Commercial Litigation Finance: Helping Companies Enforce Their Legal Rights without Blowing the Budget

William P. Farrell, Jr. – Longford Capital Management, LP – wfarrell@longfordcapital.com
Michael A. Nicolas – Longford Capital Management, LP – mnicolas@longfordcapital.com

Most U.S. corporations have been a party to a lawsuit and many are involved in multiple lawsuits every year. Litigation is unpredictable and expensive and most companies would prefer to avoid it. But companies sometimes find litigation necessary to enforce contractual rights, to prevent competitors from violating antitrust laws or other trade regulations, or to protect intellectual property. Even when legal action is necessary, in-house legal departments frequently feel constrained in their ability to pursue meritorious legal claims because of limitations on the company's legal budget—limitations that are expected to continue throughout corporate America for the foreseeable future. The annual Huron legal benchmarking survey of legal departments finds that 43 percent of 75 U.S. companies of various sizes expect the same legal spend in 2015 as there was in 2014. Among the largest companies with annual revenues of over $10 billion, 40 percent expect to spend less than they did in 2014. Add to that the long-held notion that in-house legal departments are cost centers and not revenue generators, and the motivation for in-house counsel to pursue meritorious legal claims diminishes.

Now, an attractive specialty finance option—commercial litigation finance—is drawing the attention of an increasing number of general counsel who wish to pursue meritorious legal claims without exceeding the company's legal budget. Litigation finance firms provide companies with non-recourse capital to pay attorneys' fees and expenses incurred in litigation in exchange for an agreed-upon share of any favorable outcome. If a claim is successful, the litigation finance firm is paid back its investment plus an agreed-upon return. If a claim is unsuccessful, the company owes the litigation finance firm nothing. This structure aligns the interests of the parties and enables companies to realize the value of meritorious legal claims without the risk and expense normally associated with litigation.

Public and private companies of all sizes find commercial litigation finance attractive in a variety of situations. Many public companies appreciate the opportunities afforded by litigation financing to pursue meritorious claims without adversely affecting quarterly earnings. Other companies seek litigation financing as an alternative to the traditional hourly billing model, and as a way of transferring some of the risk and expense of litigation. Still, other companies utilize litigation finance when experiencing liquidity problems, facing budgetary constraints, or looking to deploy capital otherwise spent on legal fees toward core business operations.

Leaders in business, law, and finance have also embraced commercial litigation finance. For example, Simpson Thacher & Bartlett LLP partner Barry Ostrager, repeatedly recognized by *The Legal 500* as one of the "Top Ten Trial Lawyers" in the United States, has represented clients successfully with the assistance of litigation financing. As the use of commercial litigation finance continues to expand and the benefits of this type of financing become more widely known, more companies and law firms will look to litigation finance when considering their next affirmative legal claim.

How Commercial Litigation Finance Works

Typically, companies seek litigation funding to pay attorneys' fees and other expenses incurred during large-scale litigation. When approached by a corporate plaintiff or its law firm, litigation finance firms evaluate numerous attributes of the investment opportunity, including, among other things, the strength of the claim, the current state of the applicable law, the capabilities of the lawyers on each side of the dispute, jurisdictional issues, damages, and the ability to enforce a judgment. If the case is determined to be strong on the merits and passes the underwriting requirements of the litigation finance firm, a funding agreement is negotiated with the company. The funding is non-recourse financing, not a loan. Therefore, a company receiving funds is not asked to repay the funds if the claim is unsuccessful. Rather, the litigation finance firm assumes that risk. If the claim is resolved successfully, either through settlement or award at trial or arbitration, the litigation finance firm recovers its investment, plus an agreed-upon return.

Experienced litigation finance firms also add value beyond the capital they provide, including:

- Encouraging best practices for litigating affirmative legal claims
- Helping companies understand and manage the fees and expenses incurred in pursuing affirmative legal claims
- Independently evaluating and affirming the merits of a company's legal claims
- Serving as experienced, outside advisors to companies and their legal counsel
- Helping companies select the right law firm (and lawyers) for the engagement

Each litigation finance firm has its own process for underwriting potential investment opportunities. In our view, a preferred method is to employ a two-stage underwriting process. During the first stage of underwriting, the litigation finance firm's experienced litigation team analyzes the legal claims to determine if they meet the firm's investment criteria and portfolio objectives. Next, for claims identified for further underwriting, the litigation finance firm engages outside legal, subject matter, and damages experts to evaluate independently the merits of the legal claims.

