

Business & Practice

Clients Cry Foul Over Litigious Litigation Finance Company (4)

By Valerie Bauman and Roy Strom

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- Pravati Capital embroiled in multiple disputes with clients
 - Company blames 'predatory borrowers' for legal actions
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Texas attorney Christopher Phillippe thought the deal was simple: Get money up front to pay for litigation costs and pay it back only if he wins in court.

But the 81-year-old lawyer says that's not how it worked when his solo practice accepted \$55,000 from Scottsdale, Ariz.-based litigation funder Pravati Capital in 2019.

"I had to pay them back no matter what," he said, noting that he now owes roughly \$160,000, with interest still accruing, even though he only won a single case out of the dozen listed in his contract with Pravati—and that one netted him just \$3,000.

The litigation finance industry bills its system as a "win-win." In a traditional agreement, funders give attorneys money as they prepare a lawsuit and the lawyers only repay it if the case turns into a winner. But some Pravati clients say they end up losing. Pravati's contracts regularly stretch the industry's win-win concept by striking a claim to any case that walks through a law firm's door and by ensuring it will be paid even if a big lawsuit is lost.

Experts who reviewed Pravati's agreements for Bloomberg Law questioned both the structure of the deals and the startlingly high interest rates the company charges. Pravati has gone to arbitration with at least 14 of its clients, including Phillippe, according to court filings, obtaining judgments in at least seven that force lawyers to pay back more than twice the amount they borrowed within two years of receiving the cash.

Alexander Chucuri, CEO of Pravati, says the lawsuits represent a tiny fraction of the agreements Pravati has struck. He has a simple explanation for the suits: "bad actors" refusing to honor their contracts.

"Some of these guys just say, 'I'm a lawyer. I know we have an agreement, but we don't have to pay you back,'" Chucuri told Bloomberg Law.

Pravati clients who spoke with Bloomberg Law maintained they had legitimate reasons for running afoul of their contracts and many disputed having done anything wrong.

Bloomberg Law reviewed the paper trail of litigation in these cases, brought in lawyers and academics with experience in the funding industry to unpack the contracts that ended up in arbitration, and spoke with former Pravati employees. The picture that emerges—a rare peek into a largely opaque industry—is both a tale of one funder’s business and of a fast-growing legal phenomenon whose practices are only now starting to be scrutinized.

“Lawyers and law firms are smart, educated people. But they don’t know enough about litigation finance to know what they don’t know,” said John Hanley, a lawyer who frequently negotiates litigation finance agreements. Hanley reviewed two of Pravati’s contracts on behalf of Bloomberg Law.

However, Jody Kraus, a professor of contracts law at Columbia Law, said that’s no excuse for signing a contract they don’t fully understand.

“This is a law firm. They are some of the most sophisticated people on the planet, if they can’t negotiate this contract for themselves, what the hell are they doing for their cases? There’s nothing untoward here,” he said.

Funding Explosion

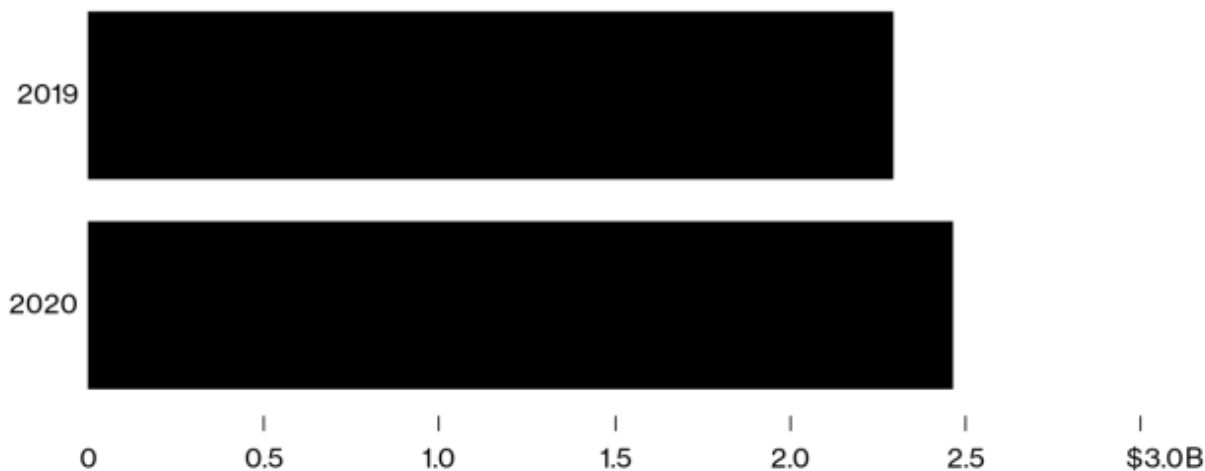
The U.S. litigation finance industry has attracted more than \$11 billion in capital, according to an industry survey. Law firm Brown Rudnick said the market totaled \$39 billion in 2019. Funders don’t make loans, they “invest” in lawsuits, and—in most cases, anyway—only get paid if the lawsuits result in a monetary award.

