Arbitration & Litigation Too Expensive?
Construction Contract Dispute Funding May Be The Answer

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ABSTRACT

In the 18th, 19th, and early 20th centuries polo was thought to be the “sport of kings” because it required a king’s wealth to maintain and field a successful team. In the 21st century, arbitration and litigation seems to have replaced polo as one of the most expensive forms of epic, if not lethal combat undertakings in modern society. As a result, many legitimate construction claims and disputes are abandoned because one or more of the parties involved are unable to afford the legal process. Third party construction mediation, arbitration or litigation funding in the U.S. is emerging to alleviate this situation. These situations present both extreme risk and potential opportunity as well. This paper discusses how third party litigation financing has come of age over the past decade. For various reasons the construction industry has lagged other industries in this approach to litigation but can now participate. Litigation funding, or the independent funding of litigation costs by third parties, is now a multibillion dollar industry. Third party financing of construction mediation, arbitration or litigation or non-recourse litigation funding represents a significant new risk management tool in the construction industry for claimants to help quantify pending claims and balance upside goals with downside liquidity risks. The paper describes how litigation funding operates when one of the parties to a dispute employs this option to finance the pursuit of a construction claim. The paper also outlines the benefits and the risks of using construction litigation funding.
Introduction

Construction claims – requests for additional money and/or time – are common on most construction projects. Most claims are resolved on the project site through negotiation. However, some claims are not settled and become potential legal disputes through mediation, arbitration or litigation or some other form of alternative dispute resolution. These claims tend to be more complex, much larger, and considerably harder to resolve once legal action commences. A recent survey by a large international law firm looked at different approaches to resolving legal disputes. Based on their survey of 287 corporate (in-house) legal counsels, the authors of this survey reached the following conclusion.

“…this year’s results have shown that less than one in ten have an appetite for early or quick settlements, around half the number that usually or always contest their disputes. Unsurprisingly, choosing to contest as a matter of course may bring a financial burden with average disputes spending for these organizations well above those who generally settle and spending as a proportion of revenue also tracks higher.”

This survey determined that while 35% of the responding corporate legal counsel “…expect [the] volume of disputes to rise moving forward, only 9% expect volume to decrease.” The survey also found that 71% of the contracts in the energy sector and 39% of the contracts in the infrastructure, mining and commodities sector resulted in legal disputes. Another recent survey indicates that the average construction dispute value in the U.S. over the period of 2014 – 2019 was $22.2 million and took 16 months to resolve.2 (It should be noted that the 16 month period referred to in this report was after claim settlement negotiations failed.)

While the percentage of contracts resulting in disputes is substantial and many in-house legal counsel “…always contest their disputes…”, there is another side to this story, one

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that is relevant to this paper. A recent article contained the following statement and startling statistics that bear on this topic.

“[A] report from Burford Capital found that a 63% majority of polled finance professionals said their companies have opted to abandon claims valued in the millions rather than pay the legal expenses to pursue them. This was especially true at large companies with $1.0 billion or more in annual revenue where 73.3% of respondents said they chose to abandon the claims.”³

The article summarized the data developed from this survey and displayed it in the following manner.

<table>
<thead>
<tr>
<th>Anticipated Value of Claim</th>
<th>% of Claims Abandoned</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100M or more</td>
<td>6.8%</td>
</tr>
<tr>
<td>$50M to $99.9M</td>
<td>17.3%</td>
</tr>
<tr>
<td>$20M to $49.9M</td>
<td>23.5%</td>
</tr>
<tr>
<td>$10M to $19.9M</td>
<td>30.1%</td>
</tr>
<tr>
<td>$5M to $9.9M</td>
<td>14.3%</td>
</tr>
<tr>
<td>Less than $5M</td>
<td>7.3%</td>
</tr>
<tr>
<td>Don’t Know / Not Sure</td>
<td>0.9%</td>
</tr>
</tbody>
</table>

Whether these claims would have been successful if pursued into the legal arena is unknowable as they were not prosecuted and never adjudicated. But what is apparent is that these claimants dropped their claims not on the basis that they were unjustified, lacked merit or not winnable, but because claimants could not afford the legal costs.

**Cost of Arbitration and Litigation**

The author has been involved in construction claims and disputes as a contracting officer, construction manager, owner representative, and construction claims consultant for both owners and contractors since 1972. It is the author’s experience that when a large,

complex construction claim goes into arbitration or litigation, claimants (typically contractors for the purposes of this paper as contractors are most often the claimants in construction) can expect to spend between 10% - 15% of the damages sought in order to pursue the claim through the dispute resolution process. When pursuing a $50 million claim in arbitration or litigation, for example, a contractor can expect to spend between $5 and $7.5 million to prosecute the claim to award or decision. This expenditure is analogous to having to ante up $5 to $7.5 million on a Las Vegas gaming table in order to get the cards dealt to you!

Where is the money spent? The cost of pursuing a specific construction claim through mediation, arbitration or litigation is, typically, highly confidential information even in publicly traded companies. However, two surveys have gathered data that provides a general answer to this question. A 2006 doctoral dissertation submitted to the University of Texas revealed the following breakdown of legal dispute costs.4

<table>
<thead>
<tr>
<th>Cost Category</th>
<th>% of Total Transactional Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outside Counsel Fees</td>
<td>61%</td>
</tr>
<tr>
<td>In-House Counsel Fees</td>
<td>5%</td>
</tr>
<tr>
<td>Consultant &amp; Expert Witness Fees</td>
<td>11%</td>
</tr>
<tr>
<td>Management &amp; Staff Costs</td>
<td>16%</td>
</tr>
<tr>
<td>Court/Mediation/Arbitration Fees</td>
<td>3%</td>
</tr>
<tr>
<td>Other Costs</td>
<td>4%</td>
</tr>
</tbody>
</table>

