

# Professional Liability

COMMENTARY

REPRINTED FROM VOLUME 17, ISSUE 6 / NOVEMBER 2007

## Four Myths About Legal Funding

By Gary Chodes

Legal funding is the fastest-emerging financial trend in the U.S. justice system. With industry leaders currently reviewing more than 40,000 funding applications per month, legal funding has risen from relative obscurity five years ago to be at the forefront of marketplace solutions for attorneys and their clients.

Yet despite the undeniable foothold it has gained in the legal system, several myths about legal funding persist. Although some of these myths are rooted in problems that existed when legal funding first appeared on the scene, others circulate throughout the legal community with no factual basis to support them.

With legal funding growing at an exponential rate, the time for separating fact from fiction is long overdue.

### Myth #1: Legal Funding Exploits Plaintiffs

One of the most common misconceptions about legal funding is that it exploits vulnerable plaintiffs at a time when they are least able to make informed decisions. This myth is especially prevalent among attorneys who are concerned that unscrupulous lenders might use their clients' situations for unfair advantage.

In reality, legal funding provides an escape hatch for people who have been backed into a financial corner by a combination of circumstances and the slow wheels of the legal process.

A prototypical recipient of an advance from Oasis Legal Finance is a working mom: a single-parent head-of-household living paycheck-to-paycheck with no savings.

Given the lack of any financial cushion, an accident can easily result in a financial downward spiral. While legal fees are handled on contingency, addressing basic living expenses presents a significant challenge to many plaintiffs.

With legal funding, a modest advance for living expenses provides relief from accumulating bills, potential eviction or foreclosure, and keeps food on the table for the client and her family.

Rather than exploiting vulnerable plaintiffs, legal funding acts as a safety net for people who don't have the resources to withstand prolonged litigation on their own. Without third-party funding, a difficult financial situation would likely deteriorate into a total financial disaster.

### Myth #2: Legal Funding Is a Loan

It's understandable why many people confuse legal funding with loans. On the surface, legal funding appears to possess the same characteristics as an unsecured loan with a traditional lender.

In actuality, legal funding is very different from traditional loans and other credit alternatives.

The principal difference is that loans always need to be paid back and generally require monthly payments. This is simply not the case with legal funding advances.

In the past, plaintiffs who were not aware of legal funding often turned to credit cards and personal loans to cover living-expense shortfalls while they waited for litigation to be resolved. Regardless of whether the lawsuit was successful, the plaintiff was still required to repay the debt and deal with the heavy burden of monthly payments on principle and interest.

In many instances this personal debt did little to alleviate plaintiffs' financial pressures. Instead, the loans increased the plaintiffs' personal finance problems. With mounting personal debts, many plaintiffs ended up in a significantly worse financial condition than they were in before they filed the lawsuit.

In contrast, with legal funding, a cash-strapped client submits an application to a funder and, if approved, receives a cash advance. There are no payments of any kind until the case settles, which could take months or years.

In a legal funding arrangement, repayment of an advance is only required if the client's lawsuit is successful. If the suit is not successful for any reason, everyone goes their separate ways and the client's obligation to repay the cash advance simply disappears.

Legal funding companies are for-profit operations, so it's not surprising that they charge fees on their investment. But in stark contrast to traditional lenders, the total fee is often capped after a specified time period, so the plaintiff doesn't feel undue pressure to settle the case early.

Because legal funding advances are not debt and are not reported to the credit bureaus, client credit ratings cannot be adversely affected if they obtain a legal funding advance.

Moreover, the underwriting of legal funding advances is based on the merits of the lawsuit. In contrast, banks do not recognize lawsuits as assets when determining an individual's qualification for a traditional loan. As such, many plaintiffs that may not qualify for traditional credit can qualify for legal funding.

The bottom line? Legal funding is not a loan. Rather, it is non-recourse debt that need not be paid back unless the plaintiff is successful in his or her lawsuit.

### **Myth #3: Funding Firms Interfere With the Legal Process**

Attorneys are sometimes hesitant to recommend legal funding to their clients based on the myth that funding companies interfere with the legal process.

The fear is that once a plaintiff engages the services of a legal funder, the funder will exert pressure on the attorney to settle the case and repay the funding advance.

In reality, funding companies never get involved with the case. All legal strategy and settlement decisions are made by the lawyer and his or her client.

Best practices defined by the American Legal Finance Association, an industry trade group, reinforce this strict practice of non-interference, and it is also being codified into an emerging legislative framework for regulating legal funding companies.

### **Myth #4: The Legal Funding Industry Is Largely Unregulated and Open to Abuse**

When legal funding was in its infancy, regulation and oversight were sorely lacking in the industry. These days, however, legal funding is becoming an increasingly

regulated industry, with practices designed to protect plaintiffs' best interests.

ALFA is leading the way in establishing the highest standards and a set of business practice principles for the legal funding industry.

In the past several years the trade association has made significant progress in promoting regulatory practices across the country. Four years ago, ALFA worked with then-New York Attorney General Eliot Spitzer to establish a set of best practices for legal funding companies operating in New York.

In 2007 this agreement was used as the basis for legislation in Maine, making the state the first in the country to formally regulate the industry.

Although the Maine legislation is expected to serve as a model for similar legislation in other states, ALFA requires its members to adhere to all the conditions of Spitzer's agreement, including full disclosure to clients, a five-day cancellation period and written review of agreements by an attorney.

### **Implications for Attorneys**

For attorneys, legal funding can alleviate client financial stress, which is often a burdensome distraction. More importantly, by helping clients with living expenses, a legal funding advance can buy attorneys extra time to fight for a fair and often larger settlement.

To be sure, many of your clients will undoubtedly experience personal financial challenges while engaging your services. As a lawyer, you need to become educated on legal funding as an option so you can counsel clients on this new financing alternative relative to other options.

Indeed, many clients will seek out legal funding on their own, in which case you will be brought into the process even if you do not proactively recommend legal funding to your clients.

By understanding the basics of legal funding — and with the knowledge to separate legal funding fact from fiction — you will be better prepared to serve your clients.

Further information about the legal funding process and the industry's best practices can be found at:

- Oasis Legal Finance: [www.OasisLegal.com](http://www.OasisLegal.com)
- American Legal Finance Association: [www.AmericanLegalFin.com](http://www.AmericanLegalFin.com)

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