Litigation funding in association with Burford Capital

Exploding myths of litigation financing

The Lawyer Research Service and Burford Capital UK litigation and arbitration funding barometer – Issue 1

Burford

Only three years ago, litigation financing in the UK was poorly understood, rarely discussed and even less frequently used. According to a survey undertaken by The Lawyer Research Service and Burford Capital, it is today regarded by the UK's top litigation lawyers as a critical component of paying for litigation. Some 58 per cent of surveyed in-house counsel and corporate C-level executives that litigated in 2014 are aware of third-party litigation financing, and 22 per cent seriously considered its use. A much smaller proportion (9 per cent) of corporates that litigated in 2014 actually used a third-party litigation funder.

More private practice litigation lawyers (92 per cent) are aware of litigation funding, but issues remain with the frequency at which they discuss funding with their clients. Only a third of surveyed private practice litigation lawyers always make their clients aware of third-party litigation financing irrespective of the size and complexity of the case. A further 52 per cent discuss litigation financing with their clients when they deem it relevant.

Anecdotal evidence indicates that this nonetheless represents a significant maturation compared with three years ago. "The litigation financing market is gaining traction," argues Laurence Lieberman, partner at Taylor Wessing. "There is definitely more awareness now although that has not translated into a huge uptake, probably because there is a lag between understanding how it works and actually utilising it. Around 6 per cent by claim value of our total case load is funded at the moment, and that is increasing. Two years ago that was zero."

About the research

This article is an extract of a larger research report written by The Lawyer Research Service and Burford Capital on the UK litigation financing market. The findings are based on a survey of 250 private practice litigation lawyers, in-house counsel and corporate C-level executives on their attitudes towards and experience of using litigation financing during 2014. The survey was conducted in November and December 2014. Some 47 per cent of survey respondents were private practice lawyers, 40 per cent were in-house counsel and 13 per cent were corporate C-level executives.

How funded cases were structured in 2014

Although litigation financing remains a relatively niche product in the UK, our survey data identified the following trends in how cases were funded in 2014:

1. The majority (77 per cent) of surveyed private practice lawyers with first-hand experience of litigation funding in 2014 worked on cases funded from the outset of the litigation process. Only 9 per cent worked on cases where funding was secured at the enforcement of judgment and only 2 per cent secured funding pre-appeal.

That said, securing litigation financing once a case has commenced is growing in popularity. "Securing litigation funding during the case itself is becoming more common practice and I can see this trend continuing," says Paul Brehony, a partner at Stewarts Law. "There are often scenarios where a case reaches a critical point, perhaps as a preliminary issue or during disclosure, when the merits of the case become clearer and more attractive to funders."

92% of UK private practice lawyers have heard of third-party litigation funding

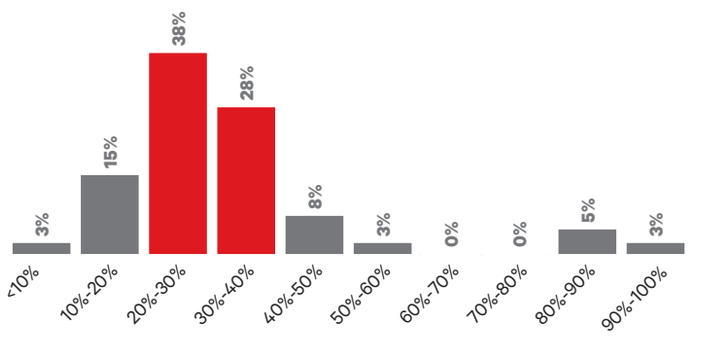
2. While litigation financing was typically used on a case-by-case basis in 2014, structuring financing around a portfolio of cases is becoming more popular. Virtually all private practice litigation lawyers that used funding in 2014 worked on a single funded case, while 19 per cent also worked on at least one case that was funded as part of a portfolio. Structuring litigation financing for a portfolio of cases is advantageous because it reduces risk for the funder, which can translate into lower pricing or other structural benefits.

