



Litigation Financing – A Conceptual Framework

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Abstract: Financial costs, which accompany the pursuit of legal redress is one of the impediments, which deter litigants from seeking legal rights, redress, or remedies. However, this domain of discussion, which pervades finance and law, is not very common in research literature. **Objective:** Accordingly, this paper aims to provide a conceptual understanding on the concept of litigation financing and a framework therefrom. **Prior work:** the paper relies on prior literature theorisations of litigation financing. **Approach:** The approach is conceptual with reliance on critical review of extant research discussions and culminates in a brief conceptual framework for further research on litigation finance. **Findings:** litigation financing is emerging in the investment arena and in legal practice. It holds potential for rewarding financial returns to investors (funders) if the risks are minimized. **Implication:** it offers practical, theoretical, and academic implications for legal policy makers, attorney firms, litigation investors (funders), and scholars of finance and law in business schools and law faculties. **Value:** it conceptualises litigation financing by adopting an interdisciplinary stance – crisscrossing the law and finance, and development of a novel conceptual framework of litigation financing for further research.

Keywords: Litigation finance; legal costs; litigation investment; claim assets; risks and return

1. Introduction

The costs associated with seeking legal redress is recognised in the literature as one amongst other obstacles, which deter litigants from pursuing their legal rights,

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redress, or remedies. This problem is more widespread in developing countries where significant portion of the population live below the poverty line. Amidst this quandary and understandably, good lawyers in many instances, base their professional service fees on an hourly rate. This leaves out the downtrodden from getting efficient legal representation and hence unable to proceed with much needed litigations (MSG, 2021, p. 1).

Given the above quandary, litigation finance is increasingly attracting the interest of investors for product expansion and litigants who seek financial assistance to reduce the onerous costs involved in litigations. Hence, a form of litigation financial intermediation is bourgeoning in contemporary legal system with an unprecedented level. Aside from third party companies who offer litigation finance contract, some attorney companies have equally begun to offer different forms of litigation financing. This serves a dual function for attorney companies: firstly, it has the propensity for increasing potential future clients, and, secondly it bolsters the financial capital of attorney companies because the periodic premium payments contribute to strengthening the capital base of attorney firms. This service expansion and innovation is beneficial for the attorneys and third party investment companies. For the attorney companies, it keeps them liquid during austere periods when attorney firms experience reduced number of clients and minimal turnover. On the part of the investment companies who provide third-party litigation finance, it offers additional product offered by investment companies and reduces the risk of relying on conventional investment services. It also boosts the profitability capacity of investment companies. The foremost concept of litigation financing involves the receipt of funding from third-party financiers by litigants to cover their legal costs such that when the case is won by litigants, the third party financiers gets an agreed percentage of the litigant's case claim (Bedi & Marra, 2002, p. 572).

2. Problem of the Paper

This paper is motivated by apparent low level of awareness regarding the emerging new form of financing, which is litigation financing. Accordingly, the low level of awareness obstructs the opportunity, which low income or poor litigants would have in seeking legal redress (Bedi & Marra, 2021, p. 578). Accordingly, this paper, which highlights the development and ramifications of litigation finance, is pertinent as it provides a recipe to low-income litigants about an alternative financing available for them to secure the needed finance to pursue their litigation.

Hence, the problem of the paper is inclined on little awareness by public regarding litigation financing. This paper contributes to bolstering the desired awareness given the limited literature in finance and law journals on litigation finance.

3. Objective

Relying on the foregoing problem, the objective of this paper is to provide a conceptual understanding of the concept of litigation financing and to propose a conceptual framework for further research. It thus aims to initiate further interdisciplinary discourse between finance and law, which should be guided by the proposed conceptual framework and to enlighten potential litigants about the opportunity offered by litigation financing towards obtaining legal remedy – which includes inter alia, damages, coercive remedies, declarative judgement, etcetera (LII, 2022, p. 1).

4. The Concept of Litigation Finance

In a vivid description by Juneja (2022, p. 1), litigation financing offers a contemporaneous financial relief to the legal firm and the plaintiff – thus obviating the propensity of financial restraint to the quest for justice. Accordingly, in a management study guide, Juneja (2022, p. 1) provides a description of litigation financing as follows:

“Litigation financing refers to an arrangement wherein a third party agrees to bear the legal fees related to a case in exchange for a bigger pay off later. Simply put, neither the plaintiff nor the law firms have to bear the cost of financing the lawsuit. Instead, there are specialized third-party investors who invest money by paying legal fees when a case is in progress. At the end of the case, if the side which is being backed by the investor wins, the investors get their payoff from the settlement money received. On the other hand, if the side which is being backed by the investor loses, the investors have to write down the losses with no recourse from either the plaintiff or the law firm” (Juneja, 2022, p. 1).

