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Uptick In Third-Party Litigation Financing Concerning Insurers

By **Angela Childers**

Law360 (February 9, 2022, 9:45 PM EST) -- The continued rise in insurance litigation and verdict size has the insurance industry searching for the reasons behind the trend, with third-party litigation financing targeted as a key contributor.

Insurers and defense attorneys are seeking more disclosure of litigation funders, saying the practice has led to an increase in large jury verdicts. (iStock)

The insurance industry and defense attorneys are calling for increased disclosure of litigation funders, arguing that the practice is leading to the rise in nuclear verdicts, increasing claims costs and extending the life of claims, particularly in the commercial auto sector. On the other end of the spectrum, plaintiffs attorneys and the financing sector itself argue that litigation financing opens access to the courtroom to plaintiffs who might not otherwise be able to adequately fund their suits.

The litigation financing industry in the U.S. has been expanding at a rapid pace, growing 18% in 2020 to an $11.3 billion industry from 2019, according to financing brokerage Westfleet Advisors in its 2020 report.

In the U.S., third-party litigation funders contributed $2.47 billion to litigation financing in 2020, an increase of 6% over 2019, Westfleet said. The market leader, New York-based Burford Capital, reported $4.5 billion in assets under management in 2020, with Sydney-based Omni Bridgeway and London-based

Harbour Litigation Funding coming in second and third, according to the Swiss Re Institute in a late 2021 report. The reinsurer said about 57% of those third-party litigation funds go toward legal costs and attorney fees, compared to about 45% going toward these costs in cases not funded by a third party.

About a quarter of litigation funding went to personal injury cases, with the rest about evenly divided between commercial litigation and mass tort litigation, the report said.

Ellen Greiper, a partner at Lewis Brisbois Bisgaard & Smith LLP who often represents construction and trucking companies, said the increase in litigation financing is driving up the overall settlement value of cases and negatively impacting plaintiffs who take out loans to finance these cases at high interest rates.

"Mediation is usually unsuccessful because the case is overvalued because of the funding," she said. "There's a lot of undue influence from the funding company who wants to get back [their investment]. … It's the bane of settlement."

Bob Tyson, a defense attorney and managing partner of Tyson & Mendes, said that while third-party litigation funding in the business world often is seen on both sides of the bar, in the insurance world, financiers are almost exclusively funding plaintiffs' litigation.

"There are so many different reasons for why plaintiffs and plaintiffs lawyers enter into these agreements," Tyson said. "Sometimes it's a pure financial need of the plaintiff, sometimes a pure financial need of the attorneys. [It] allows them to pursue a claim and hopefully not have the same financial hardship … without litigation funding. The problem is … instances of people taking out loans that are too big, or the case doesn't have the value that they think it has, and now you're not able to resolve a case and the plaintiff is in a worse position than they were before."

In a 2012 redacted loan agreement from a company that funds personal injury lawsuits, the plaintiff was charged a loan annual percentage rate of 37.8%. Others publicly advertise monthly loan percentages of 2.99% — which totals an annual percentage rate of 35.9%

However, personal injury attorney Daniel D. Horowitz III said this type of financing has been in use forever, likening it to taking out a loan at a bank, and provides claimants who may not otherwise have been able to pursue a case with access to the courts.

"Any sort of financing that allows plaintiffs and their lawyers to be on more equal footing with insurance companies and corporate defendants" is beneficial by allowing these injured parties to hire more competent experts and put reconstructionists on the scene, he said. "This changes the game [for insurance companies] because more [plaintiffs] lawyers now have the ability to go farther with cases because they have access to capital."

Horowitz also dispelled the idea that third-party financing impacts the settlement of a case.

"I've never once heard of a plaintiffs lawyer not being allowed to settle a case because of the money people telling them no," he said. "And the other side to it is, if a lawyer does not have adequate funding to develop a case, that leads to a lawyer potentially under-settling a case out of fear of losing money, and that hurts the plaintiff."

