Litigation Financing and How It's Growth will Impact the Insurance Industry

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"If you want to use the civil justice system, you have to have money. If there's less money, you'd have less litigation. But then you'd also have less justice."

- Alan Zimmerman, founder, LawFinance Group

“Third-party investments in litigation represent a clear and present danger to impartial and efficient administration of civil justice in the United States.”

- U.S. Chamber Institute for Legal Reform

Champerty

- Under English common law, the doctrine of champerty prohibited a third party from financially supporting a plaintiff on the condition that the proceeds of the lawsuit would be shared
- Enacted to discourage frivolous or fraudulent litigation

Traditional Financing

- Traditionally, personal injury attorneys would finance the litigation they filed, covering expenses such as:
  - Filing fees
  - Process servers
  - Stenographers
  - Experts
  - Time

Traditional Financing

- Typical intake process – counsel or paralegal
- Client interview
- Legal issue researched
- Conducted preliminary fact-finding
- Evaluated potential damages

Traditional Financing

- This provided thoughtful assessment prior to assuming representation or filing suit
- Required business/cost-benefit analysis
- Served interest of discouraging frivolous lawsuits

Financing Options Expanded

- Plaintiffs' attorneys would associate with larger firms to ensure litigation could be properly funded (e.g. class actions)
- Law firms could take out loans from banks, offering the firm's own assets as collateral
- Loans not outcome-dependent

Litigation Loans Arrive

- Small, separate loans linked to result of <u>individual</u> case or claim
- Can be taken out by claimant/plaintiff or counsel
- "Nonrecourse" loans - repayment contingent on settlement or judgment
  - If no payment to claimant, lender gets nothing
  - Not subject to rules and regulations on banking or lending in most jurisdictions
- High interest rates

Spread of Litigation Loans

- Began on the West Coast
- Initially analogous to <u>loan sharks</u>
- Small financial institutions, loaned modest sums to injured claimants at usury rates

Move to Wall Street

- Counsel Financial:
  - $1.5 billion in loans issued since 2000
- Westfleet Advisors:
  - $2.7 billion financing transactions last year
- Burford Capital:
  - More than $3 billion in capital invested (or available to be invested) in litigation financing.
  - In 2023, Burford committed over a billion dollars to finance the legal industry for the third year in a row.

How Prevalent Are Litigation Loans?

- 2024 Burford Capital Litigation Economics Research Survey:
  - Almost three quarters (73%) of respondents have used legal finance (39%) or would consider doing so (34%)

High-Profile Cases

- Bollea v. Gawker
- Gawker published sex tape of pro wrestler Hulk Hogan (real name Terry Bollea) filmed without his consent
- Hogan filed suit alleging invasion of privacy and intentional infliction of emotional distress
- Sought $100 million, judge awarded $115 million. Verdict later reduced, settled for $31 million

Hulk Hogan v Gawker

- Hogan's litigation was financed by billionaire Peter Thiel, who spent around $10 million on attorneys alone
  - Claimed it was a "philanthropic" effort, based on a personal grudge against Gawker
- After the judgment was issued, it was revealed that Thiel had a financial interest in the outcome

Loans Can (And Do) Backfire on Lenders

- Burford Capital
  - Loaned $4 million toward class-action pollution lawsuit against Chevron
  - Suit was thrown out due to fraud by plaintiffs' attorney
  - Fortunately for Burford, it had sold its interest to another investor by then.

Types of Cases Being Financed

- Personal injury – car accidents, slip and falls, etc.
- Class action suits
- Suits against large corporations
- Product liability actions

How is the Money Used?

