been some legislative proposals but nothing has been adopted…yet.

# What’s next?
# Proposed Legislation in New York

- **Consumer Litigation Funding Act**
  - NY Senate Bill: 2594
  - Introduced most recently on January 23, 2023
  - Legislative Intent
    - “promote consumer protections related to consumer litigation funding transactions…such transactions should be subject to state regulation and sets forth requirements regarding disclosure, licensing, funding company and attorney responsibilities and limitations, violations and other items.”

# New York Senate Proposed Bill 2594

- **Notable aspects**
  - Requirements of the funding contracts
  - Restrictions on lenders
  - Attorney cannot have financial interest in funding company
  - Contracted amounts
  - Disclosure requirements
    - Payment schedule
    - Specific language that the claimant does not need to pay back unless there is a recovery
    - Advising the consumer the right to consult with an attorney, tax or financial professional before signing.
  - Courts have power to null and void
  - Interplay with other liens
  - Registration and reporting



# Proposed Legislation Cont.

- **NY Assembly Bill: A115**
  - Introduced on January 4, 2023.
  - Proposes a 25% cap on interest rate.
  - Lender cannot attempt to get a waiver of any consumer rights in the underlying action, including the right to a jury trial.
  - The attorney can only disclose privileged information to the funding company with written consent of the consumer.
  - Penalties for violations
- **NY Assembly Bill: A7655/ NY Senate Bill S4146**
  - Introduced on May 30, 2023/ Introduced on February 3, 2023
  - Contracts must contain a clause regarding no prepayment penalties.

# Examples of TPLF

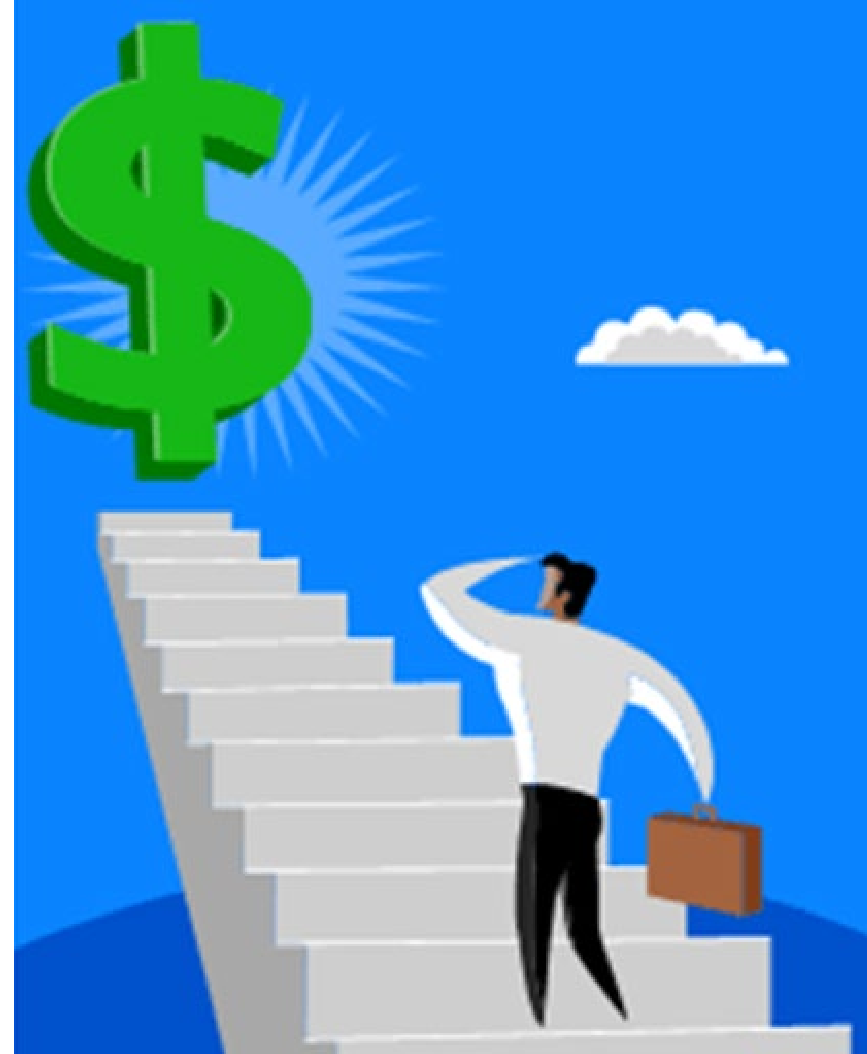
1. TPLF was disclosed on eve of trial and was extremely impactful—resulted in trial costs and years of appeals
2. TPLF was disclosed early on with minimal impact thus far.
    - But something to keep an eye on!

