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A Quick Introduction to Litigation Financing

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An introduction to litigation Financing

Litigation financing by a third-party investor is increasingly recognized as having the potential to ameliorate these barriers to justice and inequities. Litigation financing provides not only access to courts with some degree of parity, but also makes litigation more economically efficient while promoting its traditional aims.

Litigation financing is a mechanism by which third-party investors provide litigants with immediate funds and other resources in exchange for a share of any eventual recovery. These funds – available at any stage of litigation -- often serve an essential need, providing money for litigation and other expenses so that lawsuits can go forward.

Litigation financing potentially provides more than just funds as well. Often litigation involves an individual or other relative novice to litigation opposing not just a well-financed opponent but one with extensive experience in the courts. Faced with a sophisticated and experienced opposing party a litigation financing company – which directly or indirectly regularly deals with the judicial system -- can make available its experience and access to legal experts and other resources. Thus, litigation financing not only provides access to the justice system financially, but helps level the playing field through its additional resources as well.

Corporate legal departments and law firms are also increasingly turning to litigation financing because of its ability to manage litigation expenses, risk, and other benefits. It is also moving beyond its origins of funding individual claims and is increasingly being used to fund entire portfolios of cases.

Since its inception in the United States, litigation financing has grown exponentially. A 2017 survey found that nearly 30% of attorneys in private practice had used litigation financing compared to 7% a few years earlier. A review of the benefits litigation financing provides to parties and the justice system – discussed below – explains why litigation financing, according to Bloomberg, is “booming”.

The rise of litigation Financing

Forms of litigation financing are well-established in other common-law nations around the world, including England, Wales, Scotland, Australia, two provinces in Canada, Germany, the Netherlands, Australia, and New Zealand.

Litigation financing was only introduced into the United States in the past 20 years or so. Initially, many jurisdictions sought to block or limit litigation financing, generally relying on common law doctrines such as barratry, champerty and maintenance. In recent years, a significant number of these jurisdictions have rethought their resistance to litigation financing as its benefits have become widely acknowledged among practitioners and academics. According to one recent survey, "[t]he doctrines of maintenance and champerty have slowly declined in the United States since the mid-nineteenth century . . . [and] litigation funding in the United States is governed by a patchwork of relatively weak laws, cases, rules, and regulations and they are only in force in a handful of states."

As these historic doctrines have proved to be inapplicable to modern litigation finance, the industry has seen dramatic growth, quadrupling between 2013 and 2016. Still, "the demand in the legal world is [] much higher than the supply of litigation finance".

While the federal government does not regulate litigation financing, and only a few states have codified law which regulates this funding, most jurisdictions have guidelines which permit third-party financing of litigation as long as the funding company does not control the litigation.

The basics litigation Financing

Despite differences in various jurisdictions, the litigation financing process has become increasingly standardized and accepted. Established companies which provide litigation financing have experience with the issues involved and are able to guide potential clients through this process.

There are three principal parties to litigation financing: The plaintiff and/or plaintiff's attorneys; the investor, and the plaintiff's attorney. Ligation financing has also recently expanded to making funding available to corporate legal departments and law firms, sometimes funding entire portfolio of cases.

A litigation funding agreement will typically be preceded by a due diligence – or underwriting – period. This vetting process may include an exclusivity agreement. Funders typically ask for pleadings and/or a summary of the legal and factual arguments. They may also ask for the key evidence that both supports and refutes the claims. Funders also require a measurable theory of damages, even if it is preliminary.

This process may be completed in a matter of days or may take longer. Coordination with the party's attorneys is critical. Maintaining the confidentiality of communications is central to this process and beyond. A non-disclosure agreement is typically executed at the outset of the due diligence period, and other precautions are taken to preserve the confidentiality of information. Provisions designed to maintain these protections are incorporated into the final funding agreement. The final agreement (which may contain ancillary agreements) will typically also address issues such as termination, priorities in distribution, maximum investment, verification, and notifications.

The American Legal Finance Association ("ALFA") maintains a Code of Conduct for its members. ALFA's Code of Conduct requires that its members comply with the laws, regulations and other rules of applicable jurisdictions, as well as adhere to the standards set forth in the Code. ALFA has also developed standardized documentation for funding agreements for use by its members.

