NEW YORK UNIVERSITY
JOURNAL OF LAW & BUSINESS

VOLUME 12 SPECIAL ISSUE 2016 NUMBER 3

PANEL 1: LITIGATION FUNDING BASICS

2015 CONFERENCE: LITIGATION FUNDING:
THE BASICS & BEYOND
NEW YORK UNIVERSITY SCHOOL OF LAW
FRIDAY, NOVEMBER 20, 2015

MODERATOR: *Selvyn Seidel*
PANELISTS: *Timothy Scrantom, Alan Zimmerman, Lee Drucker, John Desmarais, Radek Goral*

[Editor's Note: This transcript starts approximately twenty minutes into the first panel. Unfortunately, Mr. Peter Zimroth's opening remarks and Mr. Timothy Scrantom's panel presentation are ommitted from this publication.]

MR. ALAN ZIMMERMAN: Thank you. Can you hear me? Okay. I don't have a PowerPoint. I'm a little too old to learn. I mean, I'll learn how to do PowerPoints one day. But I do have a prop.

I was very delighted to hear you refer to me as a rock star, because my daughter, who is a student at NYU, is here, and it's great that you have said that. And then you said I was anal, and I'm not so sure I wanted her to hear that.

MR. SELVYN SEIDEL: Can I say one more thing, which I forgot? Alan is the dean of the law financing, which is a parallel industry where funders put money into law firms to then bring cases. So, he's now seguing into, also, commercial funding.

MR. ZIMMERMAN: So, I've been doing this for about twenty years. I got into this business, actually, by accident, and I have my own take on what this about, and what litigation funding is about. I'm going to try to give you what I've learned in twenty years in eight minutes. And I apologize, because I'm sure

there were a lot of things I would have loved to say that I didn't say.

First of all, we live in a wonderful country that for 225 years has grown and thrived because we have a capitalistic, economic system that allows people to pursue economic ventures without hindrance, and we are blessed to have that today. We've amassed more wealth than any country in the history of mankind because of that, among other things.

Secondly, you cannot have an effective, well-performing, economic capitalistic system unless there is a place where people can go when they have disputes to get those disputes resolved—that is fair, that is orderly, and that ends up with the parties knowing where they stand at the end of the day. In America, we have what we call the civil justice system, and that's why this whole litigation funding sector exists.

I don't refer to the kind of funding we're talking about as "third party" funding, because I don't know who the second party is. My view is, you're either a party or you're not a party. The party is the plaintiff and the defendant, and if you're coming in and putting money in, then you're a "non-party" funder, and that's really how I look at this universe.

So, here you are. You are a citizen and you have a claim and a dispute with somebody, we called that a "chose in action" and it also is what they called it in England—it is, essentially a property right that you have to go to court and pursue a claim.

It costs an enormous amount of money today to have access to the civil justice system that we have. It's a fact, okay? And I don't think anybody in this room could tell you that is not true.

So, here's my prop. [Holds up two handfuls of cash.] You need to have this, okay? If you want to have access to the civil justice system, you need to have this. Period. And I don't think there's any dispute about that, and I would be happy to debate anybody who has a difference of opinion.

Secondly, or thirdly, we have tremendous economic disparity, with all that wealth. And most people, I would say most people in America could not afford to hire a lawyer and to participate in this civil justice system, because it's enormously expensive. And I'm talking—and we're involved in this world—$25,000 a month in attorney's fees, a month, is not unusual. $100,000 a month in attorney's fees is not unusual. How

many people in this room could start writing checks for $100,000 a month, or $25,000 a month, or want to?

So, if you want to have access, if you want to give people access to this system, you have two choices. Either you have a system that's only for the wealthy who can dip in their pocket and afford to pay, or you have some mechanism in our economic system where you provide funding, non-party funding, to that person seeking access. And those are the two options that we have, I believe, if, and I think everybody in this room would agree, we want to provide access to our civil justice system to people who cannot afford it- which is the vast majority of people.

What you have, what we have developed, here, in America are various mechanisms, and historically, various ways to provide that economic funding. I'm not going to talk much about the contingency fee because it's going to be discussed later, but it was in the mid-1800s in the United States, at the beginning of the Industrial Revolution in America, that we accepted the contingent fee as a means to fund a lawsuit. What that means is I, as a lawyer, can offer my legal services to an individual or a company, whoever it may be, to have access to this system. But in addition to that, I am a non-party funder. I'm putting my money in to pay costs, and my money in to keep my business going, and to live until that case is resolved. And it is a non-party funding mechanism that still exists today.

The second thing that developed in the late 1800s, as the Industrial Revolution got started, was liability insurance. What is liability insurance, a non-party funder who is paid a premium and who runs a business to make a profit, and who agrees, among other things, that if there is a claim that's made that fits within the term of that particular contractual policy, that the insurer will pay the attorney, and pay the funds for addressing that claim. Everybody accepts that today, but the fact of the matter is, that in the 1880s, when this got started, all of the issues that are being raised today about litigation funding were raised then about liability insurance. I don't have time to go through that, but I have a paper that does discuss it, if you'd like to look at it.

What does the insurance company do as a non-party funder? They pick the lawyer, they negotiate the fee with the lawyer, and they decide whether to settle the case or not settle the case, in most cases. So, that is a non-party who's earning a

profit, trying to earn a profit, by selling somebody a contract to fund their case.

