Alternative Litigation Finance, Part 1: The Waiting Game—The Economics of a Fiduciary Litigation Practice

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A Practitioner’s Dilemma

Trust and estate litigators often struggle with one critical aspect of a successful practice—getting paid.

Although payment is a common cause of distress for many (if not all) lawyers, obtaining timely and consistent payment of monthly bills is particularly challenging for litigators with trust and estate cases. The reasons are numerous: illiquid estate assets, a recalcitrant personal representative, outstanding trust or estate liabilities, disputes with the IRS, or perhaps pending litigation or required court approvals. Each of these can cause major delays or total roadblocks in receiving distributions from the trust or estate to pay legal fees. Or, perhaps a beneficiary wishes to bring a contest in a jurisdiction where the trust or estate corpus cannot be used for legal fees until the claims are proven. Often the beneficiary is entitled to an eventual disbursement of trust or estate funds, even if the litigation is unsuccessful, but in the short term the contest results in an inability to pay fees for the litigation work.

Whether to take on this “I can pay you, just not yet” client—even one with strong claims—can be a difficult decision. A more troublesome quandary is determining the best course of action when faced with a client who was paying your bills but is no longer able or comfortable doing so. All too often, meritorious claims go stale, beneficiaries remain at the mercy of bad fiduciaries, parties settle unfavorably, or attorneys begin the practice of carrying a balance for the client.

The challenge of fee-payment in this area is exacerbated by the fact that trust and estate disputes often can be as expensive for the parties as an average commercial litigation (if not more expensive because of the attendant emotional aspects and the testimonial nature of evidence required). Further, legal bills are paid by individuals and families, rather than corporations with insurance and litigation reserves. While plaintiffs in general commercial and consumer litigation have an immense array of alternatives for litigation funding, until fairly recently the trusts and estates bar was left without many choices.
Alternative litigation finance (ALF) generally refers to companies that fund litigation fees and costs up-front in exchange for a fee. ALF has existed for decades but in recent years has become an increasingly common practice in the United States. Traditionally, these companies have financed either commercial or consumer civil litigation, often fronting significant costs for plaintiffs or their attorneys, such as for filing fees, court reporters, investigators, and experts. Options specifically designed for financing trust and estate litigation, however, have emerged as extremely useful tools for clients and attorneys in this area.

**What Is Alternative Litigation Finance?**
The structure of a litigation finance deal can vary significantly depending on the type of case, the company involved, the stage of the case when funding is sought, the amount of money requested, and many other factors. At its core, though, ALF is the advancement of funds to attorneys or clients by a third-party company to pay legal fees and costs related to litigation.

In general, a litigation funder makes a return on the funds, whether through interest earned over the life of the advance, a multiple of the advanced amount, or a percentage of the recovery paid to the client at the conclusion of the matter. The transaction is typically nonrecourse, meaning the company only recovers to the extent that the client recovers. The funder does not look to the client’s other assets, beyond the settlement or judgment, to satisfy the repayment of the funds. In some circumstances, however, the client may offer additional collateral to secure the amount needed.

Because of the prevalence of third-party litigation finance in other areas, there is a great deal of existing scholarship on litigation finance generally. For instance, the American Bar Association Commission on Ethics 20/20 issued a detailed White Paper on Alternative Litigation Finance that overviews the issue and discusses a number of the ethical issues at play in these arrangements. ABA Comm. on Ethics 20/20, *White Paper on Alternative Litigation Finance* (Feb. 2012), [www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf). Practitioners considering ALF are strongly encouraged to consult relevant state bar opinions as well.

**Champerty—Putting Historical Notions to Bed**
Champerty—an ancient legal doctrine dating back hundreds of years—is an “[a]greement to divide litigation proceeds between the owner of the litigated claim and a party unrelated to the lawsuit who supports or helps enforce the claim.” *Black’s Law Dictionary* (10th ed. 2014). Historically, champerty was disfavored by courts as encouraging frivolous litigation and therefore banned. With the development of modern ethics laws, however, many courts have found champerty outdated and inapplicable, which has allowed for expansive growth in the ALF industry.

**The Emergence of Trust and Estate ALF**
Although traditional ALF has been largely confined to either consumer or commercial litigation for much of the past two decades, another form of quasi-financing has been available specifically to trusts and estates clients—the inheritance advance, a distant cousin to ALF. Companies often advance modest sums to heirs who have cases in probate (typically $25,000 or less), usually with a promise of a quick
turnaround (some companies claim to make the advance within 24 hours of submitting an application). These heirs are looking to realize some of the money tied up in probate. Although the heirs might use some or all of this money for legal costs and fees, these advances are not specifically designed or intended for the costs and fees necessary to fund a large, hard-fought litigation matter.