As Lieberman puts it, securing litigation financing for a portfolio of cases is sometimes the only option when a series of smaller cases are

How often do you make your clients aware of third-party litigation funding? (Private practice lawyers)

Source: *The Lawyer Research Service*

For your most recent dispute that involved third-party litigation funding, what percentage of damages were to be payable to the third-party litigation funder(s) in the event of a successful outcome?
(Private practice lawyers)



Source: *The Lawyer Research Service*

not sufficiently large to attract funding. "I haven't yet worked on cases funded as part of a portfolio but it is something I've heard about and have my eye on," he says. "It would be appropriate in cases where a large number of SMEs or individuals have similar claims against a single organisation. Individually those claims may not be significant enough to attract funding but together, as a package, it would be a lot more palatable for funders. Obvious examples where this might be the case are product misselling by financial institutions or damages claims following a finding of anti-competitive behaviour by a regulatory authority against a particular company."

3. Two thirds of surveyed private practice firms stated that between 20 per cent and 40 per cent of damages (in addition to the return of the funder's investment) were payable to the funder in the event of a successful outcome in their most recent dispute that involved third-party financing (structures not based on a share of the damages also exist). Naturally, the proportion of damages payable increases the closer a dispute gets to trial, since the dispute becomes a more risky proposition for funders.

4. Almost 80 per cent of surveyed private practice lawyers stated that their clients made the opposition aware they were funded on their most recent funded case, although the primary reason for doing so differs: 44 per cent did so because they wanted the opposition to know that they were sufficiently well capitalised to fund the case, 12 per cent did so because they wanted the opposition to be aware that the merits of their case had been validated by a third-party funder and a further 23 per cent cited other reasons.

"Our clients typically want to disclose they are funded because they perceive it as a sign of strength", confirms Gavin Foggo, head of litigation and dispute resolution at Fox Williams. "They normally want to send the opposition the message that they have the financial clout to get to the end of the case if they need to. It also shows that an independent third party agrees that their case is sufficiently strong to back it with their own money."

Why do UK corporates use litigation financing?

Our survey data reveal that, contrary to perception, litigation financing is often used by companies that could have pursued their case even if financing was unavailable: 35 per cent of surveyed private practice firms stated their clients do not typically need to use litigation financing out of necessity.

Litigation financing is an attractive proposition for well-capitalised clients for many reasons. Some 19 per cent stated their clients primarily use litigation funding because it enables them to remove litigation costs from their balance sheets.

"A very significant reason for using litigation financing concerns public company accounting," says Christopher Bogart, CEO of Burford Capital. "When corporations pay their own legal costs, from a financial perspective they are hit in the year they pay them. If they use litigation financing, there is no P&L impact in taking on a piece of litigation until its conclusion."

Some 14 per cent of surveyed private practice lawyers stated that their clients used litigation financing in the past 12 months because it enabled them to focus financial resources elsewhere within their business. Although not covered in the survey, private practice lawyers often mentioned in interviews that de-risking litigation from a cost perspective is a strong motivating factor for structuring financing around litigation.

"Many companies that can afford to pay their own legal costs use litigation financing because it insulates them from cost overruns, so it is essentially a de-risking measure," explains Nick Rowles-Davies, managing director of Burford Capital. "They would rather have a percentage of something than an open-ended commitment, effectively a cash flow drain with a potential down side in adverse costs. Funding and insurance changes this. With funding, clients are guaranteed an amount of the upside if they win with no downside."

58% of UK corporates that litigated in 2014 have heard of third-party litigation funding

22% discussed the use of third-party litigation funding

9% used third-party litigation funding

Addressing litigation financing misconceptions

Misconception 1: Litigation funders influence proceedings
The most significant misconception about litigation financing is that it will result in the claimant losing control of the case. Two thirds of in-house counsel and C-level executives cited concerns about losing control as being one of their top three reasons for not approaching litigation funders. However, our data confirm there is an enormous gap between this perception and the reality.