More recently, now, we have the development of what we are describing as "third party funding," which is just another form of non-party funding. I've been involved in it for about twenty years, and it has various forms.

One of them is specialty finance companies that focus their attention, specifically, on how to underwrite and evaluate the cases of a law firm in order to qualify them for funding. Many, many contingency fee law firms, and other law firms, go to banks. But more often, now they can't go to banks, because banks don't want to fund law firms, for various reasons that I don't have time to discuss. They go to these specialty funders, and the specialty funders are the ones that give the money to the contingency-fee lawyers, so they can afford to take the case on a contingency fee. Those are law firm lenders, and they get interest.

The another funder is (and there is now a whole set, which we're involved in as well) offering post-judgment funding, where somebody files a lawsuit, they win the case, and the other side now appeals it. Now the winner, having waited for three or four years for a judgment, faces an appeal and they have to wait another one to two years before somebody pays them the money judgment. Nobody on the other side iss going to write them a check until the case is over. So one of the things that post-judgment funders do is come to them and say, "Okay, I'll buy part of that judgment. I'll take a ride with you, and if you win, I get a certain amount of money. If you lose, you get to keep the money and I'm basically aligned with you."

There's another group that funds settled cases. Class action lawyers spend years, and years, and years pursuing cases and not getting paid. They settle the case and now often wait another two years, three years, before they get paid. There is another group of funders who come in and say, okay, I'll give you money now to keep you going while you're waiting for this settlement payment to be paid to you after many years.

Finally, and which I won't go into in a great deal today, because that's what a lot of the discussion is going to be about today, are those funders who putting money up to pay attorneys' fees, typically—hourly-rate attorneys—to fund a piece of civil litigation where on the other side, you have a deep pocket

defendant, or an insurance company that's paying the defense fees and costs.

It's a wonderful, burgeoning area, and it's growing. Some of you think it's controversial. I don't think it's controversial, because if you don't have that, then you're not going to have access to that system. I'm looking forward to the discussion today. Thank you very much.

MR. SEIDEL: Thank you, Alan. Great. Great. Thank you, Alan. That was terrific.

We now have Lee Drucker, who will talk to us about evaluating the claim. What do you do as a funder to evaluate it, what do you do as a company that may evaluate it as well, but in a different way than the funder. And one of the key things here, and you should remember it forever, is that you're evaluating an asset. This is an alternative asset that is just like the chairs you're sitting on, just like a piece of art that's hanging on the wall. You *can* evaluate it. You can evaluate a share of stock, and once you can evaluate it, you can do all sorts of things with it. So, just derivatives, as Tim said. So just—if there's one key, how do you treat it? It's as an asset. Lee will tell you about the evaluations of it.

MR. LEE DRUCKER: Hi, everyone. I'm Lee Drucker. I am one of the cofounders of Lake Whillans. Today I will be summarizing my paper, "A Financial Perspective on Commercial Litigation Finance." I really hope that this is the beginning of a conversation, so anyone that would like to email me, my email address is drucker@lakewhillans.com. Or if you want to have a public conversation, feel free to Tweet me, @LeeDrucker.

What is a legal claim? From a financial perspective, a legal claim really isn't that different from any other financial instrument, like a bond. It entitles the claimholder to payment on its prescribed terms once it matures. However, unlike a bond, it's not clear whether the instrument will mature on its face. It first must be validated by the legal system, and this aspect of a legal claim causes it to bear substantial risk.

Litigation finance enables the claimholder to redistribute this risk to a party that is most willing and able to bear and manage the risk. I intend to show that this redistribution of risk allows a company to allocate its resources to the highest and best use, and optimizes economic growth.

Let's imagine that you are the CFO of a venture-backed, high-growth company, and you're faced with a prospect of in-

vesting a legal asset. How would you go about it? Let's assume that if you win, your terms will be $30 million. If you lose, nothing. And your likelihood of success is 70%. In this situation, expected return would be $21 million. To estimate the cost, you want to know the budget, which is $5 million; the duration of the expected litigation, three years; and the hurdle rate of the project, which is 30%; which comes to an expected cost of $11 million. What I have done right there is the opportunity cost. The CFO has the opportunity to either invest in his underlying business, or in the litigation, but due to capital constraints, cannot invest in both. $11 million represents what the CFO would have earned, had he invested in the company. This is a no-brainer, right? On the one hand, you can expect a profit of $21 million, and a cost of $11 million. There is an economic surplus to be had, but let's revisit the economic profile.

Can we actually expect the CFO of a venture-backed company to divert the resources necessary to grow an $11 million profit into a litigation where there's a 30% chance of losing everything? This difficult decision is only compounded by the fact that the market and investors do not view proceeds from litigation as core operating profit. It's a one-off game, and therefore will not be applied the same valuation as the rest of profits. In this example, let's assume that the company is getting a 5x multiple on revenues. Now, the situation is obvious. The CFO should definitively invest in the underlying business. A successful litigation only increases the value of the company by $30 million, whereas an investment in underlying business increases the value by $55 million.

