Testimony on Third Party Financing of Lawsuits

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Greetings. I thank the committee for giving me the opportunity to provide feedback on bills S. 3911 and A. 8966. My name is Maya Steinitz, and I am a Professor of Law at the University of Iowa College of Law and a Visiting Professor at Harvard Law School for both Spring and Fall of 2018. Third party litigation financing is one of my main fields of expertise as an academic.

I have published papers regarding Third Party financing of both domestic and international disputes, and have written extensively regarding the set up and design of litigation financing contracts.¹ I and a co-author have designed a model litigation financing contract, the development and unveiling of which is detailed on the website litigationfinancecontract.com. In this website, we examined issues such as state regulation of litigation financing, as well as the appropriate and optimal provisions which should enter into a litigation finance agreement. At Harvard Law School this past semester, I taught a course titled “Litigation and Law Firm Finance and the Future of the Legal Profession” which examined the growth of third party litigation financing and its potential implications.

¹ See, Maya Steinitz, Incorporating Legal Claims, 90 Notre Dame L. Rev. 1155, 1155-1210 (2015); Maya Steinitz & Abigail C. Field, A Model Litigation Contract, 99 Iowa L. Rev. 711, 711-772 (2014); Maya Steinitz, How Much is that Lawsuit in the Window? Pricing Legal Claims, 66 Vand. L. Rev. 1890, 1890-1924 (2013); Maya Steinitz, The Litigation Finance Contract, 54 Wm. & Mary L. Rev. 455, 455-518 (2012); Maya Steinitz, Whose Claim Is This Anyway? Third Party Litigation Funding, 95 Minn. L. Rev. 1269, 1269-1338 (2011); Maya Steinitz & Joseph Matthews, Contingent Fees and Third Party Funding in Investment Arbitration Disputes, 4 Transnat’l Disp. Mgmt. J. (2011).
Third party litigation financing is a service with great potential. If harnessed in the correct way, litigation financing can help indigent plaintiffs access justice and receive remediation for harms. For many potential plaintiffs with strong cases, legal costs serve as a barrier to the full achievement of justice in their particular circumstance. Third party litigation funders could help plaintiffs to overcome this financial barrier, thus improving access to justice for those in need of it. The potential for market competition between existing contingency fee lawyers and third party litigation funders also has the potential to lower prices for consumers of legal services across the board. Litigation finance, then, has the potential to positively impact the legal market for consumers and civil justice more broadly.

However, like all financing, litigation financing is open to abuse. Everyday consumers are particularly vulnerable, and an appropriate consumer protection regime needs to be put in place for consumer litigation financing. The pending bills, therefore, are to be commended. My comments will seek to highlight arrangements that can be put in place to ensure that litigation finance is not only economically viable but that consumers receive the full benefit of this new form of financing.

**Financing Scenarios**

Before discussing the legislation, I would like to clarify the distinction between two different kinds of litigation financing: commercial litigation finance and consumer litigation finance. Commercial litigation finance deals with litigation financing provided to corporations for commercial disputes, whereas consumer litigation finance deals with litigation financing provided to individual consumers, often in the context of torts. The reason why I note this distinction is to highlight the greater

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2 Examples of scholarship discussing the types of available consumer litigation finance options and their effects on consumers as well as on the civil justice system include: Nora Freeman Engstrom, *Re-Re-Financing Civil Litigation: How Lawyer Lending Might Remake the American Litigation Landscape, Again*, 61 UCLA L. Rev. Disc. 110 (2013) (describing the evolution of funding available to plaintiff-side personal injury firms and identifying the ways in which third party funders in this space may alter the American litigation landscape); Paige Marta Skiba & Jean Xiao, *Consumer Litigation Funding: Just Another Form of Payday Lending?*, 80 L. & Contemp. Probs. 117 (2017) (comparing and contrasting consumer litigation with payday lending); and David R. Glickman, *Embracing Third Party Litigation Finance*, 43 Fla. St. U. L. Rev. 1043 (2017) (detailing concerns that consumer litigation finance will lead to exploitation of unsophisticated consumers and that such financiers will seek to take control of litigation decisions).

3 Additional contexts include workers compensation claims and divorce. With regards to workers compensation claims, see, *Get Pre-settlement Funding for your Worker’s Comp Claim*, LAWCAPITAL (2017) [https://www.lawcapital.com/types-of-cases-considered/workers-compensation](https://www.lawcapital.com/types-of-cases-considered/workers-compensation) (both websites of litigation
importance of regulation surrounding consumer finance, which often deals with less sophisticated litigants who, unlike business litigants, are not represented in their dealings with finance providers. In particular, many corporations have extensive in-house legal teams which can examine the provisions of any litigation financing contract to ensure fairness and assess competitiveness. This is often not the case with individuals, many of whom have little understanding of finance and of the litigation process, let alone the interactions between the two; who may have little or no bargaining power; and who may bring legal action (especially in torts) during times of personal crisis. The regulatory issues raised in the commercial litigation financing context are, therefore, very different than those raised in the consumer litigation finance context. Given the scope of the bills, only the latter are addressed herein.

