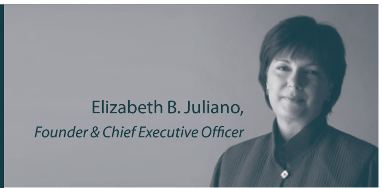
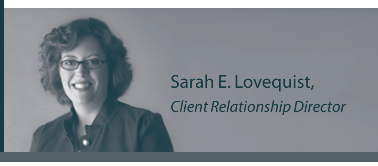
LMI Litigation Management, Inc.

SPRING 2012 ISSUE



Elizabeth B. Juliano,
Founder & Chief Executive Officer



Sarah E. Lovequist,
Client Relationship Director

MIM Reporter

THE REVIEW OF
MEDICAL INFORMATION MANAGEMENT
FOR LITIGATION

Published as an educational service to the Corporate, Insurance and Defense Legal Community by Litigation Management, Inc.

Creative Investing Through Alternative Litigation Funding

TV viewing and radio listening consumers are frequently bombarded by advertisements from attorneys and non-attorneys alike, urging consumers to contact them to file a lawsuit for injuries allegedly stemming from exposure to or use of a variety of toxins and pharmaceuticals. Of late, consumers are also targeted by commercials offering funding for these potential or existing lawsuits. Ads promise “$1,000 to $10,000 the very next day . . . providing you with the cash you need before your case settles.”[i] Cash is provided to plaintiffs through “investment advances” or “lawsuit loans,” making the business of funding litigation one of the most lucrative industries inrecent years. [ii]

As stated by the American Bar Association, “alternative litigation finance” (ALF) refers to the funding of litigation activities by entities other than the parties themselves, their counsel, or other entities with a preexisting contractual relationship with one of the parties, such as an indemnitor or a liability insurer.”[iii] The current United States ALF industry has three active segments: consumer legal funding to individuals, usually in conjunction with personal injury litigation; loans and lines of credit for plaintiff law firms; and investments in commercial lawsuits involving one corporation pursuing another.[iv]

At the outset, it should be noted that the three main ALF segments are markedly different and deserve separate treatment. ALF has recently been touted as a viable way to finance an entire law practice, with ALF companies loaning money directly to attorneys rather than investing in a particular claim or litigation.[v] Plaintiff firms that seek ALF likely have insufficient revenue to maintain a business while waiting on a contingency-fee case to resolve. For example, attorney funding company Counsel Financial specifically states that it provides “credit lines up to $5 million based upon the total value of your contingent fees.”[vi] Using ALF allows a firm to remain solvent and maintain sufficient finances to handle additional cases while waiting on resolution of contingency fee cases.[vii]

Further, funding for commercial claims, such as antitrust, intellectual property and contract disputes, typically involves corporate plaintiffs engaged in business-versus-business claims, and is deemed an “investment” since capital is provided in exchange for a share of the eventual recovery. Corporate defendants may also engage in ALF, using funding to spread or transfer the risk of litigation to counsel or the finance company.[viii] Both types of ALF typically involve sophisticated parties capable of self-policing.

Notwithstanding these two types of ALF, the majority of controversy and debate involves consumer funding to individuals involved in personal injury litigation.

ALF THROUGHOUT HISTORY

Litigation funding is not an entirely new concept and has existed throughout history in the forms of "champerty" and "maintenance." The roots of champerty may be traced back to ancient Greek and Roman civilizations, and to the Middle Ages.[ix] The official doctrines of champerty and maintenance developed in English Common Law and likely migrated to the U.S. with early settlers.[x] These doctrines were developed -"to prevent officious intermeddlers from stirring up strife and contention by vexatious and speculative litigation which would disturb the peace of society, lead to corrupt practices, and prevent the remedial process of the law."[xi]

While outwardly similar, champerty and maintenance are markedly different. Maintenance involves a completely unrelated third party who "officiously meddles" in another's lawsuit by offering monetary assistance for his or her own personal gain.[xii] Champerty, while a form of maintenance, is most similar to modern contingent fee agreements and "involves an agreement between a party to a lawsuit and a completely disinterested third party, often an attorney, who agrees to finance the lawsuit in exchange for a percentage of the recovery."[xiii] As explained by the United States Supreme Court, "[p]ut simply, maintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome; and barratry is a continuing practice of maintenance or champerty."[xiv]

