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Litigation finance enterprises: advising clients on either side

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ETHICAL QUESTIONS & DILEMMAS

In this final installment of a three-column series on ethical issues presented by "litigation finance" arrangements, we offer some practice points to lawyers advising clients who may be on either side of such a transaction.

The reader will recall that such arrangements involve either a lender making an advance on the expected proceeds of a personal injury case, or a sophisticated commercial entity agreeing to finance a claim or lawsuit.

Such arrangements have ethical implications discussed at length in the first two installments, which appeared in the April 25 and July 25, 2016, issues. In this installment, we discuss some practical and strategic issues presented for a lawyer who is asked to render advice regarding a funding agreement.

We first consider these issues from the perspective of the client who may be interested in obtaining litigation funding. The lawyer advising a potential recipient of funding will want to discuss with the client at least the following:

- Whether the existence of the litigation funding agreement may have to be disclosed to the opposing party;
- Whether communications with the third-party funder are likely to be protected from disclosure by the attorney-client privilege or work product doctrine; and
- Whether the agreement protects the client against financial disaster, by limiting the client's obligation to pay the funder the required percentage of any successful recovery on the client's claims, in the event of an offsetting judgment against the client on a counterclaim.

Regarding the first issue, some courts have held that a contract to provide litigation financing is not a document protected from disclosure by the attorney-client privilege, but at least one other granted work product protection to the terms contained in such an agreement despite that agreement's acknowledged "business function." Compare Gbarabe v. Chevron Corp., No. 14-cv-00173-SI, 2016 WL 4154849, at *2 (N.D. Cal., Aug. 5, 2016), and In re Int'l Oil Trading Co., 548 B.R. 825, 831 (Bankr. S.D. Fla. 2016), with Charge Injection Techs., Inc. v. E.I. DuPont De Nemours & Co., No. 07C-12-134-JRJ, 2015 WL 1540520, at *5 (Del. Super. Ct. 2015).

The U.S. District Court for the Northern District of California recently issued a standing order requiring that plaintiffs in any proposed class, collective or representative action must disclose the identity of any funding entity as part of the plaintiffs' initial filings in the case. See "Contents of Joint Case Management Statement," Paragraph 19, available at www.cand.uscourts.gov/filelibrary/373/Standing_Order_All_Judges_1.17.2017.

While the Advisory Committee on the Federal Rules of Civil Procedure has declined to act on the U.S. Chamber of Commerce's suggestion to add a similar disclosure provision to Federal Rule of Civil Procedure 26, http://www.uscourts.gov/sites/default/files/15-cv-kk-suggestion_us_chamber_institute_0.pdf, a strong case can be made that any litigation funding from a publicly traded entity should be disclosed so that judges can make appropriate recusal determinations.

At the same time, courts generally have held that a litigant's communications with litigation funders are protected from disclosure by some variant of the "common interest" privilege. See *In re Int'l Oil Trading Co.*, 548 B.R. at 832-33.

In that case, the federal Bankruptcy Court found that the parties had a shared common interest in litigation strategy, and intended that their communications would remain confidential. *Id.*

The court also held that the communications were protected as core work product, to the extent that they contained the "mental impressions, conclusions, opinions or legal theories" of the party's attorney concerning the merits of the litigation. *Id.* at 836; see also *Devon IT, Inc. v. IBM Corp.*, No. 10-cv-02899, 2012 WL 4748160, at *1 n.1 (E.D. Pa., Sept. 27, 2012); *Carlyle Inv. Mgmt. L.L.C. v. Moonmouth Co. S.A.*, No. 7841-VCP, 2015 WL 778846, at *10 (Del. Ch., Feb. 24, 2015).

Aside from discoverability, the lawyer advising a litigant will want to consider the various ways in which the litigation might be resolved, and whether the agreement provides protection to the plaintiff if the plaintiff's recovery on its claims (presumably triggering the plaintiff's obligations to reimburse the third-party funder) is dwarfed by an award against the plaintiff on a counterclaim. This situation recently arose in Arizona, where a litigant who was sued for fees counterclaimed against its lawyers for failing to foresee that this very scenario would force the litigant into bankruptcy. See *Cohen Kennedy Dowd & Quigley, PC v. World Wide Wheat, LLC, et al.*, No. 2014-01189 (Superior Court of Arizona, Maricopa County).