The two bills are at the same time similar and quite different. The Assembly bill does not, strictly speaking, seek to regulate litigation finance; rather it would regulate financing the consumer’s costs while the litigation is pending. Specifically, the bill forbids litigation finance companies from paying court costs or attorneys’ fees, and requires the borrower to have a contingency fee arrangement with the attorney. Presumably that attorney is also covering the costs of court reporters, transcripts, and experts as needed. That is, the costs of litigation. The Senate bill lacks this prohibition and would allow the financing of the actual litigation. Indeed, some funders in the marketplace already finance attorneys’ costs as well as plaintiffs’ costs. Such financing, if allowed, can create competition for financing vis-à-vis contingency fees and may, therefore, reduce the cost of litigation finance for consumers. It is therefore, in my view, preferable to permit it. And if it is permitted, it should be covered by the protections contemplated by the bills.

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4 See A. 08966 §899-ccc(1)(g), 201° State Assemb., (N.Y.).

5 The following states’ statutes regulating consumer litigation finance implicitly permit consumer litigation financing of legal fees and costs: Maine, see Me. Rev. Stat. tit. 9-A, § 12-101 (2008); Nebraska, see Neb. Rev. Stat. Ann. § 25-3301 (2010); Ohio, see Ohio Rev. Code Ann. § 1349.55 (2008) and; Tennessee, see Tenn. Code Ann. § 47-16-102 (2014).
The bills do not contemplate, and therefore my comments do not address, another, new, development in the marketplace: portfolio financing. In this form of financing, law firms ‘pool’ a number of cases together and contract directly with a financier to receive law firm financing tied to the performance of the entire pool. These arrangements also bring up their own set of issues (for example, whether or not the clients are aware that their cases are being financed in whole or in part by a third party rather than by the law firm and/or whether they are aware of the terms of the financing and how such terms might affect case strategy).

Finally, the bills do not contemplate and therefore my comments do not address crowdfunding of litigation, which has also emerged in recent years.

**Defining the Scope of Protection by Focusing on the Characteristics of the Plaintiff Rather than the Amount of the Financing**

The Senate version of the bill exempts contracts offering non-recourse financing of more than $500,000 from its scope, while the Assembly version provides no such exemption. In my opinion, the Senate version of the bill represents the correct direction, in the sense that the Senate bill attempts to focus its protection on those individuals who are less sophisticated litigants by exempting high dollar litigation financing contracts from its application, thereby focusing on the types of smaller scale and more vulnerable litigants who can both benefit the most from the access to justice facilitated by litigation financing, but also have the greatest risk of being exploited due to lack of sophistication with respect to finance and/or litigation. Nonetheless, it would seem that a dollar amount is an imperfect way to capture the difference between different kinds of litigation finance consumers. One can envision, for example, an indigent plaintiff with a large wrongful death claim that costs more than $500,000 to pursue. One can similarly envision an entrepreneur, with competent counsel, seeking $250,000 for a commercial claim.

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6 For articles discussing the pooling of cases for consumer litigation finance, see generally Radek Goral, *Justice Dealers: The Ecosystem of American Litigation Finance*, 21 Stan. J. L. Bus. & Fin. 98 (2015) and Jonathan T. Molot, *A Market In Litigation Risk*, 76 U. Chi. L. Rev. 367 (2009).

7 Regarding the crowdfunding of litigation, see generally Manuel A. Gomez, *Crowdfunded Justice: On the Potential Benefits and Challenges of Crowdfunding as a Litigation Tool*, 49 U.S.F.L. Rev. 307 (2015) (general overview of costs and benefits); Michael Elliott, *Trial by Social Media: The Rise of Litigation Crowdfunding*, 84 U. Cin. L. Rev. 529 (2016) (describing Lexshares, a litigation crowdfunding company).
I therefore suggest *protecting ‘unsophisticated plaintiffs’.* In making this suggestion, I am drawing from the field of securities regulations wherein the law distinguishes between “sophisticated investors” and “unsophisticated investors.” Specifically, I would suggest that the legislature consider amending sections 2 and 3 of the Senate bill to read as follows: “‘Consumer litigation funding company’ shall mean a person or entity that enters into a consumer litigation funding contract to provide non-recourse funding to an unsophisticated plaintiff” and “‘Consumer litigation funding contract’ shall mean a contract to provide non-recourse funding to an unsophisticated plaintiff.” These definitions would more accurately capture the intention and spirit of the $500,000 restriction, which is to, in fact, ensure that the bill is focused on protecting unsophisticated, vulnerable plaintiffs in the marketplace.