It is important to note the words “*without recourse*” – which provides an apparent insulation from financial liability to the plaintiff and the attorney firm. This characteristic is also echoed in Steinitz and Field (2013, p. 711) “*Litigation financing is nonrecourse funding of litigation by a non-party for a profit*”. It offers advantages such as affordable legal rights to low income and indigent plaintiffs.

Similar to other commercial instruments, it also has disadvantages, which amongst others include claims that litigation finance might pose a danger to “*impartial and efficient administration of civil justice*” (Steinitz & Field 2013, p. 711). They highlight further disadvantages including abusive litigation; prolong litigation, and compromising of professional independence, as follows:

Litigation funding can be expected to increase the volume of abusive litigation, undermine the control of plaintiffs and lawyers over litigation, deter plaintiffs from settling and thus prolong litigation, compromise the professional independence of attorneys, and more generally corrupt the attorney–client relationship (Steinitz & Field, 2013, pp. 713-714).

Analogous to the above concerns, Rodak (2006, p. 503) highlights the dual sentiments that subsist in the emergence of litigation finance industry. On the one hand, there is an applause coming from the fronts of enthusiasts who advocate legal access and the equalisation of bargaining power especially for low-income members of society in civil lawsuits, who may not ordinarily have the capacity to pursue legal redress against powerful and wealthy parties (Rodak, 2006, p. 503). On the other hand, there appear to be a derision from another front occupied by critics who vituperatively bemoan potential unpleasant business consequences that may arise from litigation financing such as meddling with efforts toward settlement. Given the two sided views, Rodak (2006, p. 503) highlights the importance of a framework to guide litigation finance to function in a balance that caters for the interest of the consumers and at the same time protect the integrity around the process of settlement. However, such balance should avoid legal bottlenecks that may alienate the desiring plaintiff from accessing their claims, which they seek through the court process with the unprecedented opportunity afforded by litigation finance (Rodak, 2006, p. 503).

According to Kuper (2019, pp. 1-6), if credible litigants are alienated from access to justice on grounds of financial incapacity, this becomes the greatest injustice. Perhaps, the likes of this sentiment may have assisted in bringing to the fore the contemporary rise in litigation financing. Although some types of litigation financing may have existed over the millennia, Kuper (2019, pp.1-6) opines that the contemporary burgeoning of litigation funding is traceable to post 2008 global financial crises. The Kuper’s research into the history of litigation financing traces the concept and practice back to the antiquity and middle ages – to the times of ancient Athens, ancient Roman Empire, to the Christian era and the modern times (Kuper, 2019, pp. 1-6). The crux of litigation finance and by implication the

humanism and equity connotation lies on the fact that justice is a necessity for all in the society to draw judicial succour when equitably treated. This empowers the seeking of legal redress by low-income plaintiffs without subjugation by the financially powerful individuals – because a society where might is rife could be tantamount to anarchy and barbarism. In addition, the concept of litigation financing unveils the importance of finance in obtaining justice, and herein lies the intersection between the legal practice and finance as separate but intersected disciplines. This interaction deserves extensive future scholarly discourse. Hence, this paper proposes a framework for further research as presented in Figure 1 in the subsequent sections.

5. Financial Models and Financial Return and Risk

The conventional professional payment billing for legal services obtained through private practice relies on two main models – namely through the hourly payment or through contingent fee payment. The hourly payment system requires the client to pay a specified hourly fee to the lawyer and the lawyer is not bound to refund any percentage of the fees paid whatsoever the outcome of the case. However, the contingent payment method is regulated by the contingency fee act (FindanAttorney, 2022, p.1), which permits attorneys to consider contingent-fee billing as an alternative fees for clients who may not have the financial capacity to pay their legal fees under the hourly billing model. In this instance, the lawyer may agree to a contingency payment based on explicit agreement between the lawyer and the client. This enables the plaintiff to obtain a free or reduced-fee legal representation by the lawyer who will in turn receive a 25% of the judgement settlement, which the lawyer may achieve for the client (FindanAttorney, 2022, p. 1). However, the percentage might vary in some instances (Pierce et al, 2013, p. 6). The lawyer enters into this agreement like a risk-taker aware of the implicit risk of loss should the client lose the case but taking the risk with a positive anticipation of 25% return if the case is successful. The contingent fee (25%) due to the lawyer can be substantial if the settlement turns large; this is justified by the lawyer's willingness to take the business risk (Flynn, 2013, p. 18).

