THE FUTURE OF FUNDING AND LITIGATING CASES

Litigation Finance & Blockchain Implications for In-House Counsel

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Agenda

• Part I – Litigation Funding

• Part II – Blockchain in Litigation and Legal Operations
Part I – Litigation Funding

1. The Basics of Litigation Funding
2. Trends in Litigation Funding
3. Opportunities and Challenges
The Basics of Litigation Funding

Litigation Funding Defined:

the practice where a third party unrelated to the lawsuit provides capital to a plaintiff involved in litigation in return for a portion of any financial recovery from the lawsuit, usually as a non-recourse investment (if a case is not successful, the funder does not recover the investment)
The Basics of Litigation Funding

How It Works

• Provide capital to plaintiffs
• May pay for costs including fees, expert witness fees, court expenses
• Fund working capital for companies in litigation
• If the case is successful, the funder will recover their investment plus a success fee. If the case is unsuccessful, the funder will lose its investment.
• Success fees = a multiple of the investment, a percentage of damages, or the greater of the two (terms vary significantly)
The Basics of Litigation Funding

How It Works

1. Non-disclosure agreement
2. Term sheet/high level conversation
3. Diligence/exclusivity period
4. Negotiation and execution of litigation funding agreement
5. Funding – drip and/or lump-sum disbursements
6. Monitoring of litigation
7. Distribution of proceeds from settlements and/or judgments
The Basics of Litigation Funding

Why Use a Litigation Funder

• Helps undercapitalized plaintiffs further meritorious cases by financing litigation expenses
• Reduces the risk of premature settlement for less than the value of the case
• Provides liquidity for working capital
• Allows companies to manage how litigation costs affect balance sheets
• Enables access to top legal talent
Trends in Litigation Funding

State of Play Today

• Enormous infusion of capital, projected to grow 20-30% a year reaching $2.1B-$2.7B by 2021
• 20-25 dedicated litigation funding companies today + investment units at hedge funds and other investment companies
• Mainstream market: high-value cases where cost/damages ratios are at least 1:10
• Investors see creation of a new asset class impervious to the stock market and economy
Trends in Litigation Funding

Trends

• Wider array of funders = financial creativity in funding arrangements/cases
• Greater adoption by in-house counsel as a risk management and corporate finance tool
• Firms will offer financing options / bundle cases into portfolios
Opportunities and Challenges

Opportunities

• Transfer of Risk
• Predictability
• Enhanced Recovery for Viable Claims (portfolio concept)
Opportunities and Challenges

Challenges

• Control of Litigation
• Attorney-Client Privilege and Work Product
• Conflicts of Interest
• Transparency: Discovery and Admissibility Issues
• Ethical Issues and Fee-Sharing with Non-Lawyers
Part II – Blockchain in Litigation and Legal Operations

1. Basics of Blockchain
2. How Blockchain Is Being Used Today
3. Impact on Litigation and Legal Operations in the Future
What Is Blockchain?

- **Blockchain is a form of** Distributed Ledger Technology ("DLT")
- **Blockchain is not Bitcoin.** It is a shared list of transactions.
  - Every new transaction creates a time-stamped “block.” Each block is linked to the previous block creating a chain of transactions.
  - The ledger is updated on a network of computers that are connected to the blockchain through the Internet.
- Benefits: **speed, security, transparency**, and **permanence**.
Blockchain: A Technology Revolution

Business Today

Business with Blockchain
Is Blockchain Secure?

- Uses encryption technology known as cryptography

- Public keys:
  - Permission-less: anyone can read the distributed ledger, send transactions to and watch them being included in the ledger, and participate in the consensus process.

- Private Keys:
  - Each member of the network has access rights so that confidential information is shared on a need-to-know basis.
Why You Should Care about Blockchain
Blockchain Applications in Business

1. FINANCIAL SERVICES AND TRANSACTIONS

2. SUPPLY CHAIN

3. CONSUMER EMPOWERMENT

4. MARKETING & BUSINESS DEVELOPMENT
Definitions

- **Distributed ledger technology:** A digital record of data that differs from traditional centralized database technology in that there is no central administrator or central data ledger; instead, the ledger is replicated and shared among many different systems or computers in a distributed network that arrives at consensus via cryptography before storing the data.

