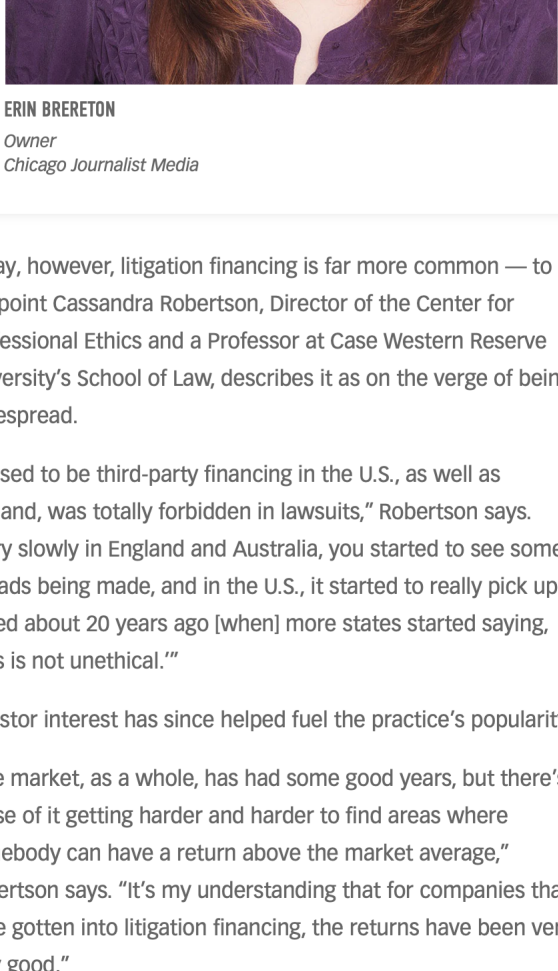


FM FEATURE FINANCIAL MANAGEMENT

Is External Funding the Future of Litigation?

Find out what external lawsuit funding deals typically involve, what factors attorneys should consider — and why the practice is gaining popularity.

Thirty years ago, cases being funded by an external third party in exchange for a share of the judgment or settlement wasn't really a prevalent practice in the United States.



ERIN BRERETON
Owner
Chicago Journalist Media

Today, however, litigation financing is far more common — to the point Cassandra Robertson, Director of the Center for Professional Ethics and a Professor at Case Western Reserve University's School of Law, describes it as on the verge of being widespread.

"It used to be third-party financing in the U.S., as well as England, was totally forbidden in lawsuits," Robertson says. "Very slowly in England and Australia, you started to see some inroads being made, and in the U.S., it started to really pick up speed about 20 years ago [when] more states started saying, 'This is not unethical.'"

Investor interest has since helped fuel the practice's popularity.

"The market, as a whole, has had some good years, but there's a sense of it getting harder and harder to find areas where somebody can have a return above the market average," Robertson says. "It's my understanding that for companies that have gotten into litigation financing, the returns have been very, very good."

FEELING THE FINANCIAL EFFECTS

For plaintiffs, obtaining external funding can mean the difference between walking away from a case or being able to afford to move forward.

Attorneys, too, who — due to the increased popularity of contingent fee arrangements in recent years have had to essentially fund cases until completion — may benefit from litigation financing becoming more readily available.

"It used to be a lawyer would front the money and take 30 percent of the recovery," Robertson says. "By having a finance company or bank be the one to front the money, more attorneys who might not have the resources on hand, but have specialized expertise, can take contingent cases [without] the [financial] risks they've been taking on for decades."

HOW LITIGATION FINANCING WORKS

Funding providers, according to Robertson, range from companies that focus on smaller claims, such as a personal injury lawsuit, to ones that specialize in large, complex cases.

Not surprisingly, because lenders may get nothing if the case isn't won or settled, they frequently vet matters thoroughly before agreeing to invest to try to control the amount of risk they take on.

"The growth of legal technology and the ability to analyze many claims at once enabled financial companies to predict a little bit better where they're likely to see success," Robertson says. "They evaluate cases enough to know they've got these 100 in a portfolio, and they're pretty sure 80 or so are likely to be successful on their merits and are against a defendant who is very likely to pay the judgment."

Often, lenders — such as litigation finance firm Lake Whillans, which customarily invests between \$2 million and \$10 million in commercial claim cases with damages in excess of \$20 million — arrange the funding agreement with the individual or company involved in a lawsuit.

"Law firms reach out on the behalf of clients saying a client needs money, clients reach out to us directly," says Lake Whillans Managing Director Lee Drucker. "We most typically are transacting with the client themselves, but we could also transact with the law firm on a portfolio of cases."

For the most part, once an agreement has been reached, financiers' involvement in the case is fairly minimal, according to Bill Patterson, who has worked on litigation finance-funded cases as an in-house counsel and in his current role as Partner and Vice Chair of the intellectual property group at Swanson, Martin & Bell LLP, a litigation firm with offices in Illinois, Missouri and Indiana.

