Litigation Funding Is Here To Stay

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By now, every personal injury attorney has heard of “litigation funding” - the non-recourse sale of a portion of a plaintiff’s future settlement proceeds in exchange for cash today. In recent years, the availability and use of litigation funding has grown rapidly and most attorneys now recognize the need for plaintiff financial support. A 2001 survey by Lawyers Weekly asked a simple question: Should Litigation Funding Be Permitted? Of the 1,876 votes cast, 82.5% responded yes.

However, reminiscent of the criticism faced by trial attorneys over contingency fees, litigation funding companies must respond to the same disparagements. Defenders of the status quo seek to brand litigation funding as profiteering by scoundrels taking advantage of the down trodden. They trot out such red herrings as champerty, usury and far flung theories of inherent conflicts to show how vexatious the practice really is. Sound familiar? Despite the criticism, we know the following: plaintiffs love it; defendants hate it; it is here to stay!

Equal Protection Requires Equal Access The lynchpin for every privilege contemplated by our founding fathers and codified in our constitution rests in one simple principle – equal protection under the law. Since 1786 when pamphleteer Benjamin Austin called it “a pernicious practice”, contingent legal fees have been criticized non-stop. Yet today, it is the most widely used fee agreement in the United States. Why? Simple – because it works! The contingent fee system helps to achieve the goal of equal protection by facilitating access.

It is axiomatic that there can be no equal protection when access to the court system is unaffordable by a significant segment of the citizenry. The entire raison d’etre for contingency fees lays in this basic access issue. So persuasive is this point that, over the years, courts, have systematically removed virtually every barrier preventing access to the court system. From contingency fees to attorney advertising to champerty, laws preventing access, in even the most indirect ways, have bitten the dust.

Perhaps Judge Michael A. Musmanno said it best:

"If it were not for contingent fees, indigent victims of tortious accidents would be subject to the unbridled, self-willed partisanship of their tortfeasors. The person who has, without fault on his part, been injured and who, because of his injury, is unable to work, and has a large family to support, and has no money to engage a lawyer, would be at the mercy of the person who disabled him because, being in a superior economic position, the injuring person could force on his victim, desperately in need of money to keep the candle of life burning in himself and his dependent ones, a wholly unconscionably meager sum in settlement, or even refuse to pay him anything at all. Any society, and especially a democratic one, worthy of respect in the spectrum of civilization, should never tolerate such a victimization of the weak by the mighty." Richette v. Solomon, 187 A.2d 910, 919 (Pa. 1963).

However, affording a lawyer is only one part of a plaintiff’s challenge. A claimant must also have the ability to sustain themselves during the pendancy of their action. After all, what good is retaining an attorney, if you can’t afford the basic necessities of life? How are financially stressed plaintiffs to sustain themselves during the pendancy of their litigation which may be the cause of their financial condition in the first place

Litigation Funding One answer is litigation funding. Being able to stay the course is a prerequisite to fair treatment and this simple transaction can help level the playing field with a well-heeled adversary. This fact was recognized by the Massachusetts Supreme Judicial Court in the 1997 case of Saladini v. Righellis, (426 Mass. 231, 234) when it noted:

"We have long abandoned the view that litigation is suspect, and have recognized that agreements to purchase an interest in an action may actual foster resolution of a dispute." Other superior courts seem to be persuaded by the Massachusetts court including the Supreme Court of South Carolina which relied heavily on Saladini when it abolished champerty in Osprey, Inc. v. Cabana Limited Partnership, 532 S.E.2d 269 (S.C. 2000). In fairness it should be noted that the Supreme Court of Ohio held a different view in Rancman v. Interim Settlement Funding Corp.99 Ohio St.3d 121, 2003-Ohio-2721. However, Ohio is in the minority and the doctrine of champerty may one day meet its final well-deserved death sentence at the US Supreme Court when the applicability of the 14th Amendment is determined. (Bennett v NCAAP 370 S.W. 2nd 79 82 (Ark 1963))

What are the real issues? Aside from 15th Century English Law, what are the real issues today? The perception is there is nothing in it for attorneys, at least not immediately or directly. Providing information to the funding company, administering the execution of the contract and observing the lien are all a nuisance for plaintiff’s counsel. However, despite this, more and more PI attorneys are forging relationships with funding companies because their clients need it, and they have found that reputable experienced companies can prove to be an invaluable resource. Cost

The most common criticism is the cost. The average amount paid for bodily injury insurance claims suffered in motor vehicle accidents is small - less than $10,000. Thus, it should not be surprising that the average litigation funding contract is also small. Most contracts are for $1,000 to $5,000. Consumer financial products have relatively fixed transaction costs meaning that smaller deals are nearly as costly as larger ones. It follows that, because of their small size, the average fees on litigation funding contracts will unavoidably be high.

