HOULIHAN LOKEY

LITIGATION FINANCE:

THE EMERGENCE OF AN INSTITUTIONAL ASSET CLASS

Just as startups can seek venture capital or homeowners can borrow against their homes, litigants and their attorneys can raise third-party capital by pledging future payments that arise from the prosecution and settlement of legal cases. Litigation finance is a rapidly emerging asset class that is drawing increasing interest from institutional investors. Dedicated fund managers and hedge funds are increasingly willing to fund a wide variety of legal cases and situations, including large commercial cases, granular mass tort consumer cases, well-publicized sovereign disputes, and international arbitrations. Funding occurs at all points in the legal cycle, from pretrial to appeal to settlement, and the market has become sophisticated enough to offer different risk/return trade-offs at each stage.

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Litigation funding was originally an outgrowth of the legal systems of the Commonwealth nations—primarily the United Kingdom and Australia—where American-style contingency fees on litigation were prohibited. Since attorneys could not speculate on their own clients' claims, litigation funders arose as the only viable option for claimants who lacked financial capacity to pursue litigation.

While litigation funding is newer to the U.S., it is quickly gaining popularity and acceptance. Among attorneys and litigants, litigation funding fills a healthy demand created by rising legal costs (particularly among BigLaw firms) and tighter legal budgets among corporate clients. Similarly, law firms with large defense practices can use litigation funding as a mechanism to attract plaintiffs with large potential payoffs while maintaining the financial stability offered by hourly-fee-paying clients.

As litigation funding has evolved beyond "last resort" funding for "David vs. Goliath" lawsuits, corporate litigants have begun to use litigation finance to address corporate finance and strategic concerns. Corporations tap into litigation funding in order to take litigation costs off their profit and loss statements. They recognize revenue earlier, de-risk appellate outcomes, and minimize the operational distraction caused by litigation.

Litigation funding has also gained judicial acceptance. Traditional impediments posed by archaic champerty and maintenance doctrines have all but disappeared, except in the rarest of circumstances. Popular commercial litigation jurisdictions—including New York, Delaware, Pennsylvania, Illinois, and Texas—have protected against the discoverability of funding contracts and underwriting documents by extending confidentiality to funding situations.

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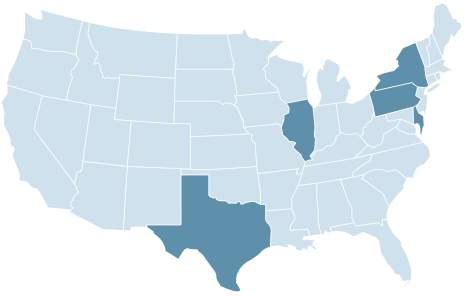

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The body of jurisprudence concerning fee-splitting, usury, and other relevant doctrines is growing and becoming better understood. Collectively, such rulings symbolize an implicit endorsement that litigation funding is an acceptable and commonplace part of a litigator's toolbox.

As with many alternative asset classes, litigation funding still faces headwinds. The U.S. Chamber of Commerce—a traditional ally of big businesses, which frequently appear as defendants in major litigations—has been vocally opposed to litigation funding. And most recently, the New York City Bar Association issued an opinion stating that non-recourse financing arrangements between litigation funders and attorneys would constitute an ethical violation by the attorney. The opinion surprised the investment and legal communities, but there is no evidence that the opinion has deterred transaction activities, as the opinion is not binding law.

Today, the litigation funding market has matured and segmented across a variety of funding products and originator structures. The market is broadly segmented between commercial funding (i.e., supporting business litigation and/or supporting attorneys themselves) and consumer funding (i.e., advances to individual litigants mostly in the personal injury context).

Funding products include single-case fundings (i.e., capital to support individual cases or portfolios), pre- and post-judgment (e.g., appellate) financing, and law firm loans (i.e., recourse and non-recourse lines of credit across attorney receivables). A host of specialty products exist to address class-action prosecution, factoring needs, judgment enforcement, and intellectual property monetization.

Financial players include specialty finance companies (private and public originators dedicated strictly to litigation funding), dedicated private-equity-style funds, family offices, and alternative asset managers. Investors are attracted primarily to returns uncorrelated with the debt and equity markets and the attempt to replicate outsized returns shown by early litigation funding players. Originators and asset allocators are similarly presented a menu of options, largely dependent on timing sensitivities and risk-reward appetite. Patient investors seeking multiples of invested capital pursue venture capital risk/return profile for single-case financings, while more conservative capital that seek shorter-term returns gravitate toward de-risked post-judgment and diversified opportunities like factoring and law firms loans.

The increasing data set and better understanding of funding among institutional investors have generated at least the first wave of asset securitization (e.g., DRB Capital), portfolio recapitalization (e.g., Bentham IMF), M&A among litigation funders (e.g., Burford Capital's acquisition of Gerchen Keller Capital), and even the occasional bankruptcy/liquidation.

Houlihan Lokey is a leading investment bank with extensive experience in the litigation funding market. The firm arranges funding for single cases, sells portfolios of legal cases, and structures transactions for litigation funders, specialty finance companies, corporate entities, law firms, and hedge funds. We have advised both originators and asset allocators and have been very active in the sector, having completed numerous transactions over the past several years. Our reputation as a leading investment bank in the asset class is based on a long track record of achieving positive outcomes for our clients.

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ABOUT HOULIHAN LOKEY

Houlihan Lokey (NYSE:HLI) is a global investment bank with expertise in mergers and acquisitions, capital markets, financial restructuring, valuation, and strategic consulting. The firm serves corporations, institutions, and governments worldwide with offices in the United States, Europe, the Middle East, and the Asia-Pacific region. Independent advice and intellectual rigor are hallmarks of the firm's commitment to client success across its advisory services. Houlihan Lokey is ranked as the No. 1 M&A advisor for all U.S. transactions, the No. 1 global restructuring advisor, and the No. 1 global M&A fairness opinion advisor over the past 20 years, according to Thomson Reuters. For more information, please visit www.HL.com.

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