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Litigation funding begins to take off

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Selvyn Seidel is a betting man. He's betting that life after a partnership at Latham & Watkins will provide continued riches and that the pallid economy can sustain his recent venture. He's also betting that it's the beginning of a new age in litigation.

Retired from Latham in 2006, he and former Time Warner Inc. General Counsel Christopher Bogart in October launched Burford Capital, a third-party litigation funding firm that plans to invest in large-scale commercial litigation and arbitration in the United States and elsewhere on both the plaintiff and defense sides.

Distinct from other kinds of litigation funding, especially for the U.S. legal system, Burford and the few others like it work with sophisticated commercial clients so that they can offload the costs of litigating or arbitrating a matter with the promise of efficient resolution. In its simplest form, the third-party funding firm provides money to a corporation to pay for the cost of arbitrating or litigating a claim as a plaintiff. Whatever the plaintiff gets from an award, the investors get a piece of it, after attorney fees are covered. These firms see litigation funding in the United States as an area ripe for investors seeking off-market places to put their dollars. They also see it as a way to get money into the hands of businesses that otherwise would steer clear of pursuing lawsuits because of the high costs.

But the investment vehicle is just starting to roll, and it's bound for some bumps.

'AN IMPORTANT PHENOMENON'

Third-party litigation funding is "an important phenomenon, and it could have substantial effects on civil justice in the U.S.," said Rand Corp. senior economist Steven Garber. The think tank launched its Law, Finance and Capital Markets Program in September and aims to dig up details on third-party funding's potential and its implications. The jurisdictions where it is permitted and the ethical concerns it raises are just some of the issues Rand is researching. Rand plans to issue a report in May 2010. "We want to sort out the common sources of confusion and help set things straight," Garber said.

With an eye toward U.S. litigation, Burford made an 80-million-share initial public offering through London's alternative investment market and caught the attention of large institutional powerhouses including Invesco U.K., which bought 45% of the shares. Fidelity International and Baillie Gifford each bought 10%. Burford Capital joins Juridica Capital Management in the U.K. market as another publicly traded litigation investment firm created in 2007, which has raised about $200 million to invest in litigation. Burford went public in the United Kingdom instead of here because of the greater familiarity among investors with the concept in the United Kingdom, Seidel said.

"It's a different attitude and approach to integrating law, finance and business," said Seidel, who chaired Latham's international litigation and arbitration group. He does not lack confidence about the future of his new undertaking. "We're the next generation in this industry."

Parties in Australia have used third-party commercial litigation funding for about 15 years, and it has been a growing trend in the United Kingdom since about 2005. But the United States has been slow to follow, primarily because of a patchwork of common law, statutes and ethics rules governing it. A handful of investment firms provide large-scale third-party commercial litigation funding in the United States. Besides the patent case funders and Burford and Juridica, another player is Credit Suisse Group, which brought aboard two former DLA Piper partners in 2006 to develop a litigation risk strategies unit. Chicago's Juris Capital also provides funding.

Buford seeks cases in which legal fees run from $5 million to $15 million. Juridica's typical investment ranges from $3 million to $10 million in cases with claims between $25 million and $100 million.

Traditionally, plaintiffs' attorneys have cornered the market on litigation funding, either on a cash-advance basis in individual tort claims or, on a larger scale, by pooling their resources to pursue big-ticket mass tort claims for a piece of the damages. There also are many companies that provide credit to plaintiffs' firms, using the firms' assets as security. The funding of patent protection and prosecution by private firms also is not new. What Burford and a few others offer is a broader scale of funding for a larger commercial plaintiff and defense clientele. They do not pursue tort or personal injury cases.

Jonathan Petrus is convinced enough about the possibilities of third-party funding that he quit his associate job at Klee, Tuchin, Bogdanoff & Stern to start Arca Capital Partners in June. He is the executive managing director of the Los Angeles-based firm. "It's going to take some time for the commercial market players to understand and to embrace the idea of litigation risk transfer," said Petrus, 36, who also practiced at Loeb & Loeb and at erstwhile Heller Ehrman. "But it will take root."