A more recent survey from the UK’s Chartered Institute of Arbitrators based on 254 arbitrations conducted between 1991 and 2010 before panels of the American Arbitration Association (AAA), the International Chamber of Commerce (ICC), the London Court of Arbitration (LCIA), the London Maritime Arbitration Association (LMAA), and the Arbitration Institute of the Stockholm Chamber of Commerce (SCC) revealed the following information on how arbitration costs were expended.5

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<table>
<thead>
<tr>
<th>Cost Category</th>
<th>% of Total Transactional Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>External Legal Fees</td>
<td>63%</td>
</tr>
<tr>
<td>Barrister Fees</td>
<td>11%</td>
</tr>
<tr>
<td>External Expenses</td>
<td>8%</td>
</tr>
<tr>
<td>Witness Costs</td>
<td>5%</td>
</tr>
<tr>
<td>Expert Fees</td>
<td>10%</td>
</tr>
<tr>
<td>Management Cost</td>
<td>3%</td>
</tr>
</tbody>
</table>

The CIArb survey went further in breaking down the costs of arbitration. In the first instance, the survey provided a breakdown of the parties external legal and barrister costs revealing the following.

<table>
<thead>
<tr>
<th>Cost Category</th>
<th>% of Total Transactional Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-commencement</td>
<td>9%</td>
</tr>
<tr>
<td>Discovery</td>
<td>5%</td>
</tr>
<tr>
<td>Hearing Preparation</td>
<td>12%</td>
</tr>
<tr>
<td>Commencement</td>
<td>10%</td>
</tr>
<tr>
<td>Fact Witnesses</td>
<td>7%</td>
</tr>
<tr>
<td>Hearings</td>
<td>16%</td>
</tr>
<tr>
<td>Exchange of Pleadings</td>
<td>25%</td>
</tr>
<tr>
<td>Expert Witnesses</td>
<td>7%</td>
</tr>
<tr>
<td>Post Hearing Briefs</td>
<td>9%</td>
</tr>
</tbody>
</table>

Additionally, there are “shared costs” in arbitration. The CIArb survey provided a breakdown of these shared costs.

<table>
<thead>
<tr>
<th>Shared Cost</th>
<th>% of Total Transactional Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transcripts</td>
<td>4%</td>
</tr>
<tr>
<td>Arbitral Fees</td>
<td>60%</td>
</tr>
<tr>
<td>Arbitral Expenses</td>
<td>10%</td>
</tr>
<tr>
<td>Hearing Venue</td>
<td>7%</td>
</tr>
<tr>
<td>Other</td>
<td>19%</td>
</tr>
</tbody>
</table>

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*It should be noted that discovery (i.e., document exchange and review, depositions, etc.) is much more limited in the UK than in the U.S. so the cost of discovery is likely much higher in the U.S.*
Two other findings from this survey include the following.

- “As an average arbitration may require between 1,500 and 4,500 hours of legal work, it is not hard to see why legal fees may be significant if billed on an hourly basis. For a relatively simple arbitration requiring 1,500 hours of legal work, for instance, if billed at the rate of USD 300/hour, legal fees would equal USD 450,000 on an hourly basis.”

- “…the overall average cost of international arbitration [is] approximately … USD 2.6 million … for Claimants and approximately 10% less for Respondents.”

It is apparent that the cost of disputes, should a contractor opt to pursue a construction claim into the legal arena, is a major concern for contractors. Additionally, construction claims in the U.S. are typically pursued under the “American rule of law” – a rule in the U.S. justice system that stands for the proposition that each party to a legal action pays their own legal costs (i.e., attorney and expert witness fees as well as court or arbitration costs, etc.) regardless of who prevails in the case. This practice must be taken into consideration when making their decision and increases a contractor’s risk. (This rule is unlike the English common law rules where the losing party pays the winning party’s legal fees.) While it is true that some contracts stipulate, and some State statutes mandate, the “loser pays” rule, in the author’s experience this extremely rare in public contracts.

**Litigation Financing – A Viable Alternative?**

Litigation financing has been discussed in the following manner.

> “’Third party litigation financing’ is a term that describes the practice of providing money to a party to pursue a potential or filed lawsuit in return

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for a share of any damages award or settlement. Litigation financing companies provide financing for myriad litigation costs, including attorneys’ fees, court fees and expert witness fees. “9

Another article discussed third party litigation funding more succinctly.

“Put simply, it’s getting someone else to fund the costs of bringing a claim – whether in litigation, arbitration or another form of Alternative Dispute Resolution (ADR) – in return for a share of the damages if the case is successful.”10

Research indicates that third party litigation funding originally arose in Australia and the United Kingdom in the 1990s. While such funding was initially utilized in bankruptcy proceedings it soon spread to group litigation (i.e., class action suits). Subsequently, third party funding spread to other commercial litigation. More recently litigation funding arrived in the U.S. in the early 2000s11 Third party financing in the U.S. initially focused on class action lawsuits. However, some of the country’s litigation funders have now entered the construction claims arena – mediation, arbitration, and litigation. As one attorney noted –

“The impetus behind the rise in third-party funding comes from the wide range of benefits found for all parties involved in the transaction – funders, law firms, and clients, whether corporate or individuals. Investors are drawn to litigation as an asset class because litigation thrives during times when many investments under perform. This is because litigation rarely tracks a down economy, since hard times usually result in more litigation. Also, litigation funding, especially in the U.S., has been around for quite

