Litigation Alert

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Despite Its Allure, Litigation Funding is Just 'The Cost of Doing Business' for Class Counsel

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Key Points

- A federal district court rejected a novel request from class counsel for reimbursement of counsel's litigation funding expenses. According to the court in *Perez v. Rash Curtis & Assoc.*, No. 16-03396 (N.D. Cal. October 1, 2021), such expenses "fundamentally relate to the cost of doing business" and are not recoverable from the corpus of a class settlement under any statute or other authority.
- The district court emphasized that the recovery of litigation funding expenses from a class settlement fund would "effectively undermine the transparency required by class settlements" where the litigation funding arrangement was not scrutinized and pre-approved by the court. At the same time, the district court increased class counsel's fee award, in light of the increased class recovery that counsel attributed to the litigation funding agreement.
- The decision establishes that litigation funding expenses are no different from other financing arrangements traditionally used by class counsel. While class counsel may make the "independent decision to enter into a litigation funding agreement" without scrutiny and pre-approval, the expenses associated with such funding are not recoverable from the proceeds of a proposed class settlement.

Summary

After obtaining an outsized class judgment against a moderately capitalized defendant for violating the Telephone Consumer Protection Act (TCPA) and assignment of the defendant's "bad faith" claims against its insurer, class counsel entered into an agreement with a non-party litigation funder to pursue recovery of the $267 million judgment against the insurer. As part of the agreement, the funder provided $10 million in funding to class counsel, and retained a separate law firm to serve as insurance recovery counsel to assist in prosecuting the assigned claims. The insurer ultimately agreed to settle the assigned claims for over $75 million, and class counsel in turn sought approval under Federal Rule of Civil Procedure 23(e) for distribution of the settlement proceeds to the class, and recovery of counsel's fees and litigation costs from those proceeds.

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Among the costs for which counsel sought recovery were a $300,000 payment to a broker that reportedly arranged the litigation funding agreement, as well as $15 million to be paid to the litigation funder, which represented a $5 million return on the funder's $10 million investment. According to class counsel, the litigation funding agreement and the assistance of insurance recovery counsel made possible the "extraordinary" result of the $75 million in settlement proceeds.

Even so, the district court rejected class counsel's request for reimbursement of these litigation funding expenses, finding "on principal that those amounts should not be charged to the class" and that "traditional litigation expenses are appropriate generally but not those related to litigation financing." The district court highlighted that litigation funding expenses are not recognized by statute or other authority as a recoverable litigation expense. The court also explained that "[m]any plaintiff firms self-finance, and presumably have complex lines of credit with financial institutions." Accordingly, the district court found that the costs of the litigation funding arrangement are "fundamentally related to the cost of doing business," and therefore were not a recoverable litigation expense.

Class counsel also argued for reimbursement of the litigation funding expenses as a form of payment of class counsel fees, in that the funder had retained insurance recovery counsel who—according to class counsel—were indispensable in increasing the insurer's settlement offer. The court rejected that argument, noting that insurance recovery counsel had not been appointed by the court to represent the class, and explaining that to "blindly pay out an investment award, even with the impact of experienced co-counsel, would open a Pandora's box of issues and effectively undermine the transparency required by settlements due to class members." In light of the significant class recovery, however, the district court did increase class counsel's fee award from 33 to 37 percent of the total settlement proceeds, noting that the increase "address[ed], in part, class counsel's independent decision to enter into a litigation funding agreement."

Takeaways

- The district court's analysis of reimbursement of litigation funding expenses that were neither scrutinized nor pre-approved provides useful guidance concerning the recoverability of such expenses from class settlement proceeds.
- The district court noted that litigation funding should be considered presumptively a "cost of doing business" for class counsel—akin to any other financing arrangement—such that recovery of such expenses was not permitted under Rule 23 or any other authority.
- The decision puts litigation funding expenses on the same footing as other more traditional financing expenses that proposed class counsel may choose to incur. While counsel may make the "independent decision" to finance with litigation funding, it does not follow that the expenses associated with such funding may fairly be recovered from settlement class proceeds.
- The decision leaves for another day the "Pandora's box" of issues to be evaluated if class counsel were to seek advance judicial approval of a litigation funding arrangement—including the extent of disclosure of the financing terms required both to the court and the defendant, the standard applicable to the court's scrutiny of the arrangement, and the extent and timing of any disclosure to the class.