One reason litigation funding has become popular among investors is it can bring venture-capital style returns of two or three times an initial investment for a funder that bets on a winning case. But there is immense risk: If the cases a funder bets on lose, its entire investment is lost.

There have not been any real efforts to regulate the terms of litigation finance deals. Most industry critics have focused on forcing litigants to disclose cases that involve a funder—a rule one federal court in New Jersey adopted earlier this year. In Australia, a more mature market for litigation funding, legislation has been proposed to limit funders’ returns to 30% of class actions.

Litigation Funding Growth

Finance firms invested \$2.47 billion in U.S.-centric lawsuits during a 12-month period ending June 2020, a 6% increase from the same period a year earlier.



Source: Westfleet Advisors

Bloomberg Law

Data on the financial returns that Pravati generates in its successful cases is not publicly available. Based on a review of court filings, Pravati would generate those venture capital types of returns in awards from the cases that have ended up in arbitration. Although it's unclear if they collect the judgments.

In the 11 cases for which Bloomberg Law was able to obtain full financial data, Pravati won nearly \$11 million in arbitration awards against the recipients of its funding. The company lent just more than \$6 million to those lawyers. The company won arbitration awards, on average, 22 months after the lawyers received the money.

But Pravati's contracts list simple interest rates—usually around 18% to 22% annually. A law professor who reviewed the contracts said those interest rates apply to a principal that is far greater than the amount of money the lawyer received to support their practice.

"I couldn't see how the lawyer who was doing these contracts could avoid having to be obliged to pay at least twice as much as they would expect to," said Anthony Sebok, a law professor at Cardozo School of Law who has studied the industry and its agreements. Sebok has also worked as a consultant for litigation funder Burford Capital.

Pravati said it "strongly disputes" characterizations of its contracts as difficult to understand or underestimating the true cost of the advance. Arbitrators have ruled in its favor in all but one case—and even then the law firm was still ordered to repay the money it received from Pravati, without interest.

Bloomberg Law interviewed CEO Chucri twice and provided Pravati a list of more than 50 questions about its cases and business practices. Pravati declined to answer most written questions, instead sending bullet points that disputed some of the allegations raised.

Pravati says it has made roughly 300 advances and the amount of money involved in its arbitrations represents 2% of the money it has advanced. Bloomberg Law was not able to verify that claim independently.

Public filings as of September 2021 show that roughly 40 lawyers or law firms were in debt to Pravati at one time or another. It entered those agreements between 2015 and late 2020, a time frame that roughly lines up with when it filed the 14 arbitration claims. Pravati said it didn't solicit business from any of the lawyers with whom it ended up in arbitration, but that those firms approached the company. Pravati said those who never intended to pay it back are "predatory borrowers."

"No one here has been misled," Pravati said. "The people complaining to Bloomberg [Law] signed a contract, accepted advances and elected not to honor their end of the deal."

Lucian Pera, who advises lawyers on the ethical implications of litigation finance agreements, said the number of disputes Pravati had been involved in was "not a trivial finding."

