Financing Private Litigation – A European Alternative to Contingency Fees

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A. Introduction

In the past few years, some litigation financing companies have appeared on the market in Germany[1] and in Switzerland.[2] A litigation financing company takes over the cost of the legal enforcement of claims in dispute in exchange for a share of the profits. Litigation financing companies can be seen – in a manner similar to legal cost insurance companies – as a private attempt[3] to overstep the cost barriers of the legal system. Often, the costs for pursuing claims in court build up a barrier that can barely be overcome. In this situation, the persons seeking justice need to obtain financial aid and to minimize the risks of the trial.

The appearance of litigation financing companies on the market stirred up a lot of discussions among lawyers and in the media.[4] One issue, for example, was whether a litigation financing company is a legal cost insurance company.[5] If a litigation financing company were to be qualified as a legal cost insurance company, this

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1 For example, the following litigation financing companies can be found on the internet (as of October 8, 2002): <http://www.acivo.com>, <http://www.allianz-profi.de>, <http://www.das-profi.de>, <http://www.exactor.de>, <http://www.foris.de>, <http://www.prozess-finanz.de> (GEPRO – Gesellschaft für Prozessfinanzierung und Consulting mbH), <http://www.prozess-finanzierungen.de> (First Pacific Risk Financing Ltd.), <http://www.gloria-prozessfinanzierung.de>, <http://www.juragent.de>, <http://www.jurecon.de>, <http://www.kapp-stiftung.de>, <http://www.proxx.de>, <http://www.roland-prozessfinanz.de>, <http://www.solvantis.de>. *See* also the overview given by N. Maubach, *Gewerbliche Prozessfinanzierung gegen Erfolgsbeteiligung* (Bonn 2002) at p. 193 et seq.

2 As far as the author knows, Prozessfinanz was the first Swiss litigation financing company (*see* <http://www.prozessfinanz.ch> – as of October 8, 2002).

3 In contrast to the legal aid provided by the state.

4 On some of the above mentioned homepages (*see supra* notes 1 and 2), one can find press clippings, e.g., on the homepages of FORIS, proxx and Prozessfinanz.

5 Fritzsche and Schmid, 'Eine neue Form der Versicherung?' in (1999) *NJW* 2998 et seq.; L. M. Güldemeister and C. Rollmann, 'Die Prozessfinanzierung der Foris AG ist keine Versicherung' in (1999) *NJW* 48; G. Stoessel, 'Verhältnis Rechtsanwalt – Rechtsschutzversicherung: einige ausgewählte Fragen' in (2000) 6-7 *Anwaltsrevue* 4.

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would have legal consequences.[6] In Switzerland, a legal cost insurance company may not receive a share of the outcome of the trial.[7]

In Germany, the authorities[8] have already had to answer the question as to whether the services rendered by a litigation financing company are to be considered as legal cost insurance. On April 29, 1999, the BAV unanimously decided that FORIS AG is not operating as an insurance business and therefore is not subject to insurance surveillance according to § 1 VAG.[9]

Because of the shares of the profits which the litigation financing companies receive and which resemble the contingency fees, the discussion concerning whether litigation financing companies would lead to American circumstances was rather intense and emotional. The objective of the following article is to augment the ongoing discussions with a rational comparison between private litigation financing and contingency fees. To this end, the article describes some legal matters which both plaintiffs and litigation companies face in Switzerland. This is then followed by a short description of the contingency fee system and its legal environment.

These short descriptions seem to be most important, since the impression one gets from the media is often based on a few spectacular cases which do not have much to do with the daily legal reality. Based on these descriptions, the comparison between private litigation financing and contingency fees is set out, after which some final conclusions and an outlook on the litigation finance business are given.

B. Private Litigation Financing and Aspects of Its Legal Environment in Europe (Example: Switzerland)

In this section, the aim is to explain what a litigation financing company does. Also, some aspects of the legal environment are presented. The most important laws for litigation financing companies are those concerning the lawyer's profession and those concerning the costs of legal procedures. Of course, there are far more legal questions, but since they are not so important for a comparison of private litigation financing with the contingency fee system, they will not be discussed.[10]

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6 *See* 'Verordnung vom 18 November 1992 über die Rechtsschutzversicherung' (RVV), SR 961.22.

7 Art. 10 RVV: 'Die Versicherungseinrichtung oder das Schadenregelungsunternehmen darf sich keinen Anteil an einem allfälligen Erfolg des Versicherten versprechen lassen.'

8 'Beschlusskammer des Bundesaufsichtsamtes für das Versicherungswesen' (BAV).

9 *See* Güldemeister & Rollmann, *supra* note 5.

10 *See* also Maubach, *supra* note 1, who gives a thoroughly legal qualification of a litigation financing contract under German law and comes to the following conclusion at p. 104, with reference to Bräuer in (2001) *AnwBl*, 112, 114, Dethloff in (2000) *NJW* 2225, 2227, and Grunewald in (2000) *BB* 729, 731: 'Prozessfinanzierungsverträge sind Gesellschaftsverträge über eine Innengesellschaft auf der Grundlage der §§ 705 ff. BGB und daher insbesondere weder Darlehens- noch Versicherungsverträge.'

I. Private Litigation Financing

1. Definition[11]

A litigation financing company finances the legal enforcement of claims in dispute against a share of the profits from the outcome of the legal procedures. Most litigation financing companies demand a profit share of between 20 and 50 per cent. Usually, the litigation financing company assumes all costs related to the legal enforcement of claims in dispute, such as court fees, lawyer's fees, the cost of expert reports, etc. The litigation financier is not in charge of the case and usually tenders no legal advice.

2. Practice

In most of the European legal systems, plaintiffs find themselves caught in a conflict of interest between the following two ideas:

- the inexpensive administration of justice[12]
- the hindrances for thoughtless suing.

Many legal barriers have been established on purpose,[13] but legal costs often turn out to be unwanted barriers for plaintiffs. It is widely assumed that the party which has more money can afford better lawyers and therefore has better chances in court. Also, plaintiffs usually have to pay a caution which is meant to cover the court costs and the adversary's lawyer's fees. If such a caution is imposed and is not paid, the suit is considered withdrawn.

In such a situation, a plaintiff can get help from a legal cost insurance company, if he already signed a contract before the occurrence of the incidence for which he needs legal help. Another option offered by the legal system to plaintiffs in need is free legal aid from the state, if the plaintiff fulfils the requirements. The appearance of litigation financing companies on the market provides yet another alternative to just giving up.

The co-operation between the litigation financing company and the claim holder functions in the following way: the holder of the claim in dispute submits an offer for financing his case to the litigation financing company. Based on the information received, the litigation financier examines the case, estimates the costs and the probability of success, and judges the solvency of the adversary.[14] If the case seems to

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[11] *See* also < http://www.prozessfinanz.ch/eng/index.htm > .

[12] Art. 59 KV ZH: 'Das Prozessverfahren soll im Sinne möglichster Rechtssicherheit sowie rascher und wohlfeiler Erledigung geordnet werden. Für Streitigkeiten von geringem Betrag wird ein abgekürztes Verfahren eingeführt.'

[13] E.g., the formal standards with which a plaintiff must comply.

[14] Most of the above mentioned litigation financing companies (*see supra* notes 1 and 2) have questionnaires on their websites. Of course, one cannot come to a decision about whether to finance a lawsuit solely on the basis of such questionnaires, but they provide with an idea about what is examined.

be promising, the litigation financier enters into a contract with the claim holder. From this moment on, the litigation financier bears the costs of the plaintiff's lawyer, the costs for expertise, the court fees, and the reimbursement of the other party if and when imposed. In this manner, the claim holder can eliminate the financial risks related to the legal dispute. In return for this service, the litigation financing company receives a share of the outcome minus costs. The share of the profits taken by litigation financing companies varies from 20 to 50 per cent.

