THIRD-PARTY LITIGATION FUNDERS: THE "PARTY" YOU DIDN'T KNOW WAS EXERCISING CONTROL OVER YOUR LITIGATION AND WHAT YOU CAN DO ABOUT IT

By: Melody C. Kiella

Melody C. Kiella is a Senior Associate with Drew, Eckl Farnham. Melody is an specializes in complex civil litigation. She represents clients in a broad spectrum of matters, to include trucking/transportation, personal injury, premises liability, negligent security, mold damage/exposure, catastrophic injuries, commercial litigation, breach of contract, and general liability.

I. Introduction to Litigation Funding

It is undeniable that litigation funding is taking the legal world by storm. In 2017, 36% of U.S. law firms reported using litigation funding, which was a 414% increase in use since 2013 (when only 7% of law firms reported using it).[1]

In its most basic form, litigation funding allows a plaintiff or a lawyer to obtain a cash advance from a third-party lender in exchange for a percentage of the proceeds recovered from the litigation.[2] Typically, the advances are nonrecourse in that the lender cannot recover anything outside of the litigation.[3] Therefore, if the amount recovered in the lawsuit is less than the total amount owed to the lender, the lender may be entitled to the proceeds recovered, but nothing more. Similarly, if the case fails for whatever reason, nothing is owed to the lender.

Funding companies advertise their services to a wide-range of players, including individual plaintiffs pursuing claims against a corporate defendant with deep pockets (often referred to as "David v. Goliath" lawsuits by those in favor of litigation funding), class action plaintiffs, plaintiffs engaging in expansive litigation requiring significant out-of-pocket expenses, and plaintiffs' lawyers and law firms. The advances received from the funding company

can be used to fund litigation or for non-litigation related expenses, such as the payment of rent, groceries, and other necessities by individual plaintiffs.[4]

Those who support litigation funding argue that it evens the playing field between individual plaintiffs and large corporations and allows greater access to the judicial system.[5] While litigation funding may allow greater access to "justice", it is clear that litigation funding is rife with potential ethical issues and dilemmas, including the potential for inappropriate relationships between lawyers and funding companies, the potential abuse and manipulation of unsophisticated plaintiffs, the funding of litigation for purposes other than to right a wrong done to an injured plaintiff, and the inappropriate exercise of influence over the litigation by third-party funders.[6]

II. Ethical Issues to be Aware of in Cases Involving Litigation Funding

A. The Possibility That a Funding Agreement Might Allow a Non-Party to Exercise Influence and Control Over Pending Litigation

Rule 5.4 of Georgia's Rules of Professional Conduct (the "***Rules***") prohibit, among other things, a lawyer from sharing legal fees with a non-lawyer and from allowing a person who employs or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.[7] The purpose of the foregoing rule is to "protect the lawyer's professional independence of judgment."[8]

Recently, the New York City Bar Association considered whether funding agreements between lawyers and funding companies were ethical in light of Rule 5.4's prohibition against fee-sharing between lawyers and non-lawyers. The Bar Association concluded that typical funding agreements between a lawyer and a funding company were unethical pursuant to Rule 5.4 because the Rule forbids a funding

arrangement in which the lawyer's future payments to the funder are contingent on the lawyer's receipt of legal fees or on the amount of legal fees received.[9] "The Bar Association explained that, "when non-lawyers have a stake in legal fees from particular matters, they have an incentive or ability to improperly influence the lawyer."[10]

In essence, the New York City Bar Association's opinion suggests that funding agreements between lawyers and funding companies may interfere with the lawyer-client relationship and the duties owed by the lawyer to the client. Those in favor of litigation funding arrangements argue that there is no ethical difference between a non-lawyer's security interest in a contract right (fees not yet recovered from the lawyer) or accounts receivable (fees earned by the lawyer) and that the Bar Association's decision substantially undermines the ability for non-wealthy people to prosecute civil claims.[11] However, it is not irrational to worry that a funder's interest in fees not yet received by a lawyer and the funder's interest in recovering the greatest amount of money possible could result in a situation in which the lender exerts (or attempts to exert) control over the lawyer and the litigation. As explained by the Institute of Legal Reform, litigation funding "undercuts plaintiff and lawyer control over litigation because the [funding] company, as an investor in the plaintiff's lawsuit, presumably will seek to protect its investment, and can therefore be expected to try to exert control over the plaintiff's and counsel's strategic decisions."[12]