On the other side of the financing transaction, the lawyer advising a third-party litigation funder will want to consider the following:

- Whether the agreement is enforceable under Massachusetts law;
- Whether the agreement provides the funder with the option of withdrawing from the agreement if material information was withheld from the funder during the negotiation process; and
- Whether the third-party funder may be held liable for costs or attorneys' fees awarded in connection with the litigation.

As to the first issue, the Supreme Judicial Court has disavowed the old prohibitions against champerty, but stated in the same decision that it would "scrutinize" litigation financing agreements "with care," and noted some discomfort with the idea of "syndicated" litigation. *Saladini v. Righellis*, 426 Mass. 231, 235-36 & n.7.

While the SJC has not offered further guidance on what it means by "syndicated litigation," this footnote should be of concern to entities such as Burford Capital and Bentham IMF that market investments into pooled litigation risks.

A lawyer also will want to make sure that the funding agreement does not violate Massachusetts usury laws or other consumer finance laws.

The lawyer advising a litigation funder also should be mindful of the risk that a plaintiff looking for funding may not be entirely truthful with a funding entity about the strengths and weaknesses of a particular case.

In one highly publicized recent incident, Burford Capital withdrew from its participation in efforts to collect a large Ecuadorian judgment against oil giant Chevron Corp., alleging that it had been defrauded into funding the litigation by misrepresentations made by plaintiffs and plaintiffs' counsel.

In connection with its withdrawal, Burford filed an extraordinary affidavit from its chief executive officer, Christopher Bogart, setting forth the allegations of fraud in great detail, and attaching his handwritten notes of telephone calls with the plaintiffs' lawyers. See *Declaration of Christopher Bogart, Chevron Corp. v. Donziger*, No. 11-cv-00691 (S.D.N.Y., April 17, 2013), ECF No. 1039-2.

Finally, the lawyer advising funding entities should be alert to the possibility that his or her client may face exposure beyond the funds invested. In one recent case, a federal District Court judge held that a third-party funder could be held in contempt, along with the funded party, for defying a court order. See *Abi Jaoudi & Azar Trading Corp. v. CIGNA Worldwide Ins. Co.*, No. 91-cv-06785, 2016 WL 3965162, at *1 (E.D. Pa., July 22, 2016).

Moreover, a British court recently held that a litigation funder was liable to pay the defendant's attorneys' fees where the funded claim was "essentially speculative and opportunistic," the litigation was "gargantuan in scope," and the case "met with a resounding, indeed catastrophic, defeat." *Excalibur Ventures LLC v. Tex. Keystone, Inc., et al.*, [2016] EWCA Civ. 1144, [8] (appeal taken from Eng. & Wales).

While the prevailing party normally is not entitled to recover its attorneys' fees in American courts, as just one example, a third-party funder could face some risk in a patent litigation, where the prevailing party is entitled to recover its attorneys' fees if it can show that the other party engaged in litigation misconduct or the case otherwise was "exceptional." *Octane Fitness, LLC v. Icon Health & Fitness, Inc.*, 134 S. Ct. 1749, 1756 (2014) (interpreting 35 U.S.C. §285).

Of course, as the litigation financing industry matures, new considerations will surface, along with new ethical issues. As we noted in the opening installment of this series, however, it appears that litigation financing is here to stay, and lawyers will need to be attentive to the ethical and practical considerations that go with them.

Here in Massachusetts, failing to pay attention to the details of litigation financing agreements has already exposed several practitioners to formal discipline. See, e.g., *In re David M. Hass*, No. BD-2016-016 (June 1, 2016) (two-month suspension for sending intentionally false and misleading communications to a litigation funder); *In re Philip F. Mulvey, Jr.*, No. BD-2009-09 (Jan. 30, 2009) (six-month suspension for same); *In re Burton A. Waisbren*, No. BD-2008-114 (Dec. 17, 2008) (three-year suspension and restitution for pattern of misconduct that included the disclosure of confidential information to litigation funders without the clients' knowledge or consent).

Courts and bar counsel will continue to analyze the legal and ethical interplay of these agreements, and lawyers would be wise to do the same. MLW

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