

#### **BLOG**



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After several decades as a curiosity among computer programmers and science fiction fans, <u>artificial intelligence (AI)</u> is igniting the global economy. Among those enchanted by its seemingly limitless modern applications is the litigation finance industry—an unfortunate product of skyrocketing large-scale litigation costs following the (Electronically Stored Information) Revolution, where third parties invest in litigation for a chance to share in equally inflated judgments and settlements. After stumbling during the pandemic, the industry is back and stronger than ever thanks to the world's new favorite technology and its ability to help investors reap even greater profits from controversy.

When the Revolution vastly compounded the complexity and expense of civil discovery, the costs of large-scale litigation in the United States went from exorbitant to prohibitive. Rather than suffocate class action and complex litigation, however, rising costs allowed plaintiffs with the resources to pursue litigation to leverage larger and more expedient settlement payouts. This, in turn, created opportunities for third-party investors willing to fund litigation with a chance to share in those payouts. The litigation finance industry was born, quickly displacing the long-standing American legal tradition where private litigants bear their own litigation costs.

Treating private litigation as an investment vehicle has always been controversial. Some claim that this funding of lawsuits allows greater access to justice for plaintiffs who would otherwise be priced out of bringing their claim. Others see the practice as ripe for abuse, with funders providing plaintiffs' lawyers with a blank check to wrangle as many class members as possible—with little vetting—in order to force companies into settlements.<sup>[1]</sup> But if cash is king in the world of finance, it is divine in the world of private litigation, where bet-the-company financial stakes collide with uncertain risk. Investors willing to shoulder some of that risk and expense have faced little meaningful resistance from the legal community.

And investors are more willing than ever to do so. Although enthusiasm faltered when litigants lost their appetite during the pandemic, in fiscal year 2023 alone, litigation finance firms made \$2.7 billion in new commitments to funding lawsuits.<sup>[2]</sup> This industry growth appears driven, in part, by new technological advancements that reduce the risks associated with investing in lawsuits—most notably, Al.

Litigation finance firms are finding that AI can help with identifying potential cases to invest in. For example, a company called Legalist, Inc. recently created an algorithm called the "truffle sniffer"—which is used to search court

dockets "for lawsuits by focusing on variables such as the court, judge and case type"—with the goal of identifying cases that are statistically likely to yield a profit for third-party investors.<sup>[3]</sup> Other firms have used AI tools to try to create disputes in the first place by searching the Internet and combining publicly available data with industry insights to "uncover harm suffered where an aggrieved party has a strong claim of which it is unaware."<sup>[4]</sup> Litigation funding firm even created software that would search information related to cases in Latin America and Europe and automatically reach out to clients with claims that have a high probability of providing a return on investment.<sup>[5]</sup>

Litigation funders are also using AI to determine the viability of claims. As third-party funders only profit if their invested case results in a payment to the plaintiff, funders spend much time and effort assessing the strength of a potential investment claim. One of the leading litigation finance firms, Capital, believes that "[a] technology, including algorithms, machine learning and AI have the potential to enhance the underwriting diligence process in the legal finance industry," and that "[I] these technologies is often seen as the 'Holy Grail' for the industry, promising improved efficiency and accuracy in investment decisions."<sup>[6]</sup> Legalist uses technology that automatically monitors cases that have passed certain thresholds, such as surviving a motion to dismiss, which greatly increases the chances of a win or settlement.<sup>[7]</sup>

Al technology promises to allow litigation finance firms to analyze and finance more cases using fewer human hours. The outcome is almost certain to be more litigation. Litigation funders will identify claims that otherwise would not have been brought, match those claims with lawyers performing that type of work, and fund the case. Funders will identify cases currently in the courts, which otherwise may have settled, and fund them all the way through trial. Smaller-dollar cases, which previously would not have provided a sufficient return on investment, will become more attractive when Al is capable of identifying and analyzing the claim, all without human intervention.<sup>[8]</sup>

This poses a serious threat to companies frequently involved in litigation. According to Wake Forest Law professor, who studies mass tort litigation finance, the "quality of victim claims has little to do with how cases are ultimately resolved . . . the name of the game is really marketing, or 'building inventory.'"<sup>[9]</sup> By "building inventory," was "referring to the process of finding and accumulating thousands of claimants — meritorious and otherwise — in order to maximize pressure on companies to settle lawsuits."<sup>[10]</sup> If litigation funders are now able to identify more potential class members with the click of a button, companies may be in for a deluge of litigation.