To better illustrate the control that a third-party funder may exercise over a pending litigation, let's consider a real-life example. In connection with the case of *Gbarabe v. Chevron,*[13] Plaintiffs' counsel entered into a funding agreement with Therium Litigation Funding LLC ("***Therium***").[14] Pursuant to the funding

agreement, plaintiffs' counsel agreed, among other things, as follows:

(1) That plaintiffs' counsel provided only accurate information to Therium about the claim and did not fail to disclose any information, document, or material/evidence that would be relevant to Therium's decision to enter into and remain bound by the agreement;

(2) To prosecute the case in accordance with the litigation plan and within the budget agreed to by counsel and Therium;

(3) Not to make any changes to the litigation plan without Therium's prior consent;

(4) Not to engage any co-counsel or hire any experts without the prior approval of Therium; and

(5) To use all "reasonable endeavors, consistent with the professional conduct of the Claim in accordance with the terms of this Agreement, to recover the maximum possible Contingency Fee in respect to the Claim, either through an agreed settlement, a judgment, an order, or jury trial as soon as reasonably possible".[15]

Additionally, the agreement allowed Therium to (1) receive traditionally privileged attorney-client information, which the agreement states does not waive plaintiffs' privilege; (2) challenge any invoice for services performed in connection with the litigation that it did not consider "reasonable costs"; and (3) terminate the

funding if there was a material breach of the agreement.[16]

If we unpack the legal terms in the foregoing agreement, we can easily see that it allows Therium to exercise a significant amount of control over the litigation and the litigation strategy. For example, while the agreement does not specifically state that Therium has the ability to "control" the decisions being made in connection with the litigation, the agreement allows Therium to pull funding if it doesn't agree with any decision, including the strategy being pursued by plaintiffs' counsel or the experts hired. The terms of the agreement essentially ensure that plaintiffs' counsel will run every decision by Therium in an effort to maintain the funding needed to continue with the litigation.

Another cause for concern is the fact that plaintiffs' counsel owes a contractual duty to Therium, which duty is independent from counsel's duties owed to the plaintiffs.[17] Because plaintiffs' counsel must jump through certain hoops to fulfil their contractual obligations owed to Therium, there is a potential that they will be unable to fulfill their duty of independent judgment owed to their clients. For example, counsel would most likely discuss the hiring of any expert with Therium and may even decide to forego hiring an expert they believed critical to their clients' case if they knew Therium did not approve of the hiring. In fact, one of plaintiffs' expert witnesses testified at his deposition that his report had not yet been provided because plaintiffs "were putting the money in place for the work to proceed."[18] Thus, it appears that the expert's work would not have proceeded if plaintiffs' did not receive funding, which we know was coming from a third-party funder.

Additionally, the funding agreement requires the lawyers to recover the largest possible fee as soon as reasonably possible. Not only does the foregoing provision

suggest that the lawyers were in communication with Therium regarding settlement offers made and the acceptance of any such offers, such a provision would undoubtedly promote prolonged litigation and the consideration of interests other than the clients' best interests. Moreover, the fact that the lawyers' had a financial stake in the outcome of the litigation beyond the recoupment of traditional legal fees suggests that a potential conflict of interest existed under Rule 1.7(a), which prohibits a lawyer from representing a client if there is a significant risk that the lawyer's own interests or the lawyer's duties to a third person will materially and adversely affect the representation of the client.[19] There is no question, based on the terms of the agreement, that the lawyers in the case of *Gbarabe v. Chevron* and their financial interest in the outcome of the litigation could have interfered with their duty to provide honest, impartial advice to the client.

