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# The Cost of Pursuing Justice: Litigation Financing Agreements

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The pursuit of Justice can be expensive.

Unlike in many countries, litigants in the United States bear their own costs of litigation, including all out-of-pocket expenses and attorneys' fees. Often referred to as the American System, it makes litigation prohibitively expensive for some, and plaintiffs must look at their options beyond merely abandoning their case.

"Modern litigation is expensive, and deep pocketed wrongdoers can deter lawsuits from being filed if a plaintiff has no means of financing her or his case." *Hamilton Cap. VII, LLC v. Khorrami, LLP*, 48 Misc.3d 1223(A), at *5 (Sup. Ct. New York County 2015). Because costs associated with each case are unique and the potential outcome is uncertain, parties may consider possible ways to afford the lawsuit and will often turn to advisors to assist in navigating the process of securing financings. An especially popular avenue in personal injury matters and collections actions is to place the plaintiff's lawsuit with a law firm operating on a contingency fee basis. Rates may vary from 20% to as high as 40-50% going to the lawyers. But even then, expenses such as filing fees, copying costs, and costs of discovery including depositions can be prohibitive.

Litigation finance is an increasingly popular option for funding lawsuits in the United States. *Fast Trak Inv. Co., LLC v. Sax*, 962 F.3d 455, 468 (9th Cir. 2020) ("Litigation financing is a rapidly growing industry."). It is the practice of securing third-party funding for a litigation claim in exchange for a stake in the outcome of the pending lawsuit.

There are both commercial and consumer litigation financers. Litigation financing generally involves three parties: the plaintiff, their law firm, and the funder. The plaintiff or law firm seeks funding to pursue a legal claim and through this arrangement, the funds are used to pay for legal fees and/or costs.

Financing can be provided at any point of the proceedings from pre-litigation to appeal, up to recovery. Plaintiffs and law firms are using litigation financing domestically to finance legal claims. They are also deploying this globally to finance enforcement campaigns.

Litigation finance is available to litigants involved in many different types of lawsuits. This includes personal injury matters, commercial disputes, civil rights actions, etc. In some bankruptcy cases, creditors' committees may choose to pursue avoidance actions or other claims and often seek a carve out of secured lenders' collateral or from the proceeds of recoveries. Creditors may even advance funds to the trustee to litigate claims against third parties in connection with the bankruptcy case.[1]

Besides the merits of a case, funders will consider factors such as the experience and expertise of counsel, economics, and recoverability. The lender gambles on a potential return. Typically, the only collateral is the case itself so if there is an adverse decision, the funder does not recover any of its investment. This is referred to as non-recourse financing and often, lenders impose higher interest rates on potential returns that exceed the maximum permitted under usury law.

Courts have questioned the potentially "usurious" nature of litigation financing arrangement. In June of 2020, the Court of Appeals for the Ninth Circuit in *Fast Trak Inv. Co.* considered the nature of a litigation finance agreement under New York law and noted that "if the transaction is not a loan, there can be no usury, however unconscionable the contract may be." 962 F.3d at 459, 462 (9th Cir. 2020). Further, the court addressed the distinction between a litigation funding agreement with a "loan" noting that loans give lenders a right to collect from the borrower in absolute terms and not be dependent solely on the outcome of a lawsuit. *Id.* at 465.

In this regard, the Ninth Circuit posed the following question for certification to the New York Court of Appeals to reconcile whether a litigation funding agreement would be rendered unenforceable as a usurious loan:

> Whether a litigation financing agreement may qualify as a "loan" or a "cover for usury" where the obligation of repayment arises not only upon and from the client's recovery of proceeds from such litigation but also upon and from the attorney's fees the client's lawyer may recover in unrelated litigation?
>
> *And, if so*, what are the appropriate consequences, if any, for the obligor to the party who financed the litigation, under the agreements that are so qualified?

962 F.3d at 469 (emphasis in original). It remains to be seen how the New York Court of Appeals would have answered this question.[2]

Several states throughout the United States have enacted legislation to regulate litigation finance funding. In March 2019, a bill was proposed in New York addressing third-party funding of consumer litigation.[3] Notably, this bill would require consumer litigation funding companies to register with the State of New York and simultaneously post a bond determined by the State, which would not exceed $50,000 or instead, post an irrevocable letter of credit. This legislation has not been passed to date and as of January 8, 2020, has only been referred to consumer protection for review. There does not appear to be any recent movement towards enactment.

