An Introduction To

Litigation Finance

For Plaintiffs, Attorneys, Legal Departments, and Investors

Gain an in-depth understanding of how to secure capital, reduce risk and improve litigation outcomes — including how experts select cases, a review of industry growth and regulations, and a look into the future of litigation finance.

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I. Introduction

We live in a world where access to justice often depends on access to capital.

Many claimants face insurmountable legal challenges due to a lack of economic resources and find themselves unable to receive the justice they deserve, regardless of their claims' merits. The reality of ever-rising litigation costs often provides well-capitalized defendants with an overpowering weapon: financial asymmetry.

Unrepentant defendants with staggering economic advantages frequently engage in costly wars of attrition intended to exhaust and overwhelm a plaintiff's limited resources. As a result, claimants may choose to defer or even abandon legitimate claims if they are unlikely to remain solvent while the litigation plays out in court. Faced with potentially forfeiting the chance to redress their grievances, plaintiffs need a stakeholder who can bear the weight of high litigation costs, help to monetize the outcome of their claims, and keep justice-seekers on even footing with well-capitalized defendants.

Third-party litigation finance offers a powerful solution to these challenges--one that redistributes legal risk and equalizes plaintiff bargaining power with efficiency and unparalleled flexibility. The following guide presents a comprehensive overview of this burgeoning financial product, intended to demystify an industry that can provide more balanced judicial access to millions of litigants worldwide.

Max Volsky
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What is Litigation Finance?

At a basic level, litigation finance (also called litigation funding) is the practice where a third party unrelated to the lawsuit provides capital to a plaintiff involved in litigation to help improve the chances for a favorable outcome. In the event of a successful settlement or judgment, the funder receives a portion of any recovery from the lawsuit. Plaintiffs often need a partner to help monetize the outcome of their claims in order to afford all of the associated costs. Litigation finance products enable just that, making justice more accessible to undercapitalized claimants while providing a more efficient means of sharing risk.

What Litigation Finance is Not

Litigation finance is not a loan.
Most litigation investments are non-recourse "no win, no fee" arrangements, meaning plaintiffs and attorneys have no obligation to repay investors if no proceeds are recovered from the lawsuit. Typical funding agreements only require the recipient to repay a portion of any damages recovered through adjudication or settlement.

Litigation finance is not "free money" to support frivolous claims.
Litigation funders invest in claims they believe have merit and value because supporting cases that have low chances of success makes little financial sense. Lawsuit funders conduct thorough diligence for all cases to help ensure they meet the necessary investment criteria.

Litigation finance companies do not attempt to control the prosecution of the claims in which they invest.
Standard litigation finance arrangements will determine how much capital a funder will invest in the matter, and at what rates, without transferring authority over litigation strategy or settlement to the funder. A small handful of exceptions exist, such as litigation funding for class-action lawsuits in certain countries, but the vast majority of funders, including LexShares, do not control the prosecution.

Litigation finance is not uniformly regulated, and there is currently no federal regulation of litigation funding in the United States.
The practice is regulated on a state-by-state basis, and the applicable laws can vary widely. Some courts require plaintiffs to disclose the existence of third-party funding arrangements. In a minority of states, champerty or usury laws may prevent the practice outright. The majority of states have no such restrictions or have relaxed antiquated limitations on third-party funding, allowing litigation funding to proliferate.

A Common Litigation Funding Example

Acme Technology is a small computer hardware business that resells a popular device manufactured by a Fortune 500 company. One day, Acme learns that the device is malfunctioning, causing customers to lose trust in Acme and discouraging future customers from making purchases. After further investigation, the founder discovers that the device was improperly manufactured. Acme knows it has a strong case against the manufacturer but lacks the capital needed to bring its case forward. Such a high-stakes case could make or break Acme's fortunes. In this case, Acme's only hope of pursuing justice is using a litigation funding provider to cover the legal costs of bringing the lawsuit.

The Benefits of Using Litigation Finance

Litigation finance offers many potential benefits to plaintiffs, attorneys, and in-house legal departments. The capital provided by lawsuit investors may help individual plaintiffs cover litigation costs, including attorneys' fees, expert witness fees, court costs, and other expenses associated with litigation. Businesses involved in litigation may also use lawsuit funding to secure working capital when traditional financing sources are unavailable or insufficient. Furthermore, law firms may use this type of financing to directly fund case expenses or business operations.

The financial rewards litigation funding can offer investors depends on the pricing structure of the arrangement. Common variants include flat fees, a multiple of the amounts invested, and a percentage of any damages recovered, among others. In most cases, as with LexShares, litigation funding investments are non-recourse.

FOR PLAINTIFFS

Cover fees and expenses with non-recourse capital.

Increase access to justice
By leveling the financial playing field, third-party funding can help individuals and businesses redress wrongs by filing a legal claim or by providing financial support for an already-filed legal matter.

Access top resources
Outside capital provides greater financial flexibility to engage with top legal resources, including law firms and expert witnesses.