IF SELLER COMPLIES WITH THIS AGREEMENT AND RECOVERS NOTHING FROM THE LEGAL CLAIM CITED BELOW, THEN █████ SHALL RECEIVE NOTHING. SELLER IS NOT ENTITLED TO RECEIVE ANY PROCEEDS UNTIL █████ HAS RECEIVED THE █████ OWNERSHIP AMOUNT.

| █████ Ownership Amount and Fees Due upon Payment | |
|---|---|
| April 13, 2023 to October 12, 2023 | $5,061.00 |
| October 13, 2023 to April 12, 2024 | $5,514.60 |
| April 13, 2024 to July 12, 2024 | $7,546.00 |
| July 13, 2024 to October 12, 2024 | $8,351.00 |
| October 13, 2024 to April 12, 2025 | $9,191.00 |
| April 13, 2025 to October 12, 2025 | $10,836.00 |
| October 13, 2025 and thereafter | $11,837.00 |

# Effects of third party litigation funding

- Increase in lawsuits
- Slower Resolutions
- More trials
- Increase in litigation costs
- Social inflation
- Skewing settlements/impediment to settlement/inflating damages
- Predatory lending
- Confidentiality/HIPAA issues



# Effects on Medical Providers

- TPLF may encourage the filing of meritless lawsuits and litigation costs may increase because cases may run longer, since plaintiffs may not be inclined to settle. This leads to more medical providers dealing with the stress and time of meritless lawsuits.
- The nature of the monetary investment and the contractual involvement inherently puts financers in a position of control and influence over plaintiffs. This relationship encourages plaintiffs to file frivolous suits, leads to inflated settlement and trial demands, and emboldens plaintiffs to seek additional treatments and procedures such as physical therapy, MRIs, and CT scans, which can increase claim severity.
- Outside funders sometimes cover a plaintiff's expenses for medical care with the expectation that they will be repaid out of a settlement of judgment. This form of TPLF poses the risk that attorneys refer clients to medical clinics or doctors with whom they have a relationship. Outside funding of plaintiff's medical expenses has led to litigation in which patients are urged to undertake unnecessary medical treatment to drive up their cases' settlement values.
- This leads to cases going to trial when they should be settled, forcing medical professionals to have to leave their patients in order to be present in Court during trial.
- Juries may not receive the whole picture of who receives the money when they award damages, which may influence their decisions, leading to excess verdicts. Excess verdicts may lead to increased premiums for medical providers.
- Critics suggest that the practice leads to increased insurance rates and less favorable policy terms and conditions. The ripple effect of TPLF practices will continue to be felt by insurers by increasing their loss costs. Policyholders will feel the pinch as they struggle to pay for uncovered losses and higher premiums stemming from the increase in frivolous litigation and higher settlements partially driven by a TPLF.

# Effects on Insurance Companies

*Why does TPLF have a negative effect on insurance companies?*

- Litigation funding makes it harder and more expensive to settle cases, resulting in prolonged and more expensive litigation.
- With no disclosure laws and no help from the courts, insurers will likely experience increased claims expenses and litigation costs.
- Data suggests that TPLF may be a driver of social inflation, a concept that refers to the increase of insurance claims' costs above that of the general economy's inflation rate. Swiss Re notes that there has been an increase of multimillion-dollar claims in the U.S. general liability and commercial auto areas and that TPLF incentivizes initiating and prolonging lawsuits while diverting a larger percentage of proceeds to the funder instead of the plaintiff. These expanded costs may be difficult for insurers to quantify and mitigate since they are hard to predict.
- This then makes it difficult for insurance companies to calculate and plan for associated costs and mitigate legal risks, which in turn leads to an increase in insurance costs for consumer.