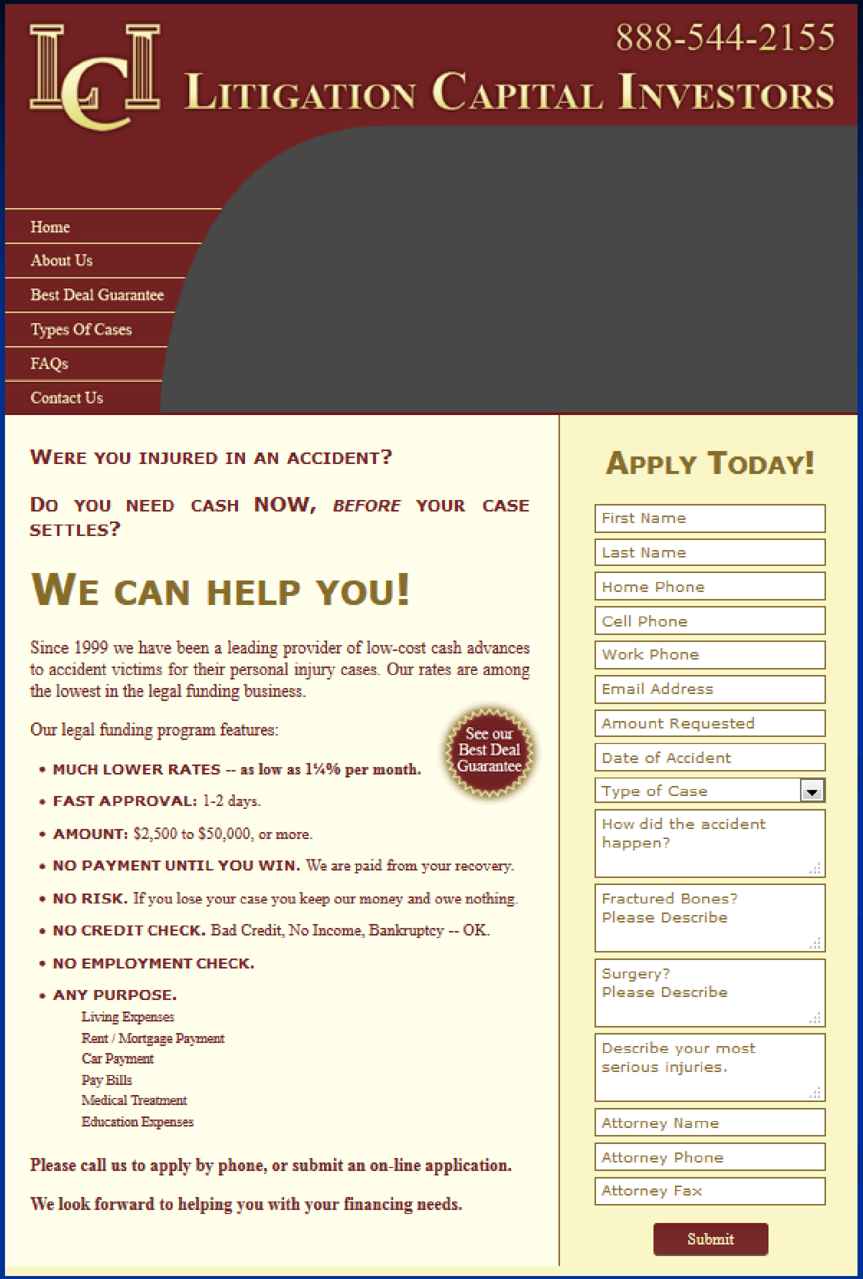
- Proceeds of loan can go directly to claimant or to their counsel
- Claimants / plaintiffs have <u>no restrictions</u> on use of loans
- Medical bills, living expenses, nonsense.

