The Case for

Litigation Financing

CHRISTOPHER P. BOGART

The author is the chief executive officer of Burford Capital, former general counsel of Time Warner Inc., and a former litigator at Cravath, Swaine & Moore LLP, New York City.

Quick: Name three things you know about litigation finance. Although not typically a betting man, I'll hazard that what you know about litigation finance may be wrong—or at least due for an update.

Let me say that in a friendlier way: When I talk to commercial litigators, too often I hear old chestnuts of conventional wisdom that betray a continuing misunderstanding of what litigation finance is for, who should use it, and how the legal industry as a whole feels about it. This matters because litigators who remain misinformed miss out in ways that hurt their practices and their firms—as well as the clients they represent.

I'd like to correct three areas of misunderstanding that I think are especially damaging. First, a disclaimer: Having litigated at a large law firm and then served as general counsel for a Fortune 100 company, I'm now the chief executive officer of Burford, a firm that provides litigation finance, judgment enforcement, and other services to law firms and companies. Naturally, I'm a big proponent of litigation finance, and this article explains why in a way I hope will be useful for litigators.

Before addressing misunderstandings, it might help to start with a simple definition: Litigation finance generally refers to using the asset value of a litigation claim as the basis for a financing transaction. As I explain below, one very consistent thing about litigation finance is precisely its variety of models and approaches. One common feature is that most transactions occur on a non-recourse basis, either to clients or law firms. That means the financier loses its investment if the underlying claim or case is lost.

Common Misunderstandings

Now to the most common misunderstandings about litigation finance. The first is the belief that litigation finance is right only for "David versus Goliath" scenarios in which a smaller plaintiff lacks the financial resources to pursue a single, high-stakes matter and therefore turns to an outside financier—out of necessity, not choice. Although this may have been the case back in the post-2008 recessionary era when "litigation funding" (as it was then known) initially thrived in the United States, this view is inaccurate on many levels. In today's litigation and business climate, litigation finance is a multibillion-dollar industry used by the country's largest businesses and law firms as well as the "Davids."

The second misunderstanding is that "corporates" don't use litigation finance, or they even dislike it, and that the law firms that use litigation finance are primarily plaintiff-side or contingency firms. Again, this plays to the stereotype of smaller companies using outside funding to attack bigger ones, which in

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turn eschew any tool used against them. I've heard more times than I can count some version of "We don't do contingent cases" or "We don't need the money" and, thus, implicitly, "Litigation finance isn't for us." I'll explain how those views are out of date, but for now let me simply quote Pamela Tracey, general counsel of Osram Sylvania Inc., who said of litigation finance: "I think it's critical to have this tool." *See* Rebekah Mintzer, *So, Your Company Wants to Start Some Litigation*, Corp. Couns., June 4, 2015, www.corpcounsel.com/id= 1202728273300. And let me also note that large and well-established firms like Latham & Watkins, Simpson Thacher & Bartlett, Quinn Emanuel, and King & Spalding have been cited in the press as having used litigation finance in one capacity or another.

The third and final misunderstanding I'd like to correct is the most fraught: that litigation finance is "controversial." There's a noisy swirl of imagined discord that often overshadows real dialogue about litigation finance, resulting in a false equivalence between a relatively small but vocal group of critics and the larger majority who support its use—a group that includes the legislators, judges, and ethics scholars who've weighed in on the subject over the past few years. In fact, though there are valid questions to ask about how it is used, and questions litigators need to ask before they engage with a financier, there is no serious debate about whether litigation finance is here to stay. Indeed, the overwhelming majority of respondents to a survey of U.S. litigators, in-house counsel, and financial executives in late 2014 said that they expect litigation finance to continue or, if anything, to grow. *See* Burford Capital, Third Annual Litigation Finance Survey 4 (2014), www.burfordcapital.com/wp-content/uploads/2014/12/BURFORD.

So with these misunderstandings out of the way, what do litigators really need to know about the kinds of matters that are suited (or not) to litigation finance? How should they approach using it? And what should they make of the criticism?

Illustration by Tim Foley

What Matters Are Appropriate?

The most obvious factor determining the suitability of litigation finance is the likelihood of success. Because the financier will lose its investment if the recipient of the funding loses the case, it will look hard at the merits of the claim or defense first and foremost. For litigators, that means being realistic about the prospect of obtaining support and being prepared to explain the strength of the client's factual and legal position.

Beyond this basic criterion, matters suited to financing are high-stakes commercial cases with significant value to the business and damages or return sufficient to appropriately balance the interests of the client, lawyers, and outside financier. Common types of cases that fit this description include business-to-business disputes featuring contract, fraud, fiduciary duty, securities, antitrust, and other commercial claims. Although ranges vary and the smartest and best financiers don't have off-the-shelf answers to questions about pricing, litigation investments (meaning, the amount provided by the financier, not the size of the case) typically start around $2 million.