Reduce risk and improve litigation outcomes

Litigation finance decreases the likelihood that you will run low on capital during litigation, preventing forced low-ball settlements worth far less than the original damages claimed. By enabling increased access to effective legal resources, litigation finance helps plaintiffs attain larger recoveries that more fairly align with the merits of their cases.

Unlock liquidity

Funding helps monetize your legal claims by providing capital to cover hourly attorneys' fees, working capital for your business and personal expenses.

FOR ATTORNEYS & LAW FIRMS

A powerful, timely resource.

Manage risk

Litigation finance reduces the risk your clients will run out of money during litigation, helping law firms avoid settling for less than their cases are truly worth.

Drive growth

Firms can use direct law firm funding or portfolio funding structures for working capital, or to cover the administrative and advertising costs associated with class action and multidistrict litigation.

Create flexibility

Litigation finance makes flexible, client-friendly engagement structures more feasible for prospective clients who may not be able to afford hourly fees.

Improve bargaining power

Third-party funding can put your clients on even financial footing with the opposing party, helping you potentially secure recoveries that are more reflective of the case's merits and the damages sought from the counterparty.

FOR LEGAL DEPARTMENTS

Turn your cost center into a profit generator.

Offset risk

Funding mitigates the financial risk of costly litigation. Legal departments can instead shift expenses to an outside provider while still benefiting from a portion of the recovery.

Optimize resources
Litigation finance makes top legal resources more accessible, increasing the potential value of your cases while avoiding the common pitfall of "getting what you pay for."

Secure internal buy-in
By shifting financial risk and burden to litigation funding providers, legal departments can more easily obtain corporate approval for proactive litigation.

Manage the balance sheet
Litigation finance mitigates the effects of expensive litigation on your quarterly earnings.

FOR INVESTORS

A compelling alternative investment opportunity.

Historical performance
Litigation finance investments have the potential for strong returns. For example, LexShares' resolved case investments generated a median 56% net annualized return to investors through December 31, 2019.

Uncorrelated asset
The potential value of a lawsuit is typically not correlated to activity in public capital markets, allowing investors to significantly diversify their portfolios--even during times of significant economic turbulence.

Moderate durations
On average, civil lawsuits in the U.S. take 27 months to resolve by way of court adjudication or settlement.

Institutional strategy
Some of the world's largest and most highly regarded institutional investors have invested in litigation-related assets. LexShares' online marketplace makes this otherwise hard-to-access asset class available to thousands of investors.

Past performance is not indicative of future performance. Returns are based on principal's internal reporting for offerings through the LexShares platform reaching resolution as of December 31, 2019. Results reported reflect the simple median annualized rate of return per the xirr function, net of fees and expenses. Diversification does not guarantee profits or protect against losses.

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The modern practice of litigation finance is less than three decades old, having originated in Australia and the United Kingdom. Historically, the medieval English doctrines of maintenance, champerty, and barratry--all of which involve one party financially supporting the legal claim of another--prohibited third-party funding of lawsuits in most common law jurisdictions. Over time, the need for champerty, maintenance, and barratry prohibitions receded as other means of controlling legal system abuses became more effective.

Today, widespread exceptions to these antiquated doctrines exist to promote equal access to justice, such as contingent fee arrangements, where an attorney is paid a fixed percentage of a recovery only if there is a favorable judgment or settlement. In light of these shifting legal attitudes, direct lawsuit financing is now permitted in many countries. The practice has flourished in this environment, and funders now hire full-time, seasoned legal professionals away from well-known law firms and corporations to assess the potential risk and value of case investments.

Litigation Finance in the United States

U.S. courts have generally permitted commercial litigation finance. Due to longstanding legal uncertainty, however, the direct funding of lawsuits by independent parties did not widely emerge in the U.S. until the mid-2000s--despite the country's vast legal industry and propensity for litigation. The global recession of 2008 significantly changed the industry's growth trajectory as tight credit markets, declining asset values, and escalating legal costs greatly expanded the practice and viability of investing in lawsuits. Increased backing by institutional investors and receptivity in the legal industry further fueled the prevalence of third-party funding.

From a legal standpoint, the American civil justice system has increasingly recognized that access to justice depends upon the broad availability of legal representation for all socioeconomic levels, stemming from the fact that civil litigants are responsible for their legal costs. As a result, concern over the financial burdens imposed by the U.S. legal system has overridden concern over third-party legal funding in many states. This distinct shift in legal attitudes is evidenced by the many U.S. states that have allowed litigation finance deals to proceed, such as New York, California, and Illinois. Notable court decisions in Massachusetts (Saladini v. Righellis), Florida (Kraft v. Mason), and South Carolina (Osprey, Inc. v. Cabana Ltd. Partnership) saw those states effectively repeal their champerty laws. Claims that litigation funding constitutes usury--or lending at interest rates above a state-mandated threshold--were also rejected in New Jersey (Dopp v. Yari) and Texas (Anglo-Dutch Petroleum Int'l, Inc. v. Haskell), among others.

