

Third Party Litigation Funding: A Significant Contributor to Nuclear Verdicts and Social Inflation

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The use of third-party litigation funding (“TPLF”) by plaintiffs has become ubiquitous. It is causing a significant rise in litigation costs, settlement values, and nuclear verdicts. However, legislatures, insurance companies, and defense counsel are starting to address the impact third-party litigation loans are having on the US judicial system and insurance industry.

What is Third Party Litigation Funding?

Third-party litigation funding is a financial agreement in which the funder, who is not a party to a lawsuit, provides money to either the plaintiff or the plaintiff’s law firm, in exchange for a portion of any recovery eventually obtained. If there is no recovery, then the borrower does not have to repay the funding.¹

Consumer vs. Commercial Litigation Funding

Consumer Litigation Funding. A funding company provides money to the plaintiff in a personal injury action such as a car accident or New York labor law action.² The money is used to finance living expenses while the case is proceeding.³ Often, litigation funders calculate the amount loaned as a percentage of the estimated value of the case. Usually, no more than 10% of that value.⁴

If the plaintiff wins the case, they will owe the funding company the original amount funded plus a return on the investment. The amount is outlined in the TPLF agreement and can include an interest rate, a multiple of the original investment by the funder, or a pre-negotiated share of the recovery.⁵

1 U.S. Gov’t Accountability Office, GAO-23-105210, *Third-Party Litigation Financing: Market Characteristics, Data and Trends*, 1 Dec. 2022 at 1. Retrieved at <https://www.gao.gov/assets/gao-23-105210.pdf>.

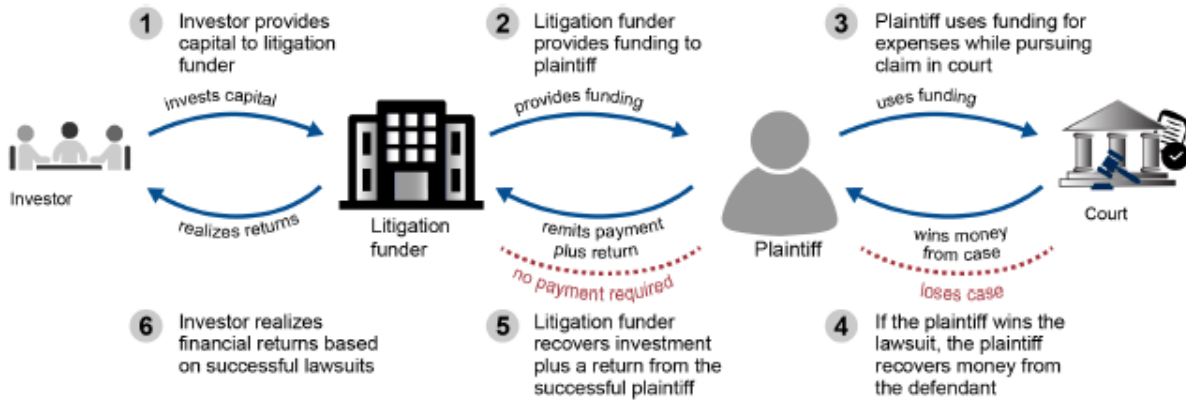
2 Id. at 5.

3 U.S. Chamber of Commerce Institute for Legal Reform, *What You Need to Know About Third Party Litigation Funding*, June 2024. Retrieved at [What You Need to Know About Third Party Litigation Funding - ILR \(instituteforlegalreform.com\)](https://www.instituteforlegalreform.com/About-Third-Party-Litigation-Funding-ILR).

4 See GAO at 13.

5 Id at 5.

Example of Third-Party Litigation Financing for Plaintiffs⁶



Commercial Litigation Funding. A funding company provides money to a corporate plaintiff or to a law firm and the litigation pertains to commercial actions.⁷ Commercial funding agreements are typically used to fund legal expenses or to supplement general operating budgets and involve funding of millions of dollars.⁸ Commercial funding arrangements may involve a single case, in which funding is in exchange for part of the value of the subject case,⁹ or may involve portfolio arrangements, in which a law firm or business obtains funding in exchange for a share of the value of several cases.¹⁰ The demand by law firms for legal funding is driven by increased attorney advertising, increased investments in data and analytics, and increased investment in mock trials.¹¹ The receiver of funds may use the money to cover any costs while pursuing the litigation.¹²

