Senate Committee on Judiciary
Testimony in Support of Senate Bill 74- Third party litigation financing disclosure
Presented by Eric Stafford, Vice President of Government Affairs, Kansas Chamber

Thursday, February 2, 2023

Madam Chair and members of the committee, my name is Eric Stafford, Vice President of Government Affairs for the Kansas Chamber. The Kansas Chamber represents small, medium and large businesses of all industry segments across the state. We appreciate the opportunity to testify in support of Senate Bill 74, which requires disclosure of third parties with financial interest in litigation. SB 74 is drafted identical to SB 152 from the 2022 session.

The U.S. Chamber Institute for Legal Reform (ILR) first published information on third party litigation funding (TPLF) back in 2009, but this practice was pretty limited to the country of Australia. However, a new niche market of hedge funds have been created for the purpose of investing in litigation in the outcome of lawsuits betting on their success and a financial return on their investment.

According to a 2020 publication from ILR, some estimate “that litigation finance is at least a $10 billion industry.” This new industry has been called “thriving” due to the expansive growth of the practice of litigation financing. This type of practice opens the door to opportunities for frivolous litigation. In short, these companies are acting as investors and base their decisions on their expected return on investment.

There are ethical questions that arise from this practice. TPLF encourages fee-sharing between lawyers and non-lawyers, and they undermine a party’s control over their lawsuit. The great thing about America’s capitalistic structure is these entities have the right to try and make money off of their investments, barring the ethical questions of whether they should or not. However, what we’re asking in SB 74 is that this information be properly disclosed to the defense that there is a third party with a financial interest in the outcome of the case.

According to ILR, “In 2018, Wisconsin enacted a comprehensive litigation funding disclosure requirement. The Wisconsin law provides that “a party shall, without awaiting a discovery request, provide to the other parties any agreement under which any person … has a right to receive compensation that is contingent on and sourced from any proceeds of the civil action, by settlement, judgment, or otherwise.”

The U.S. District Court of Northern California adopted TPLF disclosure requirements for class action lawsuits in 2018, similarly followed by the New Jersey Federal District Court in 2021. To further curb efforts to fund frivolous litigation in Kansas, SB 74 allows for recovery of costs associated with responding to a subpoena.

The purpose of SB 74 is to provide disclosure of a third party with a financial interest to a case. However, we are aware of smaller lenders who provide loans to individuals for litigation and we are open to language that would exempt them from the bill. Our focus is more on the hedge funds who are acting in a manner to invest in and profit from litigation. Last December the CBS show 60 minutes ran a segment on litigation funding. Below is a copy of part of the transcript where a University of Iowa law professor speaks about the lack of transparency in the judiciary with these arrangements.

Transcript from 60 Minutes episode on December 18, 2022:

But Maya Steinitz, a law professor at the University of Iowa, says there are ethics rules for lawyers, but not for these investors.
Maya Steinitz: The funders are not regulated. There's nothing precluding them legally from pressuring a client to settle. The rules of ethics are very clear that the lawyer has to abide by the wishes of the client. But human nature is human nature. There may be an inclination to be pulled towards the person who is paying.
Lesley Stahl: Why is this important? Why should someone out there who's not involved in a lawsuit care?
Maya Steinitz: For multiple reasons. First of all, there is this new industry and a new type of player, "litigation funders," who are reshaping every aspect of the litigation process - which cases get brought, how long are they pursued, when are they settled. But all of this is happening without transparency. So we have one of the three branches of government, the judiciary, that's really being quietly transformed. And there's -
Lesley Stahl: Very little oversight.
Maya Steinitz: Very little oversight.

We have asked opponents to the bill to provide compromise language on disclosure with no progress. On behalf of Kansas businesses, we would ask that this committee support a disclosure requirement for third-party investors of litigation.

Included at the end of our testimony are several articles related to this issue. First, when we brought SB 152 in the 2022 session, we were told this wasn't an issue in Kansas. The first article speaks about a group that obtained $100 million in start-up capital for litigation investment. We know this firm has contacted Kansas law firms asking to finance litigation in return for any profits associated with the outcome of the case. Again, these individuals have the right to make money however they want. But just as businesses are required to disclose insurance coverages, we are asking for disclosure of any third-party with a financial interest in the outcome of a case.

The second article focuses on concerns over Russia and China gaining access to sensitive defense information through discovery because of third party financing arrangements.

In closing, we believe SB 74 offers a simple solution to protect against abuses in our state's legal system. Thank you for allowing us to testify in support of SB 74, and I am happy to answer questions at the appropriate time.