"There are some industries that are very mature. And there are some industries that are more like the Wild West. Litigation funding is more like the Wild West. And you need to be careful," said Pera, a partner at Adams and Reese. "People seeking funding need to do their due diligence."

Case of a Lifetime

Phillippe was in his late 70s when he got a case that would have been—for him, at least—a once in a lifetime opportunity: a wrongful death lawsuit that he estimated would pay out a multimillion-dollar award.

"I'm a small practitioner," said Phillippe, whose storefront law office is in Brownsville, Texas, a border town at the state's southern-most edge of the Gulf of Mexico. "I don't get many cases like that walking through the door."

Taking the case to court required money Phillippe says he didn't have. That's where Pravati came in. It lent him \$55,000 in March 2018. Just months later, the case fell apart when the victim's insurer said the surviving family wasn't eligible for a payout.

In some litigation finance agreements, this would have been a bad outcome that cost the lender but not necessarily the lawyer.

Losses are part of the business model. Burford Capital, the industry's largest player that funds large commercial disputes, suffered outright losses in nearly 32% of the 148 concluded investments it made from 2009 through December 2020, according to an independent analysis of the company's public data. Burford told Bloomberg Law its most recent data show 10% of the \$893 million it has invested in cases has been lost in adjudicated cases.

Compared with Burford, Pravati is a small player, employing a relatively small staff and, according to public records, funding lawyers who handle consumer-facing claims rather than lawsuits for corporate giants. Pravati still attracts tens of millions of dollars from investors, according to U.S. Securities and Exchange Commission filings.



The exterior of the Law Offices of Phillippe & Associates PC, a Brownsville, Texas firm owned and operated by 81-year-old Christopher Phillippe.

Veronica G. Cardenas/Bloomberg

There is a crucial reason why Phillippe's big loss didn't put Pravati out entirely: The investment was tied to more than just that one case. Pravati's deals regularly include pools of cases. Precisely which cases is a question that has been disputed by its clients.

Investing in what the industry calls a "portfolio" of a law firm's cases lowers the risk for the funder, since it will have more chances to collect. Under this approach, the more cases that are in the portfolio, the lower the risk. Include enough cases in a deal, and the risk it won't trigger repayment erodes almost entirely.

The technical reason funders can charge such high interest is their deals are structured as “non-recourse” investments, meaning they only have a right to collect from the winnings of specific cases in the agreement. If a court were to find that a deal provided a funder a right to revenue from more than those cases, or regardless of their outcome, it could be considered a “recourse” loan, which carries limits on interest rates.

A New York lawyer, Richard Sax, made this argument when he sued a different litigation funder, Fast Trak Investment. As the U.S. Court of Appeals for the Ninth Circuit summarized his argument in a later decision in the case, he contended that Fast Trak’s contract gave it the right to collect from so many of his cases that it “effectively guaranteed repayment” to Fast Trak, “at rates that are usurious.”

Fast Trak had consistently argued its deals with Sax were not loans and therefore were not subject to usury laws—an argument the trial-level federal judge agreed with. On appeal, the Ninth Circuit said the case raised a novel question about whether a litigation finance agreement should be considered a loan if it gives the funder the right to collect proceeds from unrelated litigation. The case was settled before the courts could resolve the question.

In Phillippe’s case, he said he thought he agreed to pay Pravati back from fees generated by the 12 cases listed in his contract. He was surprised when the lender said he had breached the agreement by not paying Pravati “a single penny” of revenue on other cases not specifically listed in the agreement.

Phillippe said he has since won only one of those 12 cases, which paid roughly \$3,000. He said he didn’t give Pravati its share of that fee because by then the funder had been pressuring him to pay back the full loan plus a burdensome interest payment.

Phillippe later offered to settle for \$65,000, according to an email in court records, noting the debt, combined with his age, was creating stress that was bad for his health and impacting his ability to work and bring in revenue.