Today, there are dozens of litigation finance firms employing a wide variety of investment strategies, from large, single commercial cases to multi-claim portfolios and law firm loans. Some funders have begun to specialize in certain segments of the growing commercial side of the market, focusing on specific claim types, investment structures, and deal sizes. Other providers, including LexShares, are now using technology to originate cases more efficiently.

Current Regulation of Litigation Finance in the United States

Despite significant progress, the U.S. still lacks a transparent and comprehensive regulatory framework for litigation finance. Litigation finance is still governed at the state level by a diverse patchwork of case precedent, common law doctrines, state bar ethics opinions, state statutes, and agreements with regulatory bodies. Many states have differing views of how investments in lawsuits should be treated. Thus, the degree of litigation finance regulation--or whether lawsuit investments are permitted in a state at all--varies greatly across jurisdictions.

Some states, for instance, have passed laws that require disclosure of third-party funding in court. A minority of states have passed legislation restricting or preventing third-party funding in consumer-based litigation finance transactions, such as personal injury claims. Other states have determined that third-party funding violates usury, champerty, or maintenance laws. In the majority of states, however, U.S. courts have allowed litigation finance deals to proliferate. Many state bar associations have even issued ethical guidelines for litigation funding transactions.

Nevertheless, a critical question likely remains for attorneys: how do the states where they practice law view litigation finance? If you are seeking litigation funding for yourself or a client, first consider the following factors:

1. Whether your state laws permit third-party lawsuit investments
2. Whether the assignment of lawsuit proceeds is permitted in your state
3. Whether disclosure of litigation funding is required by law
4. How state usury laws and courts treat investment models where the payment of proceeds is contingent upon the outcome of the claim
5. Whether state bar ethics rules allow you to enable and participate in such deals
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Since the inception of litigation finance, three main product lines emerged:

1. **Non-recourse funding for commercial cases**, such as breach of contract, intellectual property, antitrust, and insurance matters.
2. **Lawsuit advances for tort claims**, which allow individual plaintiffs to cover living expenses during protracted litigation.
3. **Direct loans** provided to attorneys and law firms.

To keep pace with the needs of clients and dynamic law firms, today's litigation funders offer a wider range of products and investment vehicles that fall under the above categories.

Single-Case Commercial Litigation

Commercial deals tend to be much larger than lawsuit advances for tort cases, ranging from hundreds of thousands to tens of millions of dollars at the highest end of the spectrum. While available data suggests that many business lawsuits result in confidential settlements, the total value of all judgments and settlements for commercial lawsuits is estimated at hundreds of billions of dollars per year. The capital provided is largely used to fund litigation costs and, in some cases, business expenses.

To qualify for commercial funding, prospective recipients need to have:

1. A viable legal claim with clear liability
2. Quantifiable damages against a well-capitalized defendant
3. A claim in a jurisdiction that permits litigation finance
4. An accomplished legal team on a contingency or current pay basis

Patent Enforcement

Patent enforcement is a highly developed segment of litigation finance that has existed for decades. Capital is widely available for valuable patents that are infringed by affluent companies.

IP enforcement firms may also purchase patents from the owner outright, and then attempt to monetize them by sending notice letters to companies suspected of infringement. Unlike other forms of litigation finance, patent transfer and enforcement by third parties (which accounts for the overwhelming majority of deals) is allowed by U.S. federal law. For this reason, an active market has developed. For example, RPX Corporation, a single albeit large patent risk solution provider, has invested nearly $2.5 billion to acquire over 43,000 patents over a 10-year span.

Portfolio Financing

Recent years have seen the rise of portfolio financing arrangements, in which investment capital is collateralized by several cases, typically litigated by a single law firm. The portfolio might only include a small handful of cases or up to dozens of different cases, which would be represented on a full or partial contingency basis. In theory, this can include plaintiff-side and defense-side cases. Because portfolio financing can include several different case types and sizes, this relatively new product can offer a greater opportunity for investment diversification than single-case deals and potentially greater capital usage flexibility for those receiving it.

For law firms, portfolio financing can potentially reduce the inherent financial risk of contingency-based litigation, particularly when it comes to case types with lower rates of success. For example, fewer medical malpractice cases succeed today than 30 years ago, but those that do resolve favorably may result in significant judgements. Law firms can also use outside capital to maintain adequate capitalization for their businesses while still offering alternative fee arrangements. Ultimately, this positions law firms to create new client relationships and strengthen existing ones.

Portfolio financing also allows corporate legal teams to employ a more strategic litigation approach, while also reducing the effects of legal action on their balance sheet and income statement.

Law Firm Funding

Law firms do not have access to the same range of financing options that most businesses do. Most contingency firms are self-financing, having only small bank lines of credit or no bank credit at all. They generally rely on partners' contributions or fee-sharing with other law firms. Law firms, therefore, are historically underserved by capital markets and, as a result, will pay comparably higher rates to finance their operations than most businesses.