The novel type of funding – the litigation funding or financing is a modified variant of the contingency-fee payment model. Legal fee funders have emerged in contemporary fund investment market taking a different slant of financial investment risk venturing from the conventional business funding toward legal

representation funding. These funders have scouted the legal business and unravelled a niche wherein there exist instances where, on the one hand, the attorney firms may not be willing to take up the risk of financing their client lawsuit and, on the other hand, the client lacks the enabling finance to pay the legal fees. This is where the investors step in to pay the legal fees and takes the risk of return or loss. If the client wins the case, the funder gets their payoff from the judgement settlement money received, but if the client losses the case, the investor (the funder) bears the loss and will write down the losses in their accounts without any recourse from the attorney firm or the plaintiff. The litigation funders may therefore treat anticipated legal claims as a business asset; this means the funders may quantify and even trade the expected legal claims in the financial market as an asset. The literature is not certain but suggestive of how much return a litigation finance funder (the investor) may receive. As an example, according to GoLegal (2022, p. 3), the asset return profile of a litigation finance investor (funder) can be attractive. This is because the class of asset may have the propensity to possess a tilted or asymmetrical financial return, which implies that litigation funding (depending on the type) may have a gain profile potential, which in a successful judgement case can be bigger than the risk of loss. Following the example by GoLegal (2022, p. 3), the author presents the following hypothetical illustrative example of potential return.

A plaintiff presents a lawsuit, with expected \$20 million for legal expenses. The expected return to the funder is estimated to be \$60 million should the lawsuit turn favourable. However, if the lawsuit turns unfavourable, the funder will incur a capital loss of \$20 million. Assume the probability of favourable or loss in the case is 50% and 50% respectively, the gain and loss results after applying weighted probability will be:

Weighted probability of loss	0.50 x \$20 000 000	(\$10 000 000)
Weighted probability of gain	0.50 x \$60 000 000	\$30 000 000
Expected Return		\$20 000 000

Albeit the illustrated average 50% probability of win or loss, some investors may land on huge returns if they fund laudable cases with high prospects of success. However, this requires that funders embark on significant due diligence analysis on the plaintiff, the legal environment, and the attorney company before investing in the case (Pierce et al, 2013; GoLegal, 2022, p. 3). Furthermore, according to Pierce et al (2013, p. 2) environmental factors may affect the expected outcome, hence they highlight that:

“Litigation funders’ return on their investment in lawsuits depends on various factors, including the merits of the claim, the state of the law, the quality of the lawyers, the financing model (lump-sum or drip-fed), and the expected duration of the lawsuit (including time on appeal and time to collect a judgment)” (Pierce et. al, 2013, p. 2).

6. Litigation Finance Conceptual Framework

Although the attorney companies are not allowed to seek equity shares via the conventional stock markets, the legal businesses manages to survive through other means of generating capital and liquidity. However, with the passage of time, the difficulties of obtaining finance to seek justice has proven to exclude some members of the society with little income to pay legal fees from obtaining justice through the court. Accordingly, litigation financing is blossoming as a new financial asset in the legal system that offers the capacity to support low-income people to seek justice through the court According to Bedi and Marra (2021, p.563):

“Once a dispute arises, litigants may seek money from third-party financiers to pay their legal bills or monetize their claims, and in turn those financiers receive a portion of any case proceeds” (Bedi & Marra, 2021, p. 563).