Moreover, as with all litigation funding arrangements, the repayment terms of the funding agreement in *Gbarabe v. Chevron* could have influenced settlement recommendations made by Chevron's lawyers, settlement decisions made by the plaintiffs, and how the case proceeded through litigation. For example, if the plaintiffs succeeded in the *Gbarabe* litigation, plaintiffs' counsel would have been required to pay Therium $10.2 million plus all costs paid in connection with the litigation, which would have resulted in a total payment of $11.9 million to Therium.[20] Although $11.9 million was nothing when compared to the purported value of the case, there is no world in which the repayment of $11.9 million does not play a part in the manner in which any settlement offer is presented to plaintiffs and the consideration of whether plaintiffs should settle or hold out for a larger settlement. The fact that the lawyers might take into account the amount

they owed to the funder when discussing settlement options with the plaintiffs would render the lawyer incapable of providing unbiased advice as required under the Rules.

As you can see from a review of the funding agreement in *Gbarabe*, litigation funding agreements between lawyers and the funder have the potential to allow a non-party to influence and exercise control over various aspects of a pending litigation. While some litigation funding agreements may not be as far reaching as the terms in the agreement in *Gbarabe*, it is clear that the potential for influence by a non-party with a stake in the litigation should at the very least be discoverable in litigation and properly examined by the opposing party and the court.

B. *The Potential Manipulation of Individual Plaintiffs and the Effects on Settlement*

Sometimes an individual plaintiff in need of fast cash will leverage their lawsuit in exchange for a cash advance that can be used on non-litigation related expenses. In essence, a plaintiff receiving an advance from a litigation funder in such a scenario is selling a portion of her future recovery at a very large discount.

For example, a typical funding agreement might require the funder to pay the plaintiff $2,500 in exchange for recovering $3,000 from the plaintiff when she recovers in connection with her pending lawsuit.[21] However, in addition to the $3,000 owed, such an agreement would likely state that the plaintiff also owed an additional $180 per month for every month the $3,000 was not paid. Thus, the plaintiff would owe the funder $3,000 in exchange for an advance payment of $2,500, plus $2,160 per year until the funder was paid in full. If the litigation dragged on for 3 years after the plaintiff received the advance, the plaintiff would owe the funder a total of $9,480 for a one-time payment of $2,500, which is more than 3.7 times the initial advance.

For most people, $2,500 does not last very long. For someone with no savings and/or bad credit, ongoing litigation might mean that more than one advance is received by an individual plaintiff. In the end, a plaintiff might end of owing a third-party funder more than she recovers in the lawsuit due to the interest and fees paid in exchange for the one-time advance payment. Just as with payday loan sharks, funding companies are benefiting significantly from the manipulation of unsophisticated plaintiffs in need of quick cash.

C. The Potential Impediments to Settlement When Funding Agreements Are Involved

There is no doubt that the repayment terms in funding agreements can significantly impede settlement. First, a plaintiff may view a litigation funder's nonrecourse payment as an endorsement that the plaintiff's case is valuable, resulting in an increase of the plaintiff's settlement reference point.[22] Most litigators know that overconfidence is an impediment to settlement regardless of whether the overconfidence comes from the plaintiff or the defendant. This is because overconfidence results in the overestimation of the reasonable bargaining range, making it impossible for the parties to meet in the middle. When a plaintiff overestimates the value of her case and the odds of succeeding at trial, she may reject a reasonable settlement offer and choose to go to trial.[23] In the end, the plaintiff may recover significantly less at trial than she would have had her settlement range not been inflated by the receipt of funds by a third-party funder.