As society developed, so did the laws surrounding champerty and maintenance, and today none of the states adhere to the "rigor of the original champerty and maintenance doctrines."[xv] That being said, while all states today allow lawyers to enter into contingency fee agreements with client, many states frown upon one meddling in another's litigation. A recent study shows that 28 of 51 US jurisdictions explicitly permit champerty in some limited form; 28 states permit maintenance in some form, and 16 of these 28 states permit maintenance for profit.[xvi] Many states, including New Jersey, Connecticut and Massachusetts, no longer enforce the original common law doctrines since prohibitions against champerty and maintenance have been codified.

At the consumer level, these monetary advances are non-recourse loans, meaning plaintiff is only obligated to repay the lender if plaintiff successfully resolves his or her claim through settlement or trial. While states no longer follow the original champerty and maintenance doctrines, no state permits "officious meddling" in another's legal action. Whether or not the loan is officious turns on whether assistance was sought out, whether litigation was instigated by the lender, and whether the lender was acting in an officious manner in conjunction with the monetary loan.[xvii]

ALF first established itself as a viable business in Australia and then in the United Kingdom. U.S. investors adopted the concept of advancing money for personal injury claims and other consumer disputes in the late 1990s once litigation financing was determined to be a lucrative business venture.[xvii] Modern litigation funding, in its basic form, involves lending money to individual plaintiffs in exchange for a share of the money recovered through a favorable judgment. Although the practice has existed longer elsewhere, funding activity in the U.S. has certainly caught up to, if not surpassed, that of other countries.[xix]

ETHICAL CONSIDERATIONS

The Winter 2011 issue of the MIM Reporter discusses the ethical challenges of engaging in non-attorney law firm investing, highlighting an attorney's duty to maintain his or her professional judgment and the confidential information of his or her client as set forth in ABA Model Rules of Professional Conduct, Rule 5.4.[xx] So, too,

have questions been raised regarding whether ALF may co-exist with an attorney's ethical duties under the current Model Rules.

Rule 5.4 states in pertinent part that a lawyer or law firm shall not share legal fees with a non-lawyer, shall not form a partnership with a non-lawyer, and shall not permit a non-lawyer to direct or control the professional judgment of a lawyer, or compromise the lawyer's duty to maintain the confidential information of the client.[xxi] For example, Rule 5.4's prohibition against fee splitting would be implicated if a lawyer or law firm agrees to pay the ALF supplier out of its legal fees in exchange for advancing funds to the client or to the attorney. Similarly, Model Rule 1.6 states in pertinent part that, "a lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent" for the lawyer to do so, save for specifically enumerated circumstances set out in the Rule.[xxii] Similarly, under Model Rule 2.3(a), "[a] lawyer may provide an evaluation of a matter affecting a client for the use of someone other than the client if the lawyer reasonably believes that making the evaluation is compatible with other aspects of the lawyer's relationship with the client."[xxiii]

Furthermore, Model Rule 1.8 prohibits lawyers from "acquir[ing] a proprietary interest in the cause of action . . . the lawyer is conducting for the client. Rule 1.8 further provides that a third party may pay a client's legal fees only if information relating to the client's representation is protected to the extent required by Rule 1.6. To be sure, contingency fee agreements are specifically removed from the prohibitions outlined in Rule 1.8.

The funding industry is also conscious of the need for attorneys and non-attorneys alike to maintain ethical boundaries. The American Legal Finance Association (ALFA), the trade association that governs the activities of legal funding companies, has created a code of conduct that establishes best practices for the legal funding industry; all member lending companies are required to adhere to these best practices. A review of ALFA's code of conduct reveals that the funding industry's prescribed duties are substantially similar to the Model Rules. For example, ALFA's Code of Conduct provides, "to avoid compromising any privileges that are available with respect to a prospective client's claim, Funder may rely on the judgment of the claimant's lawyer. Nonetheless, Funder shall make clear that funder only desires to see non-privileged information, and funder shall seek to return any information funder receives that Funder considers to be privileged."