What does this mean for companies that face frequent litigation? They should prepare for an increase in claims in the coming years and understand the criteria litigation funders look for when funding cases. For example, because AI technology seeks to identify cases with a potentially weak defense or a defendant likely to be susceptible to settlement pressure at the early stages of litigation, companies can seek to avoid being identified as an attractive target for litigation financing by taking a more aggressive approach and devoting more resources to litigating pretrial issues, such as seeking to rack up early case wins through pretrial motion practice.

Discovery is another area where companies can seek to push back against the rising tide of third-party litigation financing. One key issue with the industry from a defense perspective is a "lack of laws requiring transparency about who or what is funding the litigation."<sup>[11]</sup> In fact, investigative reporters recently "revealed that sanctioned Russian oligarchs have been using litigation funding to evade US sanctions in US courts."<sup>[12]</sup> Courts requiring modest disclosures have revealed, for example, Chinese investors backing U.S. patent suits against U.S. companies, and in fact, "recent government reports showed some of the biggest investors in litigation funds are as-yet-undisclosed sovereign nation wealth funds."<sup>[13]</sup> But despite these concerns, lawmakers have been slow to respond and face strong and motivated lobbying efforts by funders. Courts, however, may become more sympathetic to these issues. In fact, the Judicial Conference "has since 2017 been considering mandatory disclosure akin to what courts already require for insurers and publicly traded investors." As one author put it, it may require "nothing more than a long-overdue tweak to existing Rule 7.1 and 26 of the Federal Rules of Civil Procedure, something the judiciary itself can implement."<sup>[14]</sup>

Hopefully, these or other changes to address these issues with litigation funding are forthcoming, but in the meantime, companies can seek to use examples like those mentioned and other helpful court rulings to persuade courts to permit third-party discovery and require mandatory disclosures, which would both reveal any impropriety occurring behind the scenes and (hopefully) discourage litigation funding altogether by increasing its associated costs and risks.

Companies have already been having success with this. "In recent years, an increasing number of courts have either required that parties disclose third parties with financial stakes in a litigation, or have allowed opposing parties to take discovery of third parties' financial stakes in the litigation."<sup>[15]</sup> Trends in this jurisprudence indicate a growing set of reasons courts are allowing discovery into litigation financing, including "for damages and valuations of patents, to assess witness bias, and for standing and real-party-in-interest questions."<sup>[16]</sup>

This means companies fearing third-party-funded lawsuits should familiarize themselves with the trends and cases litigating disclosure and discovery requirements for third party funders and consider expending more resources litigating these issues at the early stages of the case. This will hopefully dampen some of the industry's enthusiasm and expose improper funding relationships and activities.

These trends may, however, provide an even greater benefit by allowing companies the opportunity to turn the litigation finance industry's new Al advantages against it. The same Al technology that identifies strengths and weaknesses in the merits of a case can be used to identify cases where funders are more likely to face mandatory disclosures or discovery—and one can bet that with more courts requiring financial disclosures, and even threatening sanctions,<sup>[12]</sup> litigation financing companies are (or soon will be) taking these risks into account when identifying cases to invest in. This should allow companies to discourage interest from funders by strongly litigating these issues and making arguments that the Al algorithms will identify as consistent with those that have been successful in other cases. Companies may even be able to use this Al technology themselves to identify when litigation financing is a concern and resources should be devoted to seeking third-party discovery and to understand better which arguments are likely to be most successful in seeking such discovery.