PRETTY SIMPLE:
IF YOU'RE HIGH,

This young litigation finance startup just $100 million to chase cases it thinks will w

Connie Loizos
@cookie / 12:16 AM CDT • September 18, 2019

If you haven't heard much about litigation finance, that may change soon. The practice dates ba picking up momentum since 2006, when Credit Suisse Securities founded a litigation risk strateg

What is litigation finance? In a nutshell, the idea is to fund plaintiffs and law firms in cases where winning ruling. When everything goes the right way, the capital that helps fund the lawsuits is ret in return for the risk taken. Litigation finance firms — and there's a growing number of them — b accurately as possible the risk involved so they can bet on the right horses.

Interestingly, one of the newest entrants onto the scene wasn't founded by career attorneys or s private equity group. Instead it's a young, 11-person company called Legalist that's run by a 23-y named Eva Shang, who co-founded the company with her college classmate Christian Haigh, w

As interestingly, the pair, who say they honed the idea as part of a Y Combinator batch in 2016, j put it to work. That's roughly 10 times the $10.2 million they raised for a first fund that tested out finance civil lawsuits that pay.

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TC: First, how do you find these plaintiffs that you're backing? Do you reach out to them?

ES: We do occasionally get cases directly from plaintiffs, but attorneys are the usual point of con
repeat players in the litigation funding industry; they're seeing a lot of cases.

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TC: And who are they telling you about? Who fits your criteria?

ES: The plaintiffs we work with are involved in smaller cases, meaning they require less than a n
a lot of money to pay a lawyer, but in the world of litigation, it's akin to seed-stage investing. Onc
then our algorithms help our two underwriting attorneys perform diligence more quickly.

TC: What kind of information or patterns are they seeking out?

ES: We scrape state and federal court records and look for indicators, like whether a court is fav
particular case types tend to win, who the judge is. We also check for points at which the case c
focused exclusively on commercial cases, so often breach-of-contract [disputes] where it's a Dav
the smaller company is typically underfunded. When there's litigation, we help pay for attorneys'
we recover and if not, we don't.

TC: How many cases have you backed so far, and how many have you won?

ES: We've funded 38 cases, half of them have received a settlement, judgment or been otherwis
80% were positive.

TC: And that has translated into what kind of return for your investors?

ES: We can't talk about fund returns, but we scaled up our funds 10x [based on that performanc

TC: That's a lot of cases to churn through. When do you step into the process in the lifes

ES: The cases we're [involved with] are more advanced and are showing success indicators, so
frame. We also fund smaller cases than most other litigation funders. Because of our approach,
speed due diligence, we can do that.

TC: You can't discuss returns, but can you tell me what your investors expect to see back venture-like returns, presumably.

ES: Not venture-type returns, but high-yield returns.

TC: There is movement in a small but growing number of states that want more transpare litigation funding agreements. It aims mostly to protect consumers, but it sounds like son commercial litigation aren't so thrilled about it, either. What are your thoughts?

ES: We actually don't mind disclosure regulation so much. As long as litigation funding is becom
that's a good thing and the rules shouldn't impact us so much. I also think in the long run that it's
huge problem.

TC: Do you syndicate deals? Do you go it alone?

ES: It's not like in VC. When we invest in a case, we're [aren't teaming up with other sources of f

TC: Who owns equity in Legalist? You went through Y Combinator. You raised a little vent now have this fund.

ES: Y Combinator owns 7% of the company [because Legalist went through its accelerator prog
legal analytics company]. [Other stakeholders] include VY Capital and Refactor Capital.

TC: How will they eventually liquidate their stakes? Does a company like Legalist go publ

ES: There are two publicly traded litigation private finance companies. We're a tech company; th

TC: How long will it take you to invest this $100 million?

ES: The total fund life is five years, but we expect to deploy the fund in two years across 100 to 2

TC: What have you learned in those cases where your investment has gone to zero?

ES: That there's idiosyncratic risk in the court system that can't be anticipated. If a jury likes you, the law over you so you win, and if they don't, you won't. We see that. There's also luck involved meritorious case. That's why we want to diversify across a larger number of cases.

TC: You dropped out of Harvard because you were accepted into Y Combinator. Around tl received a Thiel Fellowship, wherein recipients are provided with a $100,000 grant to worl couple of years. What do your parents think of all this?

ES: They really don't understand it, but they can see that I like what I'm doing. My mom does ke going back to school. She's like, "I thought the Thiel fellowship was over after two years!"

Correction: This story originally reported that Legalist co-founder Christian Haigh had graduated entered into a joint BS/MS program, but he also dropped out of school with Shang when the two Combinator.