The ALFA Code prohibits members from interfering or participating in the prosecution or settlement of consumer litigation: "Each member agrees that their transaction with the consumer shall constitute the entire agreement between the member and the consumer. Each member agrees that they will not take any step to: Acquire ownership in the consumer's litigation; Interfere or participate in the consumer's litigation, and/or attempt to influence the consumer's litigation."[xxiv] Finally, with respect to fee sharing with attorneys, the ALFA Code states that, "[e]ach member agrees that they will not offer or pay commissions or referral fees to any attorney or employee of a law firm for referring a consumer to the member."[xxv]

Regardless of whether one is in favor of or opposed to ALF, there is a general agreement that ethical boundaries must be maintained and strictly adhered to in order for litigation involving ALF to be successful. The debate continues, though, on whether adherence is possible.

ARGUMENTS IN FAVOR OF ALF

The majority of ALF suppliers serve consumers and provide funding for those who may not otherwise have the means to pursue litigation – money is provided in the form of non-recourse loans and used by plaintiffs to pay rent or mortgage, medical bills, and generally survive financially during the pending litigation until recovery is secured. Those who support and embrace ALF assert that funding ensures that the justice system is accessible to all with little risk that courts will be flooded with new cases – funding is not advanced unless and until the funder reviews the plaintiff's case and determines that he or she has an actual, viable claim worthy of pursuit in court.[xxvi]

Initial case evaluations aside, opponents believe that ALF suppliers will meddle in the litigation itself, demand disclosure of confidential information against ethical prohibitions against doing so, and prevent expeditious case resolution. On the contrary, ALF supporters insist that there is no risk of ethical violations as ALFs do not ask for case-specific info. Funders point out that learning information protected by the attorney-client privilege may place the case at risk of waiving the privilege altogether, an undesirable result for all involved in the case. Funders minimize the risk of waiving this privilege by obtaining reports from their clients and separate reports from the lawyer handling the case.[xxvii] Counsel Financial, for example, only gathers information that is a matter of public record. Funders assert that they are merely "purchasing a financial stake in the litigation," and have no control over case decisions; to further support this assertion, many funders explicitly state in their lending agreements that they "disclaim any opportunity to make decisions concerning the litigation."[xxviii]

Supporters further argue that litigation funding is no different than cases where the defense is funded by an insurance carrier – the insurance company pays for a defense attorney to represent its insured and in turn demands status updates and drives settlement. In reality, though, the insurance company business model strives to minimize litigation; in other words, insurance companies make money when their insureds avoid litigation. As part of the insurance relationship, and in exchange for the insured's premium, the insurer assumes a duty to defend the insured in the event of a lawsuit and to pay any damages awarded against the insured up to the policy limits of liability.[xxix]

Still, even if the attorney-client privilege is preserved and due diligence performed, other issues arise in conjunction with ALF, such as misleading consumer advertising, inadequate disclosure of financing terms, and excessive finance charges on the money advanced.[xxx] Further, a rise in the number of companies providing funding, and a united front of plaintiff firms financing other plaintiff firms, only supports opponents' fears that ALF will gratuitously cause an upswing in newly filed litigation. Profit should not be the primary goal of the legal system.

PROS AND CONS OF ALF – THE DEFENSE PERSPECTIVE

As previously stated, ALF opponents are generally concerned that use of ALF will result in ethical violations. Violations may include allowing a third party to control the litigation and make decisions, or an attorney abandoning his or her own judgment in favor of the ALF company's judgment, consequently resulting in a waiver of the attorney-client privilege in any given case. Because the various laws and rules of professional conduct governing ALF are applied differently in each jurisdiction, it is not always abundantly clear what behaviors constitute an ethical violation.

