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Litigation Funding Series: Types of Commercial Litigation Funding and Role of Insurance in CLF

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Jonathan Friedland and Jeremy Waitzman provide this article as part of a series from their guide for plaintiffs and commercial litigators seeking funding in the United States: Litigation Funding Series: Introduction and History and Litigation Funding Series: CLF vs. Secured Lending and CLF vs. Consumer Litigation Finance**.**

Types of CLF Generally

In one respect, we painted the picture of CLF with purposeful imprecision: we defined CLF in part as “a form of financing in which a funder provides funds to a party with a legal claim.” The imprecision is that the financing is not always provided to the party with the legal claim; sometimes, it is provided to the attorney for the party with the legal claim.

This suggests there are two types of CLF. However, there are more. For example, when the attorney is the party being funded (attorney fundee), the CLF advance may be made on account of a single case (single-case funding), or it may be made on account of a portfolio of cases (portfolio funding). In this last instance (i.e., when the attorney fundee is being advanced funds based on the strength of a portfolio of cases), the transaction may sometimes be structured as a limited recourse loan rather than a variable prepaid forward contract, but the situation typically has some complexity to it that prevents the attorney fundee from securing traditional bank financing.

The variety does not stop there. Going back to the situation in which the fundee is the party with the legal claim, it is not uncommon for the fundee to have similar claims against multiple potential defendants. This is common in the case of patent litigation because when a fundee is the owner of a patent, the fundee (a) often is the owner of more than one patent and so may have unrelated claims against multiple defendants; and (b) often has claims of infringement of that patent by multiple defendants. In addition, there are instances where a fundee may have multiple causes of action against multiple separate defendants, which may also give rise to a portfolio-type transaction structure.

The portfolio structure, whether used with fundees or attorney fundees has benefits to both parties. For the funder, it allows for a diversification of risk. That is, if one of the claims or litigations against a particular defendant fails, the funder still can recover from one of the other cases and allows a funder to spread out the risk. For fundees, it allows for the funding of multiple cases without the need to separately negotiate multiple funding agreements or seek multiple funders and better pricing (see below).

The concept is very similar to a traditional diversification of investments – if one asset class is a loser, the overall portfolio may have winners in other areas so that a portfolio continues to increase in value. For a fundee, the advantage of a portfolio structure is that it often results in better pricing since the risk to the funder is lower (i.e., it is not an all-or-nothing proposition with respect to a single matter).

Nevertheless, based on a survey conducted by *Bloomberg Law* at the end of 2023, the expectation for 2024 is that the vast majority of fundings will be single-case financing direct to the claimholders or single-case law firm financings.

Area of the Law Variation

For reasons that are likely self-evident, the common themes of most legal claims in which CLF is used are that:

- The costs to litigate them are substantial.
- The potential for large recovery is significant.
- Their likely outcomes, at least within a range, are reasonably predictable.

In terms of the type of litigation where CLF is most commonly used, we tend to group such litigation into these categories:

- General commercial litigation: This encompasses a broad range of disputes between businesses, such as breach of contract, business torts, and other commercial disagreements.
- Antitrust and competition: Litigation related to anti-competitive practices, market manipulation, and other antitrust issues.
- Asset recovery and judgement enforcement: Litigation to recover assets in cases where defendants have hidden assets or fail to pay judgments.
- Bankruptcy and insolvency: Examples of claims arising in this context can include those against directors and officers for violating fiduciary duties and fraudulent transfer claims.
- Patent and intellectual property: Claims that allege the infringement of intellectual property rights, particularly patents.
- Securities litigation: Such claims may involve disputes related to securities, such as shareholder actions and other financial instrument-related litigation.
- ESG litigation: Claims related to environmental, social and governance matters.
- Class actions and mass torts: Class action lawsuits are typically complex, drawn-out, and expensive. Class action attorneys are tasked with representing a large group who have allegedly suffered a harm as a result of corporate or government malfeasance. This requires a substantial investment of time and resources. The expenses associated with class action lawsuits, which can include discovery, expert witnesses, and trial costs, can quickly become overwhelming, making it challenging for even well-established law firms to shoulder the risk alone. One recent noteworthy case in these areas was *Perez v. Rash Curtis & Assoc.*, No. 4:16 CV 03396 YGR, 2021 U.S. Dist. LEXIS 189889, 2021 WL 4503314 (N.D. Cal. October 1, 2021). In *Rash Curtis*, class counsel sought, and the court denied, reimbursement of CLF

expenses. The court held that such expenses "fundamentally relate to the cost of doing business" and are not recoverable from the corpus of a class settlement. Mass tort cases, of course, are sometimes brought as class actions, but sometimes they are not. Either way, they, too, sometimes use CLF.

Limitations of this Section

We have still not described (nor will we attempt to) all the variations in the industry because funders typically have broad investment mandates and, so, the variety of investments they may make is limited only by their creativity. In other words, while "classic" CLF involves funding one or more lawsuits, funders also engage in activities that are simply not that. For example, it can be within the investment mandate of a CLF to (a) trade securities of a company based solely (or at least primarily) on the outcome of pending or threatened litigation, and (b) purchase receivables from a law firm or a plaintiff (in which case the purchaser would effectively be acting as a factor) after litigation is concluded.

The Role of Insurance in CLF

Judgment preservation insurance (JPI) is designed to permit a plaintiff who won at trial to hedge the risk that an appeal will reverse the judgment. JPI is exactly what it sounds like – insurance that protects a claim or group of claims which have already received judgments. JPI policies are essentially structured as a math problem. If a judgment is granted for X, but the plaintiff only receives Y, the insurer will cover the difference or a portion thereof after payment by the plaintiff of the applicable premium and retention amount (as applicable). While typically thought about in the context of protection against reversal on appeal, it also has the effect of accelerating the recognition of judgment related gains in plaintiff earnings, monetizing judgments while appeals are still pending, and potentially even allowing the conversion of debt, since the policy effectively guarantees a minimum recovery so long as there is no collection or enforcement risk associated with the judgment. In the context of JPI, Insurers do not take over the case (the existing counsel of the insured often remains on the case) nor pay any of the defense or settlement costs.

Conflicts between funder and fundee can sometimes arise in the context of JPI Whereas, a fundee or funder may prefer the certainty of knowing that it may walk away from a lawsuit with a recovery equal to the judgment less the premium costs of JPI, the other party might have a different perspective on the likelihood of success on appeal or the certainty of payment. While the decision to acquire JPI remains in the fundee, unless an agreement is reached between the funder or fundee in such scenario or the funding agreement explicitly includes the obligation to fund appeal costs, the fundee may need to self-fund or seek alternate funding in the context of an appeal or pay for the insurance premiums out of its own recovery.

Other insurance products have begun to enter the mix as well, including: (i) after-the-event (ATE) insurance (policies that protect litigants against the opposing side's costs and expenses), (ii) before-the-event (BTE) insurance (policies that offer coverage for potential legal costs before a dispute arises), (iii) litigation funding insurance (specialized form of coverage designed to protect litigation funders against the risk of losing their investment in the event of an unsuccessful outcome), and (iv) portfolio insurance (comprehensive solution that covers multiple litigation cases within a portfolio). These insurances are all relatively new in the context of litigation finance and it will be interesting to see how both pricing and utilization develop over the next several years.

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