Issues with Third-Party Financing

- Impairs Assessment of Claims
- Prolongs Litigation
- Complicates Ability to Settle
- Increases Number of Frivolous Lawsuits Filed
- Increase Court Caseloads, Slow Resolution

Effect on Screening

- Limited information required to obtain loans
- Screening conducted via websites vs. in person at law office
- Unclear if anyone employed has legal training to assess merits
- Net result: Increase in weak/frivolous claims being perpetuated



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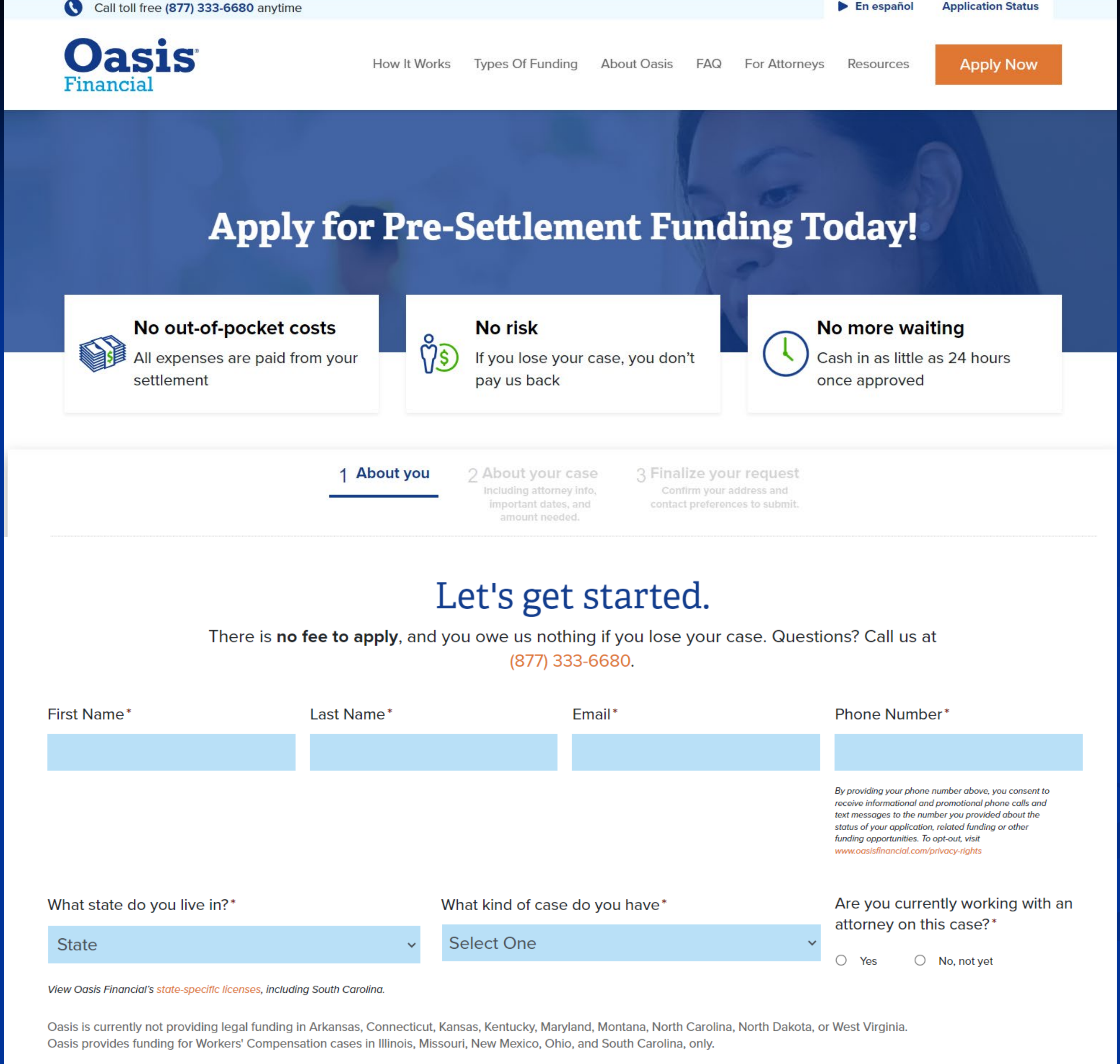
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State

