

Lawsuit Funding

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In the past six or seven years a new fast growing financial product for personal injury plaintiffs has emerged. Known by many names such as lawsuit funding, legal funding, litigation funding, pre-settlement funding, lawsuit advance, case funding and many other variations, this product offers financial help to plaintiffs waiting for a settlement, where there was none available before. Despite the high cost, the demand is strong for this hybrid product and the market has shown accelerating growth over the past couple of years.

Lawsuit Funding grew out of a hole in the financial system created by demand from the millions of people financially stressed because of injury by some sort of accidental tort and the lack of availability from traditional financial sources. Banks and other traditional financial institutions will not lend to someone whose primary collateral is an interest in their own lawsuit. Because they do not possess the skills to analyze the merits of personal injury lawsuits (or any other type of lawsuit for that matter) they will not lend regardless of the merits of the case.

A new breed of venture capitalists has filled the gap by providing these much needed funds in a unique manner. To avoid the usury limits, which would render the product economically infeasible, the typical lawsuit funding transaction is done in the form of an investment rather than a loan. This means that the funding company only gets paid if the lawsuit or claim is successfully resolved. If you lose your case you own them nothing! Generally speaking, this non-recourse element renders the transaction an investment (not a loan) under the law^[1].

The nature of lawsuit funding makes the product high cost. Because of the non-recourse nature of the product, losses are high compared to other types of consumer products and the processing costs are also high because of the small average transaction size – generally less than \$5,000. Rates vary a tremendously from one funding company to another. While rates have dropped in the past couple of years, when all charges are included, they still average between 4% and 5% per month. However, it is not uncommon to find lawsuit funding companies still charging 15% a month. Caveat Emptor!

While there are many success stories there are just as many horror stories to be told about lawsuit funding transactions. Typically, the horror stories all come from the same companies –those charging very high compounded rates. With a little bit of shopping around, it is possible to avoid these get rich quick artists and find a reputable company that will provide ample funds at simple interest rates. The cost will still be high due to the nature of the product; after all, if you lose your case the funding company's investment is wiped out.

Before making any commitments, plaintiffs would be well advised to show the proposed terms to their attorneys. Any reputable lawsuit funding company will be more than happy to provide your attorney with any information needed to make an informed decision.

[1] This is a complicated topic but, generally speaking, if repayment of any part of the principal or interest is contingent on an event that is "more than a mere colorable hazard", the transaction is not considered a loan and not subject to usury laws. Wayne C Walker

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