Future Facing Disputes

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Risk, Resilience and Reputation

Litigation Funding: The New Normal

In a few short years, litigation funding has developed from being a niche topic to becoming fully embedded in the landscape of English litigation and arbitration. That trend is set to continue, driven both by potential disputes arising out of Covid-19 and the growth of new types of disputes that are heavily reliant on funding, such as class actions. Litigation funding represents both opportunities and threats to corporates. Opportunities in that it can help to unlock the value in claims that otherwise would not be pursued and to pursue claims with no impact on working capital. Threats in that it can be used to fund claims against corporates.

This paper provides: a brief overview of litigation funding; comments on its growth and the drivers for that growth; summarises its key mechanics; and comments on its practical implications including its benefits.

Background – what is litigation funding?

Put at its simplest, litigation funders invest in claims. It is a form of non-recourse lending, whereby the borrowing party has no obligation to repay borrowed sums unless and until a recovery is made in the claim. In exchange for risking its capital, the funder will be paid a return if the claim is successful. The return can be calculated either as a percentage of the recovery or a multiple of the sum borrowed, or a combination. Thus, litigation funding typically covers all or part of a party's "own-side costs" in disputes.

A separate, but closely related product, is After The Event insurance (ATE). ATE is intended to address the risk of the claimant (or the defendant) being ordered to pay the other side's adverse costs on a loss. Provided that the claim is sufficiently attractive, litigation funders can be willing to pay the premium for ATE.

Litigation funding has sometimes been described as a tool of the "impecunious claimant" that has no other means to fund a claim. However, well-funded corporates that have the option of self-funding are increasingly using funding to share risk and to avoid litigation costs from impacting their balance sheets. Some defendants are concerned that the growth in litigation funding has facilitated claims that would not otherwise have been brought.

The continuing growth of litigation funding

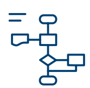
The litigation funding market has grown significantly in recent years, both in the number of market participants and the capital invested. Precise figures on growth are difficult to come by, partly as claimants that have secured litigation funding are not required to disclose a copy of their funding agreement to the other party/parties, but from 2009 to 2014, assets under management from funders active in the UK grew from £180m to £1.5bn (up 743%).[1] AIM listed Burford Capital's market capitalisation has increased more than 1,300% over the five years to 2019.[2] On the supply side, capital is attracted to the market by the potential returns and the relative underperformance of other asset classes in recent years. For investors litigation funding can assist with portfolio diversification as it is uncorrelated to other markets and asset classes.

[1] "Third Party Litigation Funding in the United Kingdom: A Market Analysis", Justice Not Profit.
[2] "Litigation finance: can growth continue?", Investors Chronicle, 17 January 2019.

On the demand side, external lawyers are increasingly experienced with using litigation funding and its potential to support "*no-win/no-fee*" arrangements through risk-sharing between the claimant law firm and the funder. This can help in marketing recovery opportunities to potential claimants. Some large corporates are also working directly with litigation funders to unlock claims that would otherwise not be pursued.

Litigation funders seek cases with sufficient quantum and merits. It is particularly developed in certain categories of claims, including arbitration, competition damages claims, securities claims and enforcement of judgments. Funders are also creating new products such as portfolio funding (to provide funding for multiple cases with the same or similar characteristics) and techniques for funding defendant costs.

Litigation funders are increasingly organising themselves to represent their interests. The Association of Litigation Funders (ALF), was founded in November 2011 and is perhaps best known for its (voluntary) Code of Conduct. The European Association of Litigation Funders (EALF) was established in Amsterdam in April 2020. More recently still, the International Legal Finance Association (ILFA) was set up in September 2020 in Washington D.C. to act as the global voice of the litigation funding industry.



The mechanics of litigation funding

So how does litigation funding work in practice? Unsurprisingly, litigation funders view potential claims as investments. They are primarily interested in risk:return, and so will carefully consider merits, quantum and enforcement risk. They will also need to be comfortable with the legal team and strategy. If the funder is in-principle willing to fund, heads of terms will be agreed followed by more detailed negotiations. All discussions will be protected by an NDA. On reaching agreement, the funder will fund an agreed litigation budget that may pay for all or part of the claim, including disbursements and barrister fees and ATE if appropriate. The return must also be negotiated, which could be influenced both by risk and time on risk.

It is important to carefully review the funding agreement, and many claimants engage an external law firm to advise on this issue. Claimants should also perform their own due diligence on the funder, including to ensure that it is reputable and that it has access to the expected funds.

What does this mean for corporates?

As noted above, litigation funding is no longer solely a product for small or impecunious claimants. Litigation funding is essentially an agreement to share risk and upside, offering the opportunity to make recoveries without taking on the financial burden should the claim fail. It aids cash-flow, avoids the claim impacting the claimant's balance sheet and allows businesses to use their working capital for other business areas.

The process of engaging with a litigation funder need not be painful – a key principle is to identify areas of aligned and diverging interests. Although it is important to carefully consider the consequences of the claim going badly, the borrowing party can take comfort from the fact that both it and the funder are aligned in desiring a good outcome.

Generally speaking, it is the claimant's choice on whether to disclose the existence of litigation funding to the defendant. The exceptions are on security for costs applications and claims brought under the UK's new competition class action mechanisms, where the class representative must demonstrate its ability to pay the defendant's costs if so ordered. Some claimants voluntarily disclose that they are funded; this can impose settlement pressure as it indicates that an external party has not only reviewed the merits but that it has decided to invest capital in the claim,[3] and it also indicates that a litigation budget has been agreed and funded.

Although considerable litigation funding capital is available, its usage is likely to continue to grow over the next few years. Whilst many corporate clients will continue to fund litigation out of working capital in the traditional way, it can be useful for them to consider funded options and the circumstances in which that approach could be more attractive.

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[3] The assessment on the merits may be inaccurate of course, including because adverse factual or expert evidence comes to light later on.

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