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Three Ways Litigation Finance Can Help Corporate Legal Departments

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Corporate legal departments are generally measured by their ability to control legal costs, manage risk, and deputize external litigation resources, especially when their company is involved in litigation. Although a common feature of modern business, litigation is an increasingly costly proposition that is fraught with risk. In recent years, commercial litigation finance has emerged as an effective means of shouldering case costs and redistributing risk. While the number of law firms that have seized the advantages of this type of financing has grown exponentially, general counsels ("GCs") and corporate legal departments have been slower to recognize the many benefits that it can offer, which has handicapped their companies by keeping a potent tool needlessly out of reach. Here are three things every GC should know about litigation finance.

Litigation Finance Offsets Risk

Litigation costs and other financial risks inherent to the legal process pose a daunting challenge to GCs. As a result, companies often forgo bringing lawsuits due to their impact on financial performance. Yet even when legal departments decide to forge ahead with legal claims, their outcome is often far from certain. The decision to bring a lawsuit, therefore, has the power to make or break entire companies. This risk is even more acute for smaller companies and those facing financial headwinds. A victory could revive a company's fortunes, while a poorly conceived effort might precipitate the firm's demise. Litigation finance mitigates that risk through funding "without recourse," which allows a company to shift costs to a third party and only share an agreed-upon portion of proceeds with the funder at the successful conclusion of the claim. If a case is lost and no proceeds are recovered, the company is under no obligation to repay the funding amount.

Consider the following example: Suppose a small tech startup sues an industry giant for theft of its trade secrets relating to a revolutionary new product. The startup's case against its unscrupulous competitor is seemingly strong as the brazen theft greatly damaged the fledgling company. Unfortunately, the lawsuit comes with a steep price tag, forcing the startup to spend more than $100,000 each month on attorneys' fees and associated costs. Small and vulnerable, the startup is quickly exhausting its cash reserves as its better-capitalized opponent employs a panoply of defensive tactics designed to delay and frustrate plaintiff's efforts at all stages of litigation. As legal bills continue to mount, the startup may need to abandon its lawsuit or accept a paltry settlement far below the actual value of its claim.

Faced with an existential threat, what the startup really needs is a cash injection from a litigation finance provider to pay for the escalating litigation costs while also providing a much-needed insurance policy against unforeseen financial difficulties that can result from litigation. The startup's GC is surprised to learn that this type of funding is an increasingly common financing option that is available to companies large and small. In a typical transaction, a third-party funder can finance most, or all of the legal expenses associated with the lawsuit in return for a portion of any recovery. The funds may be used to hire top legal talent or procure additional expert resources. Essentially a corporate finance transaction, this type of funding can even be used to supplement the company's working capital or clean up arrears to legal service providers.

The example above is just one of the ways that litigation finance can be used to hedge litigation risk. More creative GCs have been able to offset their institution's litigation costs entirely by using a portfolio-based approach to finance all of their legal claims. This type of structure typically provides a much larger financing commitment but requires cross-collateralization of several litigation matters. Where portfolio financing is utilized, it may provide a greater degree of certainty about long-term future litigation spend. If the funding amount is substantial enough, GCs may no longer need to allocate for litigation budgets on an annual basis and take a longer-term approach instead.

Litigation Finance Can Transform Legal Departments into Profit Centers Through Balance Sheet Management

Under GAAP, litigation costs are reflected as expenses, which can negatively impact a company's financials and quarterly performance. This is especially troublesome for public companies that are valued on earnings or cash flow or require certain financial criteria to be met to comply with credit covenants. For such companies, litigation costs paid from company funds must be recorded as expenses immediately when incurred, thereby diminishing reportable earnings. Worse yet, recoveries from successful legal matters may not offset the adverse impact of lawsuit-related costs because such recoveries are generally treated as below-the-line items that do not increase earnings. Moreover, some actions may result in favorable judgments which then take months or years to enforce, leaving a temporary hole in a company's cash flows despite a successful ruling.

It is no surprise then that corporate legal departments are frequently perceived by management as cost centers, necessary to put out fires or navigate the laws applicable to a particular industry, but not as potential revenue generators. Traditionally, GCs who have identified a roster of affirmative litigation likely to yield significant recoveries will still need to convince their c-suite to take on the risk and immediate financial burden of funding lawsuits from the company's own balance sheet. Enter litigation finance. When both the risk and burden are shifted to litigation finance providers in exchange for a portion of any recoveries, a company's legal department can focus on unlocking the hidden value of its legal matters without the risk of negatively impacting its financials, becoming a potential profit generator for the company.

An Experienced Litigation Funder Can Help Optimize Litigation Outcomes

The quality and breadth of resources that litigants are able to deploy can greatly impact outcomes in legal disputes. For example, the skill of the legal team, the quality of expert witnesses and other litigation consultants are important drivers of how courts and juries perceive the merits of legal claims. With litigation financing mitigating the burden of paying for legal costs, GCs have greater flexibility in assembling a first-rate litigation team. A legal department buttressed by litigation finance can focus on the skill and effectiveness of its team without worrying about negotiating for the lowest possible fees. Access to the support of top-quality counsel and litigation consultants can improve a company’s overall likelihood of success and the magnitude of any recovery.

Experienced litigation funders can provide access to these top litigation support channels by leveraging their network. In addition, they can provide an invaluable outside perspective on the merits of a case during the due diligence process and throughout the pendency of the claim. When choosing a litigation funder, consider the expertise of the funder’s team and if there are any practice areas which they target in their investment strategy.

A trusted litigation finance firm should demonstrate the highest professionalism, abide by the explicit understanding that a third-party funder should have no involvement in the litigation or strategy, and should protect attorney-client privilege and confidentiality at all times. When these essential confidences are met, engaging with a third-party funder can be enormously helpful in assessing the merits and risk of a case, budgeting litigation spend, and providing access to first-rate litigation support.

Conclusion

As litigation finance continues to gain popularity among law firms, GCs should also take notice. As businesses continuously seek to gain a competitive advantage over their peers, the ability to mitigate the risks associated with litigation should be an important consideration, especially since poorly conceived strategies can often carry existential consequences. GCs, therefore, should recognize litigation finance as an indispensable asset that has the potential to offset the risk of litigation, provide effective balance sheet management while unlocking the hidden value of prospective legal claims, and improve outcomes for meritorious cases.

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