# Effects on Insurance Companies

- Plaintiff's bar is ready to leverage their financial backing to increase the chances of achieving a nuclear verdict. Financial backing empowers plaintiffs to make absurdly high demands, which could, in turn, lead to a rise in Nuclear Verdicts at trial.
- Nuclear verdicts will continue to rise, which in turn will be paid by insurance companies, and then will be passed down to business owners and corporations, which in turn will be passed down to consumers.
- The US Chamber Institute for Legal Reform highlights the relationship between litigation funding and Nuclear Verdicts, stating "the funder may hold out for a large settlement to maximize her own return even if an early settlement might actually most benefit the plaintiff. Similarly, the presence of a funder, particularly in high-profile collective litigation, can shift the balance of power so far that defendants feel compelled to settle even if the claim is weak."

# Effects on Insurance Companies

*The other side of the argument:*

- Important gateway to the courthouse. Litigation funding improves rather than undermines our litigation system, and likely results in less rather than more litigation.
- A paper by Harvard and Stanford business professors published in the Journal of Financial Economics found litigation finance will likely deter defense spending and expedite (rather than protract) litigation, as defendants are more likely to settle strong claims if they know they cannot grind down adversaries in litigation tactics.
- Litigation is often an effective tool to ensure compliance with the law, and litigation is very expensive. Litigation finance helps people with meritorious claims access the courts and uphold their rights.

# Moving Forward

## Discoverability of Litigation Funding

- In New York, there is no statutory obligation to disclose the existence of litigation funding during discovery.
- The threshold question in discovery is whether information is relevant to the case.
- New York courts have addressed this issue, and unfortunately have found litigation funding agreements were not relevant and are not discoverable. The First Department has rejected efforts to seek disclosure of litigation funding, stating that communications with funders are neither material nor necessary to the case.
- Nothing requires TPLF to be disclosed, even to plaintiffs themselves.

# Moving Forward

## Efforts during Discovery

- Through the discovery process, parties in litigation can seek information about "any non-privileged matter that is relevant to any party's claim or defense and proportional to the needs of the case." Courts have allowed parties to obtain information on TPLF through discovery in some circumstances, especially when the presence of outside funding can be tied to the merits of the case.
- Obtaining such information through discovery is challenging, however, as attorneys for funded parties frequently object, claiming that how the litigation is funded is either irrelevant to the claims or defenses in the case, that the information is privileged and reflects litigation strategy, or both.
- What can and should be done as a basic first step is to require transparency when outside entities have a financial interest in litigation. All parties and the court should be aware that a commercial funder, hedge fund, individual or business that does not appear on the docket may have motivated the lawsuit, and could be pulling the litigation strings and complicating the ability to resolve the litigation. Disclosure of TPLF and other safeguards are critical to ensuring that hidden outside investors are not misusing the civil justice system for their own profit at the expense of patients, innovation, and fairness.
- The defense bar should always make demands for litigation funding information, including the interest rates, agreements, and lien amounts in every case.

# Moving Forward

## What if the Courts Deny Disclosure

- Even if the court denies a defense counsel's request for litigation funding information, defense attorneys may still use public resources which are available to help determine whether plaintiff in a particular case has litigation funding.
- In personal injury cases, if a plaintiff takes out a new loan for medical treatment, the litigation financer is required to file a Uniform Commercial Code (UCC) lien with the New York Department of State.
- UCC filing statements are public information in New York, and are readily available at no cost on the New York Department of State's website.
- Filing statement contains the debtor's and secured party's name and address.
- Does not include the monetary amount of the loan.
- Defense counsel can use the filing statement to press plaintiff on the existence of litigation funding during the cross-examination of plaintiff.

# Ethical Considerations

- Privilege
- HIPAA
- Usury
- Conflicts of interest/lack of transparency
- Control over the proceeding
- Consent
- Potential loss of Medicaid benefits
- Champerty and Maintenance
  - proposed changes to Rule 5.4 of New York State’s professional conduct rules for lawyers would allow a lawyer to pledge security interests in unrecovered legal fees to a non-lawyer, including a financing company

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# Questions?