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An Overview of Litigation Funding

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1 Introduction

1.1 What is litigation funding?

Litigation financing, third-party litigation funding, professional funding, settlement funding, or legal funding are all monikers that have been applied to a legal structure whereby a third party stranger to a litigation (or arbitration) provides funding to a litigant (or to a litigant's contingency counsel) to finance the fees and expenses of litigation with the hope of receiving a return on the funding investment upon the resolution of the litigation.[1] Third-party funding of litigation or arbitration has become a well-established means of supporting formal legal recovery efforts. Litigation funding has for certain investors served to transform litigation into a new investment opportunity and asset class – a financial product – capable of delivering substantial returns albeit, with an above-average risk profile.

Litigation funding has long been associated with arcane and ancient legal concepts such as "maintenance" (helping another prosecute a suit), "champerty" (maintaining a suit in return for a financial interest in the outcome), and "barratry" (the continuing practice of maintenance or champerty).[2] Under these concepts, third-party litigation funding was virtually barred as a matter of public policy until the late 20th century. In addition, rules of professional responsibility governing the behavior of lawyers placed many restrictions on a lawyer's role in a litigation funding arrangement, especially as they relate to the avoidance of interference with the attorney-client relationship and the protection of client confidentiality information.

1.2 Market background

The litigation funding market has grown from a niche industry in the 1990s to a worldwide industry worth billions of dollars today. The growth in the number of litigations subject to funding, and the number of litigation funders, has