

Litigation finance

Get the third party started

NEW YORK

A growing industry faces ethical quandaries

FROM A FINANCIAL perspective, a civil lawsuit is rather like a derivatives contract. Its value to a claimant comes from the performance of an underlying asset—litigation—with an uncertain, potentially lucrative outcome. No surprise, then, that some see the allure of funding legal expenses upfront in exchange for a share of the proceeds if the case is won or settled. Payouts are uncorrelated with other markets, so investors can use them to diversify. The complexity of the asset makes it hard to price, which offers room for shrewd calculation. Throw in reports of fat returns from third-party litigation-finance (TPLF) firms and it is easy to see why the industry is growing strongly. A survey by Westfleet Advisors, a litigation-finance broker, finds that commercial cases in America attracted \$2.3bn of investment in the year to June.

Speaking at an industry conference in New York in September, David Perla of Burford Capital, a litigation funder that is listed in London, trumpeted his firm's \$2.5bn in assets and \$225m in half-year post-tax profits. Michael Nicolas of Longford Capital, a private funder, said that lawyers are now more receptive to TPLF. So too are companies and universities harbouring "monetisable" claims of patent infringement. Boosters champion the industry's ability to provide capital, share risk and increase access to justice.

Not everybody shares that rosy view. Critics of TPLF, chief among them the US Chamber of Commerce, a lobbying group, contend that the industry encourages frivolous cases. But Brian Fitzpatrick, a law professor at Vanderbilt University, points out that a savvy investor would not back a meritless case. Another question is whether litigants should disclose their use of third-party funding before proceedings begin. Proponents say transparency would unearth conflicts of interest that a judge may have if, say, she has a stake in a hedge fund that is bankrolling the plaintiff. Others counter that forced disclosure could give the other side an information advantage, enabling them to force an early settlement or wage a spending war of attrition.

Third-party funding can have some unpalatable outcomes. In 2016 billionaire Peter Thiel funded a lawsuit against Gawker Media, a news website, over its publication of a sex tape featuring a professional wrestler, which eventually drove the company out of business. TPLF might increase the

Financial crime

Counter-Terrorists win

One of the world's biggest video-game companies admits it has a problem

FOR PEOPLE who enjoy being (virtually) shot in the head by foul-mouthed teenagers, Counter-Strike has long led the field. The game, developed by Valve Corporation, pits a team of terrorists against an anti-terrorist commando squad in a fight to the death. Its various iterations have helped make Steam, a digital marketplace for video games also run by Valve, among the most successful in the industry. But Counter-Strike has appealed to more than just twitchy young men of late. On October 28th Valve announced it was stopping the trading between players of "container keys"—an in-game gambling device that players can buy (with real money) to try to win (virtual) rewards such as special weapons or clothing. The firm says "nearly all" of the trades of such keys were "believed to be fraud-sourced". It is a rare admission of the growing problem of using

video games to facilitate financial crime.

The company has released no further details, and did not reply to a request for information from *The Economist*. But it seems likely that the keys, which were bought with stolen credit cards, were then traded between accounts on Steam's marketplace. Players cannot withdraw real money from their accounts, but in-game credit can be used to buy new virtual rewards or games. There is a burgeoning market (on third-party websites) for accounts already loaded up with virtual cash. Criminals can cash out by selling to gamers keen to acquire games or virtual items cheaply.

Valve is not the first to be affected by such dodgy trading. In 2007 eBay, an online marketplace, banned the sale of virtual gamer goods, such as gold in World of Warcraft, another game. But the problem seems to have worsened, probably because developers now earn more from in-game items. In 2016 Electronic Arts, a developer, revealed that it made 30% of its digital revenue from "loot boxes", much like Counter-Strike's container keys. Such online items "function like virtual currencies", notes Anton Moiseienko, of the Royal United Services Institute, a British think-tank. They can move value between countries and people, out of regulators' sight.

Valve's admission that fraudsters exploited its platform is striking, says Mr Moiseienko; others have ignored the problem. But at least one firm has gone further. In July Linden Labs, a games-maker, announced that players wanting to trade on its platform must provide proof of identity. Its subsidiary also registered as a money-service business. That is one way to counter-strike.



Where's the loot?

frequency of such uncomfortable consequences. But Tony Sebok, a professor at the Cardozo School of Law, points out that preventing that activity would mean virtuous causes go unfunded.

Critics of TPLF also worry that lawyers might be torn between the client and the funder, especially if investors finance the law firm on a repeated basis. Most TPLF firms claim to write their contracts to preclude such ethical conflicts. But in August Muddy Waters, an investment firm, criticised Burford's accounting, which, it claimed, suggested that ongoing litigation was concluded, and concealed losses. (Burford says the claims are based on "factual

inaccuracies" and "fallacious insinuations".) As newcomers pile in, standards could become less prudent.

The best the industry can do is to form a trade association requiring members to uphold a code of conduct. This already exists in Britain and mostly seems to work well. Industry players could also make the scale and scope of deal flow public. Mr Sebok argues that funders should be more transparent on prices charged to litigants, particularly in consumer cases, where claimants tend to be more vulnerable than on the commercial side. Appropriate guardrails could bolster the case for betting on lawsuits. ■