Some cases aren't suited for financing. Litigation that won't result in sufficient damages or return to the business to justify outside capital is problematic because no financier wants to leave a client feeling that it has won the battle but others have taken home the spoils. As a result, claims for injunctive relief or parties seeking business solutions rather than monetary awards are poor candidates for litigation finance, as are low-damages cases.

Certain kinds of litigation may be attractive to some litigation financiers but not others. The most highly regarded providers of litigation finance are specialist firms combining a high degree of legal and financial knowledge and experience and focusing exclusively on financing commercial cases (not consumer lawsuits, which are financed by an entirely distinct consumer legal funding market).

Finally, a word on plaintiff-side versus defense-side financing. The vast majority of litigation financing is for the pursuit of claims. Yet, litigation finance also works for the defense of weak claims. The fact that litigation finance can underwrite playing defense as well as offense is important for many reasons—not

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least because while many companies rarely (if ever) bring lawsuits, it's the rare company that's never a defendant in litigation (often more regularly than it would like).

Financing Defense

So how does financing defense work? When companies defending litigation ask their lawyers to consider an alternative fee agreement, the law firm will typically reduce its billings in exchange for a balloon payment when the matter is resolved successfully. Such an arrangement necessarily requires the law firm and the client to agree on what "success" means. Usually, it's defined by settlement levels. A classic defense-side alternative fee arrangement might consist of a law firm billing at 70 percent of its usual rates with two further ways to earn additional fees: (1) If the matter settles for less than $10 million, the firm will receive a further payment getting it to 100 percent of its fees; and (2) if the matter is entirely dismissed or settles for less than $5 million, the firm will receive 130 percent of its fees.

The problem is that some law firms won't actually agree to enter into alternative fee arrangements—or what they offer may not be enough for some clients. That's where litigation finance comes into play. When companies are defendants, litigation finance will do exactly what law firms would do with alternative fee arrangements but with greater flexibility. So, in contrast to the law firm that feels constrained not to go below 70 percent of its usual rates, litigation finance firms will go all the way to zero. In other words, the litigation finance firm will pay the entire cost of defending against a weak claim in exchange for the same kind of multiplier or uplift based on predefined success. For corporate defendants, that proposition makes a whole lot of sense. Although defense financing remains less common than claimant financing, it is a future growth area.

As the example of defense-side financing demonstrates, there is a significantly broader range of financing options than most litigators might realize. Indeed, the most important thing for litigators to grasp is the evolution of first-generation "litigation funding" into something more like corporate finance. Clients may look for outside funding to pay for their preferred counsel when they're unable to pay hourly fees. But just as frequently, they turn to litigation finance out of choice—using pending claims as collateral—simply because they have better uses for their cash, such as hiring or reinvesting in the business. Burford did this for Rurelec PLC, a British listed energy company that needed working capital to grow its business. With an existing claim as collateral, Burford provided a traditional loan at a lower rate than would have been obtainable elsewhere, but with a nonrecourse "kicker" in the event of a positive resolution.

"Portfolio financing" of multiple matters involving a law firm or client within a single financing arrangement is another new trend. In a law firm portfolio, the matters may be on behalf of one or more clients in related or unrelated cases. When funding a portfolio with a client, the matters may involve multiple parties in related or unrelated cases with one or more firms. A portfolio may range in size—from as few as two cases to all of a firm's cases on which it is taking some contingency or alternative fee risk. The ideal portfolio combines high-, medium-, and lower-risk matters. With particularly high-risk matters, such as patents and international arbitrations, the terms available through a portfolio structure will likely be better than the terms of single-case financing because risk is diversified across a range of matters.

Clients and firms use portfolio financing to pay for all or partial fees and expenses, to cover expenses only, or to monetize litigation asset value. Capital may be used across matters, where it is needed most. If, for example, it emerges that a particular case warrants more spending than expected, the client or firm is free to use capital from a portfolio investment toward that case. A portfolio investment can also be used in ways that benefit the overall business—reducing risk but also freeing up capital that can be used for other needs.

Portfolio financing offers flexibility in the use of capital as well as a reduction in overall risk, which typically results in a lower cost of capital. For law firms, portfolio financing can reduce contingency risk, enabling them to take on more contingency cases without increasing total exposure. For clients, portfolio financing is particularly advantageous for managing the impact of litigation on balance sheets and risk profiles; this can be hugely powerful for publicly traded companies concerned with the negative accounting impact of litigation on earnings before income taxes, depreciation, and amortization.