First and foremost, every surveyed corporate that used litigation financing in 2014 stated that they retained complete control of the case despite the involvement of liti-

What was typically the most important reason why your clients used third-party litigation funding during the past 12 months?
(Private practice lawyers)

65%	Their financial resources meant they could not cover the estimated costs of the trial without litigation funding
19%	They were able to cover the costs of the trial but chose litigation funding as it enabled them to remove litigation costs from their balance sheet
14%	They were able to cover the costs of the trial but chose litigation funding as it enabled them to focus resources on supporting the business
2%	They were able to cover the costs of the trial, but chose litigation funding as it enabled them to retain a top quality lawyer instead of an average lawyer

Source: *The Lawyer Research Service*

gation funders. Under the code of conduct of the Association of Litigation Funders (ALF), funders are specifically prevented from influencing proceedings.

"There is a perception that funders will be influential in running the litigation process, but that's not the case in my experience," confirms Lieberman of Taylor Wessing. "We have worked with several funders and the strategy, procedure and every aspect of the litigation process has always been firmly driven by me and my team."

Misconception 2: Litigation funding is prohibitively expensive

An expectation that litigation financing would be too expensive was the second most frequently cited reason by corporates for not approaching funders: 42 per cent of surveyed in-house counsel and corporate executives cited concerns that terms would be too expensive as being one of their top three reasons for not approaching funders. In the event of a successful outcome, litigation funding typically costs between 20 per cent and 40 per cent of total damages awarded. However, in the event of an unsuccessful outcome, litigation funding costs nothing.

Misconception 3: Litigation financing is a one-size-fits-all solution

Our survey data also reveal a serious lack of understanding about the range and sophistication of litigation financing products and structures that are available. Indeed, although nearly every surveyed private practice litigation lawyer was aware of the most basic form of litigation funding – in which the costs of a case are covered by a funder in return for a percentage of the damages in the event of a successful outcome – a significant proportion were unfamiliar with other forms of litigation funding. For example, 25 per cent had not heard of disbursement funding, 37 per cent were not aware of security-for-cost bonds and 39 per cent did not know about work-in-progress financing. These more niche litigation financing products are explained in the box on the right.

"In the UK the greatest misconception is that the only product being offered is a structure where 100 per cent of the cost of the case is arranged in advance and then the funder receives a percentage of the damages," says Bogart of Burford Capital. "The reality is quite different. Litigation financing products are just as flexible as any other financing product. People have to stop thinking about this as just a way of not paying your lawyers and start thinking about it as a way of financing litigation assets."

What is front of mind when selecting funders?

Pricing is essential

Unsurprisingly, pricing and the terms offered by funders is the most important factor for corporates when evaluating which funder to work with: some 44 per cent of survey respondents cited pricing and terms as their most important factor when selecting a litigation funder, more than double the proportion citing any other factor.

This focus on price suggests litigation funding is considered a commodity. But this view is mistaken given the wide range of litigation funding structures available, not to mention the differences in funders themselves. Clients and their lawyers need to consider a range of factors, including capital availability, transparency, history of reliability and scale.

Speed is crucial

Speed was on average ranked as the third most important factor by survey respondents when evaluating selecting their funder. On average, interviewees stated it takes around six weeks between providing a funder with all relevant documentation and receiving a decision in principle. This excludes informal discussions between funders and firms before documents are actually submitted.

As Foggo puts it, speed is important because clients are often faced with tight deadlines. "Very often we need an answer fairly quickly, so we are often in a situation where we can't afford to wait two or three months," he adds.

Financial security and transparency are important

The financial stability of funders and transparency with respect to how they are funded and operate also has a bearing on whether they are appointed: over 40 per cent of surveyed private practice lawyers stated that financial stability is amongst their three most important considerations when selecting a funder. These concerns are not unfounded. In February 2014 litigation funder Argentum Capital was delisted from the Channel Islands Securities Exchange. Four months later litigation fund Centaur Litigation was put into receivership following the discovery of financial irregularities.