Litigation Funders

- Traditional litigation funders are companies that may obtain capital from endowments or pensions and invest almost exclusively in legal claims.
- Another capital source for funders is traditional multi strategy hedge funds with a dedicated litigation finance desk that operates in other markets and assets as well.
- Alternative sources of capital are high net worth individuals, family offices, and hedge funds without a dedicated litigation finance desk.¹³

Benefits of Third-Party Litigation Funding

Proponents of third-party litigation funding argue that the financial assistance allows an injured plaintiff to use the money to pay for living expenses during the litigation and avoid settling for lowball offers¹⁴ or that litigation financing allows small companies to fund lawsuits and/or higher more experienced lawyers and/or experts against well-funded bigger corporations.¹⁵ TPLF also allows plaintiffs and their counsel to hedge their risk of a negative outcome since they will not have to pay anything if they lose their case.

⁶ Id.

⁷ Id.

⁸ Id. at 8.

⁹ Id.

¹⁰ Id. at 9.

¹¹ Holzhau, T., Fan, I., Finucane, J., Visher, A., Predmore, D., Uchil, A. Swiss Re Institute, *US Litigation Funding and Social Inflation The Rising Costs of Legal Liability*, December 2021 at 11. Retrieved at <https://www.swissre.com/dam/jcr:7435a896-5f4b-463b-a1e6-7d4ec17db556/swiss-re-institute-expertise-publication-us-litigation-funding-and-social-inflation-december2021.pdf>.

¹² See GAO at 9.

¹³ Perich, M. Bloomberg Law, *Profile of Litigation Funders*, January 3, 2024. Retrieved at <https://pro.bloomberglaw.com/insights/business-of-law/litigation-funding/>. See GAO at 6.

¹⁴ See GAO at 19.

¹⁵ Id. at 18-19.

Concerns of Third-Party Litigation Funding

Third-party litigation funding increases litigation costs.

There are many ways that TPLF can lead to increased litigation costs. For example, TPLF may encourage the filing of frivolous lawsuits leading to defense expenses that would not normally be encountered.¹⁶ Additionally, cases involving TPLF agreements may involve discovery fights and motions pertaining to accessing the TPLF agreement themselves, thereby driving up the costs of litigation.¹⁷ Finally, cases involving third-party litigation funding result in longer case timelines.¹⁸ The more time and money spent in discovery and pushing the case through litigation, increases the expenses of litigation and the likelihood of larger awards.¹⁹

Third-party litigation funding increases settlement values.

One of the biggest concerns of TPLF is the interest expense associated with it. The interest rates on consumer TPLF agreements may vary from as low as 15% to as high as 124%.²⁰

A direct result of these sizable interest rates is that it forces plaintiffs to reject reasonable settlements in order to make up for the significant amount owed after accounting for the interest due. If the case settles, the funder will be paid first out of those proceeds sometimes leaving little left for the plaintiff, the injured party in the lawsuit.²¹

Consumers for Fair Legal Funding highlights several cases in which a nominal amount of money was provided to plaintiffs as part of a litigation loan but after years of litigation the amount owed to the litigation loan company multiplied due to the large interest rate. For example, in one case a litigant was provided an advance of \$18,000. Six months later the litigant owed \$33,000 to the funding company, representing an 83% return in less than a year. In another case, a plaintiff borrowed \$4,000 while his lawsuit was proceeding. The matter settled five years later, and the funding company demanded \$116,000. In another case, a plaintiff borrowed \$27,000 to pursue a slip and fall case. After the case settled for \$150,000 the plaintiff realized he owed the funder almost \$100,000 in interest and principal payments in addition to the fees he had to pay his attorney. At the end of the day, the plaintiff was left with \$111.²²

According to a 2021 report by the Swiss Re Institute, it was estimated that TPLF reduces plaintiff's share of awards. For example, it is estimated that in 2016, plaintiffs received 55% of compensation paid in the commercial liability tort system. However, when TPLF was involved, that estimate dropped to 43%.²³ The same report estimated that TPLF agreements in commercial and personal liability claims reduces plaintiff's compensation by over 20%.²⁴ In order for a plaintiff to receive the same payment in a case with TPLF as opposed to one without, the plaintiff would need an award that is 27% higher.²⁵ When plaintiffs consider settlement, they must consider the effect of the funding agreement on their award. Also, some TPLF agreements allow funding companies to control plaintiff's ability to settle. As a result, plaintiffs and their attorneys are choosing to pursue nuclear verdicts.²⁶

Third-party litigation funding drives nuclear verdicts.