Litigation funders have now moved to fill the gap in the market for financing large trust and estate cases. Such funders necessarily consider trust and estate matters on a case-by-case basis, and if financing is supported, the client enters into a funding transaction whereby the legal fees will be paid to the attorney over the course of the litigation. Depending on the funder, no monthly payments are required from the client, and the funder is repaid when the case is resolved.

With such financing in place, the attorney and client are assured that all legal bills will be timely paid throughout the entire course of the litigation until resolution and asset liquidation. Accordingly, the time risk of “when will I get paid” is removed from the client and attorney, as the funder shifts and absorbs that risk.

**Trust and Estate Cases in Which ALF May Make Sense**

ALF can be a useful option for a wide variety of trust and estate cases. One common scenario is when the personal representative delays distributions to a client. This may be because the trust or estate has uncertain liabilities because of pending litigation or audit. Although the beneficiary may have an immediate need for these funds because of financial demands or age, the ultimate determination of the total liabilities could be months or even years away, resulting in prolonged delays. ALF can offer a way to pay legal fees through an advance of these funds.

Another common scenario involves the personal representative using estate funds as a “war chest” to discourage litigation by the beneficiaries or to extract concessions from them. Similarly, a beneficiary may wish to bring a contest that will result in an eventual award of funds, even if unsuccessful, but, in the short term, results in an inability to fund the litigation.

In the past, these beneficiaries would have been entirely dependent on gathering sufficient personal resources, or awaiting the distribution of funds from the trust or estate, in order to hire a lawyer to pursue their claims. Others must find an attorney willing to take the matter on a contingency fee basis. Thus, many personal representatives could afford to simply delay the proceedings until a beneficiary ran out of money or otherwise became desperate for funds. ALF places the beneficiary on more equal financial footing. Ideally, this results in fewer claims going stale and provides a disincentive to bad fiduciary conduct.

**Ethical Considerations**

The use of ALF requires the consideration of a number of important ethical issues during the negotiation of the financing contract and during the pendency of the litigation. Practitioners should pay close attention to the practices and procedures of the funder involved to make sure they are in line with the practitioner’s obligations to the client. Because of the complexity of many issues, these issues are only surveyed here and will be discussed more comprehensively in Part 2 of this article in the November/December issue.

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**Negotiating the Contract**

Financial Assistance to the Client? Among jurisdictions that have considered the issue, an attorney who assists a client in receiving funding from a third party is not considered to have provided impermissible financial assistance to a client, unless of course the lawyer also takes an interest, which would be impermissible. See Model Rules of Professional Conduct Rule 1.8(i); see also ABA White Paper, at 21–22.

**Referral Issues.** An attorney has an obligation to provide impartial advice to the client, to be loyal to the client, and to avoid conflicts of interest. Model Rules 1.7; 1.8. As a result, an attorney can run afoul of these rules if he or she receives a referral fee in exchange for referring a client to a particular litigation finance company. In such instances, the attorney must disclose this information to the client and receive the client’s informed consent.

Even when a fee is not received, but the attorney consistently works with the same litigation finance provider, the ABA has suggested that disclosure of this information to the client is desirable and, in some cases, may be required. See ABA White Paper, at 18.

**The Agreement.** The preferable arrangement, from both the attorney and the funder perspective, is that the terms of the agreement be negotiated directly between the client and the funder. It is seen as a best practice for the client to engage independent counsel or, at a minimum, be informed that the use of independent counsel is advisable, so that the funding agreement can be drafted and executed separate and apart from the attorney’s representation on the litigation matter. The scope of the attorney’s representation should be made clear to the client in the engagement letter. This serves to insulate the attorney from liability in the event of a later disagreement between the client and the funder. See *Client Funding Solutions Corp. v. Crim*, 943 F. Supp. 2d 849 (N.D. Ill. 2013).

As with anything, however, bad actors abound. Therefore, attorneys must be attentive to the credentials of the particular ALF company and the funder’s practices and procedures, as well as its financial integrity.

**Conducting the Litigation**

**Preserving Client Confidences.** Attorneys have a duty to prevent the disclosure of the client’s confidential information and to safeguard against the waiver of the attorney-client privilege and attorney work product. Model Rule 1.6. These duties have the potential to conflict, however, with the need to provide sufficient information to make an ALF funder comfortable in underwriting an ALF transaction.