Second, litigation funding can take what would typically be seen as a reasonable and fair settlement and turn that number into a loss in the mind of a plaintiff who received a nonrecourse advance from a litigation funder. This is because the plaintiff will automatically take off the amount owed to the third-party lender from the settlement offer made by the defendant despite the fact that

she received this payment in advance and has already recouped that benefit. Thus, a plaintiff who owes a litigation funding company $20,000 in principal and fees will view a $60,000 settlement offer as a $40,000 settlement offer.[24]

"For whatever reason, people are wired to be willing to take risks to avoid losses but are unwilling to take risks to accumulate gains."[25] If a plaintiff views a settlement as a gain, she is more likely to accept it, but if she views it as a loss she is more likely to take her chances with trial.[26] Thus, litigation funding can increase a plaintiff's intended settlement amount by the amount owed to the litigation funding company, which can in turn decrease the overall likelihood of settlement due to a distorted settlement range.[27]

D. The Potential That Lawsuits Will be Filed for Purposes Other Than Obtaining Recovery for an Injured Plaintiff

In addition to the potential for conflicts of interest, the exercise of control by a third-party, and possible impediments to settlement, third-party funding may allow a third-party funder with a score to settle against a particular defendant to fund a plaintiff's case for purposes of settling that score.

Take the case of *Bollea v. Gawker Media, LLC*. The lawsuit was filed as a result of a 2012 posting by Gawker Media, LLC ("***Gawker***"), a celebrity news and gossip website, of an excerpt of a video depicting Terry Bollea, more famously known as Hulk Hogan, having consensual sexual relations with his friend's wife.[28] It was not revealed until the conclusion of Hogan's case against Gawker, which took four years to take to trial, that Hogan's legal bills (estimated to total approximately $10 million dollars) were paid entirely by Peter Thiel ("***Theil***"), the billionaire co-founder of PayPal, and that Hogan and his Florida lawyers had no

knowledge of Thiel's identity and motives for funding the litigation until the conclusion of the litigation.[29] In fact, Thiel's own lawyer, Charles Harder ("***Harder***"), who pursued Hogan and offered to represent him against Gawker and assured him that all of his legal fees would be paid by a third-party funder, also did not know the identity of the person paying his fees.[30] It was later discovered that Thiel and his associate, who has only been identified as "Mr. A", used encryption apps to speak with Harder about the litigation.

Gawker, who was no stranger to lawsuits filed by humiliated celebrities outed by its writers, intended to prolong the litigation in an effort to force Hogan to settle without proceeding to trial.[31] However, Hogan's access to Thiel's secret money allowed Hogan to continue through the lengthy four-year litigation and to incur legal expenses he admittedly would not have been able to afford without Thiel's funding.

Immediately prior to trial Gawker made a last-ditch settlement offer of $10,000,000 to Hogan, "which could have been very attractive to Hogan but self-defeating for Thiel."[32] The settlement offer was rejected and no counteroffer was made on behalf of Hogan.[33] In 2016, the jury returned a verdict in favor of Hogan in the amount of $140 million, which was later reduced to $115 million in damages, $15 million in punitive damages against Gawker, $10 million in punitive damages against Nick Denton, the founder of Gawker, and $100,000 in punitive damages against Albert Daulerio, the Gawker editor who posted the video of Hogan.[34]

The legal world was buzzing after Thiel later disclosed that he had secretly funded Hogan's civil lawsuit because it was clear that Thiel, who had been outed by Gawker years before Hogan's lawsuit for being gay and who had publicly stated his distaste for Gawker and its writing, had

funded Hogan's lawsuit as a way to get even with Gawker. And in the end, Thiel's funding of Hogan's civil case against Gawker resulted in the media company going bankrupt.

So, the story of Hogan and Gawker brings to light the possibility that litigation funding may allow a third-party with an interest in getting back at or destroying a particular defendant to do just that without having to disclose his identity or motives. Even though Hogan was in fact harmed by Gawker's release of a video depicting him during a moment in his private life, should Thiel have been permitted to fund $10 million in legal fees without having to disclose to Gawker or the court his identity and the benefit, if any, he was to obtain in connection with the funding? As one person said, "[n]o harm, no foul, is the rule in basketball but not in legal ethics."[35]

It would seem that, due to the potential conflicts that could arise in not disclosing and understanding the identity of a third-party funder and the funder's interest in the lawsuit, the funder's identity and agreement with the plaintiff should at least be disclosed to the opposing party.