It is difficult to calculate the exact monetary amount that TPLF contributes to nuclear verdicts, however it is plainly evident that TPLF is fueling them.²⁷ The frequency of reported nuclear verdicts during the 2013 to 2022 years (excluding the pandemic years) has seen an upward trend.²⁸ TPLF's effects on nuclear verdicts is evidenced by the rise and size of verdicts in medical malpractice actions. From 2012-2014, 28% of verdicts exceeded \$10M, but by the end of 2023 more than 50% of verdicts were \$10M or more.²⁹

16 Id. at 20.

17 Id. at 20-21.

18 Swiss Re Institute at 18.

19 Id.

20 See GAO at 20 and Consumers for Fair Legal Funding, [Consumers for Fair Legal Funding](#), as of March 25, 2024.

21 See *What You Need to Know About Third Party Litigation Funding*.

22 Consumers for Fair Legal Funding, [Consumers for Fair Legal Funding](#), as of March 25, 2024.

23 Swiss Re Institute at 16-17.

24 Id.

25 Id. at 17.

26 U.S. Chamber of Commerce Institute for Legal Reform, *Nuclear Verdicts Trends, Causes, and Solutions*, September 2022 at 31-32. Retrieved at https://instituteforlegalreform.com/wp-content/uploads/2022/09/NuclearVerdicts_RGB_FINAL.pdf

27 U.S. Chamber of Commerce Institute for Legal Reform, *Nuclear Verdicts An Update on Trends, Causes, and Solutions*, May 2024 at 41-43. Retrieved at <https://instituteforlegalreform.com/wp-content/uploads/2024/05/ILR-2024-Nuclear-Verdicts-Study.pdf>

28 Id. at 3.

29 Davis, R (2023). Litigation Funding What Insurers Need to Watch. *The Conning Commentary Strategic Issues for Insurance Industry Executives*, (33)(11). 5.

One-way TPLF drives nuclear verdicts is by providing money for law firms to undertake mass advertising. TPLF has played a “key role in bombarding the public with lawsuit ads that can mislead and desensitize viewers about nuclear verdicts.”³⁰ These advertisements suggest it is normal for plaintiffs to receive nuclear verdicts, when in fact, some of these verdicts are either unconstitutional, significantly reduced after post-trial proceedings, or confidentially settled post-verdict for a much lower amount.³¹

Portfolio funding agreements are another tool used to drive nuclear verdicts. When a funder uses portfolio funding, they bankroll all or a portion of a firm’s cases in exchange for a share of the proceeds.³² By spreading the risk, funders secure their investments, spread the cost of litigation, and “reduce the downside risks of pursuing questionable claims in a particular case for a chance at a financial windfall.”³³

TPLF’s goal of maximizing profits is another factor that contributes to nuclear verdicts. The TPLF’s objective of profit maximization may conflict with the funding recipient’s objective, who may be willing to accept a reasonable settlement. TPLF pressures plaintiffs to reject a reasonable settlement and take a case to trial in hopes of obtaining a nuclear verdict and maximizing the funder’s return on investment. The funding company is willing to risk a plaintiff receiving nothing in exchange for a potentially high return.³⁴

Disclosure of Third-Party Litigation Funding Agreements

It is extremely rare that the details of TPLF funding agreements are disclosed during litigation since plaintiffs typically oppose the disclosure and courts generally do not compel production.³⁵ Additionally, if the disclosure is ordered, courts differ as to as to when disclosure is mandated, who is entitled to disclosure, who must disclose a financial interest, and what information must be disclosed.³⁶

There is an effort by some federal district courts, individual judges, and states to make TPLF agreements more transparent. While some states require disclosure, the majority do not. Below is a table depicting federal and state rules/laws that address TPLF.