Given these advantages, it's no surprise that there is growing interest in litigation finance not only among private practice litigators but also inside corporate legal and financial departments. The majority of in-house counsel and financial executives surveyed in late 2014 agreed that it's a useful tool. *See* Third Annual Litigation Finance Survey, *supra*, at 3. According to a recent article in *The New Yorker*, "[h]undreds of companies, increasingly from the Fortune 500, have used litigation finance, convinced it was in their interest." *See* Lincoln Caplan, *Lawyers and the Ick Factor*, New Yorker (July 9, 2015), www.newyorker.com/news/news-desk/lawyers-and-the-ick-factor.

For that reason, I respectfully disagree when private practice litigators tell me that they "don't need litigation finance" because "we don't do contingent work." They need to be aware of litigation finance—because their clients and their competitors certainly are. In fact, in England, all lawyers are now required to advise their clients about the availability of litigation finance because the English courts regard it as such a powerful tool. Lord Neuberger, president of the United Kingdom's

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Supreme Court, referred in a 2013 speech to litigation finance as "the life-blood of the justice system" and commended the code of conduct established for financiers in the United Kingdom. *See* David Neuberger, President, Supreme Court of the United Kingdom, Lecture at Gray's Inn: From Barretry, Maintenance and Champerty to Litigation Funding (May 8, 2013), www.supremecourt.uk/docs/speech-130508.pdf.

Many of the questions I encounter from litigators who are just beginning to think about litigation finance address the entirely understandable topic of ethics and the impact of litigation finance on their relationships with clients. These are indeed important questions to address.

The most important way to conceive the role of the litigation financier is as a passive outside investor who in no way alters the attorney-client relationship. Litigation financiers have no rights to manage the litigation in which they invest, and they do not seek to stand in clients' shoes. Just as a leasing company does not tell you how to drive your car, the litigation financier doesn't drive the litigation. Nor does the litigation financier get any rights to control the settlement of the litigation, which remains wholly in the litigant's purview.

Work Product Protection

Lawyers also regularly ask about the interaction of litigation finance and the protection of attorney work product. Parties seeking financing often disclose work product to potential financiers; otherwise, it's unlikely financing would be forthcoming. Fortunately, several decisions have recently confirmed that work product shared with a litigation financier under a confidentiality agreement remains privileged. *See, e.g.*, *Miller UK Ltd. v. Caterpillar Inc.*, 17 F. Supp. 3d 711 (N.D. Ill. 2014); *Walker Dig., LLC v. Google, Inc.*, 2013 U.S. Dist. LEXIS 188666. (D. Del. Feb. 12, 2013). As a policy matter, it would be preposterous to put a litigant who needs financing to the Hobson's choice of obtaining capital and sacrificing its work product or forgoing the capital in order to protect its trial strategy and lawyers' mental impressions.

Questions from lawyers exploring litigation finance are sometimes prompted by media coverage that simultaneously points to its growth and acknowledges its critics. Of the 1,140 articles pulled up by a Factiva search on litigation funding between 2009 and 2015, less than a quarter contain negative commentary. Of those that did, only half cited a source, but nine out of 10 times that source was the U.S. Chamber of Commerce, the chamber's Institute for Legal Reform, or lawyers who have testified for or consulted with the chamber. It is well known that the Chamber of Commerce is not simply critical of litigation funding—it's generally critical of litigation in all forms. Of course, the chamber is entitled to that view, but its opposition to litigation funding must be understood as part of an overarching effort to limit the use of the judicial process, regardless of the merits or financing mechanism.

Beyond ethical concerns, there are certain practical cautions every litigator considering litigation finance should keep in mind. Not all lenders are equal. A lawyer should understand the reputation and expertise of the variety of litigation financiers and seek out recommendations from peers. The lawyer should seek to understand where the financier's money comes from—for example, whether it is a publicly traded company with its own permanent capital base or whether the funds will need to be raised and additional approvals sought from a fourth party. The distinction pertains not only to timing, because financiers with their own capital are likely to be faster and nimbler in their response, but also to transparency and knowing where the cash is coming from.

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There is no trade association for litigation financiers in the United States, as there is the United Kingdom (where Burford is a founding member of the Association of Litigation Funders). Still, a litigator may seek information on financiers' websites to gauge their commitment to ethical conduct, including the existence of relationships with outside ethics advisors.

Increasingly, sophisticated law firms and companies around the world are gravitating to litigation finance in all its forms, including complex financial transactions related to their litigation assets. The bottom line for litigators: If you're not exploring this area, your peers and competitors certainly are. An analogy I have often used is email: Twenty years ago, most lawyers didn't use email. Today, life would be unthinkable without it. Litigation finance is the new email: Not knowing what it is or how it works is simply not an option. ■

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