Now, let's introduce litigation finance. In this situation, imagine the funder would willing to cover the costs of the litigation in return for: *A*, return of capital; and *B*, one third of profits. In the case of a successful litigation, the increase to the value of the company is $72 million, but even in the case of a loss, the company has accreted $55 million of value. This is because the CFO did not divert the resources to the litigation, but still maintains upside in the case.

Obviously, all the magic here is happening because somebody is willing to fund the entire litigation for only one third of the profit. So, let's take a look at why that happens. This is kind of coming out a little awkward [referring to the slide presentation]. In finance, risk is the likelihood that an invest-

ment will deviate from the expected return. The risk of holding a portfolio of claims is less than the risk of holding an individual claim.

In the hypothetical, the CFO could invest the $5 million at a 30% chance of returning zero, and an expected return of $21 million. But, if you could aggregate two of these identical claims into a portfolio, the chance of returning zero drops to 9%. If you could aggregate ten of these claims, the chances of returning zero is virtually nothing. If you can aggregate 100 of these claims, the chances of returning anything less than average return per investment of $17 million is about 1%. This is what the distribution looks like on a portfolio of 100 identical cases, in the hypothetical. The high bar is the $21 million.

On the one hand, you have a single case where there's a chance of loss of 30%, and on the other hand, you have a portfolio of 100 where the chance of getting anything less than $17 million per investment is 1%. The risk of holding a portfolio of claims is much less than the risk of holding an individual claim. Investors must be compensated for risk. In this situation, the CFO is an investor. The litigation funder is an investor. What does this mean for the underlying asset of a legal claim?

Well, if there's more risk, you must have more compensation. More compensation means that there's less value in the underlying asset. So, like, a bond with a value and the yield are inversely related. So, the risk of holding a portfolio of claims is less than the risk of holding an individual claim. Therefore, the value of that legal claim in a portfolio is greater than it is being held individually. This is one of the reasons why the litigation funder is able to offer $5 million for only one third of the profit, when the CFO has difficulty making the $5 million investment for the entirety of the profit. The other reason is that litigation financiers' core business is funding litigation. Unlike the venture-backed CFO, when there are proceeds from this litigation, the value of the litigation from this company increases.

That's really the summary of my presentation. I think I'm pretty much out of time. So, again, I'd really like to continue the dialogue, so feel free to email me or Tweet me, and I look forward to talking with you guys more later today.

MR. SEIDEL: That's fascinating, Lee. And for your questions, keep in the back of your mind is, is his very persuasive

presentation about risk right? Because the opponents of funding challenge that and say, "You're asking for something like 3 to 5 to 1 on your return. That's way overpricing it for the risk you're taking, and therefore you're gouging the claimants, and making a fortune." And is that challenge in any way valid? Is this really a risk? Or is it just something that the funders like to say is a risk so they can charge exorbitant fees of 3, 4, 5, and sometimes 10 and 14 times what the capital is they invest?

Okay. Now, we have Radek. Radek will talk to you, as I mentioned, about the sources of capital. There are many different sources that go into investing. It's not just from a funder; it could be from a bank, and so on.

MR. RADEK GORAL: Hi, everyone. My name is Radek Goral. I'm really delighted to be here. My thanks to Professor Zimroth and particularly to Dr. Linda Tvrdy for putting this together and having me here. I'm delighted and really humbled to be a part of this panel. These are some of the most experienced and knowledgeable people in the industry. So, I hope to convince you that I have earned a place at that table even if my story, compared to those stories, is a little story.

Today I wanted to talk to you a little bit about various sources of money in litigation. To do that, I selected a really large and complex case, an anti-trust case against a cartel of Asian manufacturers of LCD panels. By the way, some people in this room, including some people on this panel, know this case probably much better than I do, but still, I hope to do a pretty good job summarizing it. I'm not going to go into detail about the case itself. What I need you to know about it for today's purposes is that the case got MDL-ed, aggregating various kinds of actors, various kinds of claims and lawsuits together, and those actions then were developed and prosecuted in a sequence.

The main groups of claims were: the criminal prosecutions by the DOJ; two class actions; a bunch of *parens patriae* suits by state attorneys general; and finally, commercial opt-out cases, individual cases, filed mainly by corporate litigants.

The government went first, and it was like a ram that breached the cartels' defenses for everyone else that followed later. And the DOJ obviously was funded with public money, but the point I want to make here is that that money, and the results that the DOJ got on this case, benefited private actors as well. So to my mind, this is one example, if you consider

litigation funding broadly, this is one example of public money funding private actions, at least to some extent.

The second stage belongs to class plaintiffs and their lawyers. They were contingency lawyers. Two big classes, a huge class effort, ten truckloads' worth of documents during discovery, more than 300 years in attorney time, more than $18 million spent out of pocket. But the payout was pretty handsome as well. The lawyers, between themselves, took more than $500 million in attorneys' fees at the end of the day. The class plaintiffs were funded by class lawyers, but the question is, who funded the class lawyers? We don't really know. I don't really know, but there are some hints, and those hints come in the form of recorded transactions in secured credit.

There are around 150 law firms involved in those two class actions. The IPP class, the consumer class, was more diverse and involved smaller firms on average. The DPP class was more concentrated, and so were their lawyers. Those were some of the largest plaintiff firms on the market, including Lieff Cabraser, for example. What's interesting is that more than 60% of those smaller firms, and almost 80% of the large plaintiff firms had at least some access to external debt secured by unearned attorney's fees.

