



## Practical Guidance Overview

# Litigation Finance Industry

*David J. Kerstein and Wendie Childress,  
Validity Finance*

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# Litigation Finance Industry

Contributed by [David J. Kerstein](#) and [Wendie Childress](#), Validity Finance

According to the World Justice Project's [2019 Rule of Law Index](#), the U.S. is ranked 99th out of 126 countries on “accessibility and affordability of civil justice.” To address this problem, litigation finance has emerged as a significant innovation in civil litigation that aims to solve pressing issues of cost and fairness in our civil justice system.

Its inception in the U.K. and Australia dates to the mid-1990s. Litigation finance became available to corporate America in 2006 when Credit Suisse founded a group devoted to helping clients manage litigation risk. Since then, the industry has evolved rapidly in terms of the number and type of litigation finance providers, and in the demand for funding among companies and law firms.

## What is Litigation Finance?

Litigation finance encompasses any transaction in which a legal claim is used as collateral to secure financing from an outside party. The financing party (or funder) provides capital to the claimant in exchange for an interest in the outcome of the case. Financing is usually provided on a non-recourse basis, meaning that the funder receives a return only if the case is successfully settled or results in a collected judgment. If the case is unsuccessful, the claimant has no obligation to repay the funder.

The term “litigation finance company” typically refers to companies that have capital committed from investors to invest primarily or solely in litigation. But “litigation finance” or “litigation funders” can also refer to hedge funds or private investors who make opportunistic, one-off investments, brokers who identify cases for investment and then source capital on behalf of a company or law firm, crowd-funding platforms that solicit public donations for individual cases, or companies that offer consumer financing to individual plaintiffs based on the expected value of their case.

Litigation finance exists in both the commercial and consumer contexts.

Commercial funders typically fund high-value, complex commercial litigation cases. The most common disputes are antitrust, asset enforcement, bankruptcy, breach of contract, breach of fiduciary duty, copyright or trademark, patent, and trade secret misappropriation. Parties in a commercial funding arrangement generally are sophisticated business entities or their sophisticated counsel, and the funder's investment is often greater than \$1 million for cases with estimated damages of \$10 million or more.

Consumer funding is primarily for individuals or “consumers” looking to advance, or take an advance on, personal injury, medical malpractice, class action, and mass tort litigation claims. Recipients typically receive funding in the form of advances to cover legal costs and living/medical expenses while their lawsuit is pending. Investments tend to be smaller for consumer funding, but the goal is the same: to provide meritorious claim holders with non-recourse funding that enables access to the courts.

This overview focuses on companies or funds whose primary business is providing capital to companies or law firms that are litigating commercial disputes.

## The Market Need

Commercial litigation finance is based on an insight and a market failure. The insight is that a meritorious legal claim against a solvent defendant has value and should be treated as a financial asset. For a plaintiff company, the value is the expected damages award or settlement amount if and when the case resolves in the company's favor. For a law firm representing a corporate client on a full or partial contingency (an increasingly frequent arrangement), the value is the contingent fee the firm will collect if the case is successful.

The market failure is two-fold. First, neither traditional financial institutions nor current accounting rules treat a meritorious affirmative claim as an asset. That's largely because the complex interplay of law, procedure and other factors that impact a case's outcome can make it difficult to assess the expected value of a legal claim. That said, litigation is hardly the only contingent or difficult-to-value asset class. Financial institutions have, for the most part, simply declined to make the effort. As a result, companies and law firms have historically been unable to unlock the value of litigation assets.

The second market failure is that many—though not all—law firms have been unwilling or unable to assume 100% of the fees and costs associated with commercial litigation through contingency arrangements. Even firms that are open to assuming a great deal of risk have limited capacity; they cannot represent all clients in need of financing. And law firms have historically been cut off from traditional methods of raising money. In particular, the ethical rule against “fee sharing” between lawyers and non-lawyers has barred lawyers from raising equity from third parties in the same way other businesses might.

Litigation funders have stepped into this vacuum. Litigation funders are typically staffed with professionals who have a combination of finance and complex commercial litigation experience. This gives them the expertise to assess the merits and expected value of legal claims, and to provide capital based on their assessment of a claim's likelihood of success. The funder's success or failure depends upon its ability to correctly identify the quality of a legal claim.

## Availability of Litigation Finance

Currently, litigation finance is permitted in most American states, the federal system, and most major arbitration tribunals.

As already noted, the vast majority of commercial litigation finance deals involve the funding of corporate plaintiff cases. A company or law firm can seek funding at any stage – during the pre-filing phase, in the lead up to trial, for appeal, and even after the litigant has obtained a final judgment and is trying to collect the judgment owed.

A particular funder may specialize in a certain type of case, or may choose not to invest in entire categories of cases. However, the industry as a whole provides broad coverage for commercial disputes of almost any type and at almost any stage of litigation.

## Who Uses Litigation Finance?

Litigation finance emerged initially to help smaller, under-resourced plaintiffs bring meritorious claims against larger, better-capitalized adversaries. In this “David v. Goliath” context, litigation funding helps to “level the playing field” and provide “access to justice,” so that cases are more likely decided on their merits, and not based on which party has a deeper pocket. But, as awareness of funding has expanded, it is increasingly seen as a corporate finance tool that enables companies of all sizes to value litigation claims as an asset. In-house counsel and their CFOs are realizing that capital that would otherwise be tied up to pay for litigation can now be used to grow a business while disputes are ongoing. There are potential accounting benefits too, for companies of all sizes. For example, rather than pay for the costs of litigation themselves and have to record that spend as an expense, corporations can, in effect, use litigation finance to take that spend “off balance sheet.”

Law firms looking for innovative ways to manage risk and profitability can leverage funding to accomplish those goals. A 2009 ABA [study](#) found that more than 80% of firms had turned away cases that would not have been cost-effective to handle. Funding enables firms to take cases they would not otherwise be able to take and to pass on discounts to clients seeking alternative fee arrangements. Moreover, “portfolio funding” to law firms allows firms to smooth out lumpy revenue inherent in contingent cases and spread their risk among a larger pool of cases. Such funding can also be used for any purpose, such as to hire more staff, pay bonuses to associates, cover out-of-pockets expenditures, or simply to “keep the lights on.” Once considered a tool for growing or boutique firms, funding has increasingly become a tool used by many of the leading global firms.

## Industry Growth

The primary reason lawyers and clients use funding is because the cost of litigation is simply too high to pursue a case to conclusion without supplemental capital. However, even among large corporations, the use of funding as a risk-mitigation tool is growing. As corporate lawyers and financial officers gain deeper understanding of funding, there is increased interest in using it to mitigate litigation costs and risks, while still preserving a substantial portion of the prospective settlement or damages award.

Most legal practitioners who have used litigation finance report that they would use it again. Experienced funders can help ensure good cases get moved ahead quickly and financed sufficiently to ensure a fair outcome (and that cases without merit get “filtered out”). As more lawyers and their clients look to leverage financing to spread risk and manage costs, this is an industry that seems poised for further growth.