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some time now; therefore, investors are more confident in the viability of
the industry and motivated by the potential for large returns. Moreover, as
the economy continues to recover, larger corporations are pleased to shift
the financial risk and cost of litigation off their balance sheets. For
individuals or small corporations, litigation funding may be the only
practical way to gain access to the courts. Finally, for law firms, financed
litigation brings the security of having their fees and expenses paid on a
current basis on what might otherwise be a contingency fee based
arrangement.”\(^\text{12}\)

At the present time the U.S. market for third party litigation funding appears to be
growing. A report issued in January 2020 concluded that there are 41 litigation funders
active in the U.S. with combined assets of $9.5 billion.\(^\text{13}\)

**Is There A Role for Litigation Funding in Mediation?**

So far, this paper has discussed litigation funding in the context of arbitration or
litigation. This begs the question of whether there is a place for litigation funding in
mediation. Mediation is a facilitated negotiation process with the assistance of a neutral
– the mediator. One article that makes an interesting case for litigation funding in some
mediations asserting the following points.\(^\text{14}\)

- Litigation funders scrutinize cases very carefully before they agree to fund the case,
  providing a fresh perspective and weed out weak cases or cases with little likelihood
  of prevailing.

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\(^{14}\) Geoff Sharp and Bill Marsh, *A New Seat at The Table? The Impact of Third-Party Funding on the
The mere fact that the claimant has been able to secure litigation funding for their claim can be influential to the respondent and, sometimes, leads to mediation and settlement.

Funders approach cases with less passion than the parties and focus on risk analysis during the mediation process – that is, the risk of not settling. Further, the focus of litigation funders is on the numbers not personalities, thus pushing the mediation more toward an objective business to business process.

The article addresses the issue of whether the dispute funder should be at the table during mediation. Mediators interviewed for the article commented that the presence of a funder at the table can provide “an interesting dynamic” as their dispassionate view can be invaluable. The article also notes that when funders attend a mediation, they should not be active participants during the presentations.

A warning provided in the article is that there must not be any confusion during the mediation as to who has authority to make the final decision – it should not be the funder!

The authors note that there are two surprising benefits of litigation funding during mediation. The first surprise is that early settlement may become more attractive as some funding agreements provide for a sliding payment depending on when in the case the claim settles – early, middle or late in the process. The second is litigation funding often results in better informed parties at the mediation. And, they note, the better informed the parties are, the more likely it is that the mediation will be successful.

It appears that there is a place for litigation funding in some mediations, particularly on large, complex cases or cases with multiple parties. Mediated settlements in situations

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15 See, for example, Disney Hall Cost Overrun Suit, Los Angeles Times, July 29, 2006 where the general contractor and 18 subcontractors mediated a $43.3 million lawsuit to settlement in a single mediation.
such as these may be achieved more easily if litigation funding has been arranged and the funder is at the table.

**Awareness and Perception of Litigation Funding**

The 2018 International Arbitration Survey: The Evolution of International Arbitration was based on 922 questionnaire responses and 142 follow up telephone interviews. This survey queried the awareness and the perception of third party litigation funding and produced the following results.

- **Familiarity with Third Party Funding in International Arbitration**

<table>
<thead>
<tr>
<th>Familiarity</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aware of but have not used in practice</td>
<td>56%</td>
</tr>
<tr>
<td>Have seen it used in practice</td>
<td>26%</td>
</tr>
<tr>
<td>Have used it in practice</td>
<td>16%</td>
</tr>
<tr>
<td>Not aware of it</td>
<td>3%</td>
</tr>
</tbody>
</table>

- **Perception of Non-Recourse Third Party Funding of Claimants in International Arbitration**

<table>
<thead>
<tr>
<th>Perception</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Negative</td>
<td>4%</td>
</tr>
<tr>
<td>2</td>
<td>9%</td>
</tr>
<tr>
<td>3 Neutral</td>
<td>35%</td>
</tr>
<tr>
<td>4</td>
<td>36%</td>
</tr>
<tr>
<td>5 Positive</td>
<td>18%</td>
</tr>
</tbody>
</table>

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17 Percentages in the first 2 tables add to more than 100% due to rounding.
Perception of Non-Recourse Third Party Funding in International Arbitration by Respondents Who Have Used It

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Negative</td>
<td>0%</td>
</tr>
<tr>
<td>2</td>
<td></td>
<td>8%</td>
</tr>
<tr>
<td>3</td>
<td>Neutral</td>
<td>17%</td>
</tr>
<tr>
<td>4</td>
<td></td>
<td>39%</td>
</tr>
<tr>
<td>5</td>
<td>Positive</td>
<td>36%</td>
</tr>
</tbody>
</table>

This survey paints the following picture. Most respondents knew of the existence of litigation funding but only a small fraction had used some type of dispute funding. The perceptions of the survey respondents who had seen third party funding used (some 89%) were either neutral or positive on the subject while 92% of the respondents who had used third party funding were in the neutral to positive columns. All in all, third party litigation funding is becoming more common in arbitration of commercial disputes.

**Forms of Litigation Funding**

Currently there are four forms of funding in the construction disputes space. They are the following.18

- **Single Case Funding** – If a contractor has a claim of $50 million, for example, that has exhausted negotiations without reaching settlement, they are faced with a decision. They may decide to pursue the claim into arbitration or litigation and face the potential expenditure of $5 to $7.5 million. In the alternative, as discussed above, the contractor may decide to drop the claim all together as they may be unable to afford the cost of arbitration or litigation. In this case, litigation financing may be a viable alternative for the contractor.

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➢ **Portfolio Claims Funding** – A contractor may have several claims against the same project owner or may have several claims against multiple owners and, again, **not** have the financial resources to pursue each in a legal dispute. A litigation funder may be willing to fund the entire portfolio of claims.