To fill this liquidity gap, some lenders now offer direct law firm funding. These deals can have many different features and are typically bespoke products that meet the specific needs of the law firm. Generally, the product lines include contingency fee advances, lines of credit, case expense loans, and post-settlement funding (or fee acceleration). With proper safeguards in place, this product can provide law firms the ability to significantly grow their business models. Contingency fee acceleration, for instance, allows law firms to expand by hiring staff or taking on new cases. It can also help address unexpected expenses associated with lucrative cases or emergencies.

Post-Settlement Monetization

Post-settlement monetization assists plaintiffs with cases that have already settled. These claimants are still waiting to receive the agreed-upon funds but have pressing business or personal expenses to cover in the meantime. This financial product can be offered as non-recourse funding in exchange for a portion of the settlement proceeds. Because the case has already settled, the associated risk--and by extension, the cost of capital--is usually lower than pre-settlement funding.

International Arbitration

Litigation finance can offer claimants the capital to fund an international arbitration where their war chest would fall short. Additionally, outside funding can be used to bolster working capital, which can keep a business running while a dispute remains pending before an arbitrator or tribunal. The types of cases brought before established arbitration organizations vary, but generally can include complex commercial matters, often involving multiple jurisdictions and damages that can run up to billions of dollars.

Tort Lawsuit Advances

Lawsuit advances for tort claims are upfront cash payments to the plaintiff for living expenses in return for a portion of any future proceeds from that claim. Plaintiffs involved in an accident often lose the ability to support themselves or pay for medical bills not covered by insurance. As with other funding products, there are no interim payments with tort lawsuit advances. The capital provided is used to cover personal and medical expenses while the litigation plays out in court. The amount of a plaintiff's recovery is also a ceiling on any payments that must be made to the funding company.

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The process of evaluating which cases a funder will finance can be complex. In assessing new investment opportunities, funders investigate a wide range of factors, including the case type, its legal merits, the total damages sought, attorney fee structures, procedural concerns, and choice of jurisdiction. Trusted industry and legal experts might contribute their analyses to such decisions. Funders also have at their disposal highly sophisticated risk analysis tools to evaluate the strength and viability of prospective case investments.

What follows is an overview of funding transactions, which typically involve several parties: litigation funders, investors, attorneys, clients, and even brokers.

Origination

A full review of a potential legal claim investment can be a time-intensive commitment for client, attorney, and funder. To make the process more efficient, funders will typically pre-qualify cases by examining their overall attributes, as well as the circumstances of both plaintiffs and defendants. Therefore, when plaintiffs and attorneys submit cases for funding, providing a detailed case summary is critical. This information enables the funder to quickly identify the core legal issues relating to the claim and focus the underwriting process on requesting only relevant information from the submitting party.

Technology can also help litigation funders more efficiently put capital in the hands of attorneys and plaintiffs who require it. For example, LexShares' proprietary Diamond Mine software analyzes federal and state court dockets to quickly identify high-quality cases, assigning scores based on internally established criteria. This algorithmic analysis allows LexShares to screen more than 1,000 cases per day, helping our team proactively identify which cases may be well-suited for litigation funding.

Case Selection Criteria

What makes a case attractive to litigation finance providers? While there is no one-size-fits-all answer, there are three primary factors funders consider for every case:

1. **Legal merits**, including its procedural history and the alignment of its facts with the law.
2. **Strength of counsel.** Does the plaintiff's legal team have a track record of successfully litigating similar claims? What is the breadth and depth of its litigation experience?
3. **Defendant solvency.** A defendant's ability to pay potential damages is critical.

Most funding companies will vet cases early on in their origination process to identify opportunities that closely fit their investment criteria. As a next step, they will typically rely on in-house underwriters--attorneys who have deep legal expertise in a particular subject matter--to lead a more thorough inspection of each matter. Underwriters will examine key case documents, undertake multiple discussions with the attorney and plaintiff, and evaluate pricing considerations, helping them determine which claims are worthy of investment.

Below, we examine each of these three areas, as well as other key factors that most funders consider.

LEGAL MERITS

Funders will first assess the strength of a claim's underlying legal merits, including case facts and the prevailing law in the case jurisdiction. Public court documents such as pleadings, motion briefs, hearing and deposition transcripts, and judicial orders on dispositive motions all are central to the underwriting process and, in certain cases, are sufficient to reach a funding decision. Other factors such as dispute type, governing law, legal venue, the judge's background, quality of witnesses, size of the damages, case budget, and the projected timeline to final adjudication also contribute to this analysis Underwriters will use all of this information to determine if plaintiffs have a high probability of prevailing with their particular facts and arguments.

A legal claim's procedural posture is another important element of the underwriting process. Even claims with strong legal merits can be lost due to procedural technicalities. Skilled defense attorneys are well-versed in procedural rules and fully inclined to take advantage of them. In particular, procedural events such as motions to dismiss or motions for summary judgment can cause underwriters to postpone investment decisions, due to the possibility of an early case dismissal. Cases that survive dispositive motions, therefore, are typically viewed as more likely to succeed by litigation funders.

When a case is publicly filed, LexShares can conduct a thorough review of the case docket without requiring access to privileged information, using its proprietary Diamond Mine origination platform.

