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Litigation Finance Booming

by Julie Schaeffer

The buying and selling of interests in lawsuits—a decades-old practice known as litigation finance—is expanding.

“It is becoming more and more mainstream each month,” says Marc J. Carmel, a director at Longford Capital Management. “Several years ago, only a small percentage of attorneys knew about litigation finance and even fewer had experience with it, with less than 10% of law firms reporting using it in 2013. But it’s becoming more familiar to all types of attorneys, and, with familiarity, it is becoming more popular because it addresses many of the issues that law firms and claim owners currently face. About a third of law firms report used litigation finance last year. At the same time, investors are committing more money to litigation finance as well.”

Litigation financing is the process through which law firms and litigants can finance their legal costs through a third party. As an example, Bloomberg cites Pierce Sergenian, a trial boutique, which has an impressive array of contingency-fee cases, but the only way it can afford to handle them is to sell an interest in potential recoveries. In return for underwriting the law firm’s current and future contingency cases, Pravati Capital receives a cut of any damages or settlements, which Pierce Sergenian, says is

up to an eight-figure sum.

According to Carmel, who speaks specifically to litigation finance in the commercial (versus consumer) space, there are essentially three different periods in the evolution of litigation finance. “For hundreds of years, starting when litigation became more common in Europe, litigation finance existed in some form,” he says. “It

started to become more popular about a decade ago, mostly in the United Kingdom and Australia, and took off in the United States when non-U.S. firms (especially from the United Kingdom and Australia) opened U.S. offices. Today the United States is likely the biggest market for litigation finance because

of the size of the litigation industry here.”

There is no reliable measure of the overall size of the litigation finance market, but Burford Capital, a titan in the field, alone has more than \$2 billion in capital invested or available to be invested, according to the firm’s chief executive, Christopher Bogart, quoted by Bloomberg.

Opponents of litigation finance argue that such funding increases the volume of expensive and sometimes questionable lawsuits. It undoubtedly does increase the volume. But the rest is up for debate.

“It sends a message to deep-pocketed defendants and their law firms that we can go up against the biggest

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and best,” says Pierce Sergenianco-founder John Pierce, quoted by Bloomberg.

At the 2017 Distressed Investing Conference, Carmel, along with Benjamin I. Finestone, a partner with Quinn Emanuel Urguhart & Sullivan, and Jude Gorman, general counsel and chief administrative officer at Reorg Research, discussed the potential benefits of using litigation finance.

“Litigation finance provides so many different benefits to law firms and claim owners, that there isn’t just one category that best benefit,” says Carmel.

As an example, he says litigation finance allows a claim owner to monetize plaintiff-side litigation. “Therefore, even claim owners that do not have the money to pay experienced and well-educated attorneys—that would otherwise be too expensive for them—are able to use the funds from litigation finance to pay attorneys’ fees, expert witness costs, and other expenses,” he says.

Carmel says litigation finance can also help claim owners who can afford to pursue litigation, but do not want to commit their limited resources to litigation when they would rather invest their own money in their operations or research and development. “Litigation finance allows the funder to use its money, while the claim owner can still pursue the litigation and reap the benefits of a successful judgment or settlement,” he says.

Litigation finance also benefits attorneys by providing law firms with funding. “Law firms that have taken on contingency matters or are otherwise waiting to be paid their legal fees are able to secure litigation financing to pay the law firm’s operating expenses and make distributions to partners while reducing some of the law firm’s risk and reliance on the contingency cases that they are pursuing,” says Carmel.

Litigation finance also provides a broad societal benefit. “With the funds from a litigation funder, a claim owner can afford the right counsel for the litigation matter, not just the counsel that would otherwise be willing to discount their fees to fit within the plaintiff’s budget or agree to pursue the case on a contingency so the claim owner does not have to pay hourly rates,” says Carmel. It is also noteworthy that in minimizing the need for plaintiffs to

pay litigation costs, litigation finance allows companies to pursue meritorious cases—essentially, providing a “market check” on the viability of claims.

In distressed and bankruptcy matters, litigation finance is particularly beneficial. “Distressed matters frequently involve companies with limited financial resources and, therefore, some constituents are hesitant to pursue plaintiff-based litigation,” says Carmel. “At the same time, though, these companies often have valuable litigation that could include litigation claims for director and officer liability, fraud, fraudulent transfers, or other avoidance actions. Or the companies could have general commercial claims or intellectual property claims that are unrelated to the distress. In all of these situations, litigation finance

could provide the resources to allow the distressed company to pursue the litigation and lead to a valuable settlement or judgment. Sometimes the litigation may even be valuable enough that the litigation funder would be willing to provide proceeds in excess of the litigation costs, and those proceeds could be used to fund the distressed company’s operating

expenses or even distributions to creditors.”

According to Carmel, there are a number of things law firms and claim owners should consider when using litigation finance. “To mitigate the risks, they should focus on working with an experienced and reputable litigation finance firm,” says Carmel, who suggests they: (1) look for a litigation finance firm with professionals who are experienced in providing funding and in the relevant area of law; (2) confirm that the litigation finance firm has the financial resources to honor its commitment to fund the litigation; (3) ensure that the agreements are consistent with a law firm’s ethical duties to its client; (4) ensure that the claim owner retain control over the litigation and settlement; and (5) ensure that communications with the funder do not involve attorney-client privileged communication or otherwise impair the plaintiff’s legal claims. □

This article was taken as an excerpt from Turnarounds & Workouts, a monthly publication for people tracking distressed businesses. For more information, please visit www.turnaroundworkouts.com.

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