Dai Wai Chin Feman, director of commercial litigation strategies at Parabellum Capital LLC, a New York-based litigation funding company, said his company does mostly business-to-business disputes in antitrust and patent litigation and international arbitration, areas that "typically fall outside coverage of most insurance policies."

In its 2020 annual report, market leader Burford Capital said that the majority of its litigation investments were in mixed portfolio, antitrust and intellectual property cases, with less than 1% in torts.

"Many funds [including Parabellum] are not even permitted to invest in personal injury claims," Chin Feman said. "Our contracts contractually prohibit us from interfering in litigation or settlement decisions," which he said is standard for most of the large litigation funding companies.

"In my industry, on the commercial side … most of our money doesn't go to plaintiffs, it goes to law firms as an alternative to using more traditional forms of capital … to support their contingency cases," he said. "Most deals on the commercial side are not interest rate-based. It's a multiple of capital invested. We're not making loans."

One of the biggest areas of contention between litigation funding firms and the insurance and defense bar is disclosure of funding.

Courts have largely rejected entreaties by defense counsel to disclose funding of litigation, with 83% of courts denying a request to disclose litigation funding agreements through discovery or only allowing limited information, according to a 2021 analysis by Westfleet.

Jim Whittle, vice president and counsel at the American Property Casualty Insurance Association, said the industry would like to see the government step in to mandate such disclosures.

"There's a lot of money being made in this space, and they don't want to go shout it from the rooftops; they're fighting [to keep it private]," he said. "Everybody says, 'This is access to justice, it's really a benign, benevolent practice.' If that's true, then these financiers should have no problem with disclosure."

States are increasingly looking at the issue. According to Swiss Re, California and New Jersey now require the disclosure of litigation funding in federal district courts for class actions, and about 25 other federal courts require some sort of funding disclosure for civil cases. Several states, including Colorado and North Carolina, have stated that third-party litigation funding can violate usury laws. A few states have also limited the annual interest rate that can be charged for third-party litigation funding, including Arkansas and West Virginia, which cap the rate at 17% and 18%, respectively.

At the federal level, Sen. Chuck Grassley, R-Iowa, reintroduced the Litigation Funding Transparency Act, which would require funding disclosure in class action lawsuits in federal courts or federal multidistrict litigation proceedings. The bill remains in committee.

Greiper of Lewis Brisbois said she has found a simple web search can determine whether third-party litigation funding is involved. In her cases, attorneys search a state's secretary of state website or that state's equivalent to access the Uniform Commercial Code financing statement, which is essentially a legal form providing notice that a creditor has interest in a debtor's personal property. Although the UCC does not disclose the amount of the financing, it offers the date of the lien and the name of the creditor.

Chin Feman of Parabellum argued that the defense bar wants to disclose third-party funding not because it cares who is funding the litigation, but because defense attorneys want to know how much has been put toward the suit and when a plaintiff is going to run out of money to pursue the litigation.

Horowitz, the personal injury attorney, wonders where the line will be drawn when it comes to disclosure.

"Does that mean I need to disclose my line of credit documents with a traditional bank?" he asked. "We can dig and dig and try to find bias anywhere you want, but financing is being used by everybody on every side of the docket for all different reasons. It doesn't have any role in whether a plaintiff's claim is valid or how much the loss is valued at."

Regardless of where lawmakers come down on the topic, the debate is as unlikely to disappear as the litigation funding market, which has led Greiper to work harder with her clients on risk management strategies to try to head off litigation by "going into overdrive" to investigate claims immediately.

"Defense lawyers cannot sit back anymore and wait for plaintiffs to send bills of particulars and authorizations," she said. "It's a whole different world these days, and you have to pick it up and be as aggressive."

--Editing by Bruce Goldman.

Correction: An earlier version of this story misstated Burford Capital's assets under management. The error has been corrected.