A lawyer representing the claim holders' choice will argue the case in court. There is no contractual relationship between the litigation financing company and the claim holder's lawyer. The claim holder simply has to obligate his lawyer to inform the litigation financier about the pending lawsuit on a regular base.[15] The litigation financing company does not usually give legal advice and limits its activities to the mere financing of the litigation. Nevertheless, it monitors the pending lawsuits and has certain rights to cancel the contract, e.g. if the case turns out to be hopeless, or if the law or the precedents are changing, etc. The greatest potential source of conflict between a litigation financing company and the claim holder is the issue of settlements. The litigation financing company may wish to opt for a quick settlement rather than getting involved in a long and expensive procedure, whereas the claim holder may have set his or her sights on the highest possible award – without worrying so much about the costs. If the claim holder does not agree to the settlement suggested by the litigation financing company, he can buy out the litigation financing company, i.e. he has to compensate litigation financing company financially as if the case had been settled like the litigation financing company had suggested. This, of course, can be quite a problem, because the typical claim holders had asked for financial help in the first place due to the fact that they could not finance the lawsuit on their own.

If a case is won, then the costs will first be deducted from the outcome, and from the remainder of the outcome, the litigation financing company takes its share of the profits. If the case is lost, the claim holder does not have to pay anything. All the costs are left to the litigation financing company.

II. Courts

In Switzerland there are 26 different cantonal codes of civil procedure and 26 different cantonal codes of court organisation.[16] Three to seven judges are usually called upon

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[15] This is not a problem in Switzerland, but can be a problem in countries where lawyers' secrecy is very strictly adhered to, as in France. In any case, the claim holder himself is also obligated to inform the litigation financing company about the case.

[16] According to the new Art. 122 Abs. 1 BV, the codification in civil procedures will be a federal matter in the future, whereas the codification concerning the court organisation will remain a cantonal matter: *see* also O. Vogel and K. Spühler, *Grundriss des Zivilprozessrechts und des internationalen Zivilprozessrechts der Schweiz* (Bern 2001, 7th ed.) at §20 n. 1 et seq.

to come to a decision in the courts, while for smaller disputes there is often only a single judge. In Switzerland, there is no jury system in civil cases. Some cantons have special courts for certain legal matters, e.g. labour courts, commercial courts, etc.[17]

The cantons have usually two court stages for civil cases, with the federal court then being the third and final stage of appeal. Some cantons also have courts of reversal, from which the case would be sent back to the prior stage for a new judgement if the appellant wins. The formal requirements for a suit are quite high, especially in front of the federal supreme court.[18]

One peculiarity in Swiss civil procedures is the splitting of recourse, e.g. if a case is lost in front of the high court in Zurich[19] based on the conclusion that there has been no damage, the lawyer has either to file a recourse at the cantonal court of reversal[20] claiming a false documentation of facts or to file a recourse at the federal supreme court[21] claiming that the stage before used the legal methods for calculating damages incorrectly. If the lawyer cannot see, on the basis of the verdict, how the court has come to the conclusion that there has been 'no damage', he has to file both recourses to act according to his duty of care. This, of course, will approximately double the legal costs at that stage and increase the risks of losing due to formal mistakes. If both appeals are filed, the appeal at the federal supreme court usually remains suspended until the cantonal court of reversal has decided. And if the plaintiff wins the cantonal reversal, the case goes back to the prior cantonal high court, while it remains suspended at the federal supreme court. If the cantonal appeal of reversal is lost, the plaintiff can go to the federal supreme court with a federal appeal of reversal,[22] while the civil complaint at the federal supreme court remains suspended. If the federal appeal for reversal is won, the case goes back to the cantonal high court for a new trial; if it is lost, then the suspension of the civil recourse at the federal supreme court will be lifted.

III. Lawyers

1. The Market of Lawyers

In Switzerland lawyers have a monopoly,[23] i.e. only a registered[24] lawyer by profession may represent clients in court.

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[17] *See* Vogel and Spühler, *supra* note 16 at § 16 n. 62 et seq.

[18] *See* Geiser, in Geiser and Münch, *Prozessieren vor Bundesgericht* (Basel 1998, 2nd ed.) Rz. 1.74. The federal supreme court approves only between 10 and 15 per cent of the complaints. Many denials are due to formal reasons.

[19] *Kantonale Obergericht des Kantons Zürich.*

[20] *Kantonale Nichtigkeitsbeschwerde.*

[21] *Eidgenössisches Berufung in Zivilsachen an das Bundesgericht.*

[22] *Staatsrechtliche Beschwerde an das Bundesgericht.*

[23] *See* Art. 2, 'Bundesgesetz über die Freizügigkeit der Anwältinnen und Anwälte (Anwaltsgesetz, BGFA)' in SR 935.61; Poledna, 'Anwaltsmonopol und Zulassung zum Anwaltsberuf – Streiflichter in vier Thesen' in Fellmann *et al* (eds), *Schweizerisches Anwaltsrecht* (Bern 1998), pp. 89–106, at 89 et seq.

[24] See Art. 5, 6 BGFA.

Most of the Swiss lawyers are active members of the Swiss Bar Association.[25] In 2002 the Swiss Bar Association tallied 6,652 active members.[26] According to a study of the Zurich Bar Association,[27] only 22 per cent of the members worked for a law firm with more than 20 lawyers. The lawyers questioned in this study were billing 1412 to 1602 hours a year.[28] Pfeifer and Widmer estimate that the Swiss 'legal industry' is achieving a turnover of CHF 2 billion per year.[29]

2. *Professional Rules*

The law profession is mainly regulated by the BGFA[30] and by the cantonal acts on lawyers. Additionally, the lawyers' associations also have some rules, but those rules are basically only applicable to their respective members (exceptions are possible).

A litigation financing company is not subject to the federal act on lawyers and is also not usually subject to the cantonal acts on lawyers. However, some exceptions do exist. The cantonal rules are in part stricter than the federal rules. For example, § 39 AnwG ZH is far more limiting for the work of a litigation financing company, because it forbids even non-lawyers from providing or arranging legal aid in exchange for a share of the profits.[31] Nonetheless, the mere financing of litigation is allowed according to § 39 AnwG ZH.[32]

Out of all of the regulations concerning the law profession, the following issues are those with the biggest impact on the work of a litigation financing company:

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[25] A lawyer need not be member of the Swiss Bar Association to practise law, but most lawyers are members.

[26] *Mitgliederstatistik SAV* 1992-2002 (*see* < http://www.swisslawyers.com >).

[27] 'Studie Praxiskosten (Basisjahr 1999) des Zürcher Anwaltsverbands,' quoted according to André Thouvenin, 'Büroorganisation', in *Aktuelle Anwaltspraxis 2001* (Bern 2002) at p. 451 et seq.

[28] Thouvenin, *supra* note 27 at 463.

[29] Pfeifer and Widmer, 'Rechtsberatungsmarkt Schweiz – Nimmt der Anwalt teil am Aufbruch oder ist er Auslaufmodell?' in Fellmann *et al* (eds), *Schweizerisches Anwaltsrecht* (Bern 1998), pp. 57–70, at 61 et seq.

[30] 'Bundesgesetz über die Freizügigkeit der Anwältinnen und Anwälte (Anwaltsgesetz, BGFA)', SR 935.61.

[31] §39 AnwG ZH (LS 215.1): 'Wer in Verletzung der guten Sitten, im besonderen unter irreführenden Angaben gewerbsmässig Rechtshilfe verspricht oder unter den gleichen Voraussetzungen das Versprechen einer solchen Leistung gewerbsmässig vermittelt, wird durch das Statthalteramt mit Polizeibusse bis zu Fr. 1000 bestraft.