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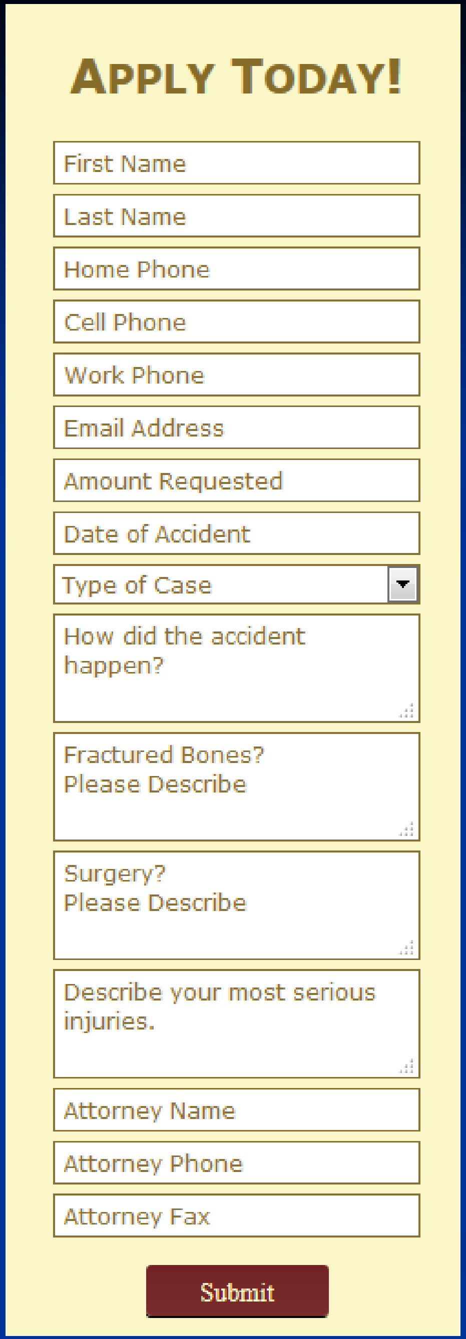
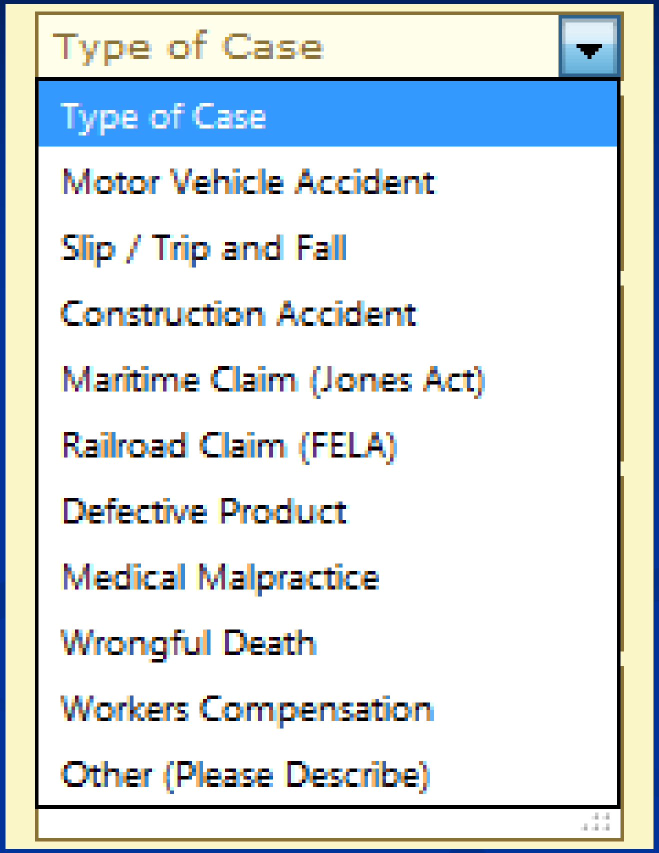
Lenders Do Little to No Due Diligence Before Issuing Loan