➢ **Claims Factoring** – A contractor may have several change orders and claim settlements agreed to at or near the end of the year, but which will **not** be paid until the following year. Should the contractor need money now, **not** later, they may be able to find a litigation funder who will “purchase” these receivables for a reduced cost in return for the full amount of the settlements when they are received.

➢ **Post Judgment Funding** – A contractor may have won a case in litigation and be faced with an appeal of the decision by the owner. Knowing that appeals process is both lengthy and costly, a contractor may seek litigation funding to finance the cost of the appeal. A recent article published by the law firm of Smith, Gambrell & Russell indicated that in Eleventh Circuit Court of Appeals (which has jurisdiction over appeals in Alabama, Florida and Georgia) the **median** time from submittal of an appellants brief (which in itself takes months to prepare) to oral arguments is 3 months and the **median** time from notice of appeal to decision is 9.7 months. This compares to the Ninth Circuit Court of Appeals (with jurisdiction over California, Arizona, Alaska and Hawaii) where the **median** time from submittal of the briefs to oral arguments is 16.5 months and from notice of appeal to decision, some 25.5 months.\(^\text{19}\)

A 2019 article on litigation funding stated that “In terms of deal type, 47% of the $2.3 billion went to portfolio arrangements, while 38% went toward single case deals. The remaining 15% went to corporate portfolio arrangements.”\(^\text{20}\) The author opined that “As a general guideline, many funders look for cases with potential damages 10 times greater

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than their investment, which necessarily excludes most disputes from consideration and slows further deals.”

Types of Litigation Funders

In a 2020 article published in *Bloomberg Law* classifies litigation funders into three categories as follows.\(^ {21} \)

- **Traditional Litigation Funders** – These are companies that specialize in and have a good deal of experience in financing litigation matters. Their experience allows them to analyze matters they are being asked finance and spot issues related to such claims in order to determine the likelihood of success of the case and the potential award. Based on this experience they will decide whether to fund the matter.

- **Hedge Funds** – Such funds are another potential source of litigation funding. While these firms do not specialize exclusively in litigation funding, they often have access to funds for financial support. Some hedge funds have groups dedicated to litigation financing which gives them a degree of insight into this type of funding.

- **Other Sources of Litigation Financing** – This article also mentions some alternative sources of litigation funding such as wealthy individuals, family offices or other hedge funds without dedicated litigation funding groups.

Additionally, some litigation funders have sold off some or all their interest in a matter to other investors while the issue is still in the adjudication process. In this regard some

“…funders are creating a secondary market where private equity firms and other institutional investors can pour money into opportunities funders have already originated.”\(^ {22} \)

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Litigation Funder Considerations

When dispute funders are approached by a contractor there are a number of issues potential funders must consider. Among them are the following.

- **Potential Claimant’s Status** – Funders must examine whether the client is a claimant or a respondent (i.e., are they playing offense or defense). The amount and type of work and the cost involved differs substantially depending on the status of the client.

- **Does the Claimant Have Objectives Other Than Recovery of Damages?** – Funders need to determine whether the client has interests other than recovery of damages. For example, does the client need or want to maintain an ongoing business relationship with the other party? Do they want to maintain their reputation in the area or the industry? Issues like this will likely complicate the process and funders need to consider how such issues may impact the outcome.

- **Amount in Dispute** – Litigation funding firms need to examine and consider the amount in dispute (i.e., both the claim amount and any counterclaims). If the litigation funding will exceed any potential settlement value, then the funder’s return on investment is likely to be too low to justify their investment.

- **Anticipated Legal and Expert Witness Costs** – In order to maximize their return on the outcome of the claim litigation funders may need or want to negotiate reduced fees or alternative fee arrangements.

- **Will the Claim Be Adjudicated in Mediation, Arbitration or Litigation?** – The predictability of the outcome in mediation, arbitration or litigation must be considered when deciding to fund a claim. As mediation is a business to business process, settlement will be more likely but on a compromised and reduced basis. In arbitration it is possible to adjudicate the case in front of a panel of arbitrators

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experienced in construction matters and in the U.S. the ability to challenge an arbitration award is extremely limited. Thus, arbitration awards are almost always final and conclusive of a matter. In litigation not only are judges and juries much less knowledgeable of construction issues it is almost always possible to appeal a court’s decision – which drags out the dispute and substantially increases costs.

- **Is the Client Potentially Subject to Other Legal Actions?** – Funders need to take into consideration how claims against a potential client from subcontractors, suppliers or vendors may affect the value of the claim recovery. Additionally, if the client is working under a contract where they are subject to counterclaims under Cost and Pricing clauses or False Claim statutes this too may also influence the funder’s decision.

There are probably more issues litigation funders will take into consideration when deciding to fund a claim in arbitration or litigation but those listed above provide contractors and their legal counsel a good idea of what will be considered when a litigation funder becomes involved in a claim.

**When Considering Litigation Funding**

Contractors seeking construction litigation financing should, at the outset, confer with legal counsel to fully understand the process. When considering litigation funding one article points out that there are five steps contractors should follow.²⁴

- **Consider Alternatives** – Different litigation funders operate differently and have different experiences – especially in funding construction disputes. Contractors and their legal counsel need to research various firms to find one with a good fit for the contractor’s situation. In this regard, contractors may want to contact a financial intermediary firm (a firm that does not necessarily finance claims in litigation but helps contractors arrange competitive financing) to assist in locating the best funder and negotiate the funding agreement.

Prepare – Contractors must be prepared to help funders complete their due diligence. Funders need to fully understand the contractor’s claim and the claimed damages. They need to know about the contractual adjudication process in order to estimate the funds needed to carry the issue through the process and how long it will likely take. Additionally, funders need information on the owner’s ability to pay. There are numerous other questions potential funders are likely to ask before making their decision. Contractors should confer with their legal counsel to help them prepare and, again, possibly employ the services of a competent intermediary firm to help guide them through the financing process.

