

# Legal Funding Gains Steam But Doubts Linger

By Anne Urda

Law360, New York (August 27, 2008) -- Still in its infancy, the legal funding industry has been gaining more acceptance, but doubts persist over whether the practice of advancing plaintiffs and businesses part of an expected settlement could lead to exploitation and fraud.

Not that long ago, people looked askance at the relatively unknown industry, but today business is booming, according to Gary Chodes, founder of Oasis Legal Finance, one of the top companies in the litigation funding arena.

“Five years ago, legal funding was pretty obscure,” he said. “Now it has emerged to a point where it is becoming more of a mainstream practice.”

With the economy's current nosedive, consumers and businesses alike are turning to legal funding as a means to survive while embroiled in litigation.

“The legal process can be difficult to understand and can go on for months and years,” Chodes said. “Many of the consumers are financially distressed.”

Companies like Oasis step in and provide money so that consumers do not get evicted and corporations do not fall behind on their massive legal fees.

“Things are tougher on the family now, and there are fewer credit options,” he said. “If anything, we will grow more in this type of environment; there is certainly not a slowdown.”

For businesses, Oasis can be a real lifeboat, with companies wrapped up in commercial litigation in the intellectual property, product liability and workers' compensation realms in particular these days.

“This is a very different legal community as are the kinds of reasons these plaintiffs are looking for money,” Chodes said. “In most cases, they are paying lawyers by the hour. Those costs are material and have an impact on litigation strategy.”

The money is also used to keep operations afloat, with the deals more structured than in a consumer litigation type of arrangement.

“It is a novel way to reduce the direct costs of the litigation budget to pursue affirmative cases while still having the full choice of counsel,” said Tim Hart, vice president of financial and economic consulting for Huron Consulting Group. “This can be particularly important in periods with strong companywide budget pressures and in periods when defense costs are high and might cause general counsel to forego valuable claims, as that spending is discretionary.”

But legal funders' motives are not purely altruistic, Chodes said.

“We are a business, and we get a return,” Chodes said. “But we are giving something that the banking system won't provide. There are not alternatives that don't involve pure debt and you only pay it back if the case was successful.”

Oasis and its competitors only advance 10 to 15 percent of the likely settlement so as not to leave the plaintiff with nothing at the end.

“This [financing] provides consumers with a windfall that allows them to stay in the game and get a reasonable settlement,” he said. “They might take something small to make the car payment or pay the rent. The benefits are very easy to see.”

Hart hailed the legal funding practice as a good way for litigants to manage their risks.

“A client with a strong claim but limited budget can now choose the lawyers they want to use and pay their market rates rather than needing to use a firm willing to take a contingent fee arrangement,” he said.

Legal funding is also a boon to law firms, helping them to keep a stable client base, according to Hart.

“For law firms, legal funding can provide a group of clients who could not or would not pay their rates as well as a source of funds to increase the number of cases they might take on partial contingency,” he said.

But despite all the benefits, legal funding is not without its risks, according to Chodes.

“Twenty to 30 percent of the time, we experience some kind of loss,” he said. “There is a material amount of risk that is similar to lawyers that take fees on a contingency basis.”

Hart maintained that there were other pitfalls as well, including clients having to relinquish some decision-making authority to the funder.

“Much like dealing with an insurer, the client gives up some of their decision-making ability, and as a case progresses, the client's interests may diverge from the funder in that other business reasons may suggest that they might settle a claim for less than the funder has targeted,” he said.

The attorneys involved in the case may also resent having another cook in the kitchen, according to Hart.

But Chodes maintained that legal financiers have come a long way in terms of earning the respect of lawyers, who now often refer clients to Oasis and other places for emergency funding.

That kind of cooperation, though, has led some to speculate that the legal funders and lawyers may be in bed with each other, which could trigger an avalanche of litigation over these types of arrangements.

“It is fairly new and interesting how this works,” a consultant said on condition of anonymity. “I can foresee many suits about this whole process.”

Though he painted a rosy picture of legal funding today, Chodes admitted that the practice was not always viewed in the most favorable light.

“The concept of giving you money in exchange for some portion of the outcome has been around for a 100 years but it's been done in an informal way,” he said. “The industry as a business has only been around for five years and there hasn't been a lot of case law in this area.”

Years ago, though, an adverse case involving an early player in the legal funding industry prompted Ohio to ban the practice altogether, with the state finally reversing course this month.

“Ohio took a harsh stand due to the circumstances that occurred in that particular case,” he said. “The impact of that case being out there is that there are higher standards now.”

The dubious player is now no longer part of the practice, and the legal funding companies that exist today have worked hard to counteract the tainted reputation created by that case, according to Chodes.

Oasis and 14 others in the lawsuit funding business established the American Legal Finance Association in 2004 in hopes of self-policing the industry.

“After we formed a trade association we needed to create a set of best practices,” he said. “It isn't a regulatory scheme but a basic kinds of protections contract.”

For example, a lawyer must sign off on the transaction, which helps ensure that the consumer or the business is protected.

“I believe that the arrangements can be crafted in a manner that is fair and balanced for the client and for the funder,” Hart said.

The Ohio State Legislature recently took note, passing a bill that endorses the association's best practices initiative and welcomes the industry into the fold.

“The Legislature felt that it was an important service for consumers to have access to in Ohio, and they gave it important consideration,” Chodes said. “Maybe in the beginning, the legal funding industry did not have the best practices, but we are a different set of companies now.”