In gleicher Weise wird bestraft, wer die Gewährung von Rechtshilfe gegen die Einräumung eines Anteiles am Erfolg in irgendeiner Form übernimmt oder vermittelt.' 'Mit der Bussenverfügung wird für den Fall der Wiederholung die Androhung gemäss § 24 verbunden.' Whereas the BGFA is not valid for litigation financing companies; Art. 2 Abs, 1 BGFA: 'Dieses Gesetz gilt für Personen, die im Rahmen des Anwaltsmonopols Parteien vor Gericht vertreten'.

[32] At < http://www.prozessfinanz.ch > , Prozessfinanz has published the decision concerning its litigation financing business.

- prohibition of cession of claims[33]
- prohibition of a share of the profits from the proceedings[34]
- the lawyer's monopoly.[35]

Because the lawyer has a monopoly over his client, a litigation financing company may not represent parties in court. On the other hand, the litigation financing company is not subject to the prohibition of a lawyer receiving a share of the proceedings. Nor is it subject to the prohibition of cession of claims. This loophole is the basis of the litigation financing business.

IV. Costs

1. Court Costs

The courts require fees for their work. The fees can either be in the form of a flat rate or can be divided up into court costs, writing costs, and delivery charges. In addition there are certain cash expenses (for witnesses, expertise or to judge by appearance).[36]

The cantons have tariffs for the court fees which impose the fees according to the amount in dispute, the kind of procedure, etc. If the contending parties have an amount in dispute, this amount is normally the basis for the assessment for the court costs.

According to most cantonal rules, the plaintiff has to pay the court an advance to cover the court costs and also eventually to cover the potential fees of the opposing party's lawyer. In most cantons, if this advance is not paid, the plaintiff faces the risk of having the court regard the case as withdrawn.

The table overleaf shows that with an increase in the amount in dispute the court costs, the lawyers' fees, and hence the total cost risk increases.[37] However, the higher the amount in dispute becomes, the more the ratio between the total costs risk and the amount in dispute declines. For example, with an amount in dispute of CHF 50,000, the total costs risk as shown in the table is 30.87 per cent of the amount in dispute, and with an amount in dispute of CHF 1,000,000, the total risk as shown in the table is 7.89 per cent of the amount in dispute. The ratio between the total costs

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[33] This prohibition is included in some of the cantonal acts on lawyers, e.g. § 10 AnwG ZH; § 14 AnwG ZG; Art. 17 AnwG BE; § 9 Abs. 2 AdvokG BL; § 11 lit. e AdvokG BS; Art. 41 LAV GE; etc.

[34] Art. 12 Abs. 1 lit. e BGFA.

[35] Art. 2 BGFA.

[36] Vogel & Spühler, *supra* note 16, at §50 n.16 et seq., provide an overview of the cantonal rules concerning the court costs.

[37] This table is based on the 'Verordnung über die Anwaltsgebühren vom 10. Juni 1987' (LS 215.3), § 2, and on the 'Verordnung über die Gerichtsgebühren vom 30. Juni 1993' (LS 211.11), § 3. It only shows the costs of one legal stage. However, the actual cost risk for each legal stage can be much higher, since the lawyers can charge their clients more, depending on the complexity of the case, etc. Moreover, value-added taxes are neglected in this example.

Amount in dispute	Court costs	Lawyer's fee according to tariff	Total costs risk[38]
CHF 50,000	CHF 4,035	CHF 5,700	CHF 15,435
CHF 100,000	CHF 6,435	CHF 8,800	CHF 24,035
CHF 500,000	CHF 15,435	CHF 20,000	CHF 55,435
CHF 1,000,000	CHF 22,935	CHF 28,000	CHF 78,935

risk and the amount in dispute is the most important reason for litigation financing companies to demand for there to be a quite high minimum amount in dispute.

2. *Lawyer Fees*

Lawyers in Switzerland are not allowed to take contingency fees, as is done in the USA.[39] They usually bill on a time base. The legal fees per hour are around CHF 200-800, depending on the region, the amount in dispute, the specialisation etc. The cantons also have tariffs for lawyer's fees – most of them take the amount in dispute in consideration.

3. *Reimbursement of the Legal Costs*

The court costs are usually allotted to the parties according to the ratio between the amount in dispute claimed by the plaintiff and the amount he or she is actually awarded by the court..[40] For example, if the plaintiff sues his opponent for CHF 300,000, the court costs will be CHF 12,435.[41] If the plaintiff is awarded only CHF 100,000, i.e. one-third of his claim, he has to pay two-thirds of the court costs, i.e. CHF 8,290. Additionally, he also has to pay two-thirds of his and his opponents' lawyers' fees. Thus, the higher the amount that the plaintiff is suing for, the higher the court costs, and the plaintiffs risk being allotted a larger share of the court costs.

There are some exceptions from this principle:[42]

- Unnecessarily-caused costs will be awarded to the party who has incurred them.

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[38] To calculate the total cost risk, the lawyers' fees according to the tariff are doubled and the court costs are then added, since the losing party is required to pay a reimbursement to the winning party.

[39] Art. 12 Abs. 1 lit. e BGFA; § 10 Abs. 1 AnwG ZH; *see* also Schenker, 'Gedanken zum Anwaltshonorar' in Fellmann *et al* (eds), *Schweizerisches Anwalt* (Bern 1998), pp. 143–159, at 143 et seq; Adrian Dörig, 'Anwaltliche Erfolgshonorare in den USA und in der Schweiz' in (1998) 6 *AJP/PJA* 687-695, 691.

[40] For example, § 64 ZPO ZH; Vogel & Spühler, *supra* note 16 at § 50; BGE 110 Ia 97.

[41] 'Verordnung über die Gerichtsgebühren vom 30. Juni 1993' (LS 211.11), § 3.

[42] Vogel & Spühler, *supra* note 16 at § 25 n. 25 et seq.

- If the losing party was suing in good faith, the judge can make an exception from the general rule (this is rather seldom).
- Third parties can be allocated costs which they have caused and for which they are culpable (e.g. a witness, who did not appear without an excuse).

4. Legal Aid

A plaintiff can receive free legal aid if it is necessary that he or she is represented by a lawyer,[43] when the case is not pointless from the start,[44] and if he or she is in need.[45] If the plaintiff complies with the above-mentioned requirements, he does not need to pay the court costs and his lawyer's fees will be paid by the court. However, in such cases, the lawyer's fees, which the court pays according to a tariff, are usually less than a lawyer would obtain otherwise. Hence, there is still a disadvantage for the plaintiff in need.

5. Legal Costs Insurance

Legal costs insurance companies cover the costs related to legal matters or related to rendering other services in legal matters.[46] The duty to render services is a speciality when compared to other types of insurance, which only render financial help.[47] Nevertheless, the claim holder must have signed a legal costs insurance contract before the occurrence of the incident with respect to which he is seeking financial help.

There are different types of legal costs insurance:[48]

- Traffic or motor vehicle legal costs insurance
- Private legal costs insurance
- Factory legal costs insurance
- Association legal costs insurance

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[43] Ibid. § 53 n. 59, 70.

[44] Ibid. § 53 n. 68 et seq.; BGE 109 Ia 9; BGE 119 III 116.

[45] Ibid. § 53 n. 64 et seq.; BGE 104 Ia 34; BGE 106 Ia 82.

[46] Art. 1RVV contains the following legal definition of legal costs insurance: 'Die Rechtsschutzversicherung besteht darin, dass gegen Bezahlung einer Prämie das Risiko übernommen wird, durch rechtliche Angelegenheiten verursachte Kosten decken oder in solchen Angelegenheiten Dienste leisten zu müssen.' *See* also D. Poltera, Der Rechtsschutzversicherungsvertrag und das Verfahren bei Meinungsverschiedenheiten in der Schadenabwicklung (Diss. St. Gallen 1999) at p. 11. For a general definition of insurance companies, *see* Stoessel, 'Allgemeine Einleitung' note 2 et seq, in Honsell *et al* (eds), *Kommentar zum schweizerischen Privatrecht. Bundesgesetz über den Versicherungsvertrag (VVG)* (Basel 2001), with many further references.