"It is a concern when smaller funders do not have their own balance sheet and have to get approval from their own funders," says Steven Mash, a partner at Fladgate. "If I have an agreement with a funder I want to know that the money is there to meet the liability. A lot of the arrangements relating to where the money is coming from and how it is going to be funded can be very opaque and that is a little bit disconcerting."

ALF membership provides some comfort

Our survey data indicate that membership of the ALF does not have much bearing on whether a funder is approached: only 6 per cent of surveyed private practice lawyers stated that ALF membership is one of their three most important factors considered when selecting a

Explaining third-party funding structures

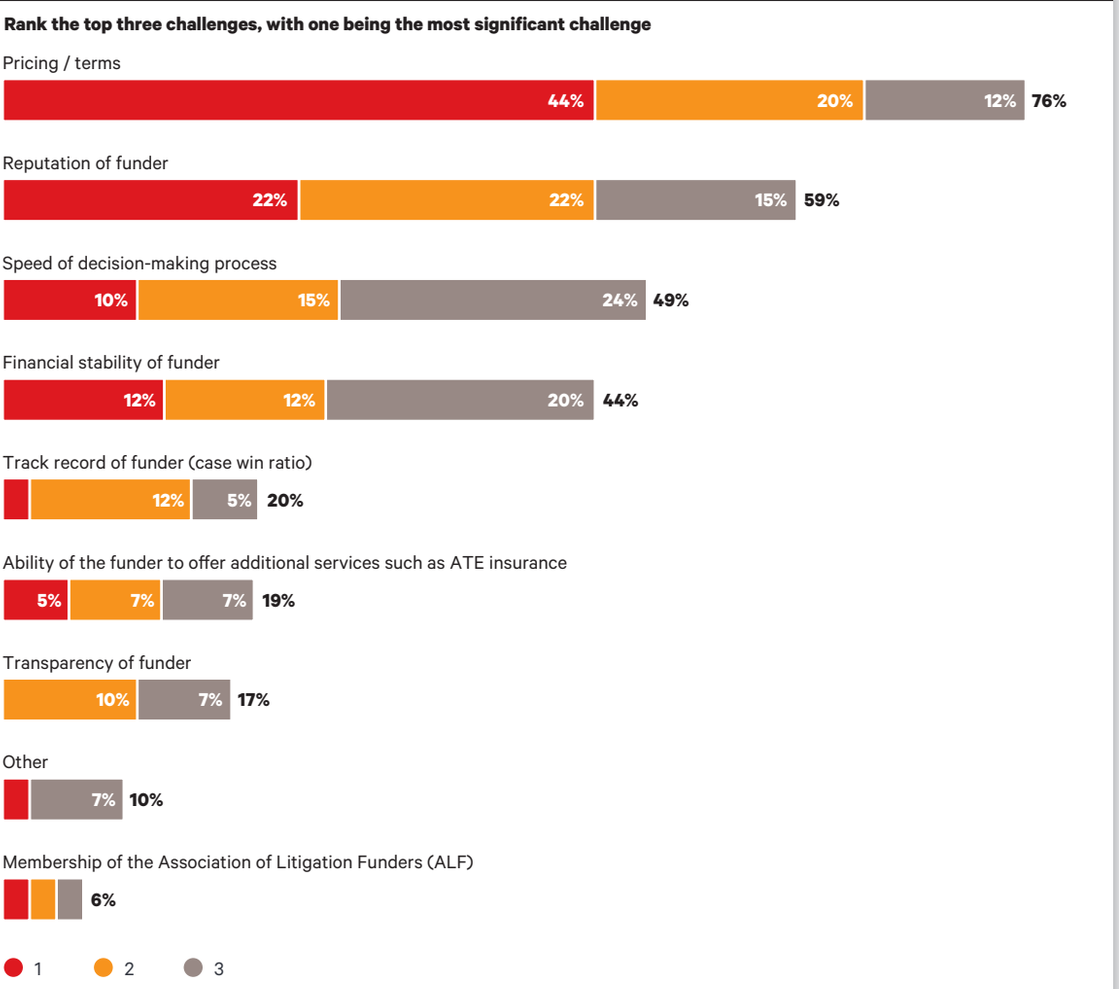
After the event (ATE) insurance: This is an insurance policy taken out to protect against the risk of having to pay the opponent's legal costs in the event of an unsuccessful outcome. Since insurers will typically only provide cover if they assess the case has a more than 60 per cent chance of success, claimants will often reveal to the opposition that they have insurance in place to demonstrate that the merits of the case have been validated by a third party.

