Litigation funding

THE GROWTH OF A NEW ASSET CLASS

The stupendous rise of litigation funding across the world has been nothing short of extraordinary. Critics think litigation funding encourages undesirable lawsuits. Its champions think it controls costs and promotes access to justice. This article presents a clear overview on the challenges and opportunities for litigation funding and whether its growth can be sustained.

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OVER THE LAST TWO DECADES LITIGATION FUNDING HAS GROWN FROM A FEW STANDALONE CASES IN AUSTRALIA INTO A £30BILLION INDUSTRY ACROSS THE UK, EUROPE, US, AND ASIA.

The growth of litigation funding has been fuelled by a combination of relatively poor returns from traditional asset classes – such as securities or real estate that are more susceptible to macroeconomic and political changes – along with a growing distressed and litigious environment.

This combination has captured the attention of hedge funds, asset managers, banks, family offices, and other institutional investors who have all steadily increased their allocation to this new alternative asset class.

What is litigation funding?

Traditionally when two parties enter into litigation, each pays for its own costs of the litigation proceedings. In litigation funding, an independent finance provider, which has nothing to do with the litigation, is permitted to fund the legal expenses and other costs of one of the parties – often the claimant but can be the defendant as well – subject to an agreement that if the financed party wins the case, then any award is shared with the funder.

If the litigation is lost then the funder does not receive any money back. One can see the immediate attraction of the litigation funding for both the borrower who may not be able to fund its claim on its own as well as the funder who, if it chooses its cases carefully, may be receiving higher returns than on traditional asset classes.

Background and profile of litigation funders

The litigation funding industry began in Australia in 2001, when a market in litigation funding, previously only used by insolvency practitioners, was expanded into non-insolvency related cases by ASX-listed IMF Bentham who began financing large, single-claimant and class action lawsuits.

Traditionally, providing finance for a dispute between third parties was restricted by the doctrine of champerty and maintenance which prohibits third parties 'meddling in' or financing disputes between parties not affiliated with the funder. However, this doctrine has been abolished in the UK and Australia, and has been relaxed in many other jurisdictions.

Litigation funders appear in all shapes and sizes, and consequentially offer different levels of funding for different contentious matters.

Several funders have raised significant capital for funding claims. In the last year alone, litigation funder Augusta raised £150million in June, Harbour Litigation raised £350million in May, and Therium unveiled a £300million fund in February. The shares of one of the largest litigation funders, Burford Capital, was the best performing stock on the AIM – the London Stock Exchange's international market for smaller growing companies – in 2017 and its share price has risen 14-fold since listing in 2009.

In addition to the traditional funds focusing exclusively on the litigation funding space, there are now litigation finance teams emanating from distressed and traditional loan trading funds. Family offices are also newcomers to the industry, especially in respect of litigation in higher risk markets such as Russia/CIS, Asia or Latin America.

Although traditionally associated with class action suits, litigation funding has since been used in a range of contentious matters, including IP, fraud and commercial disputes as well as bankruptcy, tax, asset recovery, and enforcement.

What do funders look for when choosing claims?

As the litigation funder's return is tied to the success of the case, it is essential that funders apply stringent selection criteria when choosing potential cases. Various funds will possess different strategies and criteria, but the most important will include: whether the defendant can afford to pay the award if the litigation is won; the minimum realistic value of the claim, i.e. whether the pay-out is worth the time and effort; the maximum budget for the case and whether the funder has sufficient committed capital to cover it (many funds fail as they overstretch their capital and do not manage to get the returns in time to reinvest); the merit and the legal value of the claim; and the length of the trial and the enforcement risk.

Both the funded costs and the claim values vary significantly depending on the particular case and type of the dispute. On average, clients interested in obtaining litigation funding typically seek either between £100,000 and £500,000 or, for more complex cases, between £3-£5million to fund single matters.

The actual value of the claims attracting litigation funding are normally significantly higher than the funding amounts themselves, with the average value of claims ranging from between £3-£5million for the smaller cases and between £30-£50million for the more complex cross border cases.

In certain cases, such as IP/patents, or cases involving disputes in high risk jurisdictions, such as Russia/CIS, awards can range from between £100-£300million.

Trends in litigation funding

Disclosure and transparency

Disclosure and transparency have been key market trends in the litigation space, particularly in the UK and the US where litigants have recently been required to disclose to court if their litigation is being funded by third parties. In the US for example, lawyers with third-party contingent litigation financing connected with federal opioid cases were required to disclose their funding arrangements to the federal district court in Ohio. Litigation funders may also be required to disclose their capital adequacy and the source of funds to ensure proper funding of the claim.

Role of separate counsel

The appointment of an independent legal counsel by funders, which is separate and independent of the legal counsel advising the funded party, is another important emerging trend. Historically the funders would use the same legal counsel as that of the party that they have funded. However, although the interests of the litigant and funder are aligned, recent cases have evidenced the necessity for funders to receive independent legal advice throughout the litigation process, including: advice on structuring the funding arrangement and documenting it; analysing and structuring the security package; advice on maintaining control over the litigation process and involvement in settlement decisions/voting without triggering the champerty restrictions; and assessing enforcement risk.

Diversification of funders and funding products

A further key market trend has been the diversification of funders into different aspects of the litigation funding industry. Hedge funds and private equity firms are also involving themselves with loans that finance mass tort cases against drug companies and medical device manufacturers. For example, EJF Capital is seeking to raise $300million for an investment vehicle for such cases.

Litigation funding products are becoming increasingly diverse. Litigants are now able to choose from case-specific funding, funding for multiple cases or monetising their claim to leverage their business and provide capital for operational or other purposes.

Secondary trading

There has also been an increase in the rise of secondary trading of litigation funding claims. This normally occurs where an award has been made but the successful litigant is unwilling to wait to obtain the award or there are difficulties associated with enforcing the award.

Litigation funding in 2019/2020

With nearly £1billion of funds raised this year alone, it is clear that the litigation funding industry will continue to grow with an increasing number of funders entering the market and financing a variety of disputes in numerous jurisdictions.

Legal documentation remains customised and complex for each particular case but the developing legal framework and guidelines for participants has assisted litigation funding in becoming an increasingly credible asset class, delivering potentially greater returns for investors as well as removing the costs and burden from litigants. ●

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