[47] M. Plattner & J.-P. Schmid, 'Gerichtskosten und Rechtsschutzversicherungen' in *Gerichtskosten, Parteikosten, Prozesskaution, unentgeltliche Prozessführung* (C. Schöbi (ed.)) (Bern 2001) at p. 60.

[48] Poltera, *supra* note 47 at p. 37 et seq.; *see* also H. Erb, *Grundzüge des Versicherungswesens* (Zürich 1990) at p. 123.

- Farming legal costs insurance
- Real estate legal costs insurance.

In Switzerland, the eight biggest legal costs insurance companies (Assista, CAP, ARAG, Winterthur-Rechtsschutzversicherung, DAS, Orion, Protekta, and COOP-Rechtsschutzversicherung) together hold about 94 per cent of the market share.[49]

6. *Litigation Financing*[50]

Private litigation financing is a new way for claim holders to pursue their claims in legal procedures. If they do not obtain legal aid from the state, and if they are not covered by a legal costs insurance company or do not have enough money themselves, a litigation financing company might be the only other alternative to giving up. Once a litigation financing contract is signed, the litigation financing company underwrites all the costs incurred during the legal pursuance of the claim.

V. Conclusion

The private litigation financing business is legal in Switzerland[51] and Germany.[52] In Switzerland, most of the legal limitations pertaining to the activities of a private litigation financing company derive from the federal and cantonal codes of lawyers. The rules concerning the legal costs and the formal requirements for suits and appeals reduce the attractiveness of the litigation financing business to a certain degree. However, since the enactment of the federal act on lawyers might lead to changes in the cantonal rules and since a new federal law concerning civil procedures is in the pipeline, the litigation financing business in Switzerland may become more attractive in the future. The litigation financing branch hopes that they will in the future be allowed to do some legal counselling and mediation outside the courts themselves, throughout Switzerland.

In Switzerland, there seems to be more acceptance of private litigation financing among the claim holders than among the lawyers, who might have some concerns about their independence and the lawyer's right to secrecy. Research has shown that a potential conflict of interest between a lawyer and a litigation financing company exists, since lawyers may tend to 'sell' the less attractive cases to litigation financing companies in favour of their clients and themselves, thereby receiving more fees. Hence, it is important for the litigation financing company to monitor the performance and the billing of the lawyers in charge.

Even though litigation financing companies demand quite a high value in

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[49] Poltera, *supra* note 47 at p. 13.

[50] *See supra* 'Section I. Private Litigation Financing.'

[51] *See* N. Kircher, 'Und kräftig locken die Millionen,' in (2 March 2000) *CASH*; 'Anwaltsgesetz nicht verletzt,' in (3 March 2000) *Tagesanzeiger*.

[52] *See* for example Maubach, *supra* note 1 at p. 31 et seq.

dispute,[53] the great number of enquiries[54] shows that there is a demand for the services rendered by litigation financing companies. Most of these enquiries, however, have to be declined, because the chances to win the cases are too small.[55] On the other hand, it seems reasonable to assume – on the basis of certain observations – that there is a lot of potential for business in some legal areas, especially in asset management malpractice[56] and in inheritance cases. Generally, the amounts awarded for personal injuries and product liability cases are smaller than those awarded in the USA.

C. Contingency Fees and Aspects of their Legal Context in the USA

I. Contingency Fees

1. Definition

The contingency fee[57] can be defined as follows: 'A contingency fee is a fee received for services performed on behalf of a client who is asserting a claim, payable to the lawyer if, and only if, some recovery is achieved through the lawyer's efforts. Its distinguishing characteristic is in the negative: if no recovery is retained for his client, the lawyer is not entitled to a fee.'[58] A contingency fee agreement is *a pactum de quota litis*.

The literature points out several advantages of contingency fees: they allow people who could not otherwise afford it to obtain legal aid,[59] they can reduce the conflict of interest between the plaintiff and the lawyer by creating a win-win situation, and they can be seen as part of the right to liberty in contract.[60]

The following disadvantages often form the basis on which the contingency fees

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[53] EUR 50,000–500,000.

[54] Prozessfinanz has had several hundred enquiries in Switzerland since its founding. In Germany, the market leader FORIS stated in its *Annual Report 2001* at p. 2: 'FORIS AG has processed more than 4,500 enquiries on litigation financing since starting its activities.'

[55] The rejection rate at Prozessfinanz is estimated to be at over 98 per cent. The rejection rate at the German market leader FORIS is around 96 per cent. More data on FORIS will follow *infra* at 'E. Conclusion and Outlook on the Litigation Financing Business.'

[56] *See* also U. Aeberli, 'Wie Anleger ohne Risiko Recht bekommen,' in (23 March 2001) *Stocks*.

[57] Forms for contingency fees agreements can be found for example on the following websites: <http://www.jhsclassaction.com/fees.html>, <http://www.falseallegations.com/agr-cnt2htm>, <http://www.lienlaw.com/contingency.htm>.

[58] A. Wennihahn, 'Let's Put the Contingency Back in the Contingency Fee (Comment)' in (1996) 49 *Southern Methodist University Law Review* 1640, at 1644.

[59] 'The poor man's key to the courthouse door.'

[60] Dörig, *supra* note 39 at pp. 687–695.

system is criticized: in some situations, the client lacks information and the freedom to make decisions, which can lead to contingency fees agreements which are not in favour for the client. Also, compared to time billing, the contingency fees might be exorbitantly high. Another problem is seen in the incentive of the lawyer to optimize his time effort and not the amount obtainable for his client. Moreover, contingency fees are sometimes declared responsible for frivolous lawsuits.[61]

2. *Practice*

Contingency fees are legal in every state of the USA.[62] They are not allowed in the fields of family law and criminal law for reasons of public policy.[63] Contingency fees agreements can be encountered especially in civil actions for damages, personal injury cases, class actions, antitrust actions, and derivative actions by shareholders.[64]

Some states have established limitations concerning the contingency fee system, such as:[65]

- reservation of approval by the court
- upper limits are set by law
- sliding scales.

Contingency fees agreements must be in writing. The contingency fees are usually between 25–50 per cent, depending on the stage of trial, and so on.

II. Courts

The USA have two independent court systems: the federal courts and the state courts.[66] In the USA, the federal courts have also three stages. The District Courts are the first stage. There are 91 District Courts in the 50 states, District of Columbia and Puerto Rico; additionally, there is one District Court each on Guam, the Virgin Islands, the Northern Mariana Islands, and in the Channel Zone.[67] Special courts at the level of the District Courts are the U.S. Claims Court, the Court of International Trade and the Tax Courts. Each District Court has also a Bankruptcy Court.