Now, how much of that third party money got into this particular case? I don't know, but even if it was only a fraction of their lines of credit, if you have 150 law firms, those numbers tend to add up. What's also interesting is that some of those firms were backed—a majority were backed by banks. Some were backed by non-bank alternative lenders, such as LFG. And another interesting fact is that there's a clear pattern of long-term relationships between law firms and their bankers. Some law firms, including major, major plaintiff law firms, have secured credit relationships going ten, twenty, or thirty years back, so they go twenty or thirty years without ever changing their bank, and I found that pretty interesting.

Moving on, the third stage belonged to state attorneys general and *parens* cases. They added numbers to the equation. Not all, but most of those cases made a part of a large, global settlement, so they worked hand-in-hand with class attorneys. They were publicly funded as well, but I mentioned them because I think, in contrast to the DOJ cases, this is also an example of public action, prosecuted for public goals that

benefited from the capital raised by private actors, or at leastthat exchanged some benefits with those private actors.

Finally, the final stage, corporate opt-outs, corporate individual plaintiffs. They were the master piggy-backers, because they came last, and therefore they benefited from the effort, and money, poured it into this litigation by everyone that came before them. They were major players, and they hired major law firms, Big Law AmLaw 100 listers. But what I found really interesting was that even amongst those big, powerful, corporations, some found it useful to take advantage of third party capital.

Take a look at this group of opt-outs represented by the law firm of Crowell & Moring, sometimes with a co-counsel, and what turns out is that the two leading cases within this informal coalition, the AT&T and Motorola cases were in fact backed by Juridica. It was an indirect funding through a very special law firm, but still, Juridica considers those cases a part of their anti-trust portfolio, and the AT&T and Motorola cases were the trailblazers for the entire coalition of corporate opt-outs. They were filed first, they were used for interlocutory appeals, and they were also paving the way for settlements with individual defendants. So, third party money played a big role among corporate opt-outs as well. What emerges here is what could be called a litigation waterfall, with money trickling down.

In some settings, like in this LCD case, where there is a significant overlap in cost and effort required to bring those cases to successful conclusion, what occurs is this kind of waterfall situation, where the cases brought later are not only cheaper to prosecute, but they are also less risky, because much of that early stage uncertainty that is common to those cases gets removed and paid for by somebody else.

I want to leave you with two major points. One, money in litigation comes in various shapes and forms, but much of it is indirect and flies totally under the radar. It is never disclosed in the course of litigation.

Two, there is this potential for the impact of third party money being greater than the funded case itself, in that it tends to spill over to other cases that get collaterally funded. Thanks.

MR. SEIDEL: Thank you, Radek. He is a good example, as is Lee, of the fact that we are now having coming into the in-

dustry youth that is going to carry this forward. I think both of these young men are good signs that—I mean, to write a thesis on funding? Never would have heard of it a while ago. So, this is really going on.

One thing that you should be aware of. To me, the lawyers themselves are the key to so much of funding. The lawyers themselves. In terms of prosecuting the case, in terms of getting funding, and so on, even though there are conflicts and problems. Right now, we are seeing some of the law firms actually getting funded in the U.K. by other businessmen who can—unlike the U.S., except Washington, D.C.—invest in the law firm. So, along comes Joe Business, invests in John's firm $100 million. John uses $50 million of that to litigate. So, that's the strongest example, but there's also—for example, Burford has recently set aside _30 million for one law firm—Hausmann—to prosecute competition cases, anti-trust cases, in Germany. You're getting more and more into the lawyers themselves putting—that's not to mention the contingency lawyers, which of course, invest their time and money.

Now, we have Mr. Contingency Lawyer. John is, as I mentioned, a patent lawyer, he's a contingency lawyer, and he also works with funding. So, he's got a whole bunch of complications to tell us about.

MR. JOHN DESMARAIS: Good morning, everyone. I have a little different perspective than the folks who came before me. I'm not a litigation funder. I'm a lawyer, so I think about these issues sort of the way as a lawyer does. My firm, and my career, mostly, has been about half and half plaintiffs and defense, and my firm today is in that same place. I'm about half defense, half plaintiff, so I hope I bring a balanced view. I've defended companies where the plaintiff was likely funded, and I've represented plaintiffs who were in desperate need of funding.

My practice, as Selvyn said, is mainly intellectual property with a focus on high-stakes patent cases. The reason I'm exposed to this industry so much is, patent cases are really susceptible to the need for funding, and there is a lot of availability of funding for patent cases. Patent cases, for those of you not in the industry, it's very common to have double-digit million awards, or triple-digit million awards. You read about them in the paper all the time, and it is not uncommon to have that. So, the funders want to get into the space.

Why do the plaintiffs want it, or need it? It's because patent cases are hugely expensive. I was actually charmed to hear Mr. Zimmerman's view of what it costs because in the patent space, it's not uncommon for the monthly fees to be $500,000 a month. The fees are on the kind of cases I do, which are the high stakes cases, regularly $10 million to $15 million just in fees. That's over a couple years, probably over three years, so you're spending about $5 million a year in just the fees. The out-of-pocket costs are likewise in the single digit millions. By the time the case is done, you might spend $5 million in costs.