As part of the underwriting process, litigation finance firms typically request that litigation counsel provide a detailed budget and case management plan, which should reflect counsel's understanding of the different strategies employed in large-scale litigation. For example, a "scorched earth" strategy designed to overwhelm the opposition with discovery and documents, depositions, and motion practice has little value when pursuing affirmative litigation. Instead, the litigation budget and case management plan should reflect a thoughtful approach to discovery and motion practice, all designed for one purpose: Prepare the case for trial on the merits as soon as possible.

A well-prepared litigation budget and case management plan also provides valuable insights into other key elements of the litigation approach and case strategy. These elements include the size and members of the trial team, the anticipated contributions that each attorney will make in each phase of the litigation, and the anticipated fees and expenses that will be incurred throughout the litigation.

Most important, the litigation budget and case management plan should be the trial team's road map for success in the litigation. It should be an honest assessment of the anticipated attorneys' fees and expenses that will be incurred to litigate effectively the company's legal claims. Litigation budgets that understate the anticipated attorneys' fees and expenses are unhelpful to a company or litigation finance firm. Similarly, outsized legal budgets and incomplete case management plans raise immediate concerns about the manner in which a claim will be pursued. The work litigation finance firms conduct during their underwriting process aligns the interests of the client, its law firm, and the litigation finance company, and results in a more effective and efficient case.

Structuring the Transaction to Align the Parties' Interests

Following the financial crisis of 2008, companies placed increasing pressure on their law firms to provide alternatives to the traditional hourly billing model. While many general counsel viewed this as an opportunity to negotiate fee discounts or reduce hourly rates with their law firm partners, others saw it as a chance to better align the interests of the law firm and the company.

Despite a modest shift away from the billable hour, many law firms remain reluctant to embrace alternative fee arrangements. In a survey conducted in 2013 by legal consultants Altman Weil, general counsel were asked to rate how serious they believed their firms were to alternative fees on a 1-10 scale. With a 1 meaning "not at all serious" and a 10 meaning "doing everything the law firms can," general counsel answered with an average rating of 3.[1]

[1] Corporate Law Departments Focus on Cost Control," Altman Weil 2013 Chief Legal Officer Survey, Altman Weil Inc., Oct. 23, 2013.

Many law firms traditionally are risk averse. As a result, alternative fee arrangements that require law firms to put "skin in the game," such as full- or partial-fee contingencies or other success-based compensation, are often a new and challenging proposition. However, experienced litigation finance firms believe that aligning the interests of the parties is essential to the success of any litigation campaign.

With a detailed litigation budget and case management plan in hand, an honest dialogue occurs between the litigation finance firm, the company seeking financing, and litigation counsel regarding potential risk-sharing arrangements. Such arrangements can take many forms, including full-fee or partial-fee contingencies, flat monthly fees, discounted hourly fees, and the like. However, each of these risk-sharing arrangements has one thing in common: The parties work together to achieve a positive resolution as efficiently as possible. This shared risk ensures the alignment of interests because all parties have some "skin in the game."

Conclusion

Companies often feel constrained in their ability to pursue meritorious legal claims because of budgetary or other restrictions. Litigation finance allows companies of all sizes to pursue valid legal claims without increasing legal budgets or exposing companies to additional risk. Experienced litigation finance companies add value beyond the capital they provide by assessing the merits of legal claims independently, bringing best practices to the litigation process, and aligning the interests of the parties.

Commercial litigation finance is still in its early stages but demand continues to grow at a rapid pace. For companies and their in-house legal departments, commercial litigation finance offers increased access to justice without the risk and cost usually associated with litigation.

William P. Farrell, Jr. is a Managing Director of Longford Capital Management, LP. He has more than 20 years of complex litigation experience, including extensive trial and appellate experience as both a government prosecutor and a partner in the commercial litigation departments of Neal, Gerber & Eisenberg LLP and Gardner, Carton & Douglas LLP. He received his Bachelor of Science degree from Indiana University Kelley School of Business and his law degree as a Thomas J. White Scholar from the University of Notre Dame Law School. Mr. Farrell can be reached at +1.312.212.8240 or wfarrell@longfordcapital.com.

Michael A. Nicolas is a Managing Director of Longford Capital Management, LP. He is an accomplished attorney with more than 15 years of litigation and trial experience serving in the litigation departments of Neal, Gerber & Eisenberg LLP and Gardner, Carton & Douglas. Mr. Nicolas is a frequent speaker on commercial litigation finance. He is an honors graduate of Northern Illinois University College of Business and Chicago-Kent College of Law. Mr. Nicolas can be reached at +1.312.212.8240 or mnicolas@longfordcapital.com.