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Third party litigation funding (2) 1/41/22

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As stated in the conclusion of the first instalment of this article, foreign markets offer various litigation funding models. In addition to the model we analysed before, where the claimant's litigation is funded by an institutional litigation funder – an investment fund specialised in litigation funding, in this article we are looking at available alternatives. This overview covers some of the less familiar and sometimes unusual sources of litigation finance whose successful use would reduce the number of cases where a lack of finance limits the legal remedies available to a litigant.

Legal crowdsourcing

While crowdsourcing is traditionally associated with raising start-up capital to develop business ideas via online platforms, there are no practical obstacles to applying the same funding model to a legal claim that is financed as an investment target.

Under the legal crowdsourcing model, the claimant puts out a public notice of his intention to take legal action and presents his position to a wide public range of private funders (retail investors). Private funders read this information and pay some of the required finance to the potential claimant, acquiring the right to some of the benefit to be had from a successful lawsuit. At the same time, the private investors take the risk that the lawsuit may not achieve the desired result. So this model is not fundamentally different from the third-party litigation funding model with an institutional fund we looked at in the first instalment of this article.

The main differences lie in the funder's structure. In the case of crowdsourcing, litigation is financed by a large number of private investors, each of whom provides the claimant with a small portion of the amount required to finance the litigation. In the case of an institutional investor, all the required finance comes from one or a few investors. The legal crowdsourcing model is successfully implemented by several online platforms, including LexShares, which operates in the US as a middleman between private investors and claimants.

Crowdsourcing often takes the form of a charitable action, for example if the wrong has been made known to the public and the claimant finances the lawsuit out of donations.[1] This can be seen in Latvia, too, where donations (including to finance litigation expenses) are accepted by *Sabiedrība par atklātību – Delna*, for instance.[2]

A litigation fund

Small and medium companies may become defendants in a lawsuit and be unable to cover all litigation expenses on their own. This risk can be mitigated by a joint litigation fund that several companies set up for cases where one of the fund members becomes the defendant and/or claimant in a lawsuit.

Although the litigation fund as a source of finance was historically created to protect human rights, this litigation funding model can be efficiently used by private companies, especially in sectors with a high risk of litigation.

A success fee

There is also a litigation funding model that involves a litigant agreeing on a success fee with a provider of legal assistance. This means that the claimant or the defendant receives free legal assistance and only pays some of the benefit obtained (e.g. 10% of the recovered debt or damages received by a court order) to the provider of legal assistance if the outcome of the lawsuit is financially successful.

The success fee model in fact works in a similar way to the traditional third-party funding model where the funder is an investment fund. No fund is involved here, though, and the investing is done by the provider of legal assistance, who devotes their time and staff to the litigation and receives no remuneration if the outcome of the lawsuit is unsuccessful.

A success fee is the most common of the funding models explored in this article.

Litigation (legal expenses) insurance

Finally we should mention legal expenses insurance as an alternative source of litigation funding. As the name of this insurance product suggests, the risk this contract insures is expenses the insured may incur in litigation.

Insurance as a litigation finance model is similar to a litigation fund in that funding here is not provided for a particular lawsuit but is rather accumulated before legal action is brought. Unlike a litigation fund, the finance recipient pays a premium to the insurance company, rather than making a contribution to a joint fund, even though the funding is not always used up and expenses form a small portion of the available funding in either case. Also, litigation under the insurance model is funded by a third party, rather than by a party to the lawsuit out of their own pocket.

Publicly available information suggests that Latvian insurers, too, offer such an insurance product.

Conclusion

A litigant does not always have to finance the lawsuit out of their own pocket because the market has various litigation funding models available where litigation can be financed by a third party.

Before any funding is awarded/received, it is advisable for the litigation funder and the finance recipient to hire experienced and knowledgeable experts who will advise you and monitor the economic substance and risks of your transaction, as well as making sure you do not forget about legal considerations and applicable law.

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[1]For example, D. Nakamoto sued Newsweek for damages after it wrongly claimed he was the founder of Bitcoin. The action was funded by publicly donated bitcoins worth USD 23,000. See PC World. Dorian Nakamoto prepares for possible lawsuit against Newsweek. 13 October 2014

[2]*Delna*, Transparency International's Latvian chapter. *Delna uzsāk ziedošanas kampaņu.* 25 September 2019