So, if you are a plaintiff, oftentimes in the patent space, we get solo inventors, ladies and gentlemen who have come up with ideas they've filed for a patent, and they think Microsoft is using it, or Google is using it, and they don't have the wherewithal to put up $10 million so they can go after Microsoft. So they either need a contingency fee lawyer or a funder if that claim is ever going to see the light of day. And that's why I've sort of stumbled upon this industry in my practice.

The thing that I've learned over the years, too, is there are all kinds of funders. This may be surprising to those of you who are not in this industry, but traditional private equity companies fund patent cases. I've worked with a couple, Altitude Capital, Arena Capital. These are traditional private equity funds, and they have the traditional structure for economics. Hedge funds fund patent cases. I've worked with Fortress and other huge, billion-dollar hedge funds who have funded patent cases. Banks fund patent cases. Credit Suisse had a whole division that was dedicated to finding patent cases to fund. And they met with us several times when I was a partner at Kirkland & Ellis asking to fund the cases that we took for plaintiffs. So, these litigation funders that you heard about today, and that we're going to hear about the rest today, are actually relatively new to the space, because private equity and hedge funds and banks have been doing this for years.

Now, what is the role for these guys if there are contingency fee lawyers like me? My firm does, as I said, about half defense, half plaintiff. On the plaintiff side, we regularly take the cases on contingent fee. Why do we need funders if contingency fee lawyers will take the cases? Number one, because the cases are, as I said, could be running up $10 million in fees, and that's tough for law firms to swallow sometimes.

But then there's this whole second class in patent cases, where the expense is the out-of-pockets; the payment for depositions and trials runs into the millions itself. Somebody's got to take that money out of their pocket.

Secondly, sometimes, plaintiffs, especially a solo inventor, needs money to live if they don't have enough, and a funder will come in and give them money to live. Law firms generally don't do that sort of thing.

Lastly, there's this other unique thing that has been presented to me a few times by different entities, where if the firm has a basket of contingency fee cases, funders have presented to me—I've never done it—but they've presented to me, "How about if we come and give your law firm $10 million, or $20 million and you go out and get more contingency fee cases, you will feel more comfortable getting more if we're giving you money, and then we'll take a return on the basket of cases?" So, they're not betting on one case, they're betting on the bundle. It's an interesting model. I don't know of any firms who have ever done it, but it's been presented to me a couple of times. We've never done it.

But what I want to focus on now, for the remaining minutes, is from a lawyer's point of view, what is going on here, and what are the dangers, what are the questions that need to be answered, and where can the Center help?

Number one, are these funding relationships discoverable? Prior to going into a funding a relationship, the funders' due diligence, they examine the claim, they turn up interesting information about the claim. Are those diligence documents discoverable? Are they protected by the attorney-client privilege? There's no real study about this in the law that I've seen, and the funders are adverse to the party they're going to fund during that diligence phase. So, while they have a community of interest after they agree to fund, when they're creating the diligence documents, they're actual adversaries. It will be interesting to see if that stuff starts seeing the light of day in courts. If some of those diligence documents are good for the claim, or bad for the claim, it could be relevant to the litigation.

Secondly, who selects the law firm? If a law firm has a regular relationship with the funding company, you know, is the law firm going to be more loyal to the funding company than they are to the client that they're taking the case for when they

know that their future business is actually coming from the funding company? And what are the ethical implications of that? Who controls the litigation is critically important.

If you're a law firm, and you're representing a plaintiff but you're being funded by Selvyn's firm, you know, who is calling the shots? Is the client really calling the shots on the client's own claim, and what do the funding agreements say about that? And that boils into the next sort of, who's controlling whether to settle or not? And these funding relationships get very complicated.

So in a contingent relationship, the normal relationship is a split of the outcome. So, the law firm might get 35% to 40%, the plaintiff gets the rest, and everyone's aligned the whole way through because you only share in the pot of gold at the end. The way the funding relationships, the ones I've seen, they don't set them up that way. They take what are called first dollars. If they give you $10 million, they get the first $10 million that comes from the award. Plaintiff gets nothing. More importantly, they need a return on their investment, so they actually get the first $20 million or $30 million. Depending on your terms, you could have an agreement where you have to pay two times what the investment was, or three times what the investment was. That comes out of first dollars, so that changes the dynamic of the settlement in very important ways.

Let me just give you an example. Assume you have a case with a potential judgment of $50 million. Assume the funder put in $5 million. Assume you're in the middle of litigation and the defendant offers to settle for somewhere between $10 million and $15 million, right? That $10 or $15 million pays the funder their full return. Twice the $5 million investment or three times the $5 million. They are really happy with an offer to settle of $10 million to $15 million. They're going to now pressure the plaintiff to settle, but the plaintiff gets nothing if they take a settlement of $10 million to $15 million. The claim is worth $50 million. There are ethical implications here about the structure of the agreements, what does it mean to get first dollars, what does it mean to get 2x or 3x on first dollars, and what are the ramifications for the plaintiffs?

Are the plaintiffs really in control of their case anymore, in control of their law firm anymore, and in control of the decision to settle? So, these are tough, tough questions that

need to be answered from a legal point of view, and an ethical point of view.