30 See *Nuclear Verdicts An Update on Trends, Causes, and Solutions* at 41.

31 *Id.* at 40.

32 U.S. Chamber of Commerce Institute for Legal Reform, *A New Threat: The National Security Risk of Third Party Litigation Funding*, September 2022 at 4. Retrieved at <https://instituteforlegalreform.com/wp-content/uploads/2022/11/TPLF-Briefly-Oct-2022-RBG-FINAL-1.pdf>.

33 See *Nuclear Verdicts An Update on Trends, Causes, and Solutions* at 41.

34 See *Nuclear Verdicts Trends, Causes, and Solutions* at 32.

35 Statement of the U.S. Chamber of Commerce Institute for Legal Reform Before the United States House of Representatives The Subcommittee on Courts, Intellectual Property, and the Internet, June 12, 2024 at 1. Retrieved at <https://instituteforlegalreform.com/wp-content/uploads/2024/06/FINAL-Chamber-ILR-TPLF-Statement-for-the-Record.pdf>.

36 *Id.* at 4-5.

Jurisdiction	Benefits Plaintiff	Benefits Defendants	Requirement
U.S.D.C., New Jersey		✓	Certain litigants must name the funder and describe its interest, whether its approval is needed for litigation/settlement decisions and conditions of approval. ³⁷
Chief Judge for U.S.D.C., Delaware		✓	A standing order for cases on his docket 'largely mirrors' New Jersey's approach. ³⁸
U.S.D.C., Northern California		✓	All parties in class/collective/representative actions must disclose the funding person/entity to the court. ³⁹
Arkansas	✓	✓	Caps annual interest rates at 17%. ⁴⁰
Colorado	✓		Treats TPLF as traditional loans subject to state Uniform Consumer Credit Code. ⁴¹
Indiana	✓	✓	Agreements subject to discovery. ⁴² Funders can't influence litigation/settlement. ⁴³ No commercial funding by foreign entity of concern. ⁴⁴
Maine	✓		Lenders must register. ⁴⁵ Consumer funders must disclose total amount to repay. ⁴⁶
Montana	✓	✓	Must disclose TPLF agreement. ⁴⁷ Lenders must register. Prohibits usurious rates. Limits funder's share of plaintiff's recovery. ⁴⁸
Nebraska	✓		TPFL agreements to be written in clear language. ⁴⁹ Lenders must register. ⁵⁰ Consumer funders must disclose total amount to repay. ⁵¹
Nevada	✓		Lenders need a license. ⁵² Contract void if funder willfully violates the statute. ⁵³
Ohio	✓		TPLF agreements must be written in clear language. ⁵⁴
Oklahoma	✓		TPLF agreements must be written in clear language. ⁵⁵
Tennessee	✓	✓	Lenders must register. ⁵⁶ Annual fees may not exceed 10% of the original amount funded. ⁵⁷ Contract void if funder willfully violates the statute. ⁵⁸
West Virginia	✓	✓	Provide TPLF agreement to other parties. ⁵⁹ Lenders must register. ⁶⁰ Consumer annual fee capped (18% of original amount). ⁶¹ Contract void if funder willfully violates statute. ⁶²
Wisconsin		✓	Automatic disclosure of TPLF agreements. ⁶³
Vermont	✓		Lenders must disclose alternative options to TPLF. ⁶⁴ Funders must register. ⁶⁵

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37 See GAO at 28.

38 Statement of the U.S. Chamber of Commerce Institute for Legal Reform Before the United States House of Representatives The Subcommittee on courts, Intellectual Property, and the Internet at 4.

39 See GAO at 27-28.

40 Id. at 45.

41 Abraham, H. & Graham, M. *New York's Unregulated Litigation Lending Industry*, October 13, 2023 at 4. Retrieved at <https://nysba.org/new-yorks-unregulated-litigation-lending-industry/>.

42 Popolizio, M. *Indiana Enacts Statutory Provision Regarding Third-Party Litigation Funding (TPLF) Disclosure*, June 9, 2023. Retrieved at <https://www.verisk.com/blog/indiana-enacts-statutory-provision-regarding-third-party-litigation-funding-tplf-disclosure/>; Popolizio, M. *Indiana Passes New TPLF Law Regulating Commercial Litigation Financing*, March 20, 2024. Retrieved at <https://www.verisk.com/blog/indiana-passes-new-tplf-law-regulating-commercial-litigation-financing/>.

