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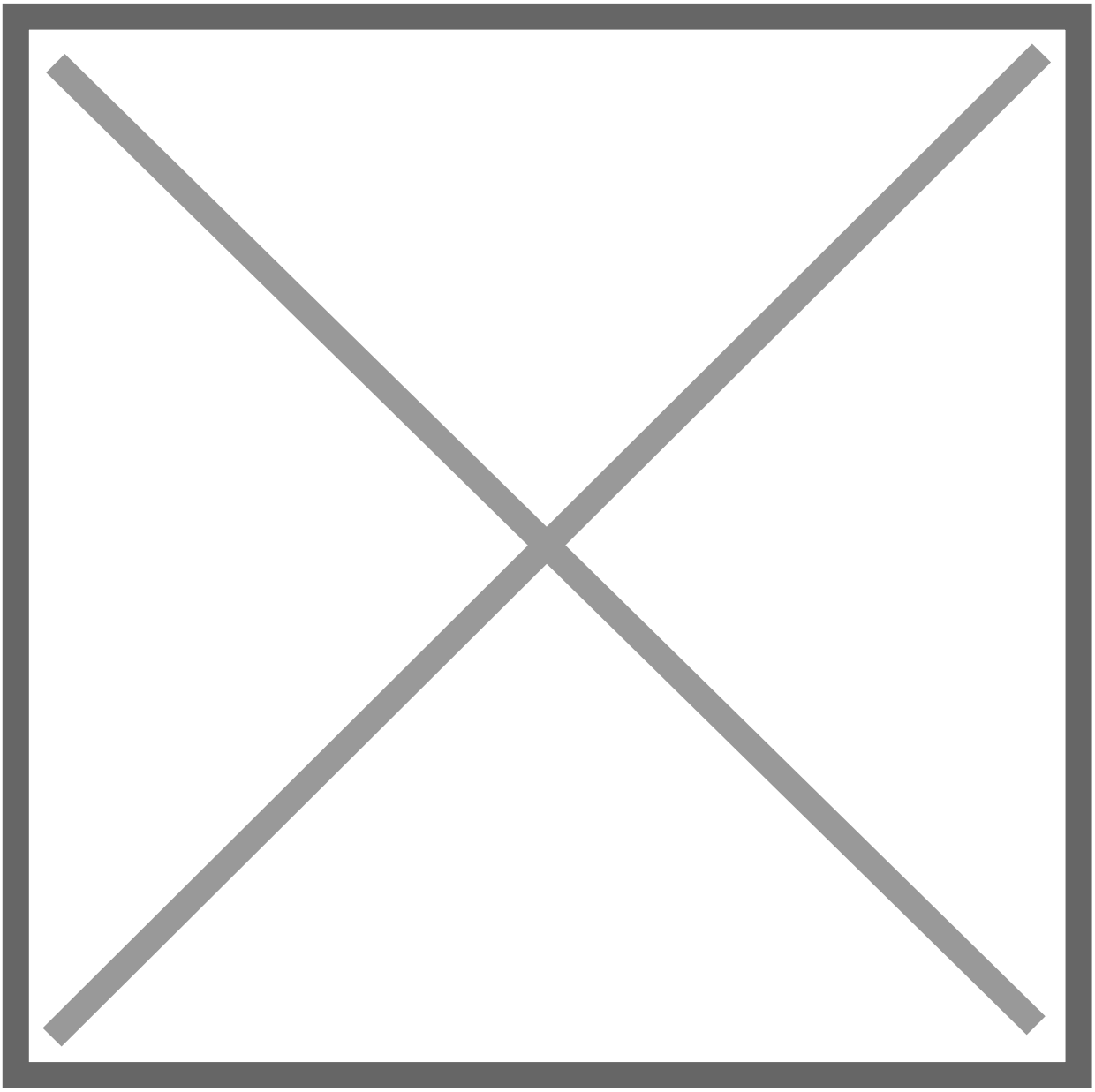
Defense Funding: The Next Frontier for Litigation Financing

Minding Your Business on **April 18, 2019**

Litigation funders are well aware that half of the potential market is largely untapped. Clients would prefer to focus on their business rather than litigation, and offload some or all of their defense costs to a third-party. Law firms want the fee flexibility that defense-side funding could provide.

So why is defense funding still the exception rather than the rule? To begin with, because the synergies that propel plaintiff-side funding are much more difficult to capture on the defense side.

Consider the Value-Producing Relationships when Funding a Plaintiff-Side Case



The balance sheet benefits, cost of capital asymmetries, risk-bearing capabilities, and fee flexibility create a win-win-win situation for plaintiff-side litigation financing.

Are There Similar Synergies for Defense-Side Funding?

Possibly, especially if those defense-side cases are packaged with valuable affirmative claims. However, structuring an agreement that creates these same synergies in a “pure defense” arrangement is substantially more challenging. Consider the following defense-side funding models:

Hybrid Financing. Perhaps the most common method for defense-side financing is packaging defense-side lawsuits with plaintiff-side claims. These packages are usually structured in one of two ways: as multi-case portfolios or as single cases where the defendant has counterclaims. In the portfolio financing model, the funder might agree to provide an aggregate amount of funding for a group of plaintiff-side and defense-side litigations in exchange for a share in the overall recovery. The agreed-upon share may be higher than if the funder was only financing the plaintiff-side claims, and any premium reflects the additional risk from the defense-side lawsuits. Counterclaim financing works similarly, but the funder agrees to finance the defense based on a promised share of the recovery for a valuable counterclaim (rather than the recovery in a separate lawsuit). Both models are promising, but each only works if the client has an affirmative claim with enough upside to offset the risks associated with financing the defense.

Success Fee. One way to structure "pure defense" financing is to build the agreement around a defined success term. For instance, the parties might agree the case is "successful" if it is settled below a certain threshold. In this scenario, the funder agrees to finance the legal fees, and in some instances to cover the settlement payment in excess of a certain amount. The client agrees to pay the funder a multiple of the funder's investment if the case is "successful." While apparently simple, there are three main obstacles to overcome:

- First, the parties must define success in a way that aligns the parties' incentives. For instance, in the aforementioned example there is a range where the client would save money by settling for *more* in order to avoid triggering the success fee.
- Second, the investment structure has to provide enough upside to the funder to justify the risk, while still providing a benefit to the client from entering into the arrangement. This is challenging in the defense context. On the plaintiff side, the premium to pay the funder's return comes out of the recovery from a third party. But in a "successful" outcome on the pure defense side there is no return, and the premium must be funded by other means—usually the client's pocket.
- Third, the parties must establish a protocol to allow the funder to appropriately evaluate the merits of the defense. A plaintiff bears the burden to provide a minimum amount of evidence or allegations to establish a viable claim. However, a defendant has no such burden to provide information, which makes it more challenging for a funder to acquire enough information to accurately evaluate the risks of the case.

Regardless of any questions raised by the models above, one thing is certain: there is still a huge amount of value to be unlocked by creatively financing the billions of dollars spent each year on defending lawsuits.

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