Collect – Contractors must gather all documents related to the claim(s) and have them available for review by the funders. Contractors need to provide enough documentation related to the claim to the funders to help them gain a full understanding of the dispute and all issues related to the dispute.

Speak – Funders will need to interview the contractor’s staff who will be percipient witnesses and the contractor’s experts to assess the contractor’s ability to properly present and support the claim in mediation, arbitration or litigation. From the funder’s perspective this set of interviews goes to the issue of the “winnability” of the case.

Ask – Contractors should ask funders a lot of questions to make certain they fully understand the deal they are making with the litigation funder. This is absolutely necessary to avoid an adverse surprise at the end of the dispute process.

Contractors probably should not ask their legal counsel to negotiate the terms of the litigation funding directly on behalf of the contractor. Attorneys probably will recuse themselves on the basis that arranging financing for the client may later be perceived as a conflict of interest. And, should the dispute not turn out to be to the satisfaction of their client, this could be grounds for a potential malpractice suit. As a result, attorneys will likely ask their client to engage other legal counsel or a litigation financial intermediary...
firm to negotiate the litigation funding deal.\textsuperscript{25} The American Bar Association’s Standing Committee on Ethics and Professional Responsibility has already published a detailed formal opinion on “A Lawyer’s Obligations When Clients Use Companies or Brokers to Finance the Lawyer’s Fee”.\textsuperscript{26}

Contractors also need to understand that litigation funders are looking for situations where the dispute is a business to business dispute involving sophisticated legal counsels; strong, well documented claims; solid evidence of entitlement, causation, and damages; and, is against a defendant who has the ability to pay the resulting damages at the end of the process.\textsuperscript{27}

Finally, contractors must remember that a litigation funder is an investor. As an investor they want to finance a dispute in the most efficient manner to reduce their costs and effectively to get a good return on their investment at the end of the process.\textsuperscript{28} As one of author’s previous managers was fond of saying when considering submittal of a claim – “Is the juice worth the squeeze?” Litigation funders, as investors, will look at each claim from an entirely different perspective than a contractor.

\textbf{Pos & Cons of Litigation Funding}

Like almost everything in modern life, litigation funding is not entirely risk free nor is it always successful. There are both good and bad points to be aware of when considering litigation financing. The following outlines perceived pros and cons of litigation funding provided by several sources.

\textsuperscript{26} American Bar Association Standing Committee on Ethics and Professional Responsibility, \textit{Formal Opinion 484}, November 27, 2018.
\textsuperscript{27} Strickler, Ibid.
Pros of Litigation Funding

Information gathered from 227Inc., a national scope firm that assists contractors in assessing their claims and helps arrange litigation funding for contractors seeking such financing offers the following points for consideration.29

➢ Non-recourse litigation funding can provide clarity and peace of mind when making the decision to pursue a claim through the legal process. Contractor executives and their board of directors need assurance that their claim is legitimate and winnable. They also need a reliable estimate of the costs they are about to invest in prosecuting their claim.

➢ Litigation funders provide an independent initial assessment of the strengths and weaknesses of a contractor’s claim. After all, they are in business to make money – at the end of the process they want a reasonable return on their invested funds. Litigation funders take a hard, objective look at each claim they are being asked to finance which provides a degree of assurance to contractors moving forward.

➢ Non-recourse litigation funding provides budget certainty for a contractor’s legal and finance departments something these departments always look for.

➢ Non-recourse funding can make a critical difference in pursuing good and valuable claims that otherwise might be dropped by a contractor. Having good idea of the merits of their claim (including options, strengths, and legal costs); the probable cost of the litigation (including legal and expert costs); and, the likely range of settlement or decision outcomes allows contractors to make more informed decisions on whether to pursue the claim into the legal process.

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29 Information provided on the firm’s website www.227inc.com and an e-mail from Douglas E. Johnston, Jr., Founder and CEO.
Non-recourse litigation funding serves as a risk management tool that provides a contractor the ability to balance downside liquidity risks against targeted upside recoveries.

An article published in *Law360* offered the following perspective on litigation financing.\(^{30}\)

The purpose of the American legal system is to resolve cases on their merit, not on the financial resources of opposing parties. Litigation financing helps balance the legal system by allowing legitimate cases to be resolved solely based on the quality of the claims.

An article in the *ABA Journal* provided the following observations concerning litigation financing.\(^{31}\)

Non-recourse litigation funding is not a loan but a form of “asset purchase”. The article offered an example where a litigation funder invests $200,000 for legal and expert fees and the case settles for ten times this amount. The funder recovers its $200,000 investment plus 10 to 30 percent of the settlement amount. However, if the contractor loses the case, the litigation funder does not recover the costs expended.

Litigation funding benefits contractors by allowing them to free up capital for core business purposes and reduces the risk for contractors to be forced to settle claims for less than their cases are worth. Small to mid-size construction firms are not cash rich. If contractors use their limited funds to pay legal and expert fees to pursue a claim into the legal process, they may not have the money to support ongoing projects or advance their business. Litigation financing mitigates the contractors’ need to make this choice.


A contractor’s ability to retain top notch legal counsel may increase if they are willing to use litigation funding as many law firms are unwilling to take on complicated construction cases on a contingency basis.

Litigation funders apply a forensic level of due diligence on a case by case basis to vet the legal validity of each case and the likelihood that the suit will be successful. Such careful case analysis creates efficiency in the legal system by weeding out the weak cases that should not go to arbitration or court.

