

Five not-so-obvious risks that keep funders up at night

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In this article, Tanya Lansky of LionFish Litigation Finance explores several complex hidden risks of litigation funding. The article explains the detailed checks funders carry out and highlights the unique nature of each case.

Much to the frustration of the many claimants and lawyers who have actually sought out litigation funding, recent discourse has centred around the convenient narrative painted by their authors: that funders finance spurious and meritless claims. Only those who have applied for funding will know the harsh reality about the industry's due diligence processes, and the high hurdles required to be overcome to get a funder on board.

When applying for funding, claimants and legal teams often focus on the strength of legal merits, detailed quantum analyses and protractive contingent enforcement strategies. Yet, beyond these lie a myriad of additional elements fuelling funders' layered assessments and analyses.

Adding to these layers is the very fact that there is no cookie-cutter approach to a funder's due diligence. Each case has its specificities and therefore rarely follow exact factual and strategic patterns, making the due diligence prism and approach necessarily nuanced and idiosyncratic. And much like investors into other asset classes, litigation funders delve far beyond the strict viability of the asset and look to assess the numerous additional components – soft and hard – that may affect their investment. The exception being that compared to other asset classes, disputes carry numerous other risks that often surprise and scare away institutional investors involved in more traditional asset classes.

This article seeks to uncover a few of the less obvious contenders that keep us funders up at night.

Claimant reliability

The claimant's reputation and credibility are obvious risk factors, and ones that could easily be used by a defendant as a means of leverage in favour of its

defence strategy. A claimant whose past conduct may – even if remotely – undermine its case or the facts surrounding its case will likely be faced with other lines of attack from the defendant. However, these elements can be identified and assessed by funders pre-investment.

What is not-so-obvious is a claimant's reliability through the life of the case. After all, disputes are an emotionally stressful and difficult time, even for corporates of certain sizes. Will they listen and follow legal advice received from their lawyers? And what if something stops them from engaging and providing timely instructions, allowing defendants to exploit potential weaknesses or procedural delays? What if they suddenly think they know better than the lawyers and the courts? Those lawyers and funders fortunate enough to have had unwaveringly reliable clients will say that is unlikely, but we suspect they are in the minority.

Legal team

As passive investors, funders need to be fully aligned to the client's choice of legal team. Not only must they have an excellent relationship with their client but their strategy and motivations must align with the funder's need to ensure that the case (that is, the investment) is in a safe pair of hands.

As passive investors, funders will have no say in the case strategy once they have invested, but they can never mitigate the unforeseen. Not merely the "hit by a bus" scenario, but what happens if the law firm folds or disappears creating delays in the transfer of the client's file? What if the acting lawyer has a sudden personal issue which requires a sabbatical mid-case? What if the legal team is struck off? For those who have had the fortune of living a trouble-free existence, these may seem unlikely risks. But for most of us, disputes rarely fail to surprise.

Commercial incentives

Understanding the parties' incentives in and around the dispute – sometimes well beyond, to include wider business incentives and activities – is key to understanding points of leverage that may arise and become detrimental to the success of a case.

Funding is generally provided on a non-recourse basis, and based on such a structure, funders will therefore endeavour to leave no stone unturned insofar as wider commercial elements that could prejudice the ability for the claimant to obtain a financial outcome on success of its claim.

However, disputes can take time to conclude, with commercial incentives evolving and changing with personal and business interests moving much quicker than the case itself. As the claimant always retains the conduct of the litigation, what if the claimant suddenly agrees to a drop-hands offer with the defendant, or conversely rejects every settlement just to go for trial in the hope of getting the biggest possible pay out – in both instances blessed by the legal team to preserve other business interests of the claimant that the lawyers may be advising the claimant on beyond the case itself?

Defendant unfamiliarity

Undertaking due diligence on a defendant's ability to pay is generally a given, including for lawyers who are taking a case on partial or full contingency. However, the legal mechanisms available to ringfence defendant monies – by way of injunction, for example – are generally limited to specific circumstances that may sometimes only arise mid-way through a dispute. And by then, the defendant may have already moved assets well beyond the reach of any judgment.

Funders can therefore assess the defendant's financial savviness as well as any asset dissipation risks from the outset, but what cannot be controlled

is what defendants may be doing behind the scenes. After all, there is no smoke without fire in most funded cases, so defendants that have something to answer for may be less concerned about winning the legal argument and more focused on minimising the amount they may be ordered to pay out.

Witness reliability and performance

Understanding the characters behind the witnesses that may be called to testify in a case can be a huge component to the success or demise of a case. Grasping the reliability, characteristics and appealability (to name a few) of potential witnesses, and the ways these traits may be used in favour of, or against, the claimant before the relevant judge or tribunal may become key.

As part of the due diligence process, funders seek as much certainty from the outset but witnesses are human after all, and given how long disputes can take, things can change. So while witnesses may not quite "change" like they might in a good John Grisham novel, there is enough scope for the reliability and performance of witnesses to change considerably by the time a funded case reaches a hearing.

The exit

From time to time, we receive direct criticism as to the expense of litigation funding. Yet, when we invite those critics to fund alongside us, they say it is too risky because too many things that can go wrong.

Given risk and reward lie on the same spectrum, it helps validate why litigation funding is necessarily expensive. In reality, no matter how rigorous the due diligence process, a lot can go wrong post-investment sometimes even beyond the imaginable that may keep us up at night.

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