III. Defense Attorneys Need to be Proactive in Discovering and Pursuing Litigation Funding Agreements

Not every agreement involving a third-party funder will be relevant to your litigation or will disclose a relevant conflict, but, as you can see from the foregoing, it is imperative that defense counsel identify potential funding agreements and obtain copies of the agreements during discovery. To do so, defense counsel should incorporate questions about potential funding arrangements and agreements in their discovery to all plaintiffs, including individual plaintiffs. The request for such information and the receipt of any and all documents bearing on the issue of third-party funding are essential to the fairness of all parties involved in litigation. In Georgia,

defendants are required to disclose the limits of their applicable insurance.[36] Why should the disclosure and production of funding agreements and advance payments received by a plaintiff in connection with the lawsuit be any different?

When you receive information regarding a third-party funding arrangement, make sure to send a non-party request to the funder and request any and all documents relating to the relationship, the funds provided to the plaintiff, the lawyer's role in the arrangement, and the amount to be paid by the plaintiff at the conclusion of the litigation. If the funder refuses to provide responsive documents, challenge the refusal by filing a motion to compel with the court. Right now, the trend in Georgia (as with other states) seems to be favoring the discoverability of such agreements.[37]

Once the funding agreement is received, study it and identify any potential conflicts and see if the agreements can help defend against certain claims asserted by the plaintiff against the defendant. For example, if the plaintiff alleges that the defendant was stubbornly litigious by continuing to engage in litigation despite the lack of any evidence supporting a denial of liability or a challenge as to the plaintiff's damages, evidence of the funding agreement and the significant amounts owed by the plaintiff in exchange for a small one-time advance payment may support your argument that it was actually the plaintiff, not the defendant, who was stubbornly litigious and who insisted on protracted litigation.[38]

In the end, educating other lawyers, the court, and the Georgia legislature about the potential harms and conflicts involved with litigation funding may be the best (and only way) to properly address the issue. As the Georgia Court of Appeals stated, while litigation funding engaged in by [parties to a lawsuit], with its associated fees and charges, may legitimately be labeled financially

insidious, it is the General Assembly, not this Court, which must, if it so chooses, expressly promulgate laws to regulate this activity."[39]

[1] *2017 Litigation Finance Survey*, BUFORD CAPITAL, p. 8, *available at* http://www.burfordcapital.com/wp-content/uploads/2017/09/Burford-2017-Litigation-Finance-Research-Whitepaper.pdf.

[2] *See ABA Commission on Ethics 20/20 Informational Report to the House of Delegates*, p. 1, *available at* https://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.pdf; 2017 Litigation Finance Survey, BUFORD CAPITAL, p. 4, available at http://www.burfordcapital.com/wp-content/uploads/2017/09/Burford-2017-Litigation-Finance-Research-Whitepaper.pdf.

[3] *See ABA Commission on Ethics 20/20 Informational Report to the House of Delegates*, p. 5-6, *available at* https://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.pdf.

[4] *Id*. at p. 5.

[5] *Id.*

[6] *Id.*

[7] GA. RULES OF PROF'L CONDUCT, R. 5.4(a) and (c).

[8] *Id.* Comment 1.

[9] *Formal Opinion 2018-5: Litigation Funders' Contingent Interest in Legal Fees*, NEW YORK BAR ASSOCIATION, p. 4, *available at* https://s3.amazonaws.com/documents.nycbar.org/files/2018416-Litigation_Funding.pdf.

[10] *Id.*

[11] Anthony E. Davis and Anthony J. Sebok, *New Ethics Opinion on Litigation Funding Gets it Wrong*, August 31, 2018, *available at* https://www.law.com/newyorklawjournal/2018/08/31/new-ethics-opinion-on-litigation-funding-gets-it-wrong/.

[12] U.S. Chamber Institute for Legal Reform, Stopping the Sale on Lawsuits: A Proposal to Regulate Third-Party Investments in Litigation (2012), p. 3, *available at* http://www.instituteforlegalreform.com/doc/stopping-the-sale-on-lawsuits-a-proposal-to-regulate-thirdparty-investments-in-litigation).

[13] Natto Iyela Gbarabe, et al. v. Chevron Corp., 14-cv-00173-SI (N.D. Ca. 2014).