Pravati turned Phillippe down and proceeded with a private arbitration hearing in Arizona. Phillippe didn’t attend the hearing to defend himself—saying he didn’t understand he could appear by phone and didn’t have enough money to fly to Arizona.

According to court filings, an arbitrator ruled Phillippe owed more than \$130,000—just 21 months after he received the \$55,000 from Pravati. Including interest and fees, the award was the equivalent of a deal that accrued interest at about 78% annually—far higher than the 20% rate stated in his contract.

“I was frustrated,” Phillippe said. “I was so depressed. There just wasn’t anything I could do about it. I thought, ‘I guess I owe this money.’”

Chucuri said Phillippe told Pravati he had cases valued at \$4 million before he received Pravati’s money, which was meant to help him grow his practice over the next few years. And when he fell behind on payments, Chucuri said Phillippe used a possible bankruptcy as a threat to try to avoid paying Pravati back. Phillippe said it wasn’t a threat, but the reality of his circumstances.

“He is very used to saying: ‘I’m a bankruptcy lawyer, this will go into bankruptcy,’” Chucri said. “These guys may come across as, ‘Aw shucks I don’t know.’ But they do know. Especially him. He does know.”

Chucri is a veteran of the industry. Before launching Pravati in 2013, he had a business that fronted cash to personal injury plaintiffs so they didn’t have to wait for a court ruling to get paid for their injuries. The company, American Legal Funding, was sued in 2010 by a client alleging it charged illegally high interest. The company settled for an undisclosed sum in the case, according to Matthew Lindsay, an Arkansas-based lawyer who represented the plaintiff.

“During the course and scope of litigating with these type of entities, we found their actions deplorable,” Lindsay said in an interview. His client alleged in the lawsuit that the company charged rates in excess of 100% for loans it made to a plaintiff who’d suffered serious head injuries.

Pravati declined to comment on Chucri’s experience with American Legal Funding or the case it settled with Lindsay’s client.

A Rare Draw

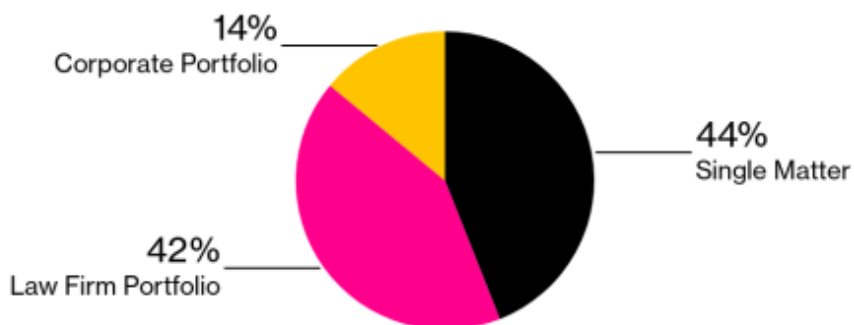
Phillippe’s issue—which of his cases served as collateral—came up in several of the Pravati disputes. One expert who helped review the cases with Bloomberg Law, Hanley, said the Pravati contracts he reviewed were “incredibly sloppy” about that crucial detail.

Based on the contracts Bloomberg Law was able to review, it can be hard to know which of a lawyer’s cases are considered collateral.

Many of these contracts include a list of specific cases that it says are subject to the terms of the agreement. Yet many of the same contracts elsewhere appear to contradict that concept, saying the firm will provide “all cases as collateral” including all fees the firm “now is or may hereafter become entitled to receive.”

One Versus Many

Law firm portfolios, where funders invest in multiple cases, represented 42% of the U.S.-centric litigation funding deals closed during a 12-month period ending June 2020. On average, they were valued at \$12.8 million, compared with \$4.5 million invested in the average single-case matter.



Source: Westfleet Advisors

Bloomberg Law

Hanley cautioned that Pravati and the lawyers involved in these disputes would have been better off if they'd sought counsel at the outset of the deals.

That potential confusion was the center of the rare arbitration ruling that did not award Pravati all the money it sought.

