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Practical Guidance Overview

Mechanics of Litigation Finance

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Single-Case Financing

The majority of litigation funding in the United States is for individual plaintiff cases, also known as single-case financing. In fact, industry surveys estimate between 65-90 percent of active capital goes toward single-case financing. In this structure, a funder advances non-recourse capital to a claimant during the pendency of a case and then takes a return from the ultimate settlement or damages award in the case. In single-case financing, the claimant, not the law firm, is always the funding recipient.

There is a lot of variation in how funding arrangements are structured. However, at a high level, in the typical arrangement, the funder, claimant and claimant's attorney aim to align interests, contributions and recoveries according to the capital at risk and expected value of the case. Because the funder's investment is secured by the future proceeds of a commercial case, the vast majority of financed cases are plaintiff-side litigation. However, funders and their clients are increasingly experimenting with defense funding and other innovative financial services.

In one common funding structure, the funder provides capital to the claimant to pay for 50 percent of legal fees and a portion of case costs. The claimant's law firm performs work on the case on a hybrid arrangement, receiving 50 percent of its fee from the funder, and operating on a contingency basis for the remaining 50 percent. Ideally, the claimant agrees to pay the balance of the case costs (such as court filing fees, travel expenses and expert and vendor costs). If the case is resolved successfully, the claimant recovers approximately 60 percent of a judgment or settlement, and the funder and law firm each receive 20 percent.

This arrangement allows the claimant to reduce its legal fees and risk, while retaining a substantial portion of the value of its claim. The cases selected for funding typically permit the law firm and funder to recover three to five times their investment, with the return typically escalating the longer it takes for the claim to resolve.

Portfolio Financing

In some instances, a corporation or law firm will have multiple cases that they want to bundle into a "portfolio". This can allow the corporation or law firm to take a larger amount of capital, cross collateralized against the bucket of bundled cases. If the cases in the portfolio are "diverse," i.e., they don't rise or fall on the same set of facts or issues of law, this might allow the funder to offer better return terms to the corporation or law firm than they can traditionally offer in a single case funding because of the lower risk profile for the funder. Most commonly, the funder provides the capital in tranches.

Return structures again vary. Some funders will insist on sharing a percentage of the recoveries in the portfolio cases. Other funders will agree to cap their returns at a multiple of their committed or invested capital. In the case of a capped multiple return, any amount recovered by the corporation or law firm over and above the funder's return will be kept by the corporation or law firm. In effect, if the corporation or law firm gets a very large recovery on one or two of the cases in the portfolio, it recognizes the upside of the cases while still mitigating the risk of high litigation fees or costs.

Common Features of Litigation Finance Transactions

Although each litigation finance deal is negotiated individually, they tend to have several common features.

First, the recipient of the funding remains the party in interest in the litigation; not the funder. In jurisdictions that permit the assignment of claims, a funder may occasionally purchase a legal claim outright through monetization. In most instances though, the funder is not actually buying the claim or the right to collect a judgment, but rather providing financial resources for the client to pursue the claim on its own behalf. The original claim holder and its counsel retain full control over case strategy and settlement decisions.

Second, the funder's investment is typically non-recourse. If the case is ultimately unsuccessful, the funding recipient does not have to pay the funder back.

Third, the calculation of the funder's return, or, from the funding recipient's perspective, the cost of capital, tends to be structured in one of three ways. When a case resolves successfully, the funder traditionally takes a multiple of what it invested, a pre-negotiated percentage of the recovery, or a percentage rate of return.

Fourth, funders almost always seek a priority return of their deployed capital. After the funder gets back whatever it deployed from the litigation proceeds, the remainder of the proceeds are shared in different proportions between the funder, the lawyers and the claimant.

By way of example, a funder might invest $1 million in a single-case financing with a contractual right to receive twice their investment if the case succeeds. If the claimant wins $10 million in the case, it will owe the funder $2 million. If the claimant wins $20 million, it will still owe the funder $2 million.

Alternatively, a funder might invest $1 million in a case in exchange for the greater of twice the funder's investment or a 20 percent share of any recovery. If the claimant wins $8 million in the case, it will owe the funder $2 million. If the claimant wins $20 million, however, it will owe the funder $4 million.

In either scenario, if the case loses, the claimant keeps the $1 million with no repayment obligation to the funder.

Finally, an important feature of funding is its accounting benefits. Because funding is non-recourse, the capital received to support litigation is not booked as debt but can be recognized as revenue. Moreover, if a corporation or law firm is no longer laying out its capital to pay for litigation fees and costs (because the funder is paying them), the corporation or law firm can be relieved of the burden of booking those payments as expenses on its books. This can have a meaningful effect on profits.

Litigation funders—like a growing number of chief financial officers and general counsels—recognize that meritorious litigation claims should be valued as assets, rather than viewed as a financial burden, on the corporations that bring those suits and the law firms that litigate them.

