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Third party litigation funding

Facts and estimates for the UK

Third party funding of commercial litigation has been much talked about. In some quarters there is the impression that it is rampant and undermining the proper administration of justice. The reality is very different. Here original research on the extent and nature of third party litigation funding (TLPF) in the UK is summarised.

Commercial TPLF defined

TPLF is where an investor otherwise unconnected with a legal action finances all or part of a claimant's legal costs. If the case fails, the funder loses its investment and is not entitled to receive any payment. If the case succeeds, the investor takes an agreed success fee. This *Casenote* is concerned with the funding of commercial litigation by dedicated TPLF investors, and not other forms of third party funding such as legal aid, legal expenses insurance, conditional and contingency legal fees, and so on.

The Funds

At November 2011there were 15 dedicated TPLF funders that stated they supplied or had raised funds in the UK. The number of active investors funding UK litigation is smaller. IM Litigation Funding ceased operations during 2011, Juridica and Burford raised funds in the UK mostly to invest in US litigation, and IMF (Australia's largest TPLF investor) only co-funded a few claims. This leaves 10 active TPLF investors, with a further four (Juridica, Burford, IMF, Argentium) making occasional investments. Others have recently announced plans to enter such as Fulbrook, Axiom Legal Financing, and Firstassist (the last just acquired by Burford to offer TPLF in the UK).

The funds invested and raised in the UK exceed £457m. Based on interviews it is estimated that eight of the UK based investors have collectively raised about £157m. A further £300m was raised on AIM in London by Burford and Juridica for litigation elsewhere. Most TPLF investors are small with the three largest UK focused investors (Harbour, Calunius and Vannin) accounting for 80% of the estimated investible funds for the UK.

The Claims

TPLF investors only fund commercial litigation such as contract, commercial, patent infringement, insolvency, and some group claims. Nearly all stated that they do not fund complex multiparty construction, patent trolling, matrimonial, personal injury, defamation, and clinical negligence claims. Several fund arbitration and group (cartel damage) claims. Most have funded claims in the English & Wales courts, and a few claims in other common law jurisdictions.

In the UK the TPLF investors are confined to the provision of funds only. They cannot interfere in the management of the claim due to the residual laws of champerty and maintenance. Thus there is a premium on good case selection, and the evaluation of the lawyers' competence and ability to control legal costs.

The Civil Justice Council estimated that by mid-2010 no more than 100 cases had received third party financing in the UK. Others have suggested that this is an underestimate putting the figure at two or three times higher. Based on interviews about 187 claims have been or are currently being funded by TPLF investors. This gives an estimated 62 claims funded in 2011.

Alternatively a crude estimate of the financial capacity of existing TPLF investors to fund new claims can be made. In 2010 Harbour raised a £60m fund which it has allocated to 30 claims over two years. This suggests an average investment of £2m. If we apply this across all TPLF investors with banked funds, this gives a financial capacity to fund around 75 cases over a two year period for seven TPLF investors. Adjusting for a proportion of smaller claims and the other four active TPLF investors who did not supply funding data, suggests that the industry can fund at least 46 new claims annually.

Case Selection

The minimum claim funded by many TPLF investors exceeds £1m, and some have larger minimum claims exceeding £5m. In addition some have a minimum investment amount, and the larger funds limit the percentage of their funds allocated to any one claim.

The acceptance rate of claims seeking TPLF is around 1 in 12. Based on data supplied by six TPLF investors, they reviewed 1,446 potential claims and agreed to fund only 118 or 8%. It is clear that fairly stringent criteria are used to select fundable cases, including that the claim should have a 70% or more chance of success.

Success fees and returns

There are two methods of 'pricing' the return to a TPLF investment – a multiple of the investment or a per

centage of the award or settlement, or a mix of both. Some TPLF investors will look for a return of between 1.5 to 6 times their investment, depending on the complexity and duration of the case. Others seek their return as a percentage of the award or settlement. This can vary between 20% to 40%, to in some cases 50% or more.

This suggests high returns. A brief, but it is suggested optimistic, glimpse is provided by Therium which has reported that the four cases successfully finalised at the beginning of 2011 generated a 207% return on their investments. Australia's largest investor IMF reported an internal rate of return of 75% before overhead expenses for claims finalised in the period 2001 to 2010.

Risks

It is important not to be mesmerised by the headline success fees. The success fees must cover the investment on those claims that have been lost. Despite due diligence and the selection of 'strong' cases, a large number will fail given the uncertain nature of litigation. Indeed, based on the selection criteria one expects a failure rate of about 30%. Interestingly (and perhaps coincidentally) IMF's 'failure rate' is 24%.

Several recent cases underscore those risks. *Moore Stephens v Stone Rolls* was a £89m professional negligence claim brought in 2007. The liquidators alleged that the company's auditors Moore Stephens failed to detect the fraudulent activities of its owner which resulted in the company's liquidation. IM Litigation Funding invested in a claim which it estimated had a 70% chance of success and a reported £40m success fee. The High Court ruled in Stone Rolls' favour, but was overturned in June 2009 Court of Appeal (affirmed by the House of Lords) ruling that a company liable for fraud committed by its director to the third parties could not bring a claim for damages against its auditors. IM Litigation Funding lost its investment and because it had not taken out ATE insurance it paid an additional £2.5m in adverse costs. While its legal director said "this is not the end of third party funding" at the time of the judgment, IM Litigation Funding has since ceased trading (for undisclosed reasons).

Arkin, described by the judge as 'disastrous piece of litigation', illustrates the potential costs of failure. Arkin's lawyers worked on a conditional fee arrangement and MPC funded the costs of expert forensic accountants in return for 25% share of the damage/settlement sum up to £5m, and 23% thereafter plus any recovery of experts' costs from the defendants. MPC budgeted for an investment of about £600,000. MPC's actual investment was over double this at around £1.3m plus the threat of adverse costs of nearly £6m. In the end the court limited MPC's liability for adverse costs to £1.3m i.e. equal to the sum it invested (subsequently know as the Arkin Rule), thus raising the investment (and loss) to £2.6m. That is, MPC's investment was over four times greater than initially estimated, and it could have been exposed to £7.3m in costs had the court ordered it to pay the full adverse costs of the defendant.

Access to Justice?

The judicial (*Arkin*) and public policy (Jackson Comiteee) rationale for TPLF is access to justice. This is a weak justification for the type of commercial litigation so far funded. In many of the cases it is not the claimant's impecuniosity but a rational commercial decision that TPLF is the best way to fund litigation. TPLF is used to take the costs of litigation off-balance sheet and to improve cashflow. For others TPLF does allow a meritorious claims to proceed which would otherwise not have been pursued. The Jackson Committee recommendation that a TPLF investor be potentially liable for all adverse costs will act as a deterrent to funding, and put those lawyers working on conditional (and soon contingent) fee arrangements in a privileged position.

The Evidence

The effects of TPLF are hard to estimate in theory and practice. The preceding discussion shows that the net increase in cases is likely to be much smaller than the number receiving TPLF. There are other reasons to believe that TPLF may actually increase settlements, decrease average legal costs, and discourage some more speculative actions. Unfortunately there is little hard evidence. One study found that TPLF did not increase the number of cases litigated in Australia but may have increased the duration of funded cases. Another study found that TPLF encouraged settlement for group (shareholder) actions in Australia.

This Casenote is based on "Third Party Litigation Funding in Europe" (double click to download draft version) forthcoming in *Journal of Law, Economics & Public Policy.*

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