The case involved a law firm based in Jamaica, N.Y., Cardenas Islam & Associates, which received \$100,000 in funding from Pravati in August 2017. The contract has a list of seven cases it says are subject to the agreement. Listing the clients' names, it describes the cases only as a litany of slip and falls, motor vehicle accidents, and assaults. Elsewhere, the contract also contains the language about "all cases" serving as collateral.

Two years into the agreement, an attorney for Pravati notified the firm it was in default for failing to submit regular reports on its revenue, ongoing cases and other information required by the contract, according to the arbitrator's ruling, which was later filed in court. Pravati's contracts require firms to provide regular financial and case reports. If the law firm fails to do so, the contracts further provide that Pravati can claim a borrower is in default, triggering an additional 6% annual interest charge.

A former Pravati employee who spoke to Bloomberg Law on the condition of anonymity to candidly discuss the situation said the company would often deem lawyers to be in default due to a lack of reporting. Under the terms of Pravati's agreements, a default converts the deal to a recourse loan—triggering repayment whether the underlying cases win or lose.

"You probably will not find a single example of what was non-recourse and then it staying as non-recourse," the former employee said.

'No Upside' to Arbitration

Chucri denied those allegations, saying pursuing litigation to get paid is an “ineffective” but necessary measure given regulations by the SEC.

“There is no upside to us to take these guys to arbitration. It’s a challenge for us,” he said. “But it’s how we cover our costs while they try to defraud us. I have a fiduciary right as an SEC entity. I can’t let it go.”

When Pravati said he was in default for failing to report the status of his cases, Barak Cardenas, founding partner at Cardenas Islam, responded that none of the cases listed as collateral for the loan had settled, so he believed he owed Pravati no money.

Pravati disagreed. It alleged the firm owed nearly twice what it had given him—\$195,000—and proceeded to arbitration. Chucri and another Pravati executive, Neal Hoyt, testified that the firm’s contract gave it the right to collect fees from any matter Cardenas Islam worked on. The arbitrator determined the contract was confusing enough that both interpretations were justified. The ruling ordered Cardenas Islam to repay the principal of \$100,000, but none of the interest or fees Pravati was demanding.

In written responses to questions from Bloomberg Law, Pravati said: “We will take a loss in a situation where a case or portfolio fails on its merits. We will not take a loss where a case is successful, and a firm keeps the information from us to avoid paying. As part of our internal risk management process, we monitor ongoing client reporting considering the periodic required reports our clients deliver to us per the terms of the respective contract.”

As of early November, Cardenas said his firm had still not recovered any money from the cases that he understood served as collateral. He felt there was a major discrepancy between what Pravati said it was selling him and what Pravati claimed he bought. If he had known there was a chance he would be on the hook for the \$100,000 even without winning any of the cases listed in the contract, “we wouldn’t have entered into the agreement at all,” Cardenas said.

Chucri said the Cardenas Islam dispute was an example of a law firm holding back information from the lender. He said the firm did not share the extent of its case list with Pravati.

“We should have done more due diligence on all of their cases,” Chucri said.

Due Diligence Questions

Other cases raised questions about the extent of Pravati’s due diligence.

Pravati has provided nearly \$1.5 million to four lawyers who’ve since been disbarred, court records show. Based on those court records, none appear to have made any serious attempt to pay Pravati back, perhaps because they had financial woes before they came to the lender.

One lawyer signed a deal with Pravati for \$50,000 just days before a federal judge was scheduled to determine whether he'd owe a \$30,000 default judgment in an unrelated case. The lawyer didn't appear in court, triggering a judgment against him.

Another now-disbarred lawyer had his bank account docketed by the Internal Revenue Service shortly after receiving \$1 million from Chucri's company. A third disbarred Pravati client used part of the \$300,000 he got from the lender to pay off another litigation funder.

And then there was the time Pravati funded the law firm of John Pierce, the controversial attorney later kicked off the defense team of Wisconsin riot shooter Kyle Rittenhouse. Pierce's law firm dissolved just a couple years after Pravati's investment, amid allegations by a former partner that Pierce inflated the company's case values to litigation funders like Pravati.