Given the nascent nature of litigation financing, the literature and hence research framework is still rare (Bedi & Marra, 2021, p.563). This rareness surfaces predominantly in the area bordering the linkage between litigation financing, financial risks and return to funders, the latent effect on welfare and/or society, effect on the legal system and administration of justice and policy makers, and the concomitant effect on the plaintiff toward securing their legal remedies. This conceptual paper conjectures that this framework (Figure 1) will metamorphose propensity for bolstering academic, theoretical, and empirical discussions on litigation financing. This will also create awareness to legal practitioners, regulators and/or policy makers, and consumers, as awareness in this intersection between finance and the law is still emerging and somewhat obscure (Abramowicz, 2013, p.195; Shepherd & Stone, 2015, p.919; Bedi & Marra, 2021, p.563). In their recognition of apparent paucity of research in this area and the need for increased research and understanding of the dynamics about litigation financing, Shepherd and Stone (2015, p.919) highlights with concern as follows:

“Third-party litigation financing remains poorly understood. No academic consensus takes account of the multiple economic conundrums that third-party litigation financing arises to solve, nor do legal scholars adequately consider obvious public and private substitutes for litigation financing that society rightfully recognizes as innocuous or outright beneficial (Shepherd & Stone, 2015, p. 919)

Relying on the foregoing premise, this paper proffers a conceptual framework in Figure 1 for further research discourse.

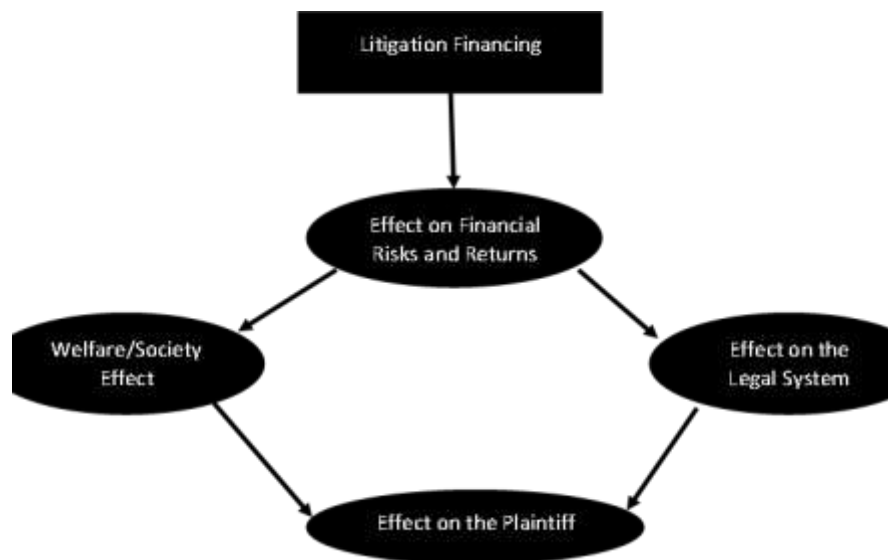


Figure 1. A Conceptual Framework for Researching Litigation Financing

Source: Author's Original Framework

7. Implication

This paper offers practical, theoretical, and academic implications for legal policy makers, attorney firms, litigation investors (funders), and scholars of finance and law in business schools and law faculties.

8. Contribution (Value)

This paper presents litigation financing conceptualisation by adopting an interdisciplinary stance – crisscrossing the law and finance – hence adopting non-technical presentation. The overall value lies in the development of a novel conceptual framework of litigation financing for further research and bolstering the awareness for litigation financing as an enabler for legal redress.

9. Conclusion

Litigation financing provides a useful opportunity for members of the society with little means and voice to seek legal rights particularly in developing countries, with high percentage of society within and/or below the poverty line. As an instance, there are many contractual relationships, which subsist between the poor and the rich. The quagmire in this asymmetric relationship, in a case of breach arises from the common law doctrine of privity of contract wherein only the parties to contracts are entitled to sue to enforce their rights for potential claim of damages from breach. In this instance, the poor or low-income citizens are by default alienated from the opportunity of seeking legal redress given their financial incapacity. This is where litigation financing offers assistance to the extent that even the poor may seek legal redress albeit their lack of personal finance. However, it needs mentioning that in few specified circumstances; exceptions for a third party rule of privity may apply in certain jurisdictions (The Law Commission, 1991, p. 1; Thomson Reuters, 2022, p. 1). Even in a case of third party exception, litigation financing is also helpful in a situation where a third party is financially indigent. Given the somewhat nascent nature of litigation financing, the awareness is still blurry, hence this paper contributes by presenting a multi-disciplinary and non-technical conceptualisation of litigation financing. The paper has elucidated the concept, which is rooted on the quest for equity and justice for all, the financing of justice, the role of investors (funders) and the financial risk and return to investors. It also provides a novel conceptual framework for researching this developing concept, which lies at the intersection of finance and law.

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