With $110 million in committed capital, Arca Capital concentrates on midsize businesses. Seidel and Bogart's venture puts a stamp of legitimacy on the industry, Petrus said. "Their footprints certainly in this space benefit us all."

Justin Miller, corporate counsel for E.I. du Pont de Nemours and Co., said he is open to the idea of third-party funding, but he needs much more information about it. He leads the corporation's intellectual property litigation group and is on the advisory board of the Rand program. "I certainly see it as a viable option for a lot of companies," he said, adding that DuPont has not used third-party funding, to his knowledge. In order for his company to use funding he "would need to know more about the context."

Third-party investors contacted for this article would not disclose details about any deals they were pursuing, but a look at the results of Juridica, which is public, provides a glimpse into the operations of these firms. For the six-month period ended June 30, the company stated that it had committed $95.8 million among 18 cases. As of September, it had committed $115.4 million, representing 59% of the net asset of the company. Realized gains on one case were $1.2 million, which yielded an internal rate of return of 61% on the initial investment of $3.1 million, the company reported.

MURKY INFORMATION

Part of the challenge for third-party investment firms seeking business in the United States is that information is murky on which jurisdictions allow such financing and under what circumstances. "There hasn't been a 50-state survey to determine if you'd feel comfortable doing it in South Dakota, for example," said James E. Tyrrell Jr., chairman of the toxic tort and products liability groups at Patton Boggs. He practiced with Seidel at Latham & Watkins.

Despite the uncertainties, he said third-party funding could be a smart choice, even for defense clients. In plaintiff funding, the investment firm provides money to the client. But in the defense-case scenario, the client agrees to pay the investor to handle the defense of a case. The investment firm bets that the cost of settling the case and the attorney fees will fall below the amount it received from the client. The investment firm can then pocket the rest.

Tyrrell sees agreements with companies like Burford as the next step in the evolution of alternative fee arrangements that motivate defense firms to resolve cases efficiently. He has met with "large industrial clients" that are interested in knowing more about it, he said. He also foresees third-party investors working with a list of preferred attorneys on whom they would rely, much as insurance companies do.

However, there are ethical questions neither Tyrrell nor the investment firms looking to expand in the United State take lightly. The general concern is that funding by investors will sway an attorney's loyalty from the client to the money provider, whose interest might not always align with the client's. Another concern is that an attorney runs the risk of breaching client confidentiality to the third-party fund, which may be trying to assess the viability of a claim or defense.

Individual states' restrictions on so-called champerty and maintenance, concepts derived from English common law that prevent nonparties from funding lawsuits, prohibit some investors from participating in third-party funding. Data is scant on the details of those states' laws and rules, but Yeshiva University Benjamin N. Cardozo School of Law professor Anthony Sebok is researching the issue. Texas is the most liberal toward the arrangement, he has found. Other permissive states include California, Florida, Hawaii, Louisiana, Massachusetts, New Jersey, South Carolina and Tennessee. New York is permissive as well, although it is critical that any agreement there between the client and the investment firm occur after a cause of action for the client is established. Georgia and the District of Columbia are considered among the most restrictive.

"For those investors in the business-to-business sector, which actively invests in very expensive lawsuits in intellectual property and contract disputes, the outlook is getting better every year, although they still have to be careful about not straying into a hostile jurisdiction," Sebok said.

At this point, third-party funding is best suited for international arbitration, a forum where the parties aren't likely to confront champerty and maintenance laws, said Richard Hans, chairman of DLA Piper's New York litigation practice group. "There's a general reluctance and fear among litigators in the U.S. that, if you don't structure [third-party agreements] right, they will run afoul of legal and ethical issues." He said that investment firms are "working hard trying to overcome those issues."

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