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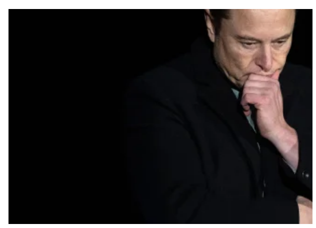

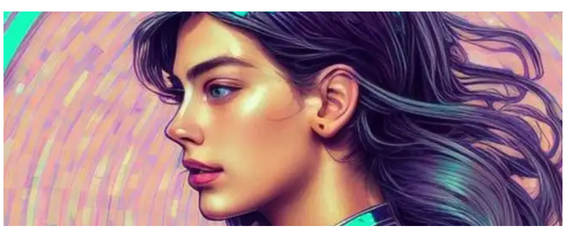

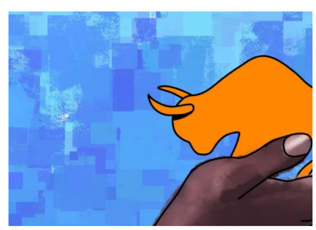

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Legal loophole exposes U.S. military secrets to China, Russia, lawmakers warn

National security issues arise with third-party litigation funding

By Alex Swoyer (https://www.washingtontimes.com/staff/alex-swoyer/) - *The Washington Times*
Tuesday, January 24, 2023

Sen. John Kennedy is sounding the alarm over a potential misuse of the U.S. legal system that would allow adversaries such as Russia and China (/topics/china/) to fund lawsuits against American companies and use the discovery process to obtain military technology or intellectual property.

Mr. Kennedy, Louisiana Republican and a member of the Senate Judiciary Committee, sent a letter this month to U.S. Chief Justice John G. Roberts Jr. and Attorney General Merrick Garland raising the national security risks linked to third-party litigation funding, which has little to no transparency requirements.

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"Few safeguards exist in any form of law, rule, or regulation to prevent foreign adversaries from participating in civil litigation as an undisclosed third-party in our country's federal courtrooms — this resulting in our national security and our entire government being vulnerable to manipulation," Mr. Kennedy wrote in his Jan. 6 letter.

"As a member of the Judiciary Committee, I ask that the Department of Justice (/topics/department-of-justice/) provide details about any course of action that has been taken to mitigate this threat. I also recommend that the Judicial Conference of the United States consider proactively providing guidance to courts from coast to coast as means of preventing foreign entities from hijacking our federal judiciary," he said.

Third-party litigation funding, or TPLF, is a commercial enterprise in which a third party — potentially a hedge fund or even a sovereign wealth fund connected to a government — pays a plaintiff's legal costs to fund a lawsuit with the intent to reap a portion of the awards if the litigation prevails.

Unregulated industry

The practice has grown in the United States to become an annual $2.5 billion to $5 billion industry, according to the Institute for Legal Reform (/topics/institute-for-legal-reform/), a tort reform advocacy group affiliated with the U.S. Chamber of Commerce.

The Government Accountability Office studied the practice and issued a report in December. It found that the enterprise began in the United States around 2010.

The GAO report emphasizes that the TPLF industry is not "specifically" regulated under federal law and that there is no nationwide requirement to disclose litigation funding agreements.

"Publicly available data on the market are limited. Some policymakers have raised concerns about the transparency of funding arrangements and other issues," the report reads.

"Funders and stakeholders [interviewed by the GAO] identified several advantages and disadvantages of third-party litigation financing for users and investors," the report reads. "For example, this funding can help underfunded plaintiffs litigate their cases. However, it is expensive and may deter plaintiffs from accepting a settlement offer because they may want to make up the amount they will repay the funder."

An appendix of the GAO report identifies members of the International Legal Finance Association, a collection of global funding sources for commercial lawsuits, and members of the American Legal Finance Association, a similar collection for U.S. litigation.

A spokesperson for the International Legal Finance Association, whose members include Burford Capital, Omni Bridgeway and Parabellum Capital, dismissed some of the concerns raised by Mr. Kennedy and the Institute for Legal Reform (/topics/institute-for-legal-reform/).

"The claims in this letter come directly from baseless Chamber of Commerce talking points, which are unsupported by any evidence. The primary takeaway from this should be the desperation of the Chamber of Commerce. Having unsuccessfully achieved their preferred policy goals, they have now sunken to fearmongering in their efforts to impose regulations that benefit some of their donors," the spokesperson said. "The commercial legal finance industry provides an essential financing tool that significantly benefits business, especially its ability to level the playing field."