MR. SEIDEL: As usual, terrific. One thing that John mentioned, which is also below the radar in many situations is, what's the defendant's role here? You know, defendants like the U.S. Chamber of Commerce a represents the defendants, have criticized funding, anywhere from being criminal to being evil, venom, and so on, because they don't like funding. However, the defendant's lawyers should have a real interest in knowing about funding for two reasons.

One is a simple reason. If a case is funded, it may have all sorts of different implications, such as what happens in settlement, and so on. The defendant should know that and be able to determine what their strategy is going to be. So, that's number one.

Number two, funding is coming to the defendant's home territory. There are some funders who have funded some defendants who have been sued in one of these strike suits. And if it's a case that'sa frivolous claim, why not fund the defendant in his defense? And why not couple that, perhaps, with insurance? A funder goes in alongside an insurance company, who might also insure the liability if it occurs. So, the defendants are going to have a much greater opportunity in the funding, which I think is going to start to hit home.

One, also, final comment about—John hit on very, very important things—control. What is a conflict that might occur between the lawyers, and the funder, and the client? To me, the lawyers are in the trickiest position in any of these cases; that is, the prosecuting lawyer, the lawyer that's getting paid. He or she puts themselves into a Bermuda Triangle. There is constant inherent conflict between a lawyer and their own client, if, in fact, they are choosing funding that might cost more but with a funder who sends them cases. Everything is not aligned in these interests, no matter what you hear, all these interests are aligned. They're different, and they're different at settlement. That's a very good example. So, what is the lawyer's role, here? Ethically, the lawyer has to look out for the client. Is he or she always doing it? Not necessarily, and that's going to come back to haunt them.

The other thing is, when a lawyer goes out to find funders, they don't know what the hell they're talking about. They don't know funding. Funding is a very complicated in-

dustry, and for a lawyer to think he or she knows how to find a funder, how to negotiate the best, they are fooling themselves, believe me. Therefore, what they're doing is they're putting themselves in the crosshairs of an ethical problem. They're incompetent to do what they're doing. What they're competent to do is to prepare a case for a funder, or to prepare a case for a trial. They're incompetent, 95% of them, to go out and get funding.

So, even just going into that arena, they're running the risk of ethical problems, and also legal problems. They can be sued for malpractice. Lawyers don't even know this, that's how little is known about the industry so far, but it's becoming clearer and clearer, and lawyers are waking up to it. That's enough, certainly, from us.

Now, I'd like to have questions or comments from everybody. Maybe we can start with anybody who has a burning question up here, or comment. And then go at—yes. Is that Maya?

Just to give her an introduction, she's on a panel a little later. Maya used to work for me at Latham & Watkins. She has since become the academic force in the funding industry. She teaches it, she participates in conferences, and so on, so I dread it when she wants to ask a question.

Ms. MAYA STEINITZ: It's actually not a question in [inaudible].

MR. ZIMMERMAN: The question is why banks are staying out of the space. I'm not a banker, but I can give you my explanation. Law firms are unstable, economic businesses today. It's a fact. Why? Because the assets of a law firm, I call them elevator assets, which means that the lawyer gets in the elevator every day, and goes to work, and if the lawyer doesn't get in the elevator every day and go to work, there's no asset. The law firm is a bunch of lawyers who depend upon each other to show up and go to work. And among the things that have happened, besides the economy and the impact of economic issues, recession on law firms is, you have another industry that's developed in the last twenty years of legal recruiters and merger acquisitions specialists.

And they have an annual ritual of getting on the phone and calling law firms and lawyers and saying, "Hey, there's greener pastures over at such-and-such and Smith. Leave your law firm and go there." And you find, then, lawyers moving

around from law firm to law firm. You can just look at the list of major law firms that have been in existence for many, many, many years—centuries, in fact—that in the last ten or fifteen years are gone. They're out of business. Dewey & LaBoeuf is the most recent, but I have in my paper a list of ten of them.

So if you're a banker and you say, "Well, what am I lending to here?" You've got a 90-day receivable list, and you've got a work in process in the law firm, and that's about it. From a banker's standpoint, they cannot evaluate. And you've got the personal assets of the partner who is going to personally guarantee the loan, but they're not enthusiastic about lending to law firms. I can tell you that.

MR. DESMARAIS: There's another complication, too. When I talked about Credit Suisse being in the business, they disbanded the unit, and the reason they disbanded the unit was, they were trying to fund individual cases, not law firms, and most of the defendants in the individual cases are big companies.

So, when the investment opportunity was fed up the chain to the management at Credit Suisse, they kept telling the group, "No, no. We don't want that case because we'd rather give Microsoft a loan, or rather do banking business with Microsoft, rather than fund a litigation against Microsoft," as an example. Ultimately, the group kept referring cases, and they kept getting rejected, so the group disbanded and all went, actually—they dispersed to these funding companies now.

MR. GORAL: Or, there's a risk that they might actually miss the conflict. And that's a very real risk that, actually, you know I realized in the past, and the bank ends up basically funding the case against either itself or its close affiliate, and that's not a good outcome for the bank .

MR. SEIDEL: That's exactly right, and that's why Credit Suisse went out of business. Allianz , the insurance company, did the same thing. It was very heavy into it, but then it found out there were too many conflicts, so it exited. I think that conflict is the biggest entry barrier.

