LITIGATION LENDING

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Reflecting on an eventful 2021, we thought it would be interesting to explain how Litigation Lenders assess and evaluate cases and to set out the drivers that we have seen at play in the private client litigation we have funded over the past twelve months or so.

As a civil litigator you will likely be familiar with "non-recourse" litigation funding solutions, in which litigation funders make investments (to pay legal fees etc) based on a merits of a case. Where successful funders are repaid their investment (i.e. the capital they deployed into the case) plus a success fee, however in the event of a loss the funder takes the loss on the chin. Success fees are often calculated as a percentage of the damages or a multiple on the funding arrangement.

Litigation lending is very different, providing a much lower cost of finance for cases the lender deems to be lower risk, but where the loan including interest and fees are repayable by the borrower regardless of outcome of their litigation. The loan is therefore full recourse to the borrower. Such arrangements are very familiar to matrimonial lawyers to the point that the Family Courts now expect evidence that specialist litigation lenders have been approached and turned down before making a legal services order. Litigation Lenders make loan directly to customers, and as such should be regulated by the FCA for Consumer Credit. Such lenders should not expect guarantees from the solicitor firm.

Whilst standard in matrimonial disputes, litigation lending is a newer concept in other areas of litigation affecting private clients.

One of the main differences between the Family Courts and other forms of civil litigation (for example probate or trust litigation) is the availability of solicitor funding through conditional fee agreements for the latter.

This additional dimension has been relevant to our experience over the last year as well, as outlined towards the end of this article.

When considering offering a loan to a customer, lenders must assess both the credit risk and customers best interests, which includes considerations as to affordability and credit worthiness. The latter is relatively simple for lender lending against fixed assets, such as a house, where affordability of monthly interest payments will be determined by demonstrable income and future values can be statistically modelled using decades of data across millions of properties, and security is based on a legal charge over the fixed asset. However thing are not quite so simple when lending against the asset of litigation.

Credit risks are the risks associated with a proposed loan; the focus is on whether the client can and will repay, the reliability of their enforcement routes and the value of the underlying assets. In probate litigation for example, this risk is assessed by reference to the strength of the claim both in terms of the legal argument and the evidence, the structure of the loan, the manner in which any proceeds of litigation are safeguarded on success, and the value of the estate and the claim.

Whilst credit risk can be assessed on facts and variables that can be measured to within given tolerance, considering a customer's best interest under consumer credit legislation is considerably harder since the regulation does not dictate specifically how we are to make such assessment.

Under the Consumer Credit Act 1974, we are required to assess both the affordability of a loan and whether it is in the best interests of the client, whilst of course ensuring decisions are non-discriminatory and in line with TCF (treating customers fairly).

The way we choose to do it is to assess what we consider to be the reasonably likely worst-case scenario of the case. We don't focus on outlandish possibilities but realistic and bad outcomes at trial, with the litigation going on for the maximum amount of time and having to fund the litigation to trial, and potentially beyond. We draw this picture by reference to the advice that has been given to the client and on our own internal specialists views. We then look carefully at the financial impact on the client with their resources if the reasonably likely worst-case scenario happened.

That is admittedly a pessimistic way of looking at a case, however it has stood us in good stead to deal with the unexpected delays and resulting increased cost caused by a global pandemic. Such a "plan for the worst and hope for the best" approach does not mean that litigation lending is only available to wealthy clients with means. We have handled a number of cases where a client brings a claim to enhance their inheritance. They may be challenging the validity of a less generous later will or bringing a 1975 Act claim, but in those cases where the client will receive value from the estate in any event, we will treat those assets as likely to be available to the client when assessing affordability.

We have also dealt with cases where the amount the client will recover may be in dispute but where they have protection against a negative outcome. For instance, we have assisted executors with the benefit of Beddoes relief and cases where executors have singularly failed to administer the estate. In those cases where the client runs very little risk of a losing and having to pay their own / adverse costs, the affordability test becomes much easier to meet.

Many trust and probate claims are now brought by lawyers acting on conditional fee agreements. But the others involved in the litigation, the defendants, also need representation and lawyers can find it much harder to fashion a CFA around a defence. Over the last year, we have helped in a number of situations where defendants need to mobilise their legal team but do not have access to cash or a CFA.

And we have worked in tandem with a number of law firms creating a hybrid retainer which is constituted in part by a traditional hourly charge and in part by a CFA.

This hybrid model changes the risk profile of the CFA for the law firm and ultimately reduces the cost for the client.

Overall, we reflect on the year gone by and the conversations we have had with lawyers and their clients. Litigation lending has provided a useful extra dimension to these conversations and meaningful optionality to clients. We look forward to the year ahead.