Pierce defended Pravati's due diligence process at the time, saying: "Pravati is a sophisticated litigation funder that has been in business for years. They perform their own robust diligence on each case they fund, and they know what they're doing. The notion that they could have been hoodwinked into making a bad investment is nonsense."

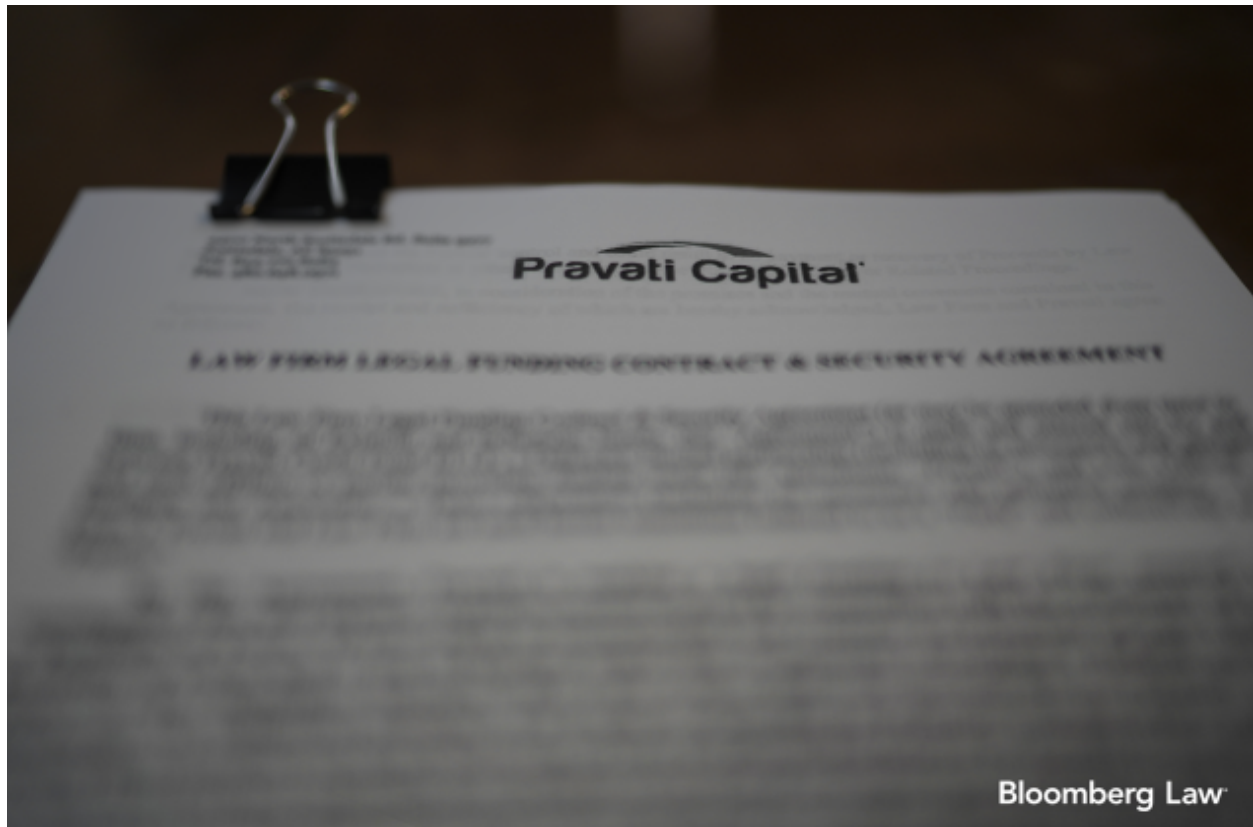
Pravati declined to answer questions about the due diligence it performed in specific cases. Chucri said that each lawyer required its own calculation, but that the company doesn't have a hard-and-fast rule when it comes to lending to lawyers who are in hock to the IRS.