43 Id.

44 Popolizio, M. *Indiana Passes New TPLF Law Regulating Commercial Litigation Financing*, March 20, 2024. Retrieved at <https://www.verisk.com/blog/indiana-passes-new-tplf-law-regulating-commercial-litigation-financing/>.

45 See *New York's Unregulated Litigation Lending Industry* at 5.

46 See GAO at 25-26.

47 U.S. Chamber of Commerce Institute for Legal Reform, *Montana Enacts Legislation to Required Mandatory Disclosure of TPLF*, May 4, 2023. Retrieved at <https://instituteoflegalreform.com/blog/montana-enacts-legislation-to-require-mandatory-disclosure-of-tplf/>.

48 Theobalt, C. *The Sunlight Disinfectant Principle: Transparency & Full Disclosure are Necessary Safeguards for Consumer Litigation Funding*, January 2024 at 15. Retrieved at <https://kahanafeld.com/2024/01/30/the-sunlight-disinfectant-principle-transparency-full-disclosure-are-necessary-safeguards-for-consumer-litigation-funding-january-2024/>.

49 See *New York's Unregulated Litigation Lending Industry* at 5.

50 Id.

51 See GAO at 25-26.

52 See *New York's Unregulated Litigation Lending Industry* at 5.

53 Id. at 6.

54 Id. at 5.

55 Id.

56 Id.

57 See GAO at 46.

58 See *New York's Unregulated Litigation Lending Industry* at 6.

59 Popolizio, M. *Governor Justice signs S.B. 850 into law amending West Virginia's TPLF statutes*, April 10, 2024. Retrieved at https://www.verisk.com/blog/governor-justice-signs-s.b.-850-into-law-amending-west-virginias-tplf-statutes/#_ednref9.

60 See *New York's Unregulated Litigation Lending Industry* at 5.

61 See *The Sunlight Disinfectant Principle: Transparency & Full Disclosure are Necessary Safeguards for Consumer Litigation Funding* at 15.

62 See *New York's Unregulated Litigation Lending Industry* at 6.

63 See *Nuclear Verdicts An Update on Trends, Causes, and Solutions* at 58.

64 See *New York's Unregulated Litigation Lending Industry* at 5.

65 Id.

66 Note that this table is not exhaustive and some rules/laws may have been updated.

What Should Be Done

There are many concerns about TPLF funding, including, but not limited to, delaying/discouraging reasonable settlements, creating conflicts of interest, contributing to nuclear verdicts, and allowing foreign entities to control US litigation in a way that harms US companies.

The initial step for insurers is to understand and educate the courts about TPLF.⁶⁷ Defense counsel should explain to the courts that the disclosure of TPLF agreements is material and necessary because it would facilitate settlements and allow defendants to see who is controlling the litigation and settlement discussions on the other side.⁶⁸ TPLF agreements should be discoverable for the same reason that a defendant's insurance coverage is discoverable. Both insurance companies and TPLF companies are interested non-parties who have a direct financial interest in the litigation. Additionally, as the litigation continues, the TPLF company's interest accrues. Defense lawyers can argue that the production of TPLF information would facilitate settlement and allow defendants to adjust their litigation strategy, if necessary.⁶⁹

New York defense counsel can “[a]rgue that TPLF agreements executed after liability has been determined against the defendant (or where the risk of non-recovery is miniscule) are not contingencies but loans subject to New York’s usury statutes and the unconscionability strictures of the UCC.”⁷⁰ The theory being that the TPLF agreement is a loan since the contingency aspect is not applicable as liability has already been determined.⁷¹ Counsel should argue that the court and defendant need to know if the TPLF agreement is unenforceable and potentially criminal which may hinder settlement. Even if liability has not yet been determined, defense counsel can seek discovery of the TPLF agreement in order to confirm it is a contingent agreement.⁷²

Defense counsel should push to have third-party litigation funders appear for court-ordered settlement conferences. Not only would this allow the defense to negotiate directly with those who may be exerting control of the litigation and settlement of a case, but it would also change the optics for the court by showing that the true adversary is a hedge fund or other financial firm, rather than the injured plaintiff.⁷³ Defense counsel can also argue that disclosure of TPLF agreements would reveal any conflicts of interest that may exist between the funding company, plaintiff, and/or judge.⁷⁴