STRENGTH OF COUNSEL

The strength of the legal team is highly correlative to a claim's prospects for success. For this reason, funders generally focus on investing in matters that are being handled by highly reputable, experienced and well-resourced attorneys. When performing this analysis, underwriters will review the legal team's track record in litigating similar types of claims, usually by reviewing court records from current and previous matters and interviewing members of the legal team. Attorneys should exhibit a clear understanding of their client's objectives and have a well-developed strategy that accounts for all steps in the litigation process, including aspects that extend beyond the courtroom, such as settlement and enforcement. These considerations inevitably affect the likelihood of recovery and are an essential step in the funder's due diligence process.

The litigation budget is another critical consideration. In some cases, the budget might be excessively high for the size of the claim or inappropriately low for the complexity of the matter. A reasonable budget, therefore, is one that anticipates the various litigation milestones and uses them to project future expenses. A well-conceived budget accounts for the probable routes in the litigation process while efficiently utilizing resources and mitigating cost overruns. In evaluating the propriety of a litigation budget, the interests of the plaintiff's counsel should also be aligned with those of the funder, ensuring that the legal team is adequately motivated to bring the case to its conclusion. For this reason, most funders expect some "skin in the game" from the legal team, often in the form of full or hybrid contingency arrangements--wherein a significant portion of the legal team's compensation is derived from a successful resolution of the dispute.

DEFENDANT SOLVENCY

Underwriters will evaluate the creditworthiness of the defendant early in the vetting process, determining their ability to pay any potential damage award. After all, even the most meritorious claim can fail to culminate in a recovery if the liable party simply

lacks the economic viability to pay what they owe. Based on a funder's previous investment experience, an independent analysis of the defendant's solvency may help the plaintiff and counsel revise their expectations for potential recovery outcomes. Sharing quantitative information related to the case's underlying claims, such as the financial terms of a disputed contract, ultimately helps funders make more informed investment decisions.

Structuring

Once underwriting is completed, the structuring of the transaction begins. The funder and attorney or plaintiff may negotiate the terms such as the funding amount, budget allocation caps, funds deployment timeline, and pricing. The deal structure is reflected in the investment agreement, which sets forth the rights and obligations of investors, plaintiffs, and their attorneys, budgeting, payment arrangements, inter-claimant provisions, and addresses other issues that arise throughout the investment process. The investment agreement is the primary mechanism for controlling after-the-fact risk in litigation finance transactions. For funders, the challenge posed in drafting effective investment agreements lies in striking a balance between the enforceability and flexibility of the document,while still keeping its terms attractive to clients and attorneys. Timely disclosure and cooperation from all parties involved are keys to finalizing any funding agreement.

Servicing

The investment process continues even after the consummation of a funding transaction. Providers and their servicing teams must exercise vigilance in managing their investments for the entire life of the claim. Considerations must be made concerning the priority of liens, attorney substitutions, or other situations that can lead to a complete write-off of an investment. For example, investments require payment monitoring, or, in cases of default, collection and dispute resolution. A successful investment process entails thorough preparation, an investment agreement that accounts for a myriad of contingencies while remaining attractive and easy to understand, as well as continuing oversight of all aspects of the lawsuit and related obligations.

The Attorney-Funder Relationship

A funder's relationships with the attorneys and law firms driving the legal claims is one of the most important factors during all phases of the investment process. Respecting the attorney's role, the obligations of the attorney-client relationship, and the attorneys themselves --through courtesy, clear communication, and understanding--helps solidify the working partnership among funder, attorney, and client throughout the investment process.

While every litigation funder must perform some combination of the evaluative steps outlined above, the precise implementation, as well as their relative importance to the ultimate investment decision, is a balance that varies among funders. LexShares utilizes a combination of extensive in-house experience, industry best practices, and proprietary technology to effectively assess new cases. This allows attorneys and plaintiffs to maximize the potential outcomes of their cases in a flexible, highly efficient manner.

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Overview

Litigation finance is not without controversy, having been praised and criticized by legal scholars, practitioners, the media, and special interest groups. This expanding industry is celebrated by those who view it as an equalizer that provides broader access to the legal system. Others deride it as a threat to public interest, citing public policy and legal ethics concerns. Yet many who oppose the industry struggle to articulate why.

As with any new trend, much of the suspicion and criticism surrounding litigation finance stems from misunderstanding, with detractors often lacking nuanced knowledge of the industry. The following section aims to clear up common misconceptions relating to funding practices.

Does Litigation Finance Promote Frivolous Lawsuits?

Many critics of litigation finance suggest that it promotes excessive litigation, leading to an explosion of frivolous claims and unsavory practices in cases that would otherwise not be filed. However, after several decades, the anticipated cascade of frivolous litigation has yet to materialize, despite the rapidly growing availability of funding in the U.S. and elsewhere.

Litigation funders inherently avoid frivolous legal claims because they seek positive returns on their investments. There is no financial incentive to support dubious cases with low chances of resolving favorably. Funders with a track record of supporting baseless claims would not only find it incredibly difficult to earn the trust and capital of investors, but they would also invite overwhelming headline risk, regulatory risk, and potentially legal risk related to aggrieved stakeholders.