A spokesperson for the American Legal Finance Association did not immediately respond to a request for comment. The group's members include Bridgeway Legal Funding, Law Street Capital and Plaintiff Support.

Funding lawsuits

In the discovery process, a company being sued may have to give the plaintiffs access to its records and communications. An undisclosed funder could use the information to obtain intellectual property or other sensitive information.

A spokesperson for the Supreme Court did not respond to a request for comment about Mr. Kennedy's letter. A spokesperson for the Justice Department (/topics/department-of-justice/) confirmed that it had received and would respond to the letter.

In his letter, Mr. Kennedy points to a lengthy November report from the Institute for Legal Reform (/topics/institute-for-legal-reform/) that detailed several third-party litigation funding sources, including Burford Capital, Ryval and Omni Bridgeway.

According to the institute (/topics/institute-for-legal-reform/), Burford Capital invested $4 million into a lawsuit against Chevron in Ecuador in 2020 claiming pollution in exchange for a share of the awards.

Page Faulk, the Institute for Legal Reform (/topics/institute-for-legal-reform/)'s senior vice president for legal reform initiatives, said it's unclear who is putting money into groups such as Burford Capital that are backing such lawsuits.

However, Burford Capital spokesperson David Helfenbein took issue with that assessment.

"Burford is a publicly listed company on both the NYSE and LSE, which requires us to be transparent in our finances and business operations," Mr. Helfenbein said in an email. "We have gone through the highest levels of scrutiny to list publicly, and we also file public reports throughout the year. We would encourage anyone interested in our business to visit our website and review our financial materials and the publicly available information on our business."

Spokespersons for Ryval and Omni Bridgeway declined to comment on their activities or Mr. Kennedy's concerns.

"We make the playing field level. And that's what people should be wanting in litigation," Mr. Bogart said. "We are a multibillion-dollar company because litigation is expensive. And there's an awful lot of demand from businesses for this kind of solution."

Burford Capital backed Craig Underwood, a small jalapeno farmer in California who sought to recover more than $20 million from a breach of contract deal that caused his farming business to crumble. He won in court with funding from Burford but ended up paying $8 million to the company, which had invested $4 million into the legal fight.

"They stepped in and helped us out when we couldn't have gotten money from anybody else. They basically rescued us," Mr. Underwood told CBS.

Chinese connection?

The Institute for Legal Reform (/topics/institute-for-legal-reform/)'s report cautioned that China Investment Corp., Beijing's sovereign wealth fund, may be financing litigation within the U.S.

"Although the extent of foreign TPLF investment in U.S. litigation remains largely unknown due to the current lack of TPLF transparency (which is itself a national security concern), the limited information available suggests that non-U.S. citizens, including sovereign wealth funds, are in fact participating in the U.S. TPLF market," the report says.

Liu Pengyu, a spokesperson for the Chinese Embassy, dismissed speculation about Chinese interference in U.S. courts.

"The Chinese side firmly opposes such claims, which are purely subjective and fabricated. China (/topics/china/) has always adhered to the principle of non-interference in other countries' internal affairs. We will not interfere in the judicial process in the United States," Mr. Liu said.

"Some U.S. politicians continue to generalize the concept of national security and put obstacles in the way of China (/topics/china/)-U.S. relations and cooperation in various fields. We urge the U.S. to abandon its zero-sum mentality and stop slandering and attacking China (/topics/china/) under the pretext of national security," he said.

To bring transparency, Ms. Faulk said, Congress or the executive branch could require foreign actors to disclose in court filings that they are funding litigation. The Department of Justice (/topics/department-of-justice/) could amend the Foreign Agents Registration Act, which requires people representing foreign interests to publicly disclose their affiliations.

“We know some of these hedge funds have investments from sovereign wealth funds, which are owned by foreign states, but there’s no disclosure, so we don’t have specific examples of the foreign actors,” Ms. Faulk said.

Chief Judge Colm F. Connolly of the U.S. District Court for the District of Delaware issued a standing order in April that would require parties in his courtroom to disclose whether they had third-party funding agreements and the potential interests of those funders. Ms. Faulk said other judges could do the same.

She pointed to the Litigation Funding Transparency Act. Introduced in 2021 by Sen. Charles E. Grassley, Iowa Republican, the legislation would require the disclosure of third-party litigation funders.

“The issue with the multibillion-dollar third-party litigation funding industry is that it operates in the shadows and there are literally no requirements for transparency — no rules, no legislation — and so we are calling for sunshine to bring it out of the shadows,” Ms. Faulk said.

Correction: An earlier version of this report misspelled the name of Burford Capital CEO Christopher Bogart.

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