The 13 Courts of Appeal are assigned to the District Courts for the appeal stage. An exception is the Federal Circuit, which offers a nation-wide stage of appeal for

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[61] Ibid. p. 690; Wennihahn, *supra* note 58 at p. 1644.
[62] Dörig, *supra* note 39 at p. 688; Wennihahn, *supra* note 58 at p. 1652; G. C. Hazard Jr. et al, *The Law and Ethics of Lawyering* (Westbury 1994, 2nd ed.) at p. 532.
[63] Dörig, *supra* note 39 at p. 688 et seq.
[64] Ibid., at p. 688; Wennihahn, *supra* note 58 at p. 1644; Hazard et al, *supra* note 62 at p. 530; H. Schack, *Einführung in das US-amerikanische Zivilprozessrecht* (München 1995, 2nd ed.) at p. 8.
[65] Birnholz, 'The Validity and Propriety of Contingent Fee Controls' in (1990) 37 *UCLA Law Review* 949-984; Dörig, *supra* note 39 at p. 689 et seq.
[66] Schack, *supra* note 64 at p. 2 et seq.
[67] Ibid., at p. 2.

the Claims Court, for the Court of International Trade, and for special actions concerning the patent law cases from all of the District Courts.[68]

The Supreme Court is the highest Federal Court over the Circuit Courts of Appeals. It is also in charge as the highest authority on decisions made by the highest state courts. The Supreme Court decides on its own which cases it takes on the basis of a petition for certiorari.[69]

The state court systems have usually two or three stages. Typically, there is a Superior Court or a District Court at the lowest level. Above this, there is a Court of Appeal and sometimes even a Supreme Court. For minor cases, some states have special courts like Municipal Courts, County Courts or Small Claim Courts.[70]

The 1996 survey of the Bureau of Justice Statistics of state courts states the following:[71]

- 'Overall, plaintiffs won in 52 per cent of trial cases. Plaintiffs won in bench cases (62 per cent) more than in jury cases (49 per cent), and in contract cases (62 per cent) more than in either tort (48 per cent) or real property cases (32 per cent).'
- 'An estimated USD 3 billion in compensatory and punitive damages were awarded to plaintiff winners in trial cases. Juries awarded an estimated total of USD 2.4 billion to plaintiff winners while USD 629 million was awarded by judges. The median total award for plaintiff winners in jury cases was USD 35,000, and in bench cases, USD 28,000.'

According to the above-mentioned survey, only 23.4 per cent of the medical malpractice plaintiffs have won their cases;[72] it seems that those cases are hard to prove.

In general, the formal barriers for filing a suit are lower in the USA than in Switzerland. Due to punitive and other legal conditions, the amounts awarded for personal injuries and product liability cases seem to be higher than in Switzerland.

III. Lawyers

1. The Market of Lawyers

The lawyers are organized in state bars, but there is no distinction made between solicitors and barristers as in England. Once a candidate has passed the bar exam in

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[68] Ibid.
[69] Ibid., at p. 3.
[70] Ibid., at p. 4.
[71] 'Civil Trial Cases and Verdicts in Large Counties, 1996,' Bureau of Justice Statistics Bulletin, September 1999, *NCJ* 173426, 1; available on <http://www.ojp.usdoj.gov/bjs/pub/pdf/ctcvlc96.pdf>.
[72] Ibid., at p. 7.

one state, he has access to all federal courts. If the lawyer moves to another state, he has to pass the bar exam again.[73]

In the United States, big law firms with a high level of specialisation are quite common. The largest law firm has more than 1600 lawyers, and there are more than 18 law firms with over 500 lawyers.[74] Law firms expect about 2000 billable hours a year from their lawyers.[75] The hourly fees are for the most part between USD 150 and USD 400, but higher hourly fees are possible.

According to the 'Draft Chapter on Professional Business Services,' the US legal industry had an output of USD 220.9 billion in 1992, with 777,000 lawyers.[76]

2. *Professional Rules*

US lawyers have some advantages when it comes to their business interests, in comparison with Swiss lawyers. The attorneys in the USA have nearly no legal limitations in advertising, in agreeing on success orientated fees, etc. There are no tariffs on lawyer fees – there is only a control of abuse which takes the reasonableness of the fee into consideration.[77]

IV. Costs

1. *Court Costs*

In the USA, court costs are usually very low in order not to create overly high barriers for those persons seeking justice.[78] The filing fee for a civil action was USD 120 in 1986.[79] In addition to the filing fees, the courts also require the following costs:

- delivery charges
- expenses for witnesses
- expenses for experts ordered by the court
- expenses for translators

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[73] Schack, *supra* note 64 at p. 6.
[74] Ibid., at p. 7.
[75] Ibid., at p. 8, with reference to Gibbons, *AnwBl.* 1990, 283.
[76] 'Draft Chapter on Professional Business Services,' quoted according to Pfeifer and Widmer, *supra* note 29 at p. 61. *See* also Schack, *supra* note 64 at p. 6, who sees a connection between the number of lawyers per capita and the number of civil trial cases per capita. In 1991, the number of civil trial cases per capita was 25 per cent higher in the USA than in Germany. Meanwhile, there were 2324.5 lawyers per 1 million inhabitants in the USA and 743.2 lawyers per 1 million inhabitants in Germany. (Author's remark: the figures quoted by Pfeifer and Widmer do not match up with those quoted by Schack.)
[77] Dörig, *supra* note 39 at p. 689; 'ABA Model Rules of Professional Conduct' 1.5 (1983)
[78] W. Schurtman & O.L. Walter, *Der amerikanische Zivilprozess* (Frankfurt am Main 1978) at p. 34; Schack, *supra* note 64 at p. 7 et seq.
[79] Ibid.

– docket fees for lawyers.[80]

Depositions, as well as legal documents which may have to be copied (or even printed) several times, may also turn out to be further cost factors.[81]

2. The Lawyer's Fees

There are no fixed tariffs on lawyers' fees in the USA. Lawyers make fee agreements on the basis of time invested or success achieved. In fee agreements on the basis of time, there is no fixed relationship to the amount in dispute. There are also flat fees, retainers, and value billing.[82]

Most lawyers, especially defence lawyers, bill on a time basis. Plaintiff lawyers often make contingency fee agreements in cases of car accidents, product liability, and medical malpractice.[83]

3. The Reimbursement of the Legal Costs according to the American Rule

According to the American Rule, the winning party cannot claim costs from the losing party.[84] There are some exceptions to this rule – for example, in lawsuits pursued either vexatiously, wantonly, or in bad faith, or for oppressive reasons – where most of them are in favour of the winning party.[85] In addition, there are some federal rules which impose certain legal costs on the losing party.[86]

The defendant, who has to pay expensive time based fees, is in a worse position when compared to a plaintiff with a contingency fees arrangement. Even if the defendant wins the case, he will have to bear the costs himself.[87] This makes the defendant more willing to agree to a settlement for opportunity costs reasons.

According to Schack, the American Rule is strongly supported by lawyers because if the legal costs risk was raised by a general cost shifting, the number of lawsuits and the income of the lawyers would fall.[88]

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[80] Ibid.
[81] Ibid., at p. 8; Schurtman and Walter, *supra* note 77 at p. 34.
[82] A. Dörig, referring to Lars-Uwe Pera, *Anwaltshonorare in Deutschland und den U.S.A.* (Bonn 1995) at p. 95.
[83] Schack, *supra* note 64 at p. 8 et seq.
[84] Ibid. p. 9 et seq.; Schurtman and Walter, *supra* note 77 at p. 35.
[85] Schack, *supra* note 64 at p. 10.
[86] 28 USC § 1920; Schack, *supra* note 64 at p. 10.
[87] Ibid., p. 9; *see* also C. Lenz, *Amerikanische Punitive Damages vor dem Schweizer Richter* (Zürich 1992) at p. 11, with reference to J.B. Sales and K.B. Cole, 'Punitive Damages: a Relic That Has Outlived Its Origin' in (1984) 37 *Vanderbilt Law Review* 1117.
[88] Schack, *supra* note 64, at page 10.