Instead, funders conduct thorough diligence for each of their investments, ensuring that funded cases only involve highly meritorious matters that they believe will likely result in positive outcomes, so long as the plaintiff is sufficiently capitalized. Litigation finance, therefore, promotes equilibrium within the justice system by allowing those with legitimate and serious causes of action to enforce their rights. This has the effect of correcting previous distortions in the system that resulted from capital scarcity.

At LexShares, most investments are made only once a claim is filed--and when legal representation is already in place--so that underwriters can review relevant court documents and ensure the case has survived key procedural milestones. As a result,

funders filter out meritless claims with a low likelihood of success--whether due to jurisdiction, the nature of the damages, or any number of other factors. LexShares funds fewer than 5% of cases submitted to our underwriting team, which consists of industry experts and seasoned former litigators. This “acceptance rate” is in line with the industry’s more experienced litigation finance firms.

Does Litigation Finance Deprive Plaintiffs of Reasonable Awards?

Litigation finance opponents claim that funding agreements do not always favor plaintiffs when a case resolves favorably. Out of necessity, most deals prioritize payouts to the litigation funder and its investors before litigation proceeds are distributed to the plaintiff. If counsel litigates the case on a full or partial contingency basis, they are also owed a portion of the proceeds. The critical question then becomes: do plaintiffs receive a smaller portion of the monetary recovery with litigation finance? This argument is a common one, yet it ignores important realities of most funding deals.

The cost of providing non-recourse funding is significant due to the high risks of litigation investments, which will typically result in a total write off of cases that are not successful. Lawsuits are often unpredictable and even the strongest of cases can prove difficult to win. Moreover, these types of investments are illiquid, and funders have few options to exit their investments before they resolve. Data from the Administrative Office of the U.S. Court shows that civil cases have a median length of 27 months from filing to trial. However, litigation can extend to three or four years in some districts. The cost of providing litigation funding is also high due to the labor-intensive investment process and related operational expenses, which can include expert underwriters, origination specialists, financial and administrative staff, as well as outside counsel. As a result, funders expect a rate of return that adequately reflects the associated levels of risk and capital investment and are understandably entitled to a meaningful percentage of any recovery.

It is also important to consider that litigation finance is often instrumental in changing the trajectory of a claim by improving its prospects for a successful resolution. From the plaintiff’s perspective, a well-resourced case represented by skilled attorneys is more likely to result in a larger recovery, whereas a case that is starved of capital will often result in a loss or a nuisance value settlement that does not adequately compensate the plaintiff for his or her damages.

Litigation funders typically provide no more than 15% of the total damages sought in exchange for a multiple of their original investment. Consider that an attorney representing her client on full contingency seeks $5 million in damages for a breach of contract case. The client then accepts $750,000 from a funder to cover his most critical business expenses, agreeing to a variable return rate based on the length of time between the initial funding and case resolution. If we assume the attorney secures a $5 million award for the client 48 months after accepting the funding, the payment distribution might look like this:

The payment distribution might look like this:

1. The attorney receives 30% of the recovery for her time and expertise (**$1,500,000**)
2. The litigation funder receives a 2.0x return on its investment (**$1,500,000**)
3. The balance goes to the plaintiff (**$2,000,000**)

In this scenario, the plaintiff recovered $2 million, in addition to the $750,000 investment provided by the funder. In the event his case was unsuccessful, the plaintiff would still manage to keep his business afloat while waiting for the case to resolve, whereas the funder and attorney walk away with nothing.

Does Litigation Finance Affect Attorney-Client Privilege?

Perhaps the most common criticism of litigation finance from a legal ethics perspective is its supposed potential to negatively impact the legal profession's duty of confidentiality. Some are concerned that litigation finance may undermine the fiduciary and professional obligations of attorneys toward their clients. They argue that the attorney-client privilege may be compromised when attorneys disclose case details to funding companies for the purpose of evaluating case merits. Although breaches of confidentiality are certainly possible, a closer examination of how funding companies make their investment decisions will reveal that these concerns are overstated.

Funders may indeed review confidential case materials, but they should not need to review attorney-client communications to accurately assess most matters. Furthermore, the attorney is allowed to disclose confidential information to third parties if the client gives "informed consent." The client is also free to tell a funder anything other than what the client said to the attorney, without waiving the privilege. As a result, the client could tell the funder a great deal about the case, so long as he or she is not asked about privileged attorney discussions. As such, a prospective investor can expect to receive substantial information from the plaintiff about the claim without ever creating waiver problems.

While the “common interest” doctrine that preserves privilege is not universally recognized, more and more courts have begun acknowledging the benefits of litigants sharing privileged information and work product with third parties that share their lawsuit-related interests. This approach focuses on whether the client and third party are engaged in a “common enterprise,” and whether the information shared relates to the enterprise’s goal. Furthermore, most funders remain passive investors during litigation, as their investment agreements expressly disclaim any right of control over legal strategy or settlement negotiations. Thus, the sharing of case information is centered around the parties’ common financial interests.