- Loans can typically be obtained for <u>any litigation</u>, with little to no effort conducted by the lender to determine the potential litigation costs, value of the claim, or its merits
- May encourage frivolous or fraudulent claims to be filed





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Effect on Claim/Litigation

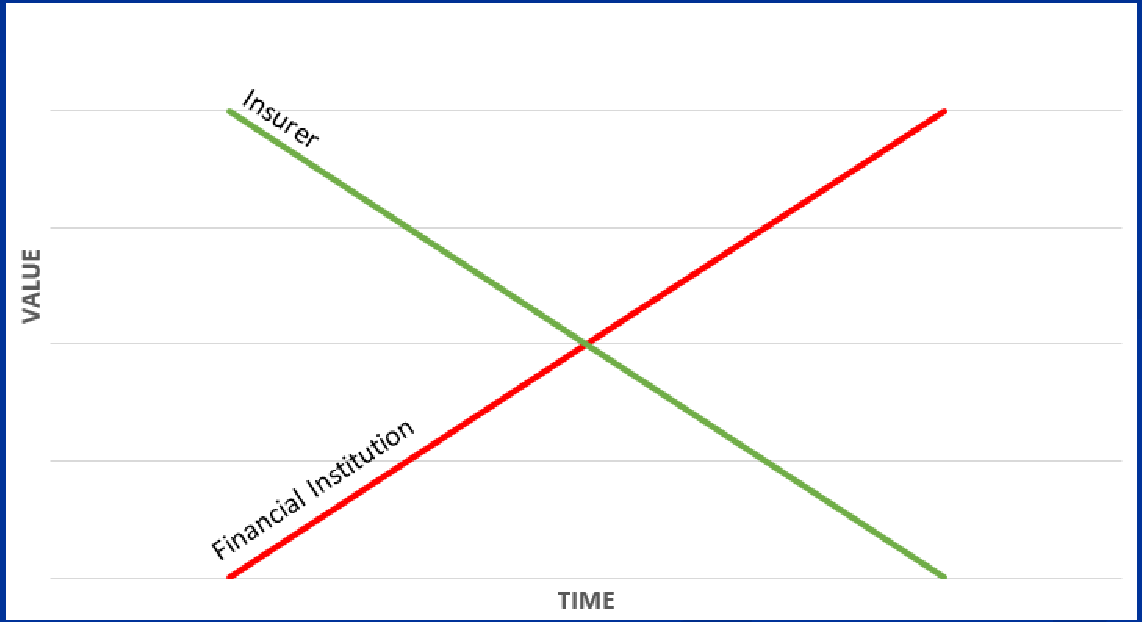
- Claimant can use money to pursue additional medical treatment (whether warranted or not)
- Claimant can extend period of unemployment/lost wages by living off of loan proceeds
- <u>War chest</u> to wage prolonged litigation battle by retaining experts, taking depositions, filing aggressive discovery motions, etc., where previously cost-prohibited
- Insurer's litigation expenses will rise

Effect on Settlement / Relative Perceived Claim Value

- Typically, the value of a personal injury claim is at its <u>highest</u> upon submission of the demand package
- Claimants' evidence is untested, no adverse discovery conducted
- Over time, as more information becomes available about the loss and associated injury, the potential recovery typically <u>diminishes</u>

Effect on Settlement / Relative Perceived Claim Value

- The lender expects the value of the claim to <u>increase</u> over time due to accrued interest.
- Now <u>lender</u> also needs to be satisfied out of settlement proceeds
- The "pie" (settlement value) is not necessarily expanding
- No longer about plaintiff, attorney, and medical liens



Effect on Settlement / Relative Perceived Claim Value

- Plaintiff's interest in litigation is of decreasing importance
- Suit becomes a <u>commodity</u> to be invested in, and perhaps traded

What's Next for Litigation Loans?