4. Legal Aid

According to 28 USC § 1915, legal aid exempts one only from the court costs. According to 28 USC § 1915 (d), the court can charge a lawyer with the representation of a poor party; the lawyer will not get paid by the court or the poor party. Rule 6.1 ABA 'Model Rules of Professional Conduct' (1993) demands that a minimum of 50 hours pro bono work be done annually.[89]

V. Punitive Damages

1. Definition

Black's Law Dictionary gives a useful definition of punitive damages:[90] 'Exemplary or punitive damages. Exemplary damages are damages on an increased scale, awarded to the plaintiff over and above what will barely compensate him for his property loss, where the wrong done to him was aggravated by circumstances of violence, oppression, malice, fraud, or wanton and wicked conduct on the part of the defendant, and are intended to solace the plaintiff for mental anguish, laceration of his feeling, shame, degradation, or other aggravations of the original wrong, or else to punish the defendant for his evil behavior or to make an example of him, for which reason they are also called "punitive" or "punitory" damages or "vindictive" damages. Unlike compensatory or actual damages, punitive or exemplary damages are based on an entire different public policy consideration that of punishing the defendant or of setting an example for similar wrongdoers, as above noted. In cases in which it is proved that one has acted wilfully, maliciously, or fraudulently, a plaintiff may be awarded exemplary damages in addition to compensatory or actual damages. Damages other than compensatory damages which may be awarded against person to punish him for outrageous conduct. Wetherbee vs. United Ins. Co. of America, 18 C.A.3d Cal. Rptr. 678, 680.'

2. Practice

Since the mid-1970s, the number of punitive damages verdicts and the amounts awarded have risen: punitive damages of USD 3.5 million were imposed on Ford in

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[89] Ibid., at p. 11.

[90] *Black's Law Dictionary*, p 352; detailed information about punitive damages can be found in L.L. Schlueter and K.R. Redden, *Punitive Damages*, vol. I and II (1995, 3rd ed.). The German literature about punitive damages seems to be especially interested in the question whether American verdicts which impose punitive damages can be held as valid in Europe. *See*, for example, C. Lenz, *Amerikanische Punitive Damages vor dem Schweizer Richter* (Zürich 1992); D. Brockmeier, *Punitive Damages, Multiple Damages und Deutscher Ordre Public* (Tübingen 1999); J. Rosengarten, *Punitive Damages und ihre Anerkennung und Vollstreckung in der Bundesrepublik Deutschland* (Hamburg 1994); P. Müller, *Punitive Damages und Deutsches Schadensersatzrecht* (Berlin 2000).

Grimshaw v. Ford Motor Co.,[91] while damages amounting to USD 5 million were imposed on Honda in *Dorsey v. Honda*.[92]

According to the Civil Justice Survey of State Courts 1996, about 5 per cent (360 cases) of the 7,892 trial cases in which the plaintiff won 'received punitive damages as part of the final award, totalling over USD 600 million and accounting for about 21 per cent of the USD 3 billion awarded to plaintiffs overall.'[93]

One reason why the awarded punitive damages are so high is seen in the contingency fee system. The jury knows that the successful plaintiff has to pay a big share of the awarded amount to his lawyer. Therefore, the jury will award a correspondingly higher amount.[94]

VI. Conclusion

The contingency fee system is viewed as the poor man's key to the courthouse door, but as a matter of fact, most lawyers bill on a time basis, especially defence lawyers. If the US lawyer takes on a case with a high amount in dispute which he also regards as promising, it is economically interesting for him to make a contingency fee agreement with his client. If the amount in dispute is too small or if the case seems hopeless, the lawyer will instead propose a time-based or a flat fee. A oft-raised criticism is that the lawyer can benefit from the situation of asymmetric information, since he is better able to forecast the outcome of a case.

Fearing abuse of the contingency fee system, some states in the USA have established limitations like reservation of approval by the court, upper limits by law, and sliding scales.

Contingency fee lawyers also profit from the American Rule, from punitive damages, and from advertising.

D. Comparison: Contingency Fees and Private Litigation Financing

The contingency fees system in the USA has a long tradition and is well established. It is also generally accepted, even though there are some controversial discussions and some legal limitations concerning it. In Europe, however, private litigation financing in the form described thusfar is quite new, is not yet well

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[91] *Grimshaw v. Ford Motor Co.* (1981), 119 Cal. App. 3rd 757, 174 Cal. Rptr. 348.

[92] *Dorsey v. Honda Motor Co.* (5th Cir. 1982), 655 F.2d 650, modified, 670 F.2d 21, cert. Denied, 459 U.S. 880, 103 S.Ct. 177, 74 L.Ed.2d 145 (1982).

[93] Bureau of Justice Statistics, *supra* note 71 at p. 9.

[94] Lenz, *supra* note 90 at p. 12 et seq. with reference to E.C. Stiefel and R. Stürner, 'Die Vollstreckbarkeit US-amerikanischer Schadenersatzurteile exezessiver Höhe' in (1987) *Versicherungsrecht* 829 et seq., 831 in note 33.

known[95] and accepted. Moreover, there are still some reservations – more among lawyers[96] than among claim holders. The lawyers might be partly justified in being reserved, because if their client has a contract with a litigation financing company, his work will be more critically monitored. The claim holders, however, often do not have any other options for pursuing their claims. They would thus rather agree to split a share of the profits than to write off their claim in toto by not doing anything.

The following table shows some of the most important differences between the contingency fees system in the USA and private litigation financing in Europe (with Switzerland as example).

Contingency Fees System in the USA	Private Litigation Financing in Europe
– Long tradition	– New
– Generally accepted.	– Still some reservations – more among lawyers than among claim holders.
– No criminal law cases, no family law.	– No legal limitation as to what kind of cases, but deliberate specialization of the litigation financing companies excludes mostly criminal law cases.
– A profit share of 20–50 per cent.	– A profit share of 20–50 per cent.
– Profits from punitive damages.	– No punitive damages.
– The contingency lawyer runs the case himself.	– External lawyers run the cases. There is no contract between the external lawyer and the litigation financing company.
– Comparably low court costs.	– Comparably high court costs.
– The American Rule reduces the legal costs risk.	– Rules imposing legal costs on the losing party increase the legal costs risk.
– Contingency fee lawyers seem to be quite flexible concerning the amount in dispute.	– Litigation financing companies demand a relatively high minimum amount in dispute.

The most meaningful advantage of the American contingency fee lawyer compared to the litigation financing company is the following: the American contingency fee lawyer can run the case himself. In this way, he or she obtains more direct and eventually more accurate information about the case and has more influence on the legal measures that should be taken. The litigation financing company, however, has a potential conflict of interest with the client's lawyer and has nearly no influence over the legal measures that should be taken, once the litigation financing contract has been signed. Also, the different rules concerning legal costs create a sizeable advantage for the American contingency fee lawyer compared to the litigation financing company.

On the other hand, since the litigation financing company does not run the case, it has less responsibilities than the lawyer in charge and need not fear malpractice suits.

From the claim holders' point of view, the litigation financing company offers some advantages compared to the contingency lawyer:

- The claim holder basically has a free choice of the lawyer he wants to put in charge. He can also switch lawyers, if he is not satisfied with their performance.
- The litigation financing company will also pay the court costs and the costs for the opposing party as imposed.
- Depending on the jurisdiction under which the litigation financing company works,[97] the claim holder can also get a free[98] second opinion about his case.

The contingency fees system and the litigation financing companies can both be regarded as the poor man's key to the courthouse – but the poor man has to have a rather large amount in dispute. Otherwise, neither the contingency fees lawyer nor the litigation financing company will have any economic interest in entering into a contract with him.

E. Conclusions and Outlook on the Litigation Financing Business

As we have seen, most of the cases in the USA are billed on an hourly basis and not through contingency fees. There are ongoing discussions about the abuse of contingency fees in the USA which have already lead to some limitations to the use of contingency fees (caps, maximum fee schedules, sliding scales, checks on abuse).

Taking into consideration the fact that litigation financing companies face more difficulties in remaining economically successful than do US contingency fee lawyers, one can surmise that litigation financing companies in Europe never will be as well established as contingency fee lawyers are in the USA, unless some legal conditions are changed in favour of the private litigation financing business.

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[95] Litigation financing companies have undertaken many PR campaigns and have gained some media coverage. This accomplishment is already considerable, but there is still a long way to go.