Commercial deals with a more intensive underwriting process may require the disclosure of privileged information, such as attorney-client work product. However, there are ways to avoid privilege-related challenges in these litigation funding relationships. For example, non-disclosure agreements are an effective tool for safeguarding confidential information and are a common feature of most funding transactions. Courts have generally recognized the types of protections these types of agreements provide. In addition, the funding company’s attorney could be designated as co-counsel to evaluate a claim’s merits, via a legal services agreement.

Does Litigation Finance Create Conflicts of Interest?

Critics also suggest that litigation finance providers will seek to maximize the expected value of their claims by demanding control over the litigation--perhaps by hiring the lawyers directly, devising the litigation strategy to be employed, or influencing whether the plaintiff accepts a settlement offer. However, this argument assumes that attorneys are not sophisticated enough to deal with potential conflicts of interest in a professional manner. It also assumes that funders will attempt to control litigation.

Neither claim reflects the reality of the litigation finance industry. Most funders do not attempt to control litigation, which means the identity of the client should never be in question. Moreover, standard litigation finance transactions do not transfer a cause of action to a new party, and their contracts confer no right of interference. They are transfers of only a portion of a claim’s proceeds. In practice, most funders maintain a purely passive role when it comes to litigation tactics and strategy.

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Overview

While the ascent of litigation finance is a truly international phenomenon, most of the market's activity has been concentrated in common law jurisdictions, which also contend with many of the same problems as the U.S.--namely the high costs of litigation that impede access to justice. Among common law countries, litigation finance has been most enthusiastically embraced in Australia and the United Kingdom. Singapore and Hong Kong, however, have quickly emerged as key markets for international arbitration investments. The great strides made in these areas toward acceptance of and mounting participation in litigation financing speak to the international market potential of the industry, as well as the increasing likelihood that such progressive viewpoints may overtake more restrictive attitudes, including those found in some U.S. jurisdictions.

Australia

The leadership Australia has demonstrated in the global litigation finance market stands as a venerable example for the development of the industry in other countries. Their progressive views have outpaced the development of the industry in other countries by a large margin. Some Australian courts, meanwhile, have gone so far as to welcome third-party litigation funding. The country has pioneered many methodologies now being applied by companies targeting markets in the U.S. and U.K., including key metrics that funders use to assess risk in commercial deals. Additionally, the development of the legal framework that enables litigation finance in Australia serves as an important precedent for other jurisdictions, as the debate there shares many of the same features with those that are occurring in other countries. As the global industry matures, many continue to view Australia as the vanguard of the litigation finance industry.

United Kingdom

The United Kingdom's position as a global financial and legal center has bolstered its litigation finance sector for several reasons. Foremost, English law is often persuasive for courts and cited by jurists in other jurisdictions because it serves a foundation for all common-law countries, including the U.S. Recent court cases in the United Kingdom, as well as reports by legal scholars, government agencies and professional organizations, have all confirmed the legality of litigation finance transactions.

The acceptance of litigation funding in the United Kingdom, however, comes with a caveat. English courts have consistently held that champerty and maintenance

prohibitions against third-party funding do not apply so long as investors do not control the plaintiffs or the underlying claims. Issues of control also trouble English courts because of the perception of interference with the attorney-client relationship that arises when a third party, rather than the claimant, is directing the litigation. As a result, U.K. funding companies have sought to assure regulators that their investment practices are in line with public policy. In a typical funding transaction, the plaintiff decides which lawyers to hire. Furthermore, plaintiffs and their attorneys, not the investors, agree on case strategy and direct the prosecution of their claims. Moreover, the plaintiff will ultimately decide whether to settle the claim for a given amount.

These factors, combined with the growth of litigation finance in the U.K., created an organic push for voluntary self-regulation. The result was a voluntary code of conduct, the Code of Conduct of Litigation Funders, which became law in November 2011. The Code requires lawsuit investors to give certain assurances to claimants regarding their participation in their claims. Among other things, these assurances hold that:

1. The funder will not try to take over or control the litigation
2. The funder has enough capital to fund the litigation
3. The funder will not withdraw from funding a claim unless there is a material adverse development

While these developments have been positive for litigation funding in the U.K., questions surrounding adverse costs awards--wherein the losing litigant covers some or all of the winner's legal costs--threaten to have a chilling effect on the market. Specifically, it is unclear when and to what extent litigation funders are required to cover adverse costs in cases where defendants prevail.

Hong Kong & Singapore

For a long time, these two jurisdictions prohibited litigation finance due to champerty and maintenance doctrines. In 2017, however, both Hong Kong and Singapore passed regulations permitting third-party litigation funding in arbitration disputes and related proceedings, creating a limited but viable market for litigation funding in the region--one that holds compelling promise.