- Wild west – largely unregulated in most states
- Going the way of the housing bubble, derivatives
- Congress conducting investigations, may be regulating such loans on the federal level in future

Federal Attempts to Regulate

- Pending federal legislation introduced affecting issuance of litigation loans:
  - US Congress: Protecting Our Courts from Foreign Manipulation Act of 2023
    - Introduced to the Senate: September 14, 2023
    - Would:
      - Increase transparency and oversight of third-party funding by foreign persons,
      - Prohibit third-party funding by foreign states and sovereign wealth funds

State Attempts to Regulate

- Several states have enacted laws regulating litigation loans since 2007:
  - Maine, Ohio, Nebraska, Oklahoma, Tennessee, Arkansas, Indiana, Vermont, Indiana (2024), West Virginia (2024), Montana (2023)

Recently-Enacted Legislation

- Recent Legislation has <u>prohibited</u>:
  1. Foreign companies from financing loans
  2. Lenders from influencing outcomes
  3. Commissions to attorneys and medical providers who refer clients to the company
  4. False or misleading advertising
  5. Referring clients to specific attorneys

- Recent Legislation has <u>required</u>:
  1. Funding to be disclosed in the litigation
  2. Establishment of consumer protections and disclosures

Usury Interest Rates

- Litigation loans often violate usury laws
- Funding companies have been known to charge up to 124% per annum
- Interest rates have been capped in some jurisdictions:
  - Nevada: 40%
  - Indiana: 36%
  - Maryland: 24%
  - Oklahoma: 21%
  - West Virginia: 18%
  - Arkansas: 17%
  - Tennessee: 10% (pre-settlement funding is 36%)

Should Existence of Litigation Loan Be A Permissible Area of Discovery?

- Is this germane to the underlying claim?
- Should the courts have notice of such an arrangement?

Effects on Fraud

1. Increase in damages including unnecessary medical treatment and lost wages

2. Financing fraudulent suits

3. False investment schemes

Plaintiffs Become Pawns

- McClenny Moseley & Associates (MMA)
  - MMA raised $40 million from investors for litigation
    - Thousands of policyholders were signed up for hurricane-related home insurance claims without their knowledge
  - Loans used to file 1,500 lawsuits in just three months
  - Allegedly received insurance settlement checks without the authority to do so from the policyholder
  - Allegedly failed to deposit $20 million in insurance payout to policyholders
  - MMA fined $2 million in February 2023
  - Currently under criminal investigation from the FBI

United States v. Dickerson

PRESS RELEASE

Sacramento Woman Indicted for Fraudulent Investment Scheme

Tuesday, September 3, 2024

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For Immediate Release

U.S. Attorney's Office, Eastern District of California

- According to the Attorney General: scheme established a fake litigation fund for personal injury attorneys
- Scheme allegedly ensnared more than 140 investors, for a total of $10 million
  - Investors were allegedly told $ would be used for loans to attorneys in exchange for a cut of settlements and judgments + they could receive between 10% and 17.5% in returns monthly
- Money allegedly spent on real estate, luxury cars, gambling and Ponzi-style payments to other investors
- Product of an investigation by the FBI, IRS, Alabama Securities Commission.

What Insurers Can Do To Combat Influence of Third-Party Lenders

- If possible, identify claims which are backed by third-party lenders early in the claim process
- Remember that insurer has no obligation to reimburse claimants for any interest or fees incurred
- Do not allow presence of third-party loan to influence determination of whether a claim is payable or the valuation of a claim
- Remember that communications between the attorney and the lender are generally not privileged, and therefore discoverable if the claim goes into litigation
  - Except those jurisdictions which have specifically legislated otherwise, e.g. Vermont

Call to Action!

- Emerging legislation and regulations will have a direct impact on claims administration and settlement
- Insurers must work with lawmakers to ensure reasonable rules are put in place to prevent abuse and the negative effects of easily-accessible, high interest rate third-party loans

Questions?

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