**Ensuring Appropriate Plaintiff Recovery: A Statutory “Minimal Recovery” Approach**

It is critically important that third party litigation does not lead to a drastic reduction in plaintiffs’ recovery in lawsuits since its entire rationale is access to justice, namely, ensuring that individuals of limited means can seek and receive remediation for harms. Particularly in the cases of vulnerable populations, and of personal injuries and claims, it is important that a significant portion of the recovery would be used to remediate the harm to the plaintiff. The concern is that the combination of the compensation of the third party litigation funders and the attorneys’ contingency fees would, separately or combined, leave the wronged or injured plaintiffs without meaningful recovery and remediation. To achieve this goal, the bills focus on the methodology through which the funders’ return is calculated; the Senate’s bill sets a limit on the percentage of the return and the Assembly bill

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8 See 17 CFR §230.501. In that context, there has developed a rich jurisprudence and literature on how to assess financial sophistication which courts considering consumer litigation finance arrangements could draw upon. For a description and analysis of the “sophisticated investor” concept, see, e.g., C. Edward Fletcher III, *Sophisticated Investors Under the Federal Securities Laws*, 1988 Duke L. J. 1081, 1081-1154 (1988).

9 An example of this can be found in the so-called Lago Agrio litigation between Chevron and a group of Ecuadorian plaintiffs, in which Burford Capital, a litigation finance company, entered into an agreement to fund the post-judgment phase of this transnational mass tort litigation. The potential for *de minimis* recovery for the plaintiffs under the arrangement has been summarized as follows: “What if the case settles for less than a [billion]? Then Burford gets 98.25% of “Net Recoveries” after paying $2.5 million to another outside investor… and certain expenses of other lawyers. But it doesn’t stop there. Should the Ecuadorean villagers decide to accept less than $1 billion from Chevron, another clause two pages away reveals that the “Net Recovery” is deemed to be the “Settlement Amount.” In other words, if the outside funder isn’t happy with the amount the villagers accept, it gets $55.5 million — a 270% return on its money — before the villagers get a dime.” See Daniel Fisher, *Litigation Finance Contract Reveals How Investors Back Lawsuits* FORBES, July 6, 2011.
requires a flat rate. I propose that, rather than focusing on the financiers’ return formula, the statute directly guarantee a minimum return to the plaintiff.

If the suggestion above to allow funders to fund the legal fees and costs is accepted, then in order to guarantee this minimum return for the plaintiff, the focus will need to broaden to include both the contingency fees of attorneys and the litigation funders’ returns, and ensure that the returns of both lawyer-financiers and third party-financiers combined do not exceed the plaintiff’s minimum recovery.

Currently, return on lawyers’ litigation financing – the contingency fee – are capped in New York at a third of the total recovery, barring extraordinary circumstances. If funders are allowed, as the bills currently envision, funding living expenses and similar expenses which lawyers are prohibited from advancing their clients, the combined maximum return to all financiers (lawyers and funders) should be somewhat higher than a third but, to keep the spirit of the current limitations on returns on litigation finance, should probably not exceed half of the recovery.

10 More precisely, New York’s rules capping contingency fees have been summarized as follows:

“In New York [] each of the intermediate appellate courts… adopted the fee caps… The fee caps apply to “any claim or action for personal injury or wrongful death, other than one alleging medical, dental or podiatric malpractice.” All of the New York rules provide that a contingency fee will be “deemed to be fair and reasonable” if it satisfies one of two schedules. One schedule, Schedule B, applies if the original agreement set a contingency fee “not exceeding 331/3 percent of the sum recovered.” … The other schedule, Schedule A, applies when there is no contract providing for a flat fee less than or equal to one-third. Schedule A requires a contingency fee to be less than or equal to the following tiered standard: “(i) 50 percent on the first $1,000 of the sum recovered, (ii) 40 percent on the next $2,000 of the sum recovered, (iii) 35 percent on the next $22,000 of the sum recovered, (iv) 25 percent on any amount over $25,000 of the sum recovered.” Contingency fees that meet neither of these two schedules “constitute the exaction of unreasonable and unconscionable compensation.” Like the New Jersey rule, all of the New York rules also allow the attorney to apply for higher fees. But in New York, attorneys can only seek higher fees in “extraordinary circumstances.” Notably, an attorney cannot claim extraordinary circumstances if she originally agreed to a flat fee equal to or less than one-third.”

See Monica Hughes, Applying State Contingency Fee Caps in Multidistrict Litigation (MDL) Settlements, 91 Tx. L. Rev. 961, 964-965 (2013).