Hong Kong's 2017 amendment to its champerty and maintenance doctrines has allowed third-party funding in both domestic and international arbitration. Funders are prohibited from providing capital to domestic litigants, although insolvency cases are a rare exception. Perhaps most interestingly, Hong Kong's legislation paved the way for a Code of Practice for Third Party Funding of Arbitration in 2018. The Code outlines a funder's obligation to maintain sufficient access to capital, provide contract details for

the advisory body, and have the ability to cover all funding debts and liabilities for a minimum of 36 months, among other guidelines.

In Singapore, the Civil Law Amendment Act 2017 applies only to international arbitration, but it too provides a limited early framework for litigation funding in the country. The amendment requires that dispute resolution funding is the “principal business” of any litigation funding provider that operates in Singapore, and that it includes a “paid-up share capital” of at least $5 million. As in Hong Kong, Singapore does not permit litigation funding in domestic matters, nor do its laws allow for contingency fee arrangement--a key lever in facilitating funding agreements.

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The emergence of third-party litigation funding has taken place alongside titanic shifts in the legal industry. Stress caused by recent financial crises, combined with the rapid progression of technology, has effectively restructured the way many legal services are delivered. Growing trends such as increased client control, legal self-help, outsourcing, and jurisdiction shopping are forcing attorneys and law firms to become more proactive and flexible, to subsist in an increasingly competitive marketplace. Despite these challenges, however, that marketplace is still thriving. There are currently tens of thousands of plaintiffs' lawyers who advertise for clients, find cases, and marshal their rights in court. In 2018, the top-200 revenue grossing law firms in the world generated nearly $100 billion, in an industry that employs 1.1 million people overall.

Against this promising backdrop, the litigation finance industry has experienced rapid expansion over the past decade, leaving many feeling optimistic about the years ahead. Litigation finance is poised to establish itself as a permanent fixture of the modern legal system, both in the U.S. and internationally. What will such a future hold for those who use outside capital to fund law firms or legal claims?

Information about new products now spreads at unprecedented rates, creating a deeper understanding of litigation finance among a much broader range of participants. Corporate legal departments, for instance, have generally lagged behind law firms concerning litigation finance adoption. We anticipate that will change, with more general counsels proactively using non-recourse capital to offset risk, convert illiquid lawsuits into liquid assets, and better manage the corporate balance sheet. The laws, regulations, and legal precedents relating to third-party funding will also become more developed in the U.S. as an increasing number of states allow third-party funding transactions to proliferate. Transaction documents, funding structures, and data used by litigation funders will likely become more standardized, as well, which could lead to a more efficient market for funding recipients.

As the industry continues to expand, new products will emerge to address a broader range of geographic and legal markets. Effective technology usage will become a key differentiator both in litigation finance and the legal sector overall. This will include the increased use of origination tools as sourcing high-quality cases grows more competitive, as well as data analytics tools that allow attorneys and funders to better assess risk factors--such as damage models, jurisdictions, judges, counsel, and beyond. Geographic expansion will continue in Europe and Asia. Additionally, new funding products could emerge for defendants as a mechanism for hedging downside risk in the event of adverse litigation outcomes. While defense-side financing is not yet

widely practiced, it is one example of territory still left to be discovered in the litigation finance sphere.

As competition among funders grows, consolidation within the industry is inevitable. The growth and globalization of the litigation finance industry should also spur a convergence of regulatory efforts, with expanding jurisdictions looking to import laws and regulations from more established markets such as the U.S. and Australia. Perhaps most importantly, the number of attorneys and in-house counsel working with funders should experience further growth, to the point where awareness and usage of litigation finance becomes mainstream.

Looking Forward

What first began as a cottage industry in the U.S. in the mid-nineties has acquired considerable momentum over the past several years, particularly in markets such as commercial funding and law firm lending. As more attorneys and counsel learn about this burgeoning financial product, more will explore litigation finance for themselves and, increasingly, work with funders on an ongoing basis.

As we look toward an uncertain future, volatile capital markets conditions and the increasing economic fallout are chief concerns for everyone. Despite the challenges of this new reality, equal access to justice will remain paramount. Those who have strong legal claims but lack the resources needed to bring them forward will increasingly turn to legal professionals who can enable their pursuit of justice. In our view, law firms and attorneys that embrace new approaches to their practices and more flexible fee arrangements--such as those facilitated by litigation finance--will be best positioned to meet this fundamental need. Through it all, litigation finance is poised to continue making justice attainable for all those who deserve it, regardless of their economic resources.

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IX. About LexShares

LexShares is a leading litigation finance firm with an innovative approach to originating and financing high-value commercial claims. LexShares funds litigation-related matters through both its online marketplace and dedicated litigation finance fund. Founded in 2014, the company is privately owned with principal offices in Boston and New York City. For more information, visit lexshares.com.

Max Volsky, the author of this litigation finance guide, is the Co-Founder and Chief Investment Officer of LexShares, where he leads the firm's underwriting and investment strategies. Before founding LexShares, Mr. Volsky was instrumental in fostering the growth of the litigation finance market for more than a decade, having overseen more than 10,000 investments in legal claims. Mr. Volsky also authored the first book about litigation financing, titled *Investing in Justice: An Introduction to Legal Finance, Lawsuit Advances and Litigation Funding*.

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