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Litigation financing in arbitration and international disputes

Litigation financing is becoming a common feature in arbitration -- including international arbitration. According to one estimate, more than $16 billion will be invested in arbitration costs over the next four years in Latin American. Hong Kong and Singapore are also actively promoting themselves as international arbitration centers and have introduced legislation that would enable the use of third-party funding in arbitrations seated there.

Observers have noted the significant role for litigation financing in these international markets. According to one article, while "[t]he market for lawsuit investment is already quite large in Australia, the U.K., and the U.S., [] it is poised for growth worldwide".

To help guide these developments, the International Council for Commercial Arbitration partnered with Queen Mary University of London in 2013 to establish a task force to "identify and study the issues that arise in relation to third-party funding in international arbitration, and to determine what outputs, if any, would be appropriate to address them." The Task Force's work resulted in a "Draft Report for Public Discussion on Third-Party Funding in International Arbitration", published on September 1, 2017. The Draft Report provided a detailed background on the market, scope and mechanics of dispute funding and made a number of recommendations which are still open for comment. The recommendations deal with disclosure of financing arrangements and recognition that certain aspects of funding arrangements are privileged. The report is expected to be finalized in April 2018.

The benefits of litigation financing

Litigation financing provides a variety benefits, including not just funds, but the experience and expertise that litigation financing companies may be able to provide as well.

1. Litgation Financing Levels the Playing Field

Parties do not necessarily have equal access to justice due largely to disparities in resources. Often a plaintiff does not have the money or experience to compete with the defendant, which frequently is a corporation with both money and experience with lawsuits. Plaintiffs sometimes cannot even afford to bring a lawsuit against a wealthy defendant. Even if the lawsuit is filed, the party with greater resources has a substantial advantage.

Litigation financing can help provide the resources to put plaintiffs on an even footing with defendants, and can even provide funds for personal expenses during the lawsuit. In fact, litigation financing has a well-deserved and documented record of providing the resources that plaintiffs need to effectively pursue their claims.

The record of litigation financing's success in eliminating the disparities of parties shows that litigation financing allows plaintiffs to achieve some measure of parity with larger, well-financed defendants. Providing plaintiffs with comparable resources deprives a well-funded defendant of the ability to capitalize on the disparity in resources with tactics such as delay, overwhelming discovery, and the like. Litigation financing therefore promotes recoveries which are more closely aligned with the merits of the case. Funding is potentially available at any stage of litigation and may also reduce the risk of premature settlement.

The benefits of third-party funding of litigation is not limited to plaintiffs. Corporate legal departments and law firms are increasingly recognizing that litigation financing can be used to manage risk and add predictability to litigation costs. Litigation financing has also recently expanded into funding entire litigation portfolios as opposed to individual cases.

The benefits of litigation financing (cont.)

2. Litigation Financing Provides Benefits Beyond Just Funding

Beyond providing funding, scholars and other observers have also recognized that providers of litigation financing may also be able to offer experience and connections to legal experts which can assist litigants facing experienced and well-funded opponent. The outcome of litigation strongly favors litigants which are regularly engaged in litigation -- including large corporations – over individuals who are rarely involved in lawsuits.

Funding companies over time acquire experience and expertise, and that experience can also help plaintiffs to litigate closer to parity with experienced defendants. "By compounding the bargaining power of one-shotters . . . while decreasing the bargaining power of repeat-players (such as corporations) both of whom must cede some power to the funders, litigation funding would, in essence, transform all types of parties into different types of modified repeat players."

The benefits provided by litigation financing extend to the justice system as well. Prior to providing funding, litigation financing companies conduct due diligence regarding the merits of the case, helping to ensure that support is only available for valid cases. Litigation financing also promotes settlement by equalizing the bargaining power of the parties.

3. Opposition to Litgation Financing Lacks Data.

Opponents of litigation financing have historically argued that use of litigation financing will result in ethical violations, frivolous litigation, allowing a third party to control the litigation and make decisions, an attorney abandoning his or her own judgment in favor of the litigation financing company's judgment, and a waiver of the attorney-client privilege in any given case. It was recently noted, however, that little evidence exists to support these arguments.