By comparison, the CEO of the commercial litigation financier Bentham IMF, one of the world’s oldest and largest litigation financiers, has stated that “‘We won’t do a case [] where we don’t think the client will get 50% of their recovery.’ He went on to report (with deserved pride) that during its thirteen-year tenure in Australia, Bentham has seen its clients receive at least 65% of their settlements.” See, Dylan Beynon, From the Words of Litigation Funding Company Bentham IMF, MIGHTY (July 10, 2015), https://www.mighty.com/blog/words-litigation-funding-company-bentham-imf.
Therefore, if my suggested approach is adopted, the statute should ensure a minimum recovery of no less than 50%, barring extraordinary circumstances, to the plaintiff. This can be achieved by including the following provision: “Barring extraordinary circumstances, the consumer shall receive no less than 50% of the Net Recovery.”

Such a guarantee would necessitate a definition of “Net Recovery.” A suggested definition is: “The “Net Recovery” is the total amount awarded to the consumer less the disbursements of the litigation-including filing fees, transcript costs, expert witness fees, and similar expenses--advanced by the attorney. The charges of the consumer litigation finance company and any attorneys’ fees shall not be included in the calculation of the Net Recovery.”

The minimum recovery protection can stand on its own because it is the most direct way to protect the plaintiff’s recovery. But, it may be beneficial to add, alongside it, a cap based on either a flat fee or an interest rate. That would help ensure that the minimum does not become a de facto maximum.

Financial Advice by Lawyers: Narrow Exceptions to Allow Plaintiffs the Benefit of Conflict-free Input on Pricing

The prohibition by the Assembly bill on attorneys providing financial advice is advisable. Attorneys are not necessarily qualified to give such advice and taking on such advising may create conflicts given that attorneys are likely to have repeat relationships with certain funders. However, although the exception itself is generally prudent, the legislature should consider making two exceptions to this broad rule.

One exception would be for advice relating to the rates available by different litigation finance companies. The other, would be for advice on the payment formula that may be most advantageous to the plaintiff. For example, if the final statute does not mandate a flat rate or a percentage return, an attorney may be well positioned to advise the client on which of the two would be best for her individual case. The reason this is so is because the expected duration of the litigation will likely be the most important factor to consider and the attorney will be in the best position to assess what that duration might be.
Jurisdiction

The Assembly bill defines “Consumer,” ensuring this law would apply only to natural persons residing in or domiciled in New York with a pending claim. Having such a definition is wise, as is the limitation of the protection to natural persons; however, I encourage you to consider expanding the definition to protect New Yorkers with claims and citizens of other states who are financing a claim pending in New York state courts. Further, depending on New York’s general approach to the regulation of its corporate citizens when it comes to consumer protection, it may also be advisable to extend the obligations to all New York-based funders.

Prohibition of Prepayment Penalties, Registration Requirements and Right of Rescission

Pre-payment fees are harmful to consumers, and therefore prohibiting them is advisable in a bill aimed at protecting consumers.

Registration in the model of the Assembly bill would, similarly, be very useful. The required transparency would not only deter bad acting, but would also allow ongoing research into litigation finance which, in turn, will enhance both market efficiency and informed decision-making by consumers and their advisors.

Right of rescission is a protection afforded by almost every state that has legislated on this topic,11 and is advisable in the context of consumer litigation finance, where a plaintiff is likely injured and unable to work and is therefore in a particularly difficult bargaining position.

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11 States which offer the protection include Nebraska, see Neb. Rev. Stat. Ann. § 25-3303 (2010); Maine, see Me. Rev. Stat. tit. 9-A, § 12-101 (2008); Ohio, see Ohio Rev. Code Ann. § 1349.55 (2008); Oklahoma, see Okla. Stat. Ann. tit. 14A, § 3-806 (2013); Tennessee, see Tenn. Code Ann. § 47-16-104 (2014); Vermont, see Vt. Stat. Ann. tit. 8, § 2253 (2016). Every statute requires the consumer to give 5 business days notice for rescission.
**Conclusion**

Litigation financing has the potential to expand access to justice for plaintiffs who need it the most. Indigent and middle class plaintiffs are the ones who stand to gain the most from a properly regulated litigation finance system. By encouraging the right mix of regulation, competition, information, and reputational markets in this sphere, the legislature can help promote access to justice while curbing the worst forms of abuse. My comments have focused on the need to protect the class of indigent and middle income plaintiffs, or, as I call them, the “unsophisticated plaintiffs.” These are the plaintiffs who both need access to litigation finance, as well as protection from predatory practices.

Thank you for affording me this opportunity to comment on bills S. 3911 and A. 8966.

Respectfully,

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