Although responsible funders are sensitive to issues of privilege and confidentiality and will not seek to review information that would cause a waiver, only filed documents, pleadings, and other nonconfidential information should be provided to the ALF provider. In addition, at the outset of a new matter, a confidentiality agreement between the funder, the client, and the attorney should be executed to provide the express recognition that any nonprivileged, but confidential, information that is shared is done so with the intent to maintain its confidential nature. This can provide further protection for the client. See generally *Miller UK Ltd. v Caterpillar, Inc.*, 17 F. Supp. 3d 711, 736–37 (N.D. Ill. 2014) (holding no waiver for disclosing attorney-work product to litigation funder).
The safest practice is for the practitioner to assume that anything provided to the funder will later be discoverable. And, even in instances when only nonconfidential information is being shared, the attorney should obtain the client’s informed consent, as required under applicable ethics rules.

**Maintaining Professional Independence.** Attorneys have a duty to base their advice and strategy solely on what is best for the client and ensure professional independence at all times. The ABA has suggested, however, that between the funder and the client, matters such as control over settlement, the hiring and firing of counsel, or other strategy decisions can properly be the subject of negotiation. ABA White Paper, at 25. This can lead to murky questions about who is the client in such situations. It is advisable to inquire about the funder’s policies and practices in this regard so expectations are clear from the outset.

As a practical matter, whether it is technically permissible ethically, if the attorney feels that his or her professional independence is being compromised, the attorney should avoid the representation or withdraw.

**How a Client Gets a Matter Funded**

Every application for financing—just like every new litigation matter—presents specific facts and legal arguments that inform the analysis of that case. The client’s claims, the amount of assets in the trust or estate, the jurisdiction, and the operative documents will all be considered and evaluated.

Trust and estate clients may find that determining how to fund their litigation is a gating issue to initiating a lawsuit or signing the engagement agreement. After the funder does its own initial assessment, it works in conjunction with the client to assure its counsel of choice that the bills will be paid going forward.

More often, a client has already retained counsel, and the litigation has been ongoing for any number of months or years before the client seeks litigation financing. Already having an outstanding fee balance, the client then seeks out a funder. The attorney and client are looking to alleviate that burden on the attorney-client relationship and to allow the attorney to continue pursuing the client’s case. In those cases, the funder can review all the filed pleadings, written discovery produced, and available deposition testimony to evaluate the matter.

In evaluating a trust or estate litigation for funding, in either of the above scenarios, first and foremost a funder should see that its financing supports strong, valid claims or defenses. The funder should make an independent analysis of the available court pleadings and estate planning documents, and if the legal grounds are supported by the law and facts, the funder can align its interests with the client’s and use its capital to support the case.
Certainly, the operative estate planning instruments are central to a funding analysis. When a matter is considered, the funder analyzes the documents to determine the client’s vested interest and rights under the plan, as well as any clauses that might be decisive in the ability to receive funding. For example, anti-assignment and in terrorem clauses will be reviewed in light of the relevant jurisdiction’s legal framework for the case. These issues are always decided on a case-by-case basis.

An evaluation of the trust and estate assets is also crucial to the matter being funded. Any conceivable property in the trust or estate that can be valued and is capable of liquidation can be used to support litigation fee financing.

Although the assets of the trust or estate do not need to be immediately liquid and the funder will wait until the ultimate resolution, disbursement, and sale, the assets must ultimately support repayment.

Once a client’s economic framework has been approved, the client is then asked to assign to the funder the portion of the case proceeds that have been obligated for payment of the legal fees. Typically, a funder will not lien or encumber any of the client’s other assets—this is a crucial difference between litigation financing arrangements and other lenders. If, for whatever reason, a client ends up receiving nothing of value in the case (for example, the value of an asset has diminished), the funder has no recourse to any of the client’s other assets. This is part of the risk that is eliminated for the law firm, which otherwise might find itself financing the client’s unpaid bill.

Another critical inquiry when considering a matter is the counsel who has or will be retained by the client. Because the funder is only repaid on the resolution of the matter, it is critical that the matter be pursued with vigor and professional responsibility. Although the client is the client for the purpose of the litigation funding, the purpose is to fund the attorney’s fees. As such, the attorney is asked to warrant that he or she will abide by the applicable rules of professional responsibility.

Using a funder that is experienced in this area is important to assure that current or future issues do not get overlooked and cause an unnecessary problem later. Expertise in trust and estate litigation, in particular, can be essential to a funder’s understanding the specific intricacies of financing in this area, as opposed to general litigation financing.

Conclusion
ALF is available as an option and increasingly common in trust and estate litigation. Beneficiaries have a tool to gain immediate access to funds, pursue meritorious claims, and keep bad fiduciary behavior in check. While keeping in mind that each funder is different and that it is an attorney’s duty to maintain professional and ethical obligations to the client, in appropriate cases attorneys will be well served to consider these arrangements as a tool to benefit their clients and mitigate some of the risk that has historically played an outsized role in trust and estate litigation matters.