Publication

Risk transfer in commercial litigation: risk, finance, funding and insurance solutions

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BT and Burford in the news

The litigation finance/funding market has recently hit the headlines with the announcement that BT Group (BT) signed a £31.6 million litigation funding deal with Burford Capital. Full details of the deal have not been released however press coverage reveals that Burford will finance BT’s portfolio of pending litigation matters. BT will use the money to both relieve legal expense budget pressure and for corporate purposes unrelated to the litigation matters. Capital is provided on a non-recourse basis and BT can treat this as income received, without waiting for the result of the underlying litigation matters. In return Burford will receive a portion of the proceeds (predicted to be around £150 million) from the disputes in the portfolio of cases on a ‘cross-collateralised basis’.

This BT deal demonstrates that some now view litigation cases as a commodity that can be financed in the same way that businesses finance their buildings and assets. In return for giving up a percentage of their potential damages/returns companies such as BT transfer the risk of their litigation to the funder. It may also mean that entities can bring claims they otherwise wouldn’t, so as claimant they will get a percentage of something, rather than 100 percent of nothing. Depending on how a company structures its internal legal budgets, the legal team may also be able to say they have cut their legal budget.

Some commentators suggest that Burford will only be funding claims for BT as it is more difficult to make money from funding a defence, although for the right price, funders will finance defence matters.

This BT deal has grabbed the headlines due to its size. It shows the ambitions of litigation funders such as Burford (who reported a 60% net return on invested capital since 2009) and also how some corporates view this as an innovative model that can benefit the business – not just something for cash strapped litigants. Most funding will be for much smaller sums/portfolios as set out below.

The litigation finance/funding market

Traditionally litigation finance has been considered suitable only for large multimillion pound claims. Funders are now able to offer funding for claims between £10K – 200K and also for a portfolio of smaller claims (where the ratio of fees is suitable (normally the ratio will be 4:1)). Headlines from a recent Burford funding survey include:

- 62% of CFOs expect demand for litigation finance to increase
- 58% of in-house counsel/C-level executives are aware of litigation funding
- The number one challenge for 80% of in-house counsel is reducing legal budgets, staffing and spending.

Costs/risks/certainty

Finance, funding and insurance is not just about how much money a client has. It is also about their attitude to risk and their business goals. A client with deep pockets may still benefit from litigation finance, for example, where they would rather invest their money in growing the business rather than tying it up in litigation. Sophisticated users of litigation finance can use a pending dispute/portfolio of claims as a contingent asset to raise capital, as demonstrated by the BT/Burford deal.

Benefits for clients

Helping our clients to reduce legal spend is key. Finance, funding and insurance can help clients to reduce the financial risks of both bringing and defending claims. For example, funders offer non-recourse funding where clients only share a percentage of their damages (typically between 20-40%), if they win. In the event of an unsuccessful outcome litigation funding costs nothing. In exchange for taking no financial risk clients are ‘giving up’ a percentage of their recovery.

Other benefits include:

- Gets litigation spend off the balance sheet
- Improves cash flow – no lock up in legal costs

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Focus financial resources on investment/growth

Use pending litigation as a ‘contingent asset’ to raise capital

Risk transfer

Solve portfolio challenge where a client cannot bring some claims as litigation budget is limited/consumed by defending cases

Position of strength – you can inform your opponent you have funding which makes it clear that an independent third party backs your case.

Possible downside for clients

Finance/funding/insurance will cost you money or reduce your recovery if you win. Funders are looking to make money. By sharing the risk they will be seeking a return on their investment. Typically a funder looks for repayment of its capital and up to a four-time return on this.

The third party adds a further layer of bureaucracy. They do not control the case but they will need to be informed and in some cases approve particular steps in the disputes such as settlement.

Funding is often less useful for defendants/claims not involving sums of money.

Suitable Cases

Typically £1m - £15m commitment

Product for lower value cases. Fund £25k - £500k fees and disbursements subject to suitability criteria

One off/portfolio of cases

Strong merits

Where the claimant will still receive significant portion of damages (after legal costs/financing fees)

Enforceability – defendant’s ability to pay.

Portfolio funding

As with the BT/Burford deal funders are prepared to fund multiple claims. This means the funder can spread its risk across several cases. Advantages to clients:

If the portfolio is sufficiently large, funders will offer better pricing because they can spread their risk

This might give clients access to funding where individual claims would otherwise be too small to fund

It enables light due diligence by the insurer

It is a way of funding defendant work which might not otherwise be available.

