How Litigation Funding Is Affecting Settlement Strategies, Costs

Claims and legal experts call for consistent disclosure requirements as the growing practice exhibits a greater impact on the insurance industry.

by John Weber

Litigation funding is here to stay, according to a panel of claims and legal experts who recently examined the growing issue, including trends in disclosure requirements and how funding is affecting settlement strategies and litigation costs.

Best's Insurance Professional Resources recently hosted the webinar *How Insurers Are Responding to Funding-Backed Litigation*, which included participants Michael Briggs, partner, litigation and dispute resolution, McMillan LLP; Marie Castronuovo, partner, Russo & Gould LLP; Fred Fisher, president, Fisher Consulting Group Inc.; and Janine McCartney, Ph.D., HHC Safety Engineers.

Following is an edited transcript of the conversation.

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How common is litigation funding?

Briggs: It's becoming more common. The main areas we're seeing it is in class actions, where you see the majority of the case law developing. We're also seeing it in insolvency and restructuring. It is

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taking a greater foothold in commercial litigation more generally, including in the insurance world, where insurers are starting to see there's maybe some advantage to using this tool.

Who is funding this litigation?

Castronuovo: It's all about the deep pockets. They're private firms, for the most part, getting their funds from organizations, elite university endowments, retirement funds, pension plans and certain trusts. Hedge funds are involved and venture capitalist equity groups. There are online platforms where people who have a certain amount of money to spend can get vetted and accredited and have the opportunity to invest in pre-vetted, mostly commercial cases.

These are attractive investments because they're not tied up with a stock market. They're not very volatile. They probably take a few years, but they're not as high risk as you would think in cases where they've been properly vetted.

They're not always that vetted. A lot of times, it's just individuals going to a private funder. They [funders] know they're going to get a high interest rate, so they're interested in just lending the money out.

The most recent trend we've seen is something called third-party medical funding, where a plaintiff will go to a plaintiff's attorney or funding company—mostly in personal injury cases. The funding company has a network of doctors they send this person to. The doctors take over their treatment.

The plaintiffs who undergo treatments end up transferring their right to recover the medical expenses at the time of settlement or verdict. They transfer it to the third-party funder.

The doctors likewise transfer their liens to the third-party funder and agree to take only a percentage of their medical fees because they're getting that money upfront. They'll take a percentage now instead of waiting three, four, five years down the road.

What happens is the third-party funder gets those documents and at the time of settlement, they're much more difficult to negotiate with. It's not like Medicare, Medicaid, or workers' comp, meaning that you can negotiate to some extent. The funders are not [willing to negotiate]. These things are making it much more difficult to settle those cases.

Marie, you mentioned that they're not that risky an investment. However, if you lose as an investor, you lose everything, correct?

Castronuovo: It's absolutely true. They're non-recourse. The person taking out the loan gets the money, has to pay the interest, but if they don't win, they don't pay it back. There is some risk. I don't mean to say there's no risk, but it's not as volatile as a stock market. People with a lot of money are willing to put their money in litigation financing.

Janine, how do you see litigation funding affecting case outcomes?

McCartney: Litigation funding is going to inflate the settlement. The research also says it's going to cheapen the civil court system. It allows third parties to have a stake in the litigation.

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and their insurers.

Is there any regulation or oversight regarding litigation funding?

Briggs: In Canada, the answer is yes. In Ontario, in the context of class actions, there's a stipulated test by statute that the litigation funding agreement has to be presented to the court, and an application has to be made to the court in order to go through those factors and to have the court approve the litigation funding agreement.

As part of that, it's disclosed to the defendant or defendants, with the exception of the exact terms associated with recovery percentages and whether there's any limit on the amount of funding that's going to be provided.

Outside of the Ontario class actions scheme, the answer is no. It's not regulated, per se. There isn't a statute or obligation to obtain court-ordered approval.

What's interesting, though, is there's the International Legal Finance Association, which is in the process of working to create some rules, some guidelines and procedures that will attempt to become a self-governing process for this amongst litigation financing companies.

Let's move from Canada to the States. Marie, do we know how extensive regulation is?

Castronuovo: Here in the U.S., there are no federal regulations for litigation funding. There has been recently the introduction of a Litigation Funding Transparency Act.

It's been introduced several years in a row, and nothing's been done on it yet, but it would require plaintiffs to disclose funding loans and contracts, the agreements in total, to the parties and to the courts involved in class actions and multidistrict litigation in federal court.

The federal courts in the United States have started to respond to this absence of legislation. The district courts in both California and New Jersey, over the past couple of years, have issued standing orders that litigation funding loans must be disclosed to the parties and to the courts in those districts.