Evidence of the benefits of litigation financing continues to mount, however. Proponents of litigation financing – both plaintiffs and defendants -- note that it may actually improve the current volume of pending cases by weeding out frivolous litigation that litigation financing companies deem a bad investment. Indeed, the American Legal Finance Association recommends that member companies only provide funding if the litigant has a legitimate claim and is represented by an attorney.

Legal recognition and acceptance of litigation Financing

Litigation financing is well established in countries such as the United Kingdom and Australia. While litigation financing is relatively new to the United States, since its introduction approximately 20 years ago it has rapidly expanded and statistics reflect that it is gaining widespread acceptance. A recent study reported that 36% of U.S. law firms used litigation finance in 2017, compared with only 7% in 2013.

The initial opposition to litigation financing in the United States was largely based on antiquated legal principles developed long before third-party financing. According to one article, "[t]he rise of litigation finance had legal scholars dusting off old textbooks to consider the application of principles such as champerty and maintenance."

Now, over half of the jurisdictions in the United States have issued bar ethics opinions permitting litigation finance transactions, provided attorneys fulfill certain disclosure requirements and avoid conflicts of interest.

Preserving confidentiality of Litigation Financing Communications

Most federal courts which have considered whether communications with litigation funding entities are confidential have held that those materials are protected from the oppositing party in litigation – finding that they are either immaterial, privileged, or protected by the work product doctrine. State courts are generally in agreement. Some courts have ordered litigation funding documents to be produced in discovery despite recognizing that the materials constituted work product, finding that the party seeking discovery had demonstrated a "substantial need" for the materials.

Courts are not uniform in this area, however, and having an experienced and sophisticated litigation financing company involved is important. Conflicting authority exists in the federal courts, and at least one federal court has held that the common interest privilege does not apply to communications with litigation funding entities. Automatic disclosure of third-party litigation funding has been considered by the Advisory Committee on the Federal Rules of Civil Procedure since 2014, but as yet has not been adopted.

One notable opinion – addressing this issue comprehensively -- is Miller UK, Ltd. v. Caterpillar, Inc., 17 F. Supp. 3d 711 (N.D. Ill. 2014). After finding that litigation funding did not violate Illinois champerty or maintenance doctrines, the court addressed the discoverability of those documents, holding: (1) the "deal documents" between the company and the ultimately chosen funder were irrelevant and therefore not discoverable; (2) the company waived attorney-client privilege protection for any materials shared with "any actual or prospective funders" – rejecting the company's common interest doctrine argument after concluding that "[a] shared rooting interest in the 'successful outcome of a case . . . is not a common legal interest"; and (3) the company also waived its separate work product protection for any work product that it shared with prospective funders – "except those with which it had a confidentiality agreement." Id. at 730-732 (emphasis added). The court noted that "it appears that [the company] took protective measure with some but perhaps not all prospective funders." Id.

The Miller court provided additional guidance for protecting the confidentiality of communications with a third-party financer, finding that the work product doctrine applied to information given to prospective funders pursuant to written nondisclosure agreements and by oral "similar understandings", although it remarked that the plaintiff's declaration was "just barely" sufficient to show an adequate protection of the information from disclosure to adversaries. Id. at 737.

With respect to other communications, the court found that "there was no legal planning with third party funders to insure compliance with the law. . . . [Plaintiff] was looking for money from prospective funders, not legal advice or litigation strategies. . . . In short, the funders and Miller did not share a common legal interest, and materials shared with any actual or prospective funders lost whatever attorney-client privilege they might otherwise have enjoyed." Id. at 732-33.

This issue continues to evolve, but existing authority suggests that communications regarding litigation financing are potentially privileged or subject to the work product doctrine, but the interested parties must diligently comply with the legal requirements to preserve that confidentiality.

The future of litigation financing

As noted earlier, not only has the use of litigation financing in its traditional venues grown exponentially in recent years, but the legal contexts in which litigation financing is utilized is also expanding. Historically used to fund plaintiffs' personal injury cases, litigation financing continues to expand into the areas of appellate litigation, bankruptcy, tax matters, and private equity. It is also used during the enforcement stage of litigation.

Litigation financing is expected to continue these growth trends, both vertically and horizontally.

Investments are ONLY available to Accredited Investors.

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www.yourtcp.com
E-Mail: info@yourtcp.com

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