Most attorneys who oppose ALF believe that it "threatens to chip away at – and eventually eradicate – critical safeguards against lawsuit abuse."[xxxi] Stated differently, unfettered access to the courts does not guarantee access to justice. Potentially unlimited funding may also increase the number of meritless claims, which will force companies to spend much more on litigation defense than budgeted. In response, supporters of ALF suggest that, if ALF assists those otherwise without means to litigate to file suit and defendants fear increased litigation expenses, ALF should deter defendant behavior that leads to lawsuits, thus decreasing the number of new filings.[xxxii]

Proponents of ALF have argued that ALF may actually improve the current volume of pending cases across all jurisdictions by weeding out "bad" cases and controlling frivolous, meritless suits. Investor accountability would force litigants to handle cases in a more streamlined manner – for example, the American Legal Finance Association recommends that member companies only provide plaintiff funding if the plaintiff has a legitimate claim and is represented by an attorney.[xxiii] On the contrary, opponents fear that the practice may muddy the waters and drag out litigation because plaintiffs have to answer to investors.

In addition to attorney-opposition, consumers who decide to conduct business with an ALF provider have found that, although funding is advertised as beneficial, such is not always the case. Plaintiffs have reported that advertised advancement amounts are not as large as promised, and that exorbitant interest rates are charged in exchange for a monetary advancement.[xxiv] ALF funders tout convenience, not pricing or finance terms, as a way to lure would-be plaintiffs. Repayment is often due on demand without any room for negotiation. Basically, any benefit plaintiffs may immediately receive from ALF money is quickly lost upon repayment of the ALF advancement.

The following illustrates why a growing number of consumers are hesitant to support ALF: Vioxx plaintiff Larry Long was facing eviction from his home while waiting for settlement of his claims, so he borrowed $9,150 from Oasis Legal Finance with an agreement to repay Oasis from his winnings. Mr. Long received an initial settlement payment of $27,000 18 months after borrowing from Oasis, but at the time of settlement already owed Oasis $23,588 in principle, interest and fees. Mr. Long's contract with Oasis imposed standard pricing: 50 percent of the loan amount is owed if repayment is made within six months, with regular increases thereafter. While Oasis claimed it clearly explained the terms of the advancement to the Longs, Mrs. Long stated that Oasis capitalized and profited from the Longs' crisis – "they take advantage of people that are in need."[xxxv]

CONCLUSION

As evidenced by radio and TV advertising, and by the attention it has received from both proponents and critics, ALF is gaining popularity. Crafting one-size-fits-all policies and rules may not be possible at this point, though, since ALF operates differently based on the entity being financed, and the actual effects of ALF on the judicial system are still unknown.

Although the ABA Commission on Ethics has not officially issued guidance or completed its investigation, it has concluded that the current rules of professional conduct do not need to be revised to account for ALF. Practitioners should review the ABA Commission's draft white paper as guidance on how to balance ALF with what conduct is demanded of attorneys by the Rules of Professional Conduct before delving into a case where ALF is in use.

Defense counsel are wise to ensure discovery requests ask questions designed to reveal whether ALF is in use and the terms of the arrangement, and to incorporate this information into the defense's strategy. Practitioners should also educate one's self about ALF companies' processes. Education is the key to identifying and avoiding the potential litigation issues highlighted above so same may be immediately raised to the court if necessary.

ENDNOTES

I. National Lawsuit Funding. June 23, 2011. March 30, 2012. www.nationallawsuit funding.com.
II. Id.
III. Commission on Ethics 20/20. "White Paper on Alternative Litigation Finance." American Bar Association. October 19, 2011. December 1, 2011. http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111019_draft_alf_white_paper_posting.authcheckdam.pdf.
IV. ALF has been referred to as "third-party financing," but this phrase incorrectly defines ALF because the non-party ALF funder is neither plaintiff's counsel nor the defendant's insurer. See Garber, Steven, "Alternative Litigation Financing in the United States: Issues, Knowns, and Unknowns," *infra.*

v. Your ABA. "Financing a law practice: lawsuit funding, business incubators, more." American Bar Association. April 2012. March 28, 2012. http://www.americanbar.org/newsletter/publications/youraba/201204article06.html.

vi. Counsel Financial. March 6, 2012. March 29, 2012. http://attorneylending.com/services.

vii. Garber, Steven. "Alternative Litigation Financing in the United States: Issues, Knowns, and Unknowns." RAND Corporation, 2010. December 15, 2011. http://www.rand.org/pubs/occasional_papers/OP306.