"Typically, if they have an IRS situation, we don't" lend to them, Chucri said. "Unless they have a relationship and agreement with the IRS that they're going to pay it off. So every one of these comes with a little different color."

How Costs Pile Up

Pravati contracts reviewed by Bloomberg Law regularly include an "interest reserve." Chucri says the provision, more common in the construction industry, is a way to forestall interest payments from compounding for two years while the lawyers' cases progress through the courts. He said lawyers chose to include this provision in Pravati's deals after the company explained its benefit to them.

A Bloomberg Law analysis of the provision in multiple Pravati deals shows the interest reserve provision is the primary reason the agreements can become so expensive so quickly.



Pravati Capital, an Arizona-based litigation funder, has been criticized for overly complex contracts by some of its customers (which have also landed in arbitration), a characterization the company strongly disagrees with.

Veronica G. Cardenas/Bloomberg

The interest reserve concept initially confused Donna Beasley Gibson, 52, who runs a small firm in Mount Vernon, Washington, about an hour's drive south of the Canadian border.

While negotiating her initial deal for \$25,000, Beasley emailed Pravati's executives saying she needed "the numbers spelled out better," according to documents she shared with Bloomberg Law.

The numbers ultimately went like this.

She'd receive the \$25,000. She'd have to pay \$2,250 in fees. And she'd owe a minimum six months' worth of interest, which the contract says will accrue at 1.7% per month. Applied to a \$25,000 loan over six months, that would have been \$2,550.

But Pravati's contract says the minimum payment totaled \$4,444.14.

That's because the interest is calculated from a principal amount that includes the fees she was charged and more than \$16,000 from the "interest reserve" Pravati said it funded. Pravati said it has since stopped charging interest on fees, but that it is common practice in other industries to charge interest on interest reserve accounts.

The six-month payment example explains in miniature how the arbitration awards reach such great heights in just two years: The interest accrues from a principal amount far greater than how much money the lawyers ever receive.

The notion that lawyers are charged monthly interest from the outset of the contract also clashes with the idea of a non-recourse advance where repayment is triggered by the firm generating fees from cases, said Sebok, the Cardozo School of Law professor.

"In effect, the law firm is 'paying' something every month to the funder even if they have not received proceeds from any of the cases in the portfolio, which is a weird variation of the idea that the advance is non-recourse," Sebok said.

Falling Behind

Pravati said there is "nothing nefarious" about the use of interest reserve accounts. "It is a common financing tool in other industries, allowing borrowers to forgo interest payments in expectation of a future income event," the company said.

Gibson, who later received a second \$25,000 funding round from Pravati, said she was taken to arbitration by the company and reached a settlement to pay \$100,000. Pravati refused to consent to her request to appear by telephone for the proceedings, which were scheduled a day after husband had surgery, she said.

Gibson, whose arbitration ruling was not filed in any court, represents the 15th lawyer Bloomberg Law can confirm Pravati has taken to arbitration.

She's so far paid about \$40,000 in total, she said, but has more recently fallen behind on the \$10,000-a-month payments she agreed to make.

Gibson said she was devastated when Pravati named her husband in its arbitration proceeding.

Chucri said collecting debts from lawyers requires tactics that might not be used in other industries.

"Do you just not try to collect because they're a lawyer and they're tenacious and have the ability to sue?" Chucri said. "If I'm lending to a restaurant, you don't have that tenacity where everything is a problem. When you finance an attorney, they tend to wiggle out."

As for Gibson, Pravati said in a statement that her case represented an example of someone who'd made efforts to pay despite defaulting on her agreement.

"When she defaulted, we initiated arbitration to protect our investment. When she agreed to cooperate, we began working with her and have put in place a number of payment plans. We continue to work with her to help her fulfill her obligations," Pravati said.

Gibson, though, still feels uneasy about her relationship with Pravati. She remains concerned the company could seek to take possession of her home.

"I still live in constant fear of finding another lawsuit, or them garnishing my wages or a lien on my house," she said. "Even though they're working with me to an extent, I just sit here and lay awake at night."

(Adds context on size of Burford's losses.)

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