[96] FORIS has focused its PR efforts on lawyers and considers itself to be well accepted; *see* 'FORIS AG Business Report 1999' at p. 9. However, the discussions in law journals and the reactions from claim holders lead to the assumption that the claim holders have less mental reservations than lawyers.

[97] In Switzerland, it depends on the cantonal codes for lawyers as to whether the litigation financing company may only finance a case or also may consult with the client on legal matters.

[98] Actually, this is not completely free, as the costs of the litigation financing company are first deducted from the profits, before the profit share is deducted.

Even if the number of litigation financing companies has increased,[99] only a rather small number of plaintiffs can benefit from these companies. First, the demanded minimum amount in dispute varies from company to company, from EUR 50,000 to EUR 500,000. Secondly, the litigation financing companies refuse most enquiries. For example, FORIS declined 96.2 per cent of the enquiries made to it in the first semester of 2002;[100] the rejection rate at Prozessfinanz is even higher.[101] Thirdly, the financial capacity of each litigation financing company is limited. They thus focus on the most promising cases and do not take on new ones. Some of the litigation financing companies are organized as joint-stock companies, since due to some accounting rules they would have to raise more capital by issuing new stocks each time they signed a new contract which exceeded the financial needs of the standing stock of litigation financing contracts and the allowable amount of debts.[102]

In taking a closer look at the market of litigation financing companies in Europe, one gets an ambivalent picture. On the one hand, more than a dozen firms have entered the market since the foundation of FORIS in 1996 – among them the daughters of two big insurance companies, D.A.S. ProFi AG[103] and Allianz Profi GmbH. They all seem to share the initial euphoria FORIS has been spreading in its reports:

- 'Due to the wholly new nature of the business, no comparative figures towards other companies are available. Furthermore, the temporary delay in realization of litigation proceeds caused by the procedure requires explanation. If one is taking a closer look at the business the level of financing attained and the potential expansion of FORIS AG, one will quickly become convinced of the company's future. Attention must be directed towards the statistically forecast proceeds that are to arise from the already concluded financing contracts. This is the truly meaningful figure for the valuation of the enterprise as a whole. Measured in terms of the forecast, the volume of proceeds of DEM 47.1 million which already includes the cost of lost cases the net result disclosed – which is essentially characterized by the issue costs of the IPO- will be left far behind.'[104]
- 'The company believes that the accumulated proceeds from litigation financing will total DM 7 million in the current year.'[105]

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[99] *See* also note 1.
[100] 'FORIS AG 6-Month Report 2002' at p. 16.
[101] The author estimates that the rejection rate at his company, Prozessfinanz, Switzerland, is over 98 per cent.
[102] 'Juragent Annual Report 2001' at p. 6, describes an interesting new funds model.
[103] D.A.S. ProFi AG is solely the daughter of D.A.S. Insurance, which belongs to the ERGO Insurance Group.
[104] 'FORIS AG Business Report' 1999 at p. 11.
[105] 'FORIS AG Annual Report 2000' at p. 8.

On the other hand, it seems that right at the moment none of the litigation financing companies are in profit.[106] Of course, it lies in the nature of the business that it will take some time until a case works its way through the courts – whereas during that time, a litigation financing company only has expenses and no returns.[107]

It is worth taking a closer look at FORIS, since it is regarded as the pioneer and market leader among the litigation financing companies.[108] Actually, FORIS's situation seems to be right in the middle of a serious turnaround. The share price has dropped continuously from an all-time high of more than EUR 45 to EUR 0.45;[109] this is a loss of 99 per cent compared to its all-time high! The market capitalization fell from EUR 22.27 million on 30 June 2001 to EUR 4.63 million on 20 June 2002.[110] Currently, the market capitalisation is around EUR 2.54 million.[111] Its *6-Month Report 2002* shows a net loss of EUR 1.86 million for the first semester 2002 and 'accumulated losses brought forward' of EUR 7,294,329.[112] The equity fell to EUR 11.22 million; and it would have been lower, had FORIS not activated EUR 3,639,894 for 'payments on account for litigation financing.' Worrying is also the fact that FORIS increased the 'current loans and current portion of long-term debt Bank loans and overdrafts' to EUR 3,277,969, whereas its 1999 balance sheet did not show any Bank loans.[113] These current liabilities increase the risk of insolvency.

What is the reason for FORIS's worrying financial sheet? An analysis of FORIS's data shows that FORIS has not been profitably active in the core business up to now, and that it has lost money on various activities which are not to be considered as its core business. FORIS also seems to have had enormous overhead costs.

The following table shows some key figures concerning FORIS's litigation financing business.

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[106] 'FORIS AG 6-Month Report' at pp. 2, 6, 7, 10; 'FORIS AG Annual Report 2001' II at p. 25 et seq.; 'FORIS AG Annual Report 2000' at p. 4; 'FORIS AG Business Report 1999' at p. 16; 'Juragent AG Geschäftsbericht 2001' at p. 12 shows a loss of EUR 1,992,230 for 2001; Maubach, *supra* note 1 at p. 27.

[107] Ibid., p. 28.

[108] FORIS was founded in 1996. Its initial listing on the '*Neuer Markt*' of the Frankfurt Stock Exchange was on 19 July 1999. To the author's knowledge, FORIS is the only litigation financing company in Europe which is listed on a stock exchange. Therefore, there is more information publicly available on FORIS than on any other litigation financing company.

[109] As of 8 October 2002.

[110] 'FORIS AG 6-month report 2002' at p. 2.

[111] As of 8 October 2002.

[112] 'FORIS AG 6-month report 2002' at pp. 2, 6.

[113] 'FORIS AG 6-month report 2002' at p. 7; 'FORIS AG Business Report 1999' at p. 15.

	1999	2000	2001	01.-06.2002
Cases closed	15	85	101	25
Cases won	6	28	52	17
Cases lost	9	57	49	8
Percentage cases won	40%	33%	51%	68%
Amount in dispute[114]	71.69 mio. EUR	121.62 mio. EUR	163.05 mio. EUR	168.17 mio. EUR
Option volume[115]	35.98 mio. EUR	44.51 mio. EUR	51.06 mio. EUR	51.40 mio. EUR
Average share of profit	50%	37%	31%	31%
Sales litigation financing	0.97 mio. EUR	1.36 mio. EUR	2.35 mio. EUR	1.34 mio. EUR
Expenditure litigation financing	0.22 mio. EUR	0.89 mio. EUR	1.06 mio. EUR	0.87 mio. EUR
Gross revenue litigation financing[116]	0.74 mio. EUR	0.47 mio. EUR	1.30 mio. EUR	0.47 mio. EUR
Personnel costs litigation financing	0.60 mio. EUR	1.72 mio. EUR	2.04 mio. EUR	0.87 mio. EUR
Gross revenue as percentage of option volume	2.06%	1.06%	2.55%	0.91%
Average gross revenue per case won	0.162 mio. EUR	0.049 mio. EUR	0.045 mio. EUR	0.079 mio. EUR
Average gross revenue per case closed	0.049 mio. EUR	0.006 mio. EUR	0.013 mio. EUR	0.028 mio. EUR

The gross revenue generated by litigation financing has been exceeded every year from 2000 on by the personnel costs related to the litigation financing. Only in 1999, the gross revenue from the litigation financing was EUR 0.14 million higher than the personnel costs, but even in 1999, FORIS lost money in the core business due to other overhead costs and 'allowances and reserves for capitalized litigation costs' of EUR 0.267 million.[117]

The percentage of cases won (FORIS's learning curve)[118] shows that in the past the target to win 60 per cent of the financed litigation was not reached, even though the enquiries had been stringently checked and the rejection rate had been between 85 per cent and 96 per cent.[119]

[114] The amount in dispute in this table refers to the volume of the amount in dispute of all litigation financing contracts and not to the cases settled during the year.
[115] The option volume in this table refers to the total option volume of all litigation financing contracts and not to the cases settled during the year.
[116] 'FORIS AG Halbjahresbericht 2002' (presentations slides) 4.
[117] 'FORIS AG Business Report 1999' at p. 16.
[118] 'FORIS AG Halbjahresbericht 2002' (presentations slides) 5.
[119] 'FORIS AG Halbjahresbericht 2002' (presentations slides) 3, 5, 7.