To conclude, the litigation finance industry, a longtime thorn in the side of those defending against class actions and other forms of mass litigation, has new AI weapons in its arsenal that will undoubtedly increase the amount of litigation and attractiveness of funding cases that previously appeared risky or less profitable. Companies should prepare for this development and familiarize themselves with this industry and how they are using this technology. Companies should also be prepared to fight back at the early stages of litigation, including using aggressive pretrial motion practice and discovery, to increase the risks and costs for funders and decrease the likelihood AI technology used by those funders will flag that litigation as an attractive investment opportunity. Finally, companies and law firms should both invest time and resources to learn about the latest and upcoming developments in AI, a technology that promises to provide opportunities and valuable litigation tools for plaintiffs and defendants alike as it continues to establish itself as the technology of the future.

U.S. Chamber Inst. for Legal Reform, *Selling More Lawsuits, Buying More Trouble* 17 ("Allowing [third-party litigation funding] to fester in the class action setting will not only reduce the downside risk to mounting frivolous class actions, but also guarantee that such proceedings deliver even less money for the actual class members.").

😰 Emily R., Litigation Finance Industry Shrinks After Years of Growth, L. (Mar. 27, 2024), https://news.bloomberglaw.com/business-and-practice/litigation-finance-industry-shrinks-after-years-of-growth

B Emily R., AI Helps Litigation Funders Mine Court Dockets for Legal Gold, L. (Mar. 1, 2024), <a href="https://news.bloomberglaw.com/business-and-practice/lawsuit-investors-use-ai-to-mine-cases-for-promising-returns">https://news.bloomberglaw.com/business-and-practice/lawsuit-investors-use-ai-to-mine-cases-for-promising-returns</a>.

a David Perla, The Current (and Future) State of AI in Legal Finance, Cap. (Feb. 22, 2024), https://www.burfordcapital.com/insights-news-events/insights-research/nylj-current-state-of-ai/.

supra note 3. Notably, these practices often seem to be violations of attorney ethics rules against solicitation of business.

Perla, supra note 4.

TRoss Todd, Another Look at How AI Is Shaping Litigation Finance, L. (Mar. 19, 2024), https://www.law.com/litigationdaily/2024/03/19/another-look-at-how-ai-is-shaping-litigation-finance/.

B William C. , AI & the Future of Litigation Funding (Jan. 2024), https://www.bloomberglaw.com/login?

target=https%3A%2F%2Fwww.bloomberglaw.com%2Fexternal%2Fdocument%2FX1ER10C4000000%2Flitigation-professional-perspective-ai-the-future-of-litigation-1%2F2.

🔋 , Johnson & Johnson Settlement Shows the New Stakes in Litigation Finance, Fin. Times (May 20, 2024), https://www.fl.com/content/abd5bf98-378f4322-b930-68c9b410e783.

#### [10] Id.

m Jonathan Stroud, As Litigation Funders Skirt Sanctions, It's Time for Disclosure, L. (Apr. 10, 2024), https://news.bloomberglaw.com/us-law-week/as-litigation-funders-skirt-sanctions-its-time-for-
disclosure.
<u>nz</u> ) Id.
<u>naj</u> Id.
<u>naj</u> Id.

15 Sean & Samuel , Identifying Trends and Tips in Litigation Financing Disclosure, Law 360 (Aug. 24, 2023), https://www.law360.com/articles/1714145/print?section=aerospace.

The article notes that "at least one judge [Chief Judge Connolly of the U.S. District Court for the District of Delaware] has a standing order compelling detailed information on this topic to be disclosed to the court." *Id.* The order specifically "allows for parties to seek additional discovery concerning the nature of the [funding] agreements for specified reasons as well as any other basis supported by good cause." *Id.* The order even survived a mandamus challenge in the Federal Circuit by a party seeking to avoid disclosure, and Judge Connolly has even set a "show cause" contempt hearing in a case where a plaintiff even dismissed the action in an apparent attempt to avoid disclosure. *Id.; see also* Charles M. Agee et al., *Litigation Funding and Confidentiality: A Comprehensive Analysis of Current Case Law*, Advisors (Aug. 2023) (discussing cases addressing the confidentiality of communications between parties, counsel, and funders).

[17] See supra note 16.

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