- **Blockchain:** A type of distributed ledger database that maintains a continuously growing list of append only transaction records ordered into blocks with various protections against tampering and revision, with a cryptographic key.

- **Consensus mechanism:** A method of mathematically authenticating and validating a value or transaction on a blockchain or a distributed ledger without the need to trust or rely on a central authority. Consensus mechanisms are central to the functioning of any blockchain or distributed ledger. Two of the more common ones are Proof of Work and Proof of Stake.

- **Smart contract:** A piece of written code organized into a protocol that auto-executes subject to the satisfaction of pre-agreed conditions, thus adding additional functionality to a blockchain and providing the ability to automate certain processes. The protocol can facilitate, enforce, and verify all in an automated manner.

- **Nodes:** Members or systems of a distributed ledger or blockchain network that connect to and hold a replicated copy of the ledger and can have varying roles: to issue, verify, receive, inform, etc.

- **Public Chain:** A blockchain that anyone can join, read, write transactions to and participate in the consensus process.

- **Private Chain:** A blockchain or decentralized ledger that requires permission to join. All members may have varying levels of permissible actions with regard to chain transactions.
What Is a Token?

- A **token** is a digital asset that can be used in many different ways:
  - Can describe a unit of value (for example, I have X number of Ether tokens)
  - A means of providing access to and transactional value inside a particular system, platform, or protocol
  - Can be used to create user interaction and provide a medium for the distribution of rewards and benefits to the token holders within a particular system, platform, or protocol
  - Utility, Security, Hybrid, Currency, Commodity

- **Tokens are not cryptocurrencies**
  - Cryptocurrency is digital currency that uses encryption techniques for governance and security and operates independent of any central bank.
  - Bitcoin is a type of cryptocurrency and one of the most popular applications of blockchain technology

- **Banks are now using and trading tokens**
Murky Regulatory Waters: Tokens

• Not all tokens are created equal

• No regulatory clarity: tokens are often regulated as a “security”

• No clear guideline to determine which tokens are “security” and which are commodity
  • If security unlawful to effect any transaction unless registered as a national securities exchange or is exempted from such registration
Smart Contracts: “if, then”

- A **digital representation** of the mutual agreements in a traditional contract that is stored **on a distributed ledger**
- Once recorded, it **cannot be modified** without the participating parties’ permission
- An “**if, then**” statement; if a condition is met, then a result is **self-executed**
Smart Contract: How It Works

Figure 1: How smart contracts work

1. **Identify terms and conditions**
   - The different parties agree on the terms of the transaction, the conditions, and the desired outcome. These conditions may be derived from existing legal agreements or templates. Example: a securitization waterfall.

2. **Define external sources or systems**
   - Some smart contracts require access to data sources outside of blockchain to function or to verify if the agreed upon conditions are met. Example: LIBOR on floating rate notes.

3. **Code the contract and record it on the blockchain**
   - A computer program is written to produce a desired outcome when conditions are met. The code is placed on the blockchain where it cannot be modified without agreement of the relevant parties. Example: the waterfall tie-out process between accountants and banks.

4. **Self-execution when the defined conditions are met**
   - The computer program self-executes when the agreed upon conditions are met. The outcome is recorded on the blockchain, which creates an immutable audit trail. Example: the distribution of payments to investors based on waterfall rules.

Source: Deloitte Development LLC, 2017
Blockchain Implications in Litigation and Legal Operations

1. **Smart Contracts**
   - Efficiencies and uniformity in repeatable transactions
   - Streamline routine tasks to free up braintrust

2. **Transactions, Intellectual Property, Real Estate**
   - Increased verification and security over documents
   - Streamline routine tasks to free up braintrust

3. **Employment Issues**
   - Portable health and employment records

4. **Chain of Custody and Other Record-Keeping**
Conclusion

• Blockchain has initiated a global revolution and every company irrespective of its size will eventually get involved
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