[14] *Id*. Declaration of Craig E. Stewart in Support of Chevron Corp.'s Motion to Compel Plaintiffs to Produce Litigation Funding Documents and Comply With Rule 3-15, at ¶ 20, Exhibit 19; *see also* a copy of the Litigation Funding Agreement at: https://www.documentcloud.org/documents/3898552-Funding-Agreement.html

[15] *See Litigation Funding Agreement*, at pp. 6-7, *available at* https://www.documentcloud.org/documents/3898552-Funding-Agreement.html.

[16] *Id*. at pp. 8-10.

[17] *Id.* at p. 6, ¶ 3.1.2 (stating that the lawyers must "comply diligently with the terms of, and their obligations under this Agreement.").

[18] Ben Hancock, *How Jones Day Unmasked a Litigation Funding Deal and Won*, October 29, 2017, *available at* https://www.law.com/americanlawyer/sites/americanlawyer/2017/10/29/how-jones-day-unmasked-a-litigation-funding-deal-and-won/..

[19] GA. RULES OF PROF'L. CONDUCT, R. 1.7(a).

[20] Ben Hancock, *How Jones Day Unmasked a Litigation Funding Deal and Won*, October 29, 2017, *available at* https://www.law.com/americanlawyer/sites/americanlawyer/2017/10/29/how-jones-day-unmasked-a-litigation-funding-deal-and-won/.

[21] This hypothetical is based on an actual litigation funding agreement entered into by an individual plaintiff and Green Link Solutions, LLC, which funding agreement is in the possession of the author.

[22] Jean Xiao, *Heuristics, Biases, and Consumer Litigation Funding at the Bargaining Table*, 68 VAND. L. REV. 261, 282-84 (2015).

[23] *Id.* at 283-84.

[24] *Id.* at 284-89.

[25] Barbara A. Reeves, *How Third-Party Funders Change the Chemistry of Settlements*, JAMS, August 2017 at p. 1, *available at* https://www.jamsadr.com/files/uploads/documents/articles/reeves-advocate-how-third-party-funders-change-the-chemistry-of-settlements-2017-august.pdf.

[26] *Id.*

[27] *Id.*

[28] Gawker Media, LLC v. Bollea, 170 So. 3d 125, 127 (Fla. Dist. Ct. App. 2015).

[29] Steven Lubet, *The Gawker Case Has Become More Interesting*, The American Prospect, June 14, 2018, *available at* https://prospect.org/article/gawker-case-has-become-more-interesting.
[30] *Id.*
[31] *Id.*
[32] *Id.*
[33] *Id.*
[34] Bollea v. Gawker Media, LLC, 2016 WL 4073660, at *1 (Fla. Cir. Ct. 2016).
[35] Steven Lubet, *The Gawker Case Has Become More Interesting*, The American Prospect, June 14, 2018, available at https://prospect.org/article/gawker-case-has-become-more-interesting.
[36] *See* O.C.G.A. § 33-3-28.
[37] *See* Rangel v. Anderson, CAFN: 2:15-cv-81, at pp. 17-18 (N.D. Ga. Aug. 23, 2016) (concluding that funding arrangement was relevant and discoverable because it was not a traditional collateral source, defendant was not seeking to introduce evidence of the arrangement to minimize its liability to plaintiff, and because it was relevant to the issue of the treating physicians' credibility and potential bias); *see also* ML Healthcare Servs., LLC v. Public Super Mkts., Inc., 881 F.3d 1293, 1304-05(11th Cir. Ga. 2018) (funding agreement was relevant and admissible to contest the reasonableness of plaintiff's claimed medical bills).
[38] *See* Corey v. Clear Channel Outdoor, Inc., 299 Ga. App. 487, 493 (2009) (defendant may defend against claim for attorney's fees based on alleged stubborn litigiousness by showing that it was the plaintiff rather than the defendant who was stubbornly litigious).
[39] *See* Cherokee Funding LLC v. Ruth, 342 Ga. App. 404, 410 (2017).