As the average option volume per case has been around EUR 200,000,[120] the achieved average gross revenues per case won have been significantly lower. This might indicate that the claims clearly have been settled below the value in dispute. And if one uses average figures to calculate the amount in dispute and the option volume, one comes to the conclusion that FORIS realized (sales litigation financing) only 11.8 per cent (!) of the option volume for the 101 cases settled in 2001. Furthermore, it seems that on average the cases won have been settled on at around approximately 18 per cent of the amount in dispute.[121]

On the basis of the results of the analysis of the above data, one must say that throughout the years, FORIS has not been able to operate profitably as a litigation financing business.

Even if the annual reports of FORIS are not encouraging for the whole litigation financing branch, however, it is possible to run a litigation financing company profitably.

As it turns out, the costs and the predictability of the outcome of the cases are the two main critical factors for its success.

The market shows that some litigation financing companies have come back down to earth and have started to implement some measures in order to achieve better figures. In its *6-Month Report 2002*, FORIS presents some of the measures in its restructuring program:[122]

- FORIS left the New Market and got a listing on the 'Geregelter Markt,' thereby saving on handling fees.
- FORIS will concentrate its activities on a single location. Its offices in Berlin, Frankfurt, Munich, and New York are already closed or will be closed by the end of 2002.
- In the core business of litigation financing, the number of employees will be reduced to 10.
- FORIS will focus on optimizing the income situation in the existing stock of suits.
- New enquiries will be selected more stringently. Moreover, new contracts will

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[120] The author's estimation is based on figures from several annual reports of FORIS.

[121] If one calculates that with an estimated 200 financing contracts the average amount in dispute is about EUR 815,000. Thus, 52 of the cases won would have represented an amount of dispute of EUR 42,390,000. With an average profit share of 31.3 per cent, FORIS would have received a profit share of EUR 13,260,000, had the 'cases won' been awarded the full amount in dispute. In spite of this, sales are at EUR 2,350,000. In other words, FORIS declares as won only those cases which have had an average write-off of 82.28 per cent of the amount in dispute. Of course, these calculations are based on average values. If the cases won had had amounts in dispute which were far below the average, the write-offs would have been much lower than 82.28 per cent.

[122] 'FORIS AG 6-Month Report' at p. 4.

only be financed from the income and cost reimbursements from previous suits.[123]

- FORIS has launched a cost-cutting program and hopes to have achieved a one-third reduction in costs over the previous year.

Also, FORIS and some other companies have increased the required minimum value in dispute,[124] with the result that sooner or later most of the other litigation financing companies[125] will be likely to follow suit. With this measure, the number of enquiries for litigation financing will probably drop, thus reducing the examining costs. Furthermore, since the court costs and lawyers fees usually decrease in function of the rise in the value in dispute, the risk measured by the value in demand will hence drop, and a higher value in dispute demanded will raise the expected profit.[126]

When FORIS lowered their profit share to 20-30 per cent they hoped that they would obtain higher quality cases. However, since the refusal quota has risen and since the gross revenue as a percentage of the option volume even seems to have fallen, it can be assumed that a lower share of the profits does not necessarily lead to higher quality cases.[127] Nevertheless, in the mean time, the total costs for litigation financing still exceed the gross revenues. Therefore, it can be expected that, sooner or later, the litigation financing companies will raise their profit shares again. Also, litigation financing companies will consider other points than the value in dispute when negotiating the share of the profits with prospect clients, like the specific risks of a suit, the legal stage in which the claim is pending, etc.

Many plaintiffs begin an enquiry with a litigation financing company only in the attempt to obtain free legal advice. 'During the first half of 2002, FORIS processed 445 new enquiries. It concluded 17 new financing contracts.'[128] That means only 3.8 per cent of the enquiries lead to a financing contract. Put the other way round, FORIS refused to finance 96.2 per cent of the enquiries. The rejection rate is obviously very high, whereas according to statistics used by FORIS, plaintiffs win in about 60 per cent of all cases.[129] This indicates that a litigation financing company,

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[123] Concerning new litigation financing contracts, FORIS probably also has to limit itself due to the current financial situation. If one interprets this statement as saying that 'new contract will only be financed from net profits,' FORIS can hardly sign any new litigation financing contracts at the moment.

[124] FORIS raised the value in dispute demanded from DEM 100,000 to EUR 200,000; Juragent, as shown in its 'Geschäftsbericht 2001' at p. 11, has set its new minimum value in dispute at EUR 500,000.

[125] The author's company has also planned to raise the minimum value in dispute to CHF 300,000.

[126] 'Juragent Geschäftsbericht 2001' at p. 11.

[127] On the other hand, with an average profit share of 31 per cent, FORIS's 'sales litigation financing' in 2001 was EUR 2,350,000. At an average share of profit of 50 per cent, it would have been EUR 3,790,000.

[128] 'FORIS AG 6-Month-Report 2002' at p. 16.

[129] According to FORIS's interpretation of the data provided by German Federal Statistics Office; *see* also 'FORIS AG Business Report 1999' at p. 7.

which assumes all risks from the plaintiffs, is kind of a lender of last hope and attracts too many desperados. Perhaps in the future, the litigation financing companies will impose an enquiry fee for the efforts made in examining a case. This measure would reduce the number of enquiries and, hence, the costs related to the examining of the cases, and it would generate some revenues. Also, this measure could raise the quality of the cases offered to finance, as the plaintiffs who consider their own cases as rather hopeless would no longer have any incentive just to try a litigation financing company.

Generally, there are some good reasons for letting plaintiffs take up more of the costs. Litigation financing companies will consider different models for doing so. For example, they could limit their financial aid on the plaintiffs' lawyers' fees (in such a manner, the litigation financing model would come closer to the contingency fees system, where the US lawyers also do not pay the court costs and the costs for the opposing lawyer if imposed).

There is a potential conflict of interest between the plaintiff's lawyer and the litigation financing company. The plaintiff's lawyer receives his money whether or not the suit is won. If he wants to increase his income, he might be interested in getting financial aid from litigation financing companies for cases which are not that attractive. There is thus a danger that he will give to positive estimations about the chances for winning. Facing such a potential conflict of interest, litigation financing companies would be interested in establishing closer co-operation with selected lawyers within the legal limits. This may be carried out to such an extent that a litigation financing company would compile a list of lawyers with whom they would work, so that the plaintiff might have to change lawyers if he wants to obtain financial aid. Also, litigation financing companies would be interested in installing a kind of success participation for the lawyer in charge, within the legal limits. It could thus be possible to arrange a lower hourly wage with the lawyer and a bonus based on his billable hours in case he wins.

At any rate, as experience has show, a litigation financing companies will have to monitor the performance and the bills of the lawyer in charge more critically.

In the future, the litigation financing companies will also have to check more stringently the solvency of the adversary, as there is not much use in winning a case against someone who cannot pay his debts. As well, the litigation financing companies will have to consider more intensely measures to secure the value in dispute, like blocking the selling of real estate or blocking bank accounts.

Under the current legal conditions in Switzerland and Germany, litigation financing is an extremely tough business. Companies which do not manage to keep their costs strictly under control and which do not achieve a minimal accuracy in forecasting the outcome of the cases enquiring financial aid will probably be out of market within a few years. Perhaps oncoming changes in the legal conditions – like higher awards for damages and amends, simplified civil procedures, etc. – could make the litigation financing business more attractive in the future.