Aside from that, Wisconsin and West Virginia have already promulgated legislation requiring disclosure of litigation funding loans in those states. In New York, there are several bills under consideration. The last one that was introduced is called the Consumer Litigation Funding Act.

Again, it has been referred to [governmental consumer affairs officials] and deals mostly with the requirements of the contract. It requires the funders to register with the state. It requires contracts to contain bold print disclosures to people taking out the loan, the litigants, so they know what they're getting into; the interest rates and the repayment amounts, all of that has to be disclosed within the contract, to the borrower. This act in New York does not address disclosure. States like Florida, California, Colorado, Kentucky, Missouri, Montana, North Carolina and New Jersey are all considering similar legislation.

Again, most of them do not provide for disclosure of the documents, though, to the parties to litigation. Some of them do. California, Missouri and North Carolina are discussing litigation that is going to require disclosure of those documents to the parties and the courts if legislation is passed.

I don't understand the argument against disclosure. There's this big argument about how it's not relevant, and I know the courts in New York, a lot of them, state courts have ruled that funding loans are not relevant to the litigation, and they're also possibly a part of the attorney work product.

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However, if you remember, years ago, when the defense bar and the insurance industry was being told that they had to disclose their insurance policies, they asserted the same arguments—it's not relevant to the litigation—and they lost. How is it different now? How is it not relevant?

How does it not do the parties good to know there is a third party with financial interest in the litigation that may affect whether or not a plaintiff can settle for a certain amount of money? I think it's relevant. I think the courts have to take, and the legislature, have to take a fresh look at this idea of disclosure.

Briggs: Here in Canada, that disclosure of the agreement with only very limited redactions is, I believe, the normal experience, and it's not legislated; it's just done.

Castronuovo: That's not the case here for the most part. I've even served subpoenas and a lot of these, they're not in the same state that I am, so I haven't yet gone through the trouble of going through a commission and whatnot. We've attempted to serve subpoenas on quite a few of them, and so far nobody's even responding.

Briggs: If you back up and look at it from the funder's and, I think, the plaintiff's perspective—especially in a commercial case—if the defendant's view is that they're able to litigate by attrition, once the existence of the funder is known, that takes away one of those tools from the defendant, and they may wind up being the plaintiff.

The funder may wind up being able to obtain an earlier/better settlement than if they were holding back.

Castronuovo: I agree. Clearly, it works in Canada if everybody is disclosing.

Briggs: It also saves at least one, if not multiple rounds of interlocutory matters to deal with the dispute, which otherwise takes everybody away from what is the heart of the issue.

Fisher: Litigation funding levels the playing field because a lot of small people who have been injured by a big company are suddenly having the funding to fight the law. I think that's very important.

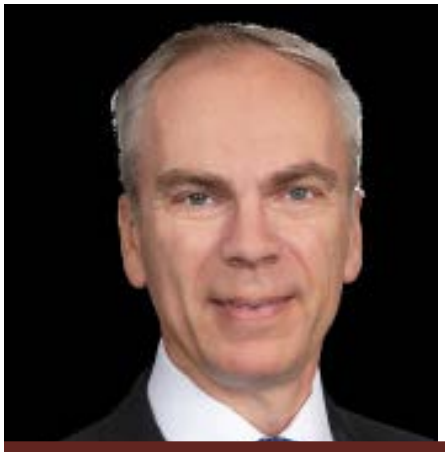
Castronuovo: I'm not disagreeing with you, Fred. However, a lot of these funding companies take advantage of what you're calling the little people. These borrowers are not going there with their attorneys. They're going on their own, and they're signing these documents with these incredibly high interest rates without paying much attention to what that's going to end up in a repayment plan.

Fisher: Agreed. When you're looking at an individual plaintiff, as statistics show, the loans are anywhere from one to 10,000 dollars, even though they may go back and dip in the well a few more times. When you're talking about corporate litigation, that's where you get into the millions of dollars.

I'd like to go around the panel and get everyone's closing thoughts. What's the big takeaway as far as you're concerned?

McCartney: Litigation funders, it appears, are here to stay. Defense experts and plaintiffs' experts alike should educate themselves on the impact that could be made.

Castronuovo: We're going to see even more and more of it on these online networks where individuals can get involved in their own



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investments. Over the course of the next five years, hopefully, we're going to see a lot of legislation and maybe even some case law addressing the issues we've discussed here today.

Fisher: It's here to stay, and now it's a matter of managing it so it's fair and transparent. I think it's going to be regulated.

Briggs: When you find out your plaintiff is litigation-funded, don't despair. Investigate your claim completely. Look for ways you can show, not just the plaintiff, but the plaintiff's litigation funder, that the claim is not nearly as good an investment as they perhaps thought when they first got into it. BR

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