"Once the ink is dry, it's really just periodical updates about major events," Patterson says. "They'll offer to be a sounding board if you ever want them to be, but the attitude of the litigation finance company usually is that part of the due diligence process is to put lawyers in place they really trust, so they stay out of it."

ADDITIONAL CONSIDERATIONS

While litigation financing can mean cases with merit are able to move forward, lawyers need to carefully navigate any state and court-related ethical rules surrounding the use of third party funders, according to Francine Griesing, Managing Member of the Philadelphia-headquartered Griesing Law, LLC.

It's first important to confirm if your state has a champerty law prohibiting agreements with third parties who sign on to pursue a suit and share in the financial outcome.

A number of courts in the United States have clarified their approach to champerty since litigation financing began being used more frequently in the United States. This, according to Drucker, makes it "less murky that what they're doing is pretty much squarely within the framework of most states."

Not all, however, have sanctioned the practice.

"States in which there was a law against champerty had to look at whether [litigation financing] violated the law," Griesing says. "To my knowledge, there still are a few [states] that [have laws against it]."

In addition to addressing other concerns — including whether the court requires you to disclose a third party funder is being used and confirming attorney-client privilege can be maintained — Griesing suggests lawyers may want to document that they've discussed any associated risks and jurisdictional requirements with clients in writing.

She also recommends attorneys remain cognizant of the responsibilities involved in Rule 5.4 of the *ABA Model Rules of Professional Conduct*. For example, they must make sure an agreement doesn't state that, unless there's no merit to proceeding, if the client decides not to continue with the case, he'd have to repay expenses the funder incurred.

Attorneys have to be able to recommend what's in the client's best interest and execute the client's wishes, Robertson says — even when that might contradict a third party funder's interests.

"Part of the risk is that a client might decide, after you put in a ton of resources, that they want to drop the case; they have to be allowed to do that," she says. "The provider can't force the client to continue with the claim. That's a risk a lawyer on a contingent fee takes and a similar risk a company takes."

Ensuring clients understand what they stand to make — and spend — is also key.

In some instances, a lender may provide money for other case-related costs, such as medical expenses, according to Robert Marcovitch, a Partner at national trial firm Weinberg Wheeler Hudgins Gunn & Dial who recently worked on a case involving such an arrangement.

If a plaintiff is responsible, however, for paying all medical costs back to the financier — potentially involving a higher amount than the typical negotiated rate an insurance provider would offer — the arrangement could end up being a costlier proposition than the plaintiff initially imagined.

"For serious injury cases, medical expenses can be in the hundreds of thousands, if not more. If there's no other way to get health care or the type the plaintiff needs, then maybe it's the only thing they can do," Marcovitch says. "But let's say the lawyer gets 60 percent of the medical expenses recovered. If it's not a high-dollar case, [it may not be] worth it."

SECURING OUTSIDE FUNDING

Law firms hoping to obtain litigation financing for a portfolio of work or pair individual clients with funding sources should look for lenders that tend to work within corresponding areas, according to Patterson.

"A litigation financing company that doesn't do a lot of intellectual property work isn't going to be good friends with a law firm that's focused on intellectual property law," he says. "Law firms should figure out what types of cases work for a litigation financing company and make sure those are the types of cases that fit with your firm's profile."

Investors may not be interested in some cases, simply because they're outside of their purview or because they believe they involve too much risk. A case involving a party that's alleging breach of an oral contract, for example, can tend to be a fairly speculative scenario to base a case on, according to Drucker.

Even if a lawsuit is in line with what a company tends to fund, different matters can involve different investment qualifications. Generally, Lake Whillans looks for cases with strong documented evidence that demonstrates a narrative, according to Drucker.

"That's what we're ultimately going to be seeking to guide our underwriting," he says. "The level of risk, potential duration, damages-to-investment ratio — all those factors lead to us valuing the return required to justify our investment."

A GROWING TREND

More and more U.S. states are permitting litigation financing — at last count, only 18 didn't clearly allow it, according to Robertson; the rest did.

In addition to situations where plaintiffs are in desperate need of funds, businesses are now turning to litigation financing because of the operational benefits it can provide, such as allowing a company to show consistent expenses year over year, according to Patterson.

"We see a lot [of cases] actually now with companies that are very concerned about freeing up cash flow," he says. "That concern was always there; the solution wasn't 10 years ago."

Some attorneys may initially fear litigation financing will result in a loss of control over how a case is managed. However, the practice can, Patterson says, take case strategy in a vastly positive direction.

"In a situation like a trade secrets case, classically, the approach a defendant takes is to try to run [the plaintiff] down so they're desperate to settle because they're running out of money," he says. "With litigation financing, the plaintiff is now funded to go to trial if necessary. It gives you the ability to pursue more complicated cases."

About the Author

Erin Brereton is a freelance writer, editor and content strategist who has written about the legal industry, business, technology and other topics for 20 years.

Email

Website

Twitter