Litigation funding may empower contractors in fee negotiations with their legal counsel and may provide a route to negotiate price with their lawyers. Litigation funding as an alternative to billable hours could give a contractor frustrated with the risk of an hourly engagement a better idea of an acceptable cost on the front end of the dispute.

Cons of Litigation Funding

The U.S. Chamber Institute for Legal Reform published a lengthy report on litigation financing focused on what they see as negative issues. While this report centers on litigation funding of class action lawsuits, many of these criticisms have also been levelled at litigation funding of individual cases.

The report concludes that third party litigation financing encourages frivolous and abusive litigation. The report opines that litigation funders will work with lawyers to design and prosecute claims that benefit them without regard to whether they actually promote justice. This position is often stated as “More litigation funding means more litigation!”

The report contends that third party litigation financing prolongs litigation in that the funders will encourage claimants to reject reasonable settlement offers, especially

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those that do not reimburse their initial investment. In this regard, the report states that funders with the profit motive will make early, beneficial settlements less likely.

- The report sets forth the position that third party litigation financing poses serious ethical dilemmas in that such funding weakens the traditional attorney-client relationship and interposes a third party (the funder) that has no duty to represent their clients and guard their confidences.

- The report asserts that third party funders will try to control the claimant’s case either by dictating legal strategy or pressuring attorneys over settlement amounts for their benefit and not the benefit of the claimants.

- The report also comments that third party funding creates conflicts of interest for the claimants’ attorneys. The reports state this is especially true if claimant attorneys arrange for the litigation funding directly or contract for such funding on their own behalf rather than the claimants’.

- Finally, the report sets out the position that third party litigation financing makes providing candid legal advice less likely. The assertion is that litigation funders will require claimants to disclose confidential and privileged information as they are vetting the claim during the decision making process. Providing privileged information to the funders may waive their privilege protection. The report takes the position that attorneys knowing about this issue will give less candid legal advice to their clients, thus depriving the claimant of all the legal advice they are due thus increasing the likelihood of more lawsuits.

The previously cited Law360 article also points out two potential negative issues concerning litigation funding.33

- The article suggests that if the focus of litigation funding strays from helping clients solve their legal problems then litigation funding may become a detriment to the

33 Sutton, op. cit.
industry. Litigation funders must remain focused on advancing the efficient and fair resolution of disputes.

➢ The article also notes that there is an increasingly large number of new litigation funders. The author points out that many of the new litigation funders are not trial lawyers. This trend means that they have never helped clients solve challenging legal problems and do not understand the ethical obligations owed to clients by attorneys.

The ABA Journal article sets forth a potentially negative aspect of litigation funding as follows.34

➢ Litigation funding may disrupt the legal process by bringing in an outside party that can potentially exert control, encourage the filing of frivolous lawsuits, and give plaintiff attorneys an unfair advantage in settlement talks.

In addition to the pros and cons of litigation funding listed above there are three issues that apparently not yet settled at the present time. A brief discussion of each is set forth below.

**Issue: The Champerty Doctrine - Is Litigation Funding Legal?**

“Champerty” is defined as “A bargain by a stranger with a party to a suit, by which such third person undertakes to carry on the litigation at his own cost and risk, in consideration of receiving, if successful, a part of the proceeds or subject sought to be recovered.”35 Champerty, once frowned on by U.S. courts, as a concept is an old doctrine in law. A recently published article addressed the doctrine of champerty in relation to litigation funding as follows.

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34 Egan, op. cit.
“Champerty is an ancient doctrine originating in medieval England that was designed to prevent feudal lords from waging their wars through the court system. Champerty involves an ‘officious intermeddler’ paying the expenses of another’s lawsuit in exchange for a portion of the recovery—at first glance, this may sound a bit like litigation financing. However, courts have applied champerty narrowly in the modern era, limiting it to situations in which frivolous litigation is instigated by a third party and/or where the third party is heavily involved in the management of the case; reputable litigation financing providers do neither. Many states have abolished champerty, drastically limited its scope, or never adopted it in the first place. Even for states where champerty laws are in effect, champerty is subject to a choice of law which provides structural latitude for avoiding champerty and related issues.”

By and large, it does not appear that construction litigation funding will be classified as champerty except in very unusual cases. New York and Pennsylvania courts have dealt with several challenges to litigation funding over the past few years. Both have concluded that if a claim is purchased solely to bring litigation then it is likely to be champertous. The author of the Law360 In Depth article cited below concluded the following regarding champerty and litigation funding.

“These kinds of rulings, however, seem to be the exception in the growing stable of new champerty case law. So far, no state court has effectively barred third party litigation funding as champertous.”

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36 Agee and Lowe, op. cit.
Issue: Is Litigation Funding Discoverable?

Discoverability in the litigation funding arena has two aspects that should be considered at the outset. The first issue is whether a contractor must disclose to the other party that the claim is being funded by an outside litigation funder. The second issue is whether all the information provided to the litigation funder during the negotiation process is discoverable. A brief review of each follows.

- At the present time only Wisconsin has a statute that mandates disclosure of litigation for all litigation funding arrangements. However, The Litigation Funding Transparency Act of 2018 was introduced in the U.S. Senate and reintroduced again if 2019. While this bill is aimed at federal class action or multidistrict litigation cases it may have potential ramifications for litigation funding of single action cases going forward should it become law. This issue is subject to active litigation at the present time. The arguments for and against disclosure of litigation funding agreements are set forth, briefly, below.

Arguments For Disclosure of Litigation Financing

- **Bias and Conflicts of Interests** – Arbitrators, judges, jurors and/or witnesses may have a financial interest in the litigation funder, and they may be more likely to side with the claimant to protect these interests.

- **Control** – If the claim is being financed by a litigation funder their identity should be revealed as the “true party in interest” in the proceedings.