The other one is, they're scared of their shadow. They don't know how to analyze and evaluate it. They don't know how to evaluate their own loans, so if you get them into risk, they run for the hills. However, there are some—and here's my only comment—there are some that are trying to sneak

into it. Deutsche Bank funded a case against Bank of America. Talk about conflicts.

Then you had the struggle that John's talking about. They wanted to find out in the court, who was the funder. And needless to say, Deutsche Bank refused to tell them, all sorts of phony reasons. And finally—I think it was Judge Kaplan—said, "You tell me," and it came out it was Deutsche Bank against Bank of America. Bank of America went wild. So there is a very real conflict.

There was another question over here. Yes?

MALE VOICE 1: [Inaudible].

MR. DESMARAIS: The way the agreements are ordinarily set up—at least the ones I've seen, and I'm not a funder, so I haven't seen as many as these guys. The agreements that I've seen are set up as when a funding company gives a loan, the agreement requires that they get a return of either twice their money or three times their money from the first dollars from any settlement, and that's the way the terms are set up. The plaintiff has agreed to that.

I wasn't complaining about the economics of the agreement. What I was talking about is this notion that that money comes from first dollars, which then creates the conflict, because then when the settlement offer comes in, the funder wants to settle because they've got their 2x or 3x return. The plaintiff doesn't want to settle because they have nothing left. So, it's in the agreement.

MALE VOICE 1: They don't negotiate?

MR. DESMARAIS: Well, you know, you're talking about individual plaintiffs who make bad deals, yes. So, I'm not complaining about the terms of the deal. I'm complaining about the ethical implications of the deal. Right? Not the economics of it.

MR. GORAL: But that's a really interesting question, right? If you have a contract like that, usually the plaintiff retains the power to decide whether to settle or not, and the plaintiff has the power to spoil the game, basically, to say, "Okay. If you get all the money, then I just won't settle." Right? So, that's the leverage that sometimes is used in this case.

MR. DESMARAIS: There's a nuance to that, too, because oftentimes, the agreements—because the funders are not stupid people—oftentimes the agreements will have financial conse-

quences to the plaintiff if the plaintiff rejects a settlement offer supported by the funder.

So, the agreement will say something like, "If, during the course of the negotiations, we recommend to you that you take a settlement and you refuse, that's your choice, because you're in control of the settlement, but you will have the following financial consequences of doing that." It could be you're now responsible for some of our return, or it could be, you know, we're not going to continue to fund. It could be anything like that, and so it puts the onus on the plaintiff. It puts him in a difficult situation of saying, "I better take the deal, or I'm going to have some financial risk myself."

MR. SCRANTOM: I think it's true, though—excuse me, Lee—that you don't come away from this thinking that there is one form of funding agreement out there, because there's not. I might say, years ago—five, six years ago—there were a couple of models floating around that people used. But with competition, and this is one of the paradoxes, with competition comes more responsiveness to client needs and genuine negotiation, so you could say, you know, there are benefits to competition that alleviate some of these compressions at the low end of recovery that John was talking about.

MR. SEIDEL: Good point. We have a question here.

Male Voice 2: [Inaudible] shared with the [inaudible] the plaintiff [inaudible] the lawyer, but also the [inaudible] and separate party [inaudible].

MR. SEIDEL: You're 100% right, and that's a fear that every lawyer who's representing a claimant should have, that they're going to screw up things for their client because they don't know how to best protect their client.

You heard a couple of comments now that won't come to the mind of an innocent lawyer. So, what do you do? You can do two things, in my view. If you're in a firm, you have that firm, set aside a small group, two, three, that learn about funding, learn about funders, and protect that firm or any lawyer who's going into the funder.

In fact, some lawyers' law firms are becoming "funder friendly." They're trying to attract cases, and to do so, they've got to become more active.

The other thing is, get an outside, independent expert. I'm not sure a lawyer is the best one. Maya is an example. You

can go to her, and she can give you expert advice. Yes. Back there. Oh, I'm sorry, Alan.

MR. ZIMMERMAN: I think that's a very important point. One of our business practices is when we are funding a client to pay the lawyer, we require that the client go to another lawyer and get advice, for that very reason, because it puts the lawyer who's getting the money in a tough spot, obviously, as you pointed out.

But also, the last thing a funder wants to have, is (a) an unhappy customer, and (b) somebody coming back and saying, "Wait a minute. I didn't know what I was doing." So, if you're giving somebody $1 million—or $2 million, or $5 million—whatever the number is, you want to make sure you've got a binding contract and they know what they're doing.

Secondly, I've been doing this for a long time and thinking about it quite a bit, and we have our own practices. The issue is whether or not you interfere with the settlement is something that comes up, and should come up, when you underwrite a case to begin with. That's when you think about it. If this person, or lawyer, needs $1 million, is there a scenario where my million dollars, or a company's million dollars is going to be such a significant amount that we're going to get in the way of settlement. And if so, we pass. We don't even do the transaction, because we don't want to be in a situation where we are frustrating the settlement.

And our agreements, we don't have any control over the settlements, so we want to make sure it's a rational decision, because we do get paid first. And we don't want to interfere with that client deciding, "Yeah, I'm going to take this number." And so that's one way, so you have to underwrite for that.