viii. Id.

ix. *Elliott Associates. L.P. v. Banco de la Nacion,* 194 F.3d 363, 372 (2d Cir.1999).

x. 14 Am.Jur.2d Champerty and Maintenance 1 (1964).

xi. 14 Corpus Juris Secondum (1991), Champerty and Maintenance, Section 3. See also *Bluebird Partners, L.P. v. First Fid. Bank, N.A.*, 94 N.Y.2d 726 (2000).

xii. "Maintenance." Black's Law Dictionary (2nd ed. 1910). http://thelawdictionary.org/maintenance-2/.

xiii. "Champerty." Black's Law Dictionary 2nd ed. 1910). http://thelawdictionary.org/champerty/.

xiv. *In re Primus,* 436 U.S. 412, 424 n.15, 98 S.Ct. 1893 (1978).

xv. 14 Corpus Juris Secondum, Champerty and Maintenance, Section 3 (1991).

xvi. Garber, Steven. "Alternative Litigation Financing in the United States: Issues, Knowns, and Unknowns," supra.

xvii. Id.

xviii. New York City Bar Association. "Third Party Litigation Financing." Formal Opinion 2011-02. June 2011. December 15, 2011. http://www.nycbar.org/ethics/ethics-opinions-local/2011-opinions.

xix. Banzaca, Jennifer. "Litigation Funding: In Turbulent Markets, Hedge Fund Managers Turn to Litigation Funding for Absolute, Uncorrelated Returns." The Hedge Fund Law Report. June 24, 2009. November 11, 2011. www.hflawreport.com.

xx. Medical Information Management, "Survival of the Financially Backed, Not Necessarily the Fittest." Litigation Management, Inc. Winter 2011 Issue.

xxi. ABA Model Rules Prof. Conduct 5.4 (2010).

xxii. ABA Model Rules Prof. Conduct 1.6 (2010).

xxiii. ABA Model Rules Prof. Conduct 2.3 (2010).

xxiv. American Legal Financial Association. "Industry Best Practices - ALFA's Code of Conduct." March 6, 2012. March 29, 2012. http://www.americanlegalfin.com/IndustryBestPractices.asp.

xxv. Id.

xxvi. Working Group on Alternative Litigation Finance. "Comments: Working Group on Alternative Litigation Finance, White Paper on Alternative Litigation Finance." American Bar Association. November 28, 2011. December 15, 2011. http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111128-alf_white_paper_comments_all.authcheckdam.pdf.

xxvii. Banzaca, Jennifer. "Litigation Funding: In Turbulent Markets, Hedge Fund Managers Turn to Litigation Funding for Absolute, Uncorrelated Returns," *supra*.

xxviii. Id.

xxix. Am. Jur. 2d *Insurance* §§ 1384 (describing insurance defense), 1396 (describing the duty to defend); Beisner, John. "Issues Paper Concerning Lawyers' Involvement in Alternative Litigation Financing." ABA Commission on Ethics 20/20. February 15, 2011. September 7, 2011. http://www.americanbar.org/content/dam/aba/migrated/2011_build/ethics_2020/comments_on_alternative_litigation_financing_issues_paper.authcheckdam.pdf.

xxx. Commission on Ethics 20/20. "White Paper on Alternative Litigation Finance," supra.

xxxi. Beisner, John. "Issues Paper Concerning Lawyers' Involvement in Alternative Litigation Financing," supra.

xxxii. Garber, Steven. "Alternative Litigation Financing in the United States: Issues, Knowns, and Unknowns," *supra*.

xxxiii. Working Group on Alternative Litigation Finance. "Comments: Working Group on Alternative Litigation Finance, White Paper on Alternative Litigation Finance," *supra*.

xxxiv. Garber, Steven. "Alternative Litigation Financing in the United States: Issues, Knowns, and Unknowns," supra.

xxxv. Appelbaum, Binyamin. "Lawsuit Loans Add New Risk for the Injured." The New York Times. January 17, 2011. December 15, 2011. http://www.nytimes.com/2011/01/17/business/17lawsuit.html?_r=1&scp=3&sq=Lawsuit%20Loans&st=cse.