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Some words to the wise on litigation finance enterprises

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The explosive growth of the so-called "litigation finance" industry is a game-changer in the civil practice arena. The New York Times Magazine recently documented the rise of this industry and described it as "transformational." One litigation financing entity, Gerchen Keller, now boasts of having more than $1 billion under management and available to "invest" in litigation matters.

While litigants may find these arrangements appealing in certain circumstances, lawyers who find themselves tempted to get involved in them must be mindful of a number of ethical issues that may be presented. We will examine those issues in a series of columns.

First, some basics. Third-party litigation financing can take several forms. On the consumer side, companies offer cash advances to personal injury plaintiffs, usually for relatively small sums of money, to keep these plaintiffs afloat while their lawsuits are pending.

These advances must be repaid, often at hefty interest rates, out of any settlement or judgment. A typical transaction might involve a $25,000 cash advance, at a monthly interest rate of 3 percent.

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If the personal injury lawsuit settles one year later, the funder will recover $37,500. If the lawsuit settles two years later, the funder will recover $57,000. As a result, some personal injury plaintiffs will end up paying all or most of their recoveries to litigation funders.

On the plus side, injured plaintiffs can shift the risk of a negative trial outcome, because there typically is no obligation to repay the loan if there is no recovery.

More recently, a growing number of litigation finance entities have been investing in high-stakes commercial litigation, and providing the funding necessary to keep the litigation going. Several of these entities, including Burford Capital and Bentham IMF, are publicly traded companies, and the success (and sometimes spectacular failure) of their investments is therefore a matter of public record.

These litigation finance enterprises advertise their ability to assess and value complicated commercial claims, and they often are advised by high-powered lawyers and law professors. Burford Capital, for example, touts having prominent legal ethicist Geoffrey Hazard as its "regular ethics counsel," and Georgetown Law School professor Jonathan Molot as its "chief investment officer."

As discussed in The New York Times story, litigation financing can level the playing field for a plaintiff facing a corporate Goliath. In the case featured in that article, Miller UK Ltd., a British manufacturer of heavy equipment parts, sued Caterpillar, Inc., in federal District Court in Chicago, claiming that Caterpillar, its former customer, had stolen the design of a coupler.

Because Miller could not afford to pay its lawyers out-of-pocket, Miller obtained litigation financing from Arena Consulting, which is based in Illinois.

In December 2015, after more than five years of litigation, a jury awarded Miller nearly $75 million in damages. Presumably, if the verdict holds, Arena Consulting will realize a significant return on its investment, and Miller will believe that its legal rights were vindicated.

At the same time, some commentators have criticized this type of litigation funding as promoting more lawsuits and increasing litigation costs.

At first blush, it would seem that these

litigation financing arrangements are perfectly appropriate and represent no more than a means of providing access to the courts for litigants — in the same way contingent fee agreements do. But as this series of columns will demonstrate, these arrangements are fraught with ethical issues and concerns.

In this first installment, we set the stage and discuss the ethical issues implicated when a lawyer recommends these arrangements to clients, or negotiates litigation financing agreements on a client's behalf.

In the second installment, we will discuss the confidentiality and conflict-of-interest concerns that litigation financing can present.

And in the third, we will consider some practical and strategic concerns, and provide suggestions for how to deal with them.

A lawyer whose client wishes to obtain litigation financing first must determine whether such an arrangement is permissible under the applicable state's law, including the question of whether litigation financing flouts the ancient prohibition against champerty. See Mass. R. Prof. C. 1.1 (lawyer shall provide competent representation to a client).

As most lawyers know, champerty is the unlawful maintenance of a suit by a person who has no interest in the subject matter of the dispute, but finances the suit in exchange for a share of the proceeds. *Saladini v. Righellis*, 426 Mass. 231, 233 (1997).

In *Saladini*, for example, the plaintiff sought to enforce an agreement under which she had advanced funds to the defendant in connection with a suit to establish rights in real estate.

The Superior Court dismissed the complaint, on the grounds that the agreement was champertous and therefore unenforceable. The Supreme Judicial

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Court reversed, holding that the doctrines of champerty, barratry and maintenance no longer would be recognized in Massachusetts. *Id.* at 231.

The court stated that it had long ago "abandoned the view that litigation is suspect," and noted the development of other devices designed to deter frivolous and vexatious lawsuits. *Id.* at 235.

The SJC further cautioned, however, that agreements to finance litigation would be closely scrutinized and held out the possibility that unfair or unreasonable provisions could be set aside or modified. *Id.* at 236-37.

In a footnote, the court further stated that its decision "should not be interpreted to indicate our authorization of the syndication of lawsuits." *Id.* at 236 n.7 (citing to two law review articles discussing the rise of litigation finance entities). With the court having abolished the rule against champerty, it is unclear on what basis the SJC would hold that "syndicated" litigation financing is inappropriate or illegal.

Moreover, in several other states, courts and/or state bar organizations have concluded that "syndicated" litigation financing is not per se illegal or unethical. Professional Ethics of the Florida Bar, Op. 00-3 (Mar. 15, 2002); Association of the Bar of the City of New York Committee on Professional Ethics, Formal Op. 2011-2: Third Party Litigation Financing (June 2011); Supreme Court of Ohio Board of Commissioners on Grievances & Discipline, Op. 2012-3 (Dec. 7, 2012).

Nevertheless, until there is further guidance, the cautious lawyer will want to tell his or her client, if the client is a litigation funding entity, that Massachusetts law is unclear as to whether a contract to provide litigation financing through the sale of shares to investors will be enforceable.

What about the lawyer who is asked to draft or review a litigation financing agreement for a litigant who is in need of the financing? The duty of competent representation would require that the lawyer understand and explain to the client all of the terms of such an agreement, including the way in which interest will be calculated; whether the agreement calls for any additional "administrative" or "lending" fees; the priority of payment in the event of a recovery, and what types of awards will constitute a recovery triggering the obligation of repayment; the liability of the litigant (if any) if there is no recovery; the types of information that will be provided to the financing company in order to persuade them to make an investment, and then after the litigation is filed; and whether the agreement provides the financing company with any control over decisions made during the litigation and, in particular, decisions regarding settlement.

As one example of the importance of thinking through these issues, a law firm recently was sued by its former corporate client for recommending a litigation financing agreement, where the client was awarded a substantial amount on its claim but had a much larger amount awarded against it on a counterclaim. After making the payment due on the counterclaim and the payment required per the financing agreement, the client was forced to declare bankruptcy, a result that the client now says should have been foreseen by its former lawyers.

In our next column we will consider the ethical issues that arise if the financing company has a role in litigation or settlement decisions. MLW

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