Disbursement funding: This type of litigation finance enables clients or firms to pay for disbursements on existing or new matters, individually or within a portfolio of cases. Disbursement funding can be used to fund a variety of expenses, including expert fees and court fees. Disbursement funding is often used by firms with significant disbursement costs to ease their cash flow. This enables them to put their cash to better use, take on more cases and employ the best experts rather than just the ones they can afford.

Security for costs bond: Litigation funders can provide a guarantee in response to a security for costs application. This product is particularly useful for corporates engaged in insolvency proceedings when faced with an application for security of costs – an application made by the defendant to demonstrate the claimant has sufficient funds to pay the defendant's costs if required. Importantly, ATE insurance does not adequately provide security for costs as it can be avoided and is subject to cancellation.

Work in progress (WIP) funding: This type of financing involves the provision of capital to firms that is secured against a portfolio of 'conditional fee agreement' (CFA) or 'damages based agreement' (DBA) cases. WIP funding can unlock cash tied up in WIP cases, allowing firms to pay ongoing expenses. This financing structure effectively acts as an advance on fees. It is particularly attractive to firms undertaking a large number of CFAs or DBAs.

Which of the following factors are typically most important to your clients when selecting their litigation funding partner? (Private practice lawyers)



Source: *The Lawyer Research Service*

litigation funding partner, making it the least important factor.

However, many firms interviewed for this research indicated that ALF membership still has an impact. "The first funder we spoke with was not a member of ALF, which was of some concern," admits Daniel Lowen, a partner at Couchmans. "We ended up working with a member of ALF, which was a significant factor for both us and our client. We look at things like capital adequacy and control of the case strategy and take comfort from the fact that funders that are members of ALF will satisfy certain minimum requirements and abide by the principles enshrined in the ALF Code of Conduct."

Only certain funders can provide more complex litigation financing structures

Although not covered in the survey, a more fundamental factor determining which funder is approached is whether the financial structure of the funder enables it to provide more complex litigation funding structures. For example, certain funders are structured in a similar way to private equity funds, where capital has been raised from investors on the basis of a very rigid investment memorandum with a defined fund lifecycle. These funds are often only able to provide the most basic form of litigation funding, in which the funder funds an individual case in return for a percentage of the damages if a case is successful.

Conclusion

There is a clear discrepancy between the level of awareness of litigation financing and its use. Around six out of 10 surveyed in-house counsel and corporate C-level executives of corporates that pursued litigation in 2014 are aware of third-party litigation financing. However, only a much smaller proportion (22 per cent) have seriously considered using this type of funding and an even smaller proportion (9 per cent) actually used it in 2014.

Part of this discrepancy is due to a series of misconceptions about litigation financing. The most frequently cited reason for not approaching litigation funders was due to fears about losing control of the case. This should not be a concern. Every single surveyed UK corporate that secured litigation financing in 2014 stated they retained complete control of proceedings. Another common misconception is that litigation financing is only used by corporates unable to afford litigation without it. In actual fact, over a third of surveyed corporates that used litigation funding in 2014 did so for strategic reasons rather than financial necessity.

The main misconception hindering wider adoption of litigation financing is its flexibility. Whilst there is a broad understanding about the most basic form of litigation financing, a significantly smaller proportion of litigation lawyers and in-house counsel understand how structures such as disbursement-only funding, security for costs bonds, work-in-progress funding and portfolio financing work. There is also a lack of understanding about how litigation can be used as a financeable asset that underpins securing financing unrelated to the litigation itself.