That having been said, the very growth of the business will resolve the issue of cost. The marketplace will set prices just as it does with contingent legal fees. Once the there is enough experience for the true risks of these transactions to be widely known, investors will price the risk to a corresponding level. Already, fees have dropped significantly. Only a few years ago it was not uncommon to find fees of 15% per month compounded – with no cap! This is now rare.

There are three basic fee methods used by most funding companies:

1. Monthly interest or fees. These can range 3% to as high as 15% per month with no cap.

2. A percentage of the recovery.

3. Flat fees that are capped and may or may not have a discount for early payment.

(Attorneys must beware of large fees at closing that serve to raise the true cost significantly)

A valid concern is that, with monthly fees rising with no cap, clients might be tempted to take a settlement just to stop the fee increases. This not only injures the client's chances of a fair recovery but also limits the attorney's fees. Fortunately, capped fees are always available in the market.

While the marketplace place will continue to drive price levels toward equilibrium, it should be comforting for those with no faith in market forces to remember that, in the final analysis, the court has the final say and can set aside abusive fees. Schlesinger v Teitelbaum, 475 F2nd 137, 141 (3rd Cir), cert. denied, 414 U.S. 1111 (1973)

On this issue Saladini is very much on point: "This means that if an agreement to finance a lawsuit is challenged, we will consider whether the fees charged are excessive or whether any recovery by a prevailing party is vitiated because of some impermissible overreaching by the financier."

Is it really a loan in disguise? Litigation funding contracts are almost universally non-recourse. The definition of a loan is blackletter law. If any part of the principal or interest is contingent on an event that is "more than a mere colorable hazard", the contract is not a loan. A challenge on the grounds that the requisite degree of hazard is not present would have to be adjudicated case by case, each case being unique. Bear in mind that the funding company is subordinate to attorney's fees and costs, statutory liens and prior liens. The risk for an attorney is substantially better than for the funding company that is last in line. Many regulatory authorities from attorneys general to banking commissioners have reviewed the practice and taken no action. It seems clear that non-recourse means non-recourse and that litigation funding is a risky business.

Draconian Contracts

A second widely held concern is the use of contracts with draconian clauses. While the enforceability of such clauses is questionable at best, they still present a formidable nuisance value. Typical objectionable clauses are:

• Prior permission of funding company required to change attorneys

• High liquidated damages

• Waiver of all defenses

• Disclosure of non-discoverable information

Most reputable companies, including CapTran® have modified their contracts to address these concerns.

Ethics

George Kuhlman, ethics counsel for the American Bar Association, was quoted in Lawyers Weekly USA as stating: "The problem only comes in when lawyers are acquiring an interest in the subject matter of the litigation, but anybody can buy a piece of someone's judgment. I don't see any lawyer involvement so I don't see any problem. This is a third party becoming involved; making sure people can survive their judgments."

With one exception, all Ethics Opinions of which we are aware find litigation funding ethical. Michigan finds contracts with certain clauses to be impermissible.

State Bar of Michigan Ethics Committee Opinion RI-321, June 29, 2000

"1. The ultimate control of the litigation may be transferred to the venture capital corporation due to the fact that the lawyer is permanently appointed to the case;

2. The original lawyer cannot be terminated without the venture capital corporation's consent in light of the fact that on demand of the venture capital corporation all documents and things must be demanded by that group; and

3. Privileged materials may be disclosed.”

We should also note that some states require certain specific procedural issues to be observed. (A listing of ethics opinion relating to litigation funding can be found at www.captran.com) Where do we go from here?

As experience grows, capital will enter the business in ever increasing amounts, making it fairly commonplace while competition will undoubtedly mold the product, and fix most, if not all, of the problems.

Many savvy attorneys understand that litigation funding is not going away anytime soon and they are embracing it and learning how best to use it. They are forging relationships with funding companies and using their services to meet the needs of their clients. In doing so, they get the added benefit of negotiating for a client that is no longer under the unnerving and destabilizing effect of financial duress.

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