There has also been discussion at the federal level about disclosing the existence of litigation funding in connection with a pending lawsuit. This past year, Congress reintroduced legislation known as the Litigation Funding Transparent Act of 2021 which would require disclosure of third-party litigation financing agreements in civil lawsuits.[4] This bill would require lawyers for plaintiffs in civil lawsuits to disclose before the court and other parties to the lawsuit information pertaining to these litigation financing arrangements. This bill went to the Senate on March 18, 2021 and no further action has been taken since. Query whether there are any ethical concerns of privilege and confidentiality that could arise by disclosing documents and other information relating to these financing arrangements depending on the nature of what has been shared with the financer. The argument over discoverability of litigation funding may boil down to whether the litigation funding is or is not relevant to the allegations subject to the matter.[5]

In further consideration of potential ethical issues related to litigation finance, lawyers themselves should avoid being the funder of their own client's litigation to avoid running afoul of Rule 1.8(e) of the New York Rules of Professional Conduct. This rule prevents a lawyer from loaning money to a client except in the instance of a public interest lawyer may provide financial assistance to indigent clients to a certain extent.[6] Not funding a lawyer's own client's litigation also avoids any conflicts of interest that could arise under Rule 1.7 of the New York Rules of Professional Conduct if the lawyer were to have a financial stake in the outcome of the litigation.[7]

Another practical consideration with respect to litigation finance arrangements is the potential liability of the lawyer representing the litigant and that lawyer's duty to protect the lender's receipt of return. In contingency matters - such as personal injury plaintiff cases - the litigant's lawyer is customarily provided with a funding agreement whereby he or she signs and agrees not to make any payment - whether by settlement or verdict - to the litigant-plaintiff without first ensuring the lender is paid its principal and interest due.  This imposes a duty on the litigant's lawyer to make sure the lender's principal and interest is accounted for when negotiating a resolution and upon receipt of any settlement funds.  In the event the litigant's lawyer fails to pay the lender, the lender is entitled to seek recovery from the litigant's lawyer directly. That is why it is important to ensure the litigant's lawyer is advised of any funding arrangement and the case file is marked accordingly so payment is properly issued to all those necessary if the lawsuit is successful.

"There is proliferation of alternative litigation financing in the United States, partly due to the recognition that litigation funding allows lawsuits to be decided on their merits, and not based on which party has deeper pockets or stronger appetite for protracted litigation." *Lawsuit Funding, LLC v. Lessoff*, No. 650757/2013, 2013 WL 6409971, at *6 (Sup. Ct. New York County Dec. 4, 2013).

Litigation financing agreements are still a relatively novel funding arrangement and more so in certain areas than others. *Seidel*, 2021 WL 1541550, at *2. Issues relating to litigation finance will continue to develop and varying concerns will continue to arise. We will continue to monitor new developments in this area and report accordingly.

Please note that this is a general overview of developments in the law and does not constitute legal advice. Nothing herein creates an attorney-client relationship between the sender and recipient. If you have questions regarding these provisions, or any other aspect of bankruptcy law, please contact Michael Traison at 312.860.4230, Andrew Nitkewicz at 516.357.3895, and/or Amanda Tersigni at 516.357.3738.

## Footnotes

[1] *See Dean v. Seidel*, Civil Action No. 3:20-CV-01834-X, 2021 WL 1541550 (N.D. Tx. Apr. 20, 2021). In *Seidel*, the district court affirmed the bankruptcy court's decision that the chapter 7 trustee could grant a 30% interest in estate-related litigation recoveries to a creditor who advanced funds to pursue the litigation.

[2] The New York Court of Appeals had, in fact, accepted the question for certification, however, this case was settled between the parties and certification was withdrawn, rendering the question moot.

[3] S.B. 4555, 2019-2020 Legis. Sess. (N.Y. 2019). Click here to see a copy of this bill.

[4] S. 840, 117th Cong., 1st Sess. (2021). Click here to see a copy of this bill.

[5] Fed. R. Civ. P. 26(b); *see also Art Akiane LLC. v. Art & Soulworks LLC*, No. 19 C 2952, 2020 WL 5593242, at *6 (N.D. Ill. Sept. 18, 2020) ("[B]roadly asking in discovery for 'documents relating to third-party funding for this litigation' is insufficient without some detailed, meaningful explanation to satisfy the requirement of relevancy."); *In re Valsartan N-Nitrosodimethylamine (NDMA) Contamination Products Liability Litigation*, 405 F. Supp. 3d 612, 615 (D. N.J. 2019) (holding that discovery of plaintiff's litigation funding was irrelevant); *Benitez v. Lopez*, at *1 (E.D.N.Y. Mar. 14, 2019) ("[w]hether plaintiff is funding this litigation through savings, insurance proceeds, a kickstarter campaign, or contributions from the union is not relevant to any claim or defense at issue"); *Kaplan v. S.A.C. Cap. Advisors, L.P., S.A.C.*, No. 12-CV-9350 (VM(KNF), 2015 WL 5730101, at *5 (S.D.N.Y. Sept. 10, 2015), *aff'd*, 141 F. Supp. 3d 246 (S.D.N.Y. 2015) (denying defendants' request for plaintiffs' litigation funding documents because defendants did not show the requested documents were relevant to any party's claim or defense and "provided no nonspeculative basis for raising such concerns").

[6] As per recent amendments to New York Rules of Professional Conduct, Rule 1.8(e)(4) allows for this so long as such financial assistance is not assured prior to retention or used to induce the continuation of the client-lawyer relationship.

[7] Rule 1.7(a)(2) of the New York Rules of Professional Conduct prohibits a lawyer from representing a client if there is a "significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial … interests."

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