Is litigation funding a creative way to help “the little guy” or the resurrection of a practice that even the Athenians deemed impolitic? In an environment where many posit that access to the courts can be at least somewhat dependent on a person’s financial viability, does outside financing of litigation level the playing field between the Davids and the Goliaths? Some say yes; some say no. And each side says so vehemently. Those in favor argue that an infusion of funds helps the smaller players pursue more complex, long-term, high-stakes lawsuits. Those opposed maintain that the practice proliferates unmeritorious claims and that reasonable settlements for valid suits would occur more quickly if the stakes were not escalated by monied meddlers with no “skin in the game” other than the bottom dollar (or “first dollars”). Adding to concerns is the fact that there is very little – read: no – regulation over this type of investing. And there is disagreement over whether plaintiffs should have to disclose that they have “investors,” who those investors are, what has been told to the investors about the claim, and the amount and contingencies of the investment. While much remains unclear about how this practice will evolve, everyone seems to agree that it will continue to grow.
WHAT IS IT?

Third party litigation funding is the practice of an otherwise disinterested investor providing financing to litigants in exchange for a percentage of a successful outcome – whether a jury verdict or a favorable settlement. These agreements typically are non-recourse, meaning the investor takes nothing if the plaintiff loses. To justify the shouldering of this risk, some funding contracts call for quite high interest rates.

A new offshoot of litigation funding is treatment or surgical funding. Under this scenario, a plaintiff contractually allows her treating surgeon to discount his bill and sell it to a medical lender, which then places a lien – not just for the discounted note but the entire cost of care – against any legal reward. In particular circumstances, liens “can spiral to as much as 10 times what health insurers would pay for the same procedures.” Some medical funders also offer “concierge” services, such as cash advances, hotel rooms for recovery after the funded surgery, and travel arrangements – also available at high interest rates.

THE GOOD, THE BAD AND THE UGLY

A. THE ALLEGED GOOD

As noted above, the demarcation lines are pretty starkly drawn. For those in favor, the first “virtue” of litigation finance is that it “can help the powerless avail themselves of our civil justice system.” Proponents make the unremarkable point that “litigation is expensive,” and that funding provides access to the courts for those unable to afford it. But is that not the point of contingency fees? Such funding can go beyond access to the courts, however, and stretch to include living costs or operating costs for a business. And any recovery is held hostage until repayment of the loan and the interest. The service also can morph into funding for either uninsured surgeries, deductibles, or surgeries performed by out-of-network doctors. The advantage trumpeted for this controversial practice is akin to that for litigation finance – it helps the vulnerable, economically disadvantaged person have access to that which he formerly could not. In this circumstance, the argument is that it facilitates surgery or other treatment by “top doctors.”

Another outcome lauded by advocates is that it helps manage risk – either in a commercial setting or perhaps mass tort. Who, they ask, is better able to handle the uncertainty associated with high litigation costs juxtaposed against a high and likely – but not guaranteed – return? The single company who has this promising claim but perhaps little free excess capital to expend on lawyers? (Again, the question of the purpose of contingency fees arises.) Or … a litigation finance company/hedge fund? The enthusiasts champion the latter because diversification is protection: “the risk of holding an entire portfolio of litigation claims is lower than the risk of holding a single claim; just like the risk of holding a portfolio of stocks is lower than the risk of holding a single stock.” Defenders also suggest that a business that monetizes its claim frees itself and its money to stick with – as Michael Corleone said, albeit in a different context – “strictly business.”

Lastly, some supporters claim “litigation finance might actually reduce the time and cost of litigation.” The idea as espoused is two-fold and, actually, self-contradictory. First, they theorize that defendants will settle more quickly when they realize that a plaintiff is backed by outside funds and able to hold his own in a discovery war of attrition. But such conjecture requires the acknowledgement that “litigation finance might prolong the litigation by allowing for robust discovery.” The latter outcome is quickly embraced, however, by noting that “there’s nothing wrong with that – the record should be properly developed before the parties decide how to resolve the case.”

For those in favor, the first “virtue” of litigation finance is that it “can help the powerless avail themselves of our civil justice system.”
B. THE BAD

You know things have gone awry when Spider-Man enters the fray. But yes, even Spidey has gotten caught in “the web of litigation finance.”

Elliott Management Corp., a hedge-fund giant, helped bankroll a lawsuit by Stan Lee Media Inc. against Walt Disney Co. over profits made from comic book characters such as Spider-Man. But this investment went belly-up when a federal judge dismissed the lawsuit.

So does the plight of our hero, who in the movies lives hand to mouth as Peter Parker, epitomize equal access to justice for the little guy? Or was this a bad investment from the start and a lawsuit that never should have been brought?

Some business groups, the U.S. Chamber of Commerce and U.S. Chamber Institute for Legal Reform (ILR) chief among them, say “the practice gives outside undue influence over cases and drives up the cost of litigation.”

According to the ILR, there is no question but that “[l]itigation financing is a sophisticated scheme for gambling on litigation, and its impact on American companies is unambiguous: more lawsuits, more litigation uncertainty, higher settlement payoffs to satisfy cash-hungry funders, and in some instances, even corruption.”

Opposers also note that litigation funders might have conflicting interests. For instance, a funder typically has as part of the agreement that he takes “first dollars.” This means that he recoups his investment (and generally some percentage on anything above his investment) first before any trickle down of funds to the actual plaintiff or plaintiff’s lawyer. If the prospects of the case have dimmed with time and a settlement offer is made that would allow the financier to break even and also perhaps have a little cushion, he might push for resolution despite the fact that the plaintiff takes little to nothing. The flip side of that same bad coin is that “a litigation financier may set a threshold amount for a settlement, which may force the litigation into later stages in the hope of obtaining a larger damage award at trial or through settlement.”

And while proponents of the practice argue, as noted above, that a plaintiff company can focus on its business as opposed to the litigation with the help of outside litigation finance, what of the defendant company? Opponents say it is exactly the opposite as litigation costs increase and “companies may be diverted from investing their own capital in the economic markets and may not be able to invest their own capital into research and development.”

Those increased costs, as we all know, get passed down. Perhaps litigation truly is expensive.
The doctor might have his own separate agreement with the funder to claim it on insurance because it is funded by outsiders. The scenario: (1) the plaintiff need not pay for the surgery or at the time. Or a plaintiff who truly does need treatment could be forced into signing an unconscionable agreement where he essentially signs away his potential legal recovery.

Lastly, a defendant could face artificially inflated damages claims where a funder seeks upwards of 10 times the cost of treatment. It is little wonder that the Consumer Financial Protection Board has been called upon to examine the practices of the medical funding industry.

The Conclusion

One last consideration is this: what effect does financing have on the profession itself? Is it a good thing for our profession or our society in general to allow outsiders to profit on legal disputes? Methinks maybe not. As one author aptly put it:

Over the last century, many have come to see lawsuits as a means of expression, a political weapon and a powerful deterrent against those who might do wrong. And yet creating lawsuits is not the same as creating something like the [Volkswagen] Bug. Litigation is a zero-sum industry – every dollar in damages taken home by the winner, minus fees, must be wrung out of the loser. Litigation also helps shape legal precedent, defining the winner, minus fees, must be wrung out of the loser.

And how much. At whose peril.