- **Proportionality** – Claimants often attempt to narrow discovery on the basis that it is “overly burdensome” due to the expense involved. This argument,

38 Egan, op. cit.
however, does not seem to be supportable if it is known that the claimant is backed by litigation funding.

- **Fee-Shifting and Security for Costs** – Where costs are shifted to a prevailing party and the adverse party lacks the ability to pay such costs, litigation funding should be disclosed, and the funder should be liable.

- **Insurance Analogy** – Just as the Federal Rules of Civil Procedure 26(a)(1)(A)(iv) requires full disclosure of any insurance a party to a litigation has that may be available to satisfy any judgements, the existence of litigation funding should be likewise be disclosed.

**Arguments Against Disclosure of Litigation Financing**

- **Irrelevance** – The existence of litigation funding has nothing to do with the legitimacy or the merits of the claim.

- **Definition** – Litigation funding takes many forms. Trying to legally define what type of funding, given all the different forms, is highly problematical.

- **Prejudice** – Disclosure of the details of the litigation funding agreement could prejudice the funded parties because litigation funding does not always involve an unconditional obligation to fund the litigation. If an adverse party understands the claimant’s litigation budget, it could employ tactics designed to exhaust that budget and leverage an unfair advantage in the proceedings.

- **Efficiency** – Disclosure of litigation funding could provide an opportunity for lengthy and expensive motion practice and fishing expeditions by the respondent. This will drag out the arbitration or the trial making the dispute resolution process less efficient.
o **Passivity** – Litigation funding agreements are, typically, passive in nature. Disclosure on the basis that “control may exist” will likely lead to more discovery requests, motions, etc., making the process much less efficient and delaying the outcome of the proceedings. This outcome is analogous the adage – “Justice delayed is justice denied!”

o **Lack of Reciprocity** – If disclosure of litigation funding is required then this should result in reciprocal disclosure of the adverse party’s assets available to defend the case and pay the judgement. Disclosure of the respondent’s assets may promote judicial efficiency by preventing wasteful cases that would result in unrecoverable judgements.

The issue of disclosure of litigation funding is still in active litigation in cases around the country and is an issue that contractors and their legal counsel should be aware of and keep an eye on.40

➢ The second part of the disclosure issue is whether privileged documents made available to the litigation funder are no longer privileged and thus, subject to discovery by the respondent and their legal counsel. When claimants seek litigation funding, funders vet the claim thoroughly. Among the documents they need to review are the claimants’ legal counsel memoranda and legal opinions on various aspects of the case. Remember, the funder is looking at the issues of “winnability” of the case as well as the potential return on investment. Documents and communications between attorneys and their clients are generally privileged and not subject to discovery in arbitration or litigation. However, if such documents are provided to a third party, such as a litigation funder, are they now discoverable? Requiring a claimant to turn over all documents provided to the litigation funder may result in making privileged documents discoverable, to the detriment of the claimant.

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A recent analysis of court decisions concerning this issue was published in June 2019. The authors found 37 cases around the country where courts have ruled on this specific issue. In 30 of the cases (81%) courts allowed “no significant discovery or discovery on a redacted basis”. In the remaining 7 cases (19%) court decisions resulted in “discovery permitted”. The authors noted that …

“…lawyers cannot predict whether a court will compel discovery of information shared with a commercial litigation funder because few decisions exist on the issue. Indeed, no appellate court has ruled on precisely this issue.”

Like the disclosure issue discussed above, this issue too is still in litigation and both claimants and their legal counsel should be aware of and pay attention to the issue when seeking litigation funding.

**Issue: Are Litigation Funding Costs Recoverable in Arbitration?**

The third issue concerning litigation funding that is not yet fully resolved is the recoverability of third party funding costs in arbitration. Costs that claimants generally attempt to recover in arbitration include legal fees and expenses such as the arbitrator fees. A contractor’s fee to the funder is often measured as a percentage of the recovered amount or a multiple of the financing provided. According to the cited article there have been some recent arbitrations where the prevailing parties were awarded such costs. In one of the cases cited in this article the court commented that “…third party financing of litigation is generally not a bar to an award of attorneys’ fees…” The court went on to state this position is

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“…consistent with the more general proposition that the wrongdoer should not reap the windfall of the victim’s industry in having secured an alternative source of payment.”

Obviously, the few cases cited in the article do not resolve this issue definitively and the author offers the opinion that the issue will find its way to judicial review in the next few years. Like the prior issues discussed above, this issue is still a up in the air and both claimants and their legal counsel should be aware of and pay attention to the issue when seeking recovery of damages in arbitration.

Trends and Predictions Concerning Litigation Funding

While researching litigation funding for this paper the author located several articles that held forth what they see as potential trends concerning litigation funding and offered some predictions about the future of litigation funding. Many of the trends and predictions are summarized below in chronological order based on the date of publication.

An article published in 2015 offered commentary on the following trends in litigation finance.43

➢ Increase in volume of claims requiring funding – The article noted the increasing use of litigation funding is due to several factors including “...the recognition that funding of claims ‘works’ and benefits all those involved, ... an established track record of successfully funded claims by ... funders and better promotion of the industry...”

➢ Higher quality of claims presented for funding – As the article suggests “Reviewing and rejecting bad claims is part and parcel of a funder’s job.” The argument posited

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is that the quality of claims going into mediation, arbitration or litigation will be improved.