The first call on finite in-house legal budgets is often defending claims (if only to prevent judgment being entered and protect the brand). Once that budget is spent, this can mean there is less budget left to pursue other legitimate claims. Portfolio funding can therefore allow clients to pursue those claims where finite budgets might not otherwise have allowed it.

Possible finance/funding/insurance solutions

There is no one-size fits all. Brokers and funders are increasingly flexible and creative with their offerings. Options include (in certain suitable cases):

Corporate finance for disputes

Fund litigation fees - full/partial

Fund disbursements only

One off third party funding

No-recourse funding/recourse funding

Security for costs bonds

ATE insurance

These options could be used separately or in combination with conditional fee agreements (CFAs) or damages based agreements (DBAs) and contingency fee offerings.

Myth busting

Funder does not manage or control cases

No impact upon privilege

Not prohibitively expensive (mostly non-recourse). However, your view of this will largely depend on how you finance litigation, the risk profile of your claims, your litigation budget, internal accounting for legal spend/recoveries and if you are bringing claims that you...
Range of products/flexibility
- Not just for clients that cannot afford to fund litigation. Also for those that would rather invest their money in growing the business or just not tie money up in litigation.

Costs v risk v reward

Funding and insurance can be viewed as expensive. A litigant may give up 40% of its award in exchange for funding in a successful claim. A different view of the benefits of funding is gained by looking at how much money clients risk when they bring/defend a claim. The transfer of risk is often the key reason for entering into funding arrangements as illustrated in the example below.

Example: The claimant (Company A) has a breach of warranty claim against company B and is claiming £3.77m. Company A seeks £380,000 funding for its own solicitors fees, disbursements, counsel’s and experts fees. B’s costs are £300,000. At trial A is awarded £3.4m plus 75% of recoverable costs (£285,000) total = £3,685,000.

The table below illustrates how different case funding impacts upon client recovery, cash outlay and financial risk. Less risk = less recovery. In the example below with funding and ATE insurance, company A makes a 61% recovery with nothing to pay if they lose.

<table>
<thead>
<tr>
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<th>Recovery if win</th>
<th>£ risk if lose*</th>
<th>Cash outlay to run case</th>
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</thead>
<tbody>
<tr>
<td><strong>Hourly rate</strong></td>
<td>Client receives £3,685,000 less £380,000 own costs = £3,305,000</td>
<td>Client pays £380,000 (own and adverse costs) Client makes no recovery</td>
<td>Client funds £380,000 own costs</td>
</tr>
<tr>
<td>ATE only</td>
<td>Client receives £3,685,000 less £380,000 own costs £120,000 ATE premium = £3,185,000</td>
<td>Client pays £380,000 own costs ATE pays £300,000 adverse costs and no ATE premium is charged</td>
<td>Client funds £380,000 own costs (ATE insurance premium normally deferred to end of case)</td>
</tr>
<tr>
<td>Funding &amp; ATE</td>
<td>Client receives £3,685,000 less Funders outlay £380,000 Funders return £950,000 (R.O.I x2.5) ATE premium £120,000 = £2,235,000</td>
<td>£0 client nothing to pay Funder loses investment ATE pays £3000,000 adverse costs and no ATE premium is charged</td>
<td>£0</td>
</tr>
</tbody>
</table>

* This example assumes there is no counterclaim

Commentary on example

The example above, although simple, is useful to demonstrate the transfer of financial risk by using funding/insurance. It also illustrates that funders are prepared to accept lower returns on investment. In this example x 2.5. It is important to remember that funders are looking to make money and with the right case/portfolio the funder’s investment and return will often be open to negotiation.

Considerations for in-house legal teams
Funding might be particularly advantageous to an in-house legal team in reducing its own external legal spend where such spend comes out of its legal budget and the recovery goes into a different business unit. However, where the external legal spend is charged to the business unit (i.e. not in-house legal) – and the recovery goes to that unit too, businesses may be more concerned that the net return to them from litigation is diminished by the funder taking their fee. In that sort of situation, businesses should assess whether the benefits of funding (e.g. cash flow, risk transfer, getting legal spend off balance sheet) outweigh the reduction in the net return.

Bond Dickinson expertise

We have experience of a wide range of funding solutions including: multimillion pound litigation/arbitration and large portfolios of multiple claims. If you have a case/portfolio of cases that you think may be suitable for finance/funding/insurance or to discuss any of the issues in this briefing please do not hesitate to get in contact.