One more point. There's a lot of things I want to say, but we don't have time. This issue about discoverability is very, very critical. Actually, there are is some case law in this. One is *Miller vs. Caterpillar*, and some other cases, cited in this paper we did. But the best practice in what you do is you sign an NDA with the law firm, so that the law firm, when they call you and tell you about their case, is covered by this confidentiality agreement that is binding. And you do the same thing with the client, when the client comes on board. So, everybody's subject to an NDA, first of all.

Secondly, personally—and I've debated this many, many times with a lot of trial lawyers—I'm fine with the other side

knowing that our side has a lot of money. It promotes settlement. The first time I ever did a transaction was by accident, and the case settled in three months because the other side found out that the plaintiff had money. I don't know what's wrong with that. I don't know that they need to know all the details and the terms of the transaction, but if you tell the defendant, "Hey, they tell you that they've got $10 million in coverage," and you say, "Yeah, we've got $3 million in money available to fight this case, let's sit down and try to settle the case," I think you're going to get a lot more settlements out of that. That is my personal view, and a lot of people disagree with me. So, I'll leave it at that.

MALE VOICE 3: So, going after the issue of [ethics]. And it seems like most of this [inaduble] is covered currently by [the rules of professional responsibility]. But in terms of regulation [inaudible] finance, as the [inaudible] are we seeing federal recommendation, or [inaudible] regulations that are covered under insurance law. And also, is the prospect of [inaudible] for now a [inaudible] ? I mean you can see [inaudible] .

MR. DESMARAIS: On the first point about ethics, and then I'll pass it to these guys about the regulatory stuff—but on the first point of ethics, I'm not sure the current rules help in all instances, because the funders are not lawyers. So, if it's a transaction between a funder and a plaintiff, the traditional legal doctrines about lawyer ethics, I'm not sure are valid.

MR. SEIDEL: That's true, John. However, it does help in controlling the lawyer, which the lawyer has to be ethical. What you're seeing on the ethics front is that Bar Associations are coming out with ethics opinions specifically on this industry, because the general rules are very, very hard to manipulate.

New York, your home state if you're from here, has what seems to me to be the best opinion on it. You should read it. I think it came out in 2012—where's Tony? Tony was the first one to notice it. He brought it to our attention, and it's a wonderful discussion of whether this is even ethical. According to champerty rules, it says it's ethical. You may have misstated—you can milk out of that that you can actually control as a funder, which I think you should be able to do anyway, but that's a very hot topic. The final thing is, it went through a bunch of ethical traps that a lawyer can fall into. The best

thing you can do is in any state you're involved in, check the opinions that might have come out, specifically.

As to rules and regulations, yes. They're coming right down the pipe. As you're sitting there, a Senate subcommittee is examining rules and regulations in this industry, because a lot of people have called it the Wild West, and this and that, therefore there is rule-making going on.

It started in the U.K. They're now revisiting it. They have voluntary codes. They're revisiting it for legislation. The U.S. has it, and Hong Kong is in the process of enacting rules right now. So, Peter, I think said, it's coming down there. It's coming. Yes?

MR. SCRANTOM: Let me make a quick comment on that Selvyn because I think it's pretty crucial, thinking about regulation in this audience. There's a huge distinction between transactions with consumers, and transactions between businesses.

MR. SEIDEL: Exactly.

MR. SCRANTOM: Everything we've heard about this morning, at least from our two paper discussants, was about commercial transactions. Obviously, there's less need for regulation where Microsoft is transacting with Burford or what have you. There are regulations dealing with consumer related finance in the litigation area. Probably not many dealing with law firm lending, but if you look at those three areas—and if you're wondering how they break out, there's a pretty seminal paper that the Rand Corporation did in 2006, 2007, that discussed these three areas.

MR. SEIDEL: Tim ghostwrote it, by the way.

MR. SCRANTOM: I think that what you're seeing is more regulation with respect to consumer activity, could come out of the Consumer Protection Finance Bureau at the federal level, most likely at the state level. So, that's kind of my view on it.

Last thing about ethics. The key issue that lawyers face in dealing with third party funding all comes back to a single basic principle, and that is, independent, professional judgment. That's what underpins the fee-splitting rules that say that lawyers can't split fees with a non-lawyer. It underpins other parts of the rules.

But the key position is independent, professional judgment. Can the lawyer withstand the contractual rights or the

demands that might be made by a funder that would seek to interfere with his relationship with the client, and his protection of the client?

And that's the big issue. I mean, are lawyers powerful enough to exercise their duty of independent, professional judgment to stand up to these kinds of things.

MR. SEIDEL: Tim, that's—as usual—absolutely right. Let me make one related point. Currently, every state has rules and regulations that we, as a funder, have to abide by. So, you have fifty different states, even though there's a lot that are the same, they're different, and each one is independent. And then you have the federal, which is federal courts, but they're looking at the states. Now, we might have federal regulations as well, and then you get into issues of preemption and so on.

Okay. Yes. We're almost at an end, so—no, go ahead. Oh Boaz, how are you?

MALE VOICE 4: [Inaudible] .

MR. SEIDEL: Thank you, Boaz. That's Lee's partner. Anything else that we have, before we shut it down, because it's time to shut it down? We're shutting it down. Thank you very much. Excellent questions.

***

Editors Note: This Conference transcript has been edited for clarity.