A 2017 Engineering News-Record article included the following comment – “Given the rising tide of new development and megaprojects taking shape around the world, there is a growing opportunity to provide litigation financing for construction and engineering firms battling it out in court…”

A third article offered the following observations concerning the future of litigation funding for consideration:

- **Litigation financing will increasingly be about more than litigation** – While this prediction sounds counterintuitive, the article suggested that litigation funding will be “…able to de-risk or monetize litigation positions as well as more traditionally “corporate” legal activity…”

- **Uncertainty and political flux will make managing legal risk more relevant** – The article commented on the shifting political and legal issues in 2017 and noted that these issues “…will create a new demand for risk management and a need for every tool available to help … hedge uncertainty and move cost and risk off their own balance sheets.” The article asserted the position that litigation financing is one way to manage risk for claimants and their legal counsel.

- **Continued affirmations of commercial litigation finance by courts will undermine its few remaining critics** – The article took note of the arguments against litigation funding by its opponents. However, the article stated that “Over the past decade, the practice of litigation finance has been repeatedly affirmed by courts and legislatures in the U.S., with the overwhelming majority of states validating the rights of litigants to access financing for complex litigation.”

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A 2019 article provided five predictions concerning litigation funding, the first two of which are set forth below.46

- **Law firms will become more like funders** – The article suggests that law firms will arrange litigation funding for themselves for individual large cases or a portfolio of cases in “…the recognition by law firms that borrowing money against their books of contingent fees as a way for them to be more efficient with capital.”

- **Funders will become more like financiers** – The article continues with the assertion that when law firms become more like funders then litigation funders will turn their expertise to evaluating the financial risk of funding claims and evaluating potential returns on their investments. Additionally, the article opines that funders will start accepting more risk but will hedge their risk through a secondary market for such asset purchases.

And, in a follow on article by the same author published the next day, the author provided the other three predictions.47

- **Pricing will continue to become more competitive** – The article suggests that as more capital comes into the litigation funding marketplace and more funders enter the funding arena pricing will become more competitive and it is likely that claimants will start receiving multiple offers to fund a matter. Additionally, the article opines that funders will start accepting more risk but will hedge their risk behind the scenes by selling off portions of their financing deals to other investors.

- **In order to maintain returns, funders will create new products** – The article sets forth the idea that as pricing of litigation funding falls funders are likely to maintain their return on investment by creating new financial products such as monetizing work in

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progress, investing in new start up law firms, purchasing court judgements or arbitration awards, etc.

- Courts will become more sophisticated at dealing with issues created by funding – The article asserts the as courts see more funded cases, then a larger body of case law will develop that will set forth guidelines for litigation funders. However, the article also suggests that as litigation funding becomes more common the likelihood of mandatory government regulations will rise.

An article published in January 2020 highlights some “things to watch” regarding litigation funding in 2020 among them are the following. 48

- Greater transparency and accountability – The article notes the publication of The Litigation Funders Buyer’s Guide 49 helps the funding industry and potential clients learn about options that they may have been unaware of previously. If is also suggested that more articles about litigation financing are prompting funders to investigate creation of an association of funders to self-regulate the industry.

- Funding expands its geographic reach – The author suggests that litigation funders will open, and staff dedicated, full service offices in multiple cities around the country thus expanding their ability to service clients.

- Pricing begins to segment deal size – The article predicts that as claimants and their legal counsel are beginning to see the utility of transferring their risk to litigation funders, the size of the deals will likely become larger, especially as portfolio deals become more common.

- Secondary market growth – The author notes that secondary transactions are similar to re-insurance in that funders can shed some of their potential risk by selling a

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48 Ralph Sutton, 5 Things to Watch in Litigation Finance This Year, Law360, January 1, 2020.
49 Agee and Lowe, op. cit.
portion of their funding agreements to other investors ad predicts that this will become more common.

The most recent article concerning litigation funding, published on January 27, 2020 suggests something entirely different.50 This article relates a presentation by Deputy Associate Attorney General Stephen Cox at the 2020 Advanced Forum on False Claims and Qui Tam Enforcement. The article related that, according to Mr. Cox, “…the courts and Congress are also looking at litigation funding… [and] …DOJ hopes to better understand the role that such arrangements play in qui tam actions.” Further, Mr. Cox is quoted as saying –

“Aside from what the litigation finance industry says publicly. We have little insight into the extent to which they are backing the qui tam cases we are investigating, litigating or monitoring.”

The article notes that “…courts and Congress are considering possible disclosure rules and the New York State Bar has launched a study to investigate whether litigation finance rules comport with attorney ethics rules.” Obviously, this issue is still undecided but should Congress pass legislation or the Department of Justice issue regulations, construction dispute litigation financing may be impacted.

Conclusion

Litigation financing in the U.S. is not new, having been employed in the U.S. since the early 2000s. Until recently, litigation funding has been used primarily in class actions or large commercial disputes. What is new is the funding of construction claims. As noted earlier in this paper, many construction claims are abandoned because contractors lack the financial wherewithal to pursue a claim into the legal process – mediation, arbitration or litigation. Litigation funding appears to be a way to level the playing field especially when the contractor pursues a claim against a large, well financed owner. It also appears that the quality of the construction claims going into mediation, arbitration or litigation

will be substantially improved as litigation funders will considerable due diligence of each matter they fund to arrive at a reasonable and achievable return on their investment once the legal process has been completed.

Contractors and their legal counsel looking into litigation funding for a construction claim or a portfolio of claims need to understand what potential funders need to consider when examining a claim funding opportunity; how the funding process works; and, the various forms of litigation funding. If a contractor and their legal counsel do not have prior experience with litigation funding a great deal of study is required prior to signing a funding agreement.

Based on the research, it appears that non-recourse litigation funding is the most favorable option for contractors who have decided to pursue their claims into the legal process. And, given the large number of litigation funders now in the industry, it appears that a contractor seeking litigation funding would be well advised to work with a litigation funding advisor that specializes in assisting contractors land the most favorable funding agreements.

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