Insurers can lobby for legislative changes that would require the disclosure of TPLF agreements. On June 12, 2024, the U.S. Chamber of Commerce Institute for Legal Reform called on Congress for a uniform federal statutory disclosure requirement.⁷⁵ The argument was made that a uniform federal statutory disclosure requirement is needed in order to make TPLF arrangements more transparent and calls for legislation that would disclose “the existence of funding, the identity of the funders, the identity of any foreign funding sources, **as well as the production of the underlying TPLF agreements.**”⁷⁶ The call for disclosure is based on the premise that disclosure would: facilitate settlements, allow defendants to see who is bringing the legal and financial claim against them and who is controlling the litigation and settlement discussions;⁷⁷ allow the court and parties to see if the agreements create conflicts of interest and whether judges need to recuse or disqualify themselves from a case;⁷⁸ allow courts to see if the agreements violate state champerty laws (laws that prevent a non-party from funding a litigation); and allow the court and parties to see if foreign actors are involved, as disclosure would allow the parties to see who is really pursuing the litigation and whether they have any ulterior motives.⁷⁹

67 See *The Sunlight Disinfectant Principle: Transparency & Full Disclosure are Necessary Safeguards for Consumer Litigation Funding* at 6.

68 *Id.*

69 *Id.*

70 *Id.*

71 *Id.* at 4.

72 *Id.* at 6.

73 *Id.* at 7.

74 *Id.* at 12-13.

75 See Statement of the U.S. Chamber of Commerce Institute for Legal Reform Before the United States House of Representatives The Subcommittee on courts, Intellectual Property, and the Internet, June 12, 2024 at 5.

76 *Id.*

77 *Id.* at 5 and 12-15.

78 *Id.* at 7-9. See *The Sunlight Disinfectant Principle: Transparency & Full Disclosure are Necessary Safeguards for Consumer Litigation Funding* at 12-13.

79 See Statement of the U.S. Chamber of Commerce Institute for Legal Reform Before the United States House of Representatives The Subcommittee on courts, Intellectual Property, and the Internet, June 12, 2024 at 5, 15-16.

Underwriters should be aware of the TPLF agreements lurking in the background and their financial impact on claims, whether due to increased defense costs due to longer drawn-out cases, higher settlement values, or the nuclear verdicts being seen across the country. Third-party funding allows for plaintiffs to continue to prosecute their case if they think it will garner a larger settlement or verdict, irrespective of the parties usual practice of litigating the matter as efficiently as possible and settling for the true value of the case. TPLF leads to longer case timelines, an increase in defense fees, claim costs, and expert costs. It also leads to a higher propensity and lower risk for a plaintiff to take a case to trial, resulting in greater risk to insurance companies. Since these agreements are typically not disclosed, insurers may not anticipate spending as much to defend, settle, try, or pay verdicts on cases with TPLF. The outcomes generated by the use of TPLF funding leads to increased premiums for insureds.

The Future of Litigation Funding

It is critical that insurance carriers be aware of the rise of TPLF and the effects it has on the market. TPLF is a multi-billion-dollar industry. There were \$15.2B of assets under management (June 30, 2023) of third party litigation funders who finance US commercial lawsuits.⁸⁰

As a result of TPLF, a secondary market has emerged in which the litigation funder sells some of its portfolio to free up liquidity or because the original deal is taking longer than anticipated to resolve. This secondary market is expected to continue to expand in the future.⁸¹ The secondary market may cause an influx of capital for funders, increased competition amongst funders, and better prices for borrowers.⁸²

If you have any questions or are interested in learning more about this topic, please feel free to contact Frank DeMento (fdemento@transre.com) or Howard Freeman (hfreeman@transre.com).

⁸⁰ See Westfleet Advisors *2023 Litigation Finance Market Report* at 3.

⁸¹ Lula, J. *5 Litigation Funding Trends to Note in 2024*, January 10, 2024. Retrieved at <https://www.law360.com/articles/1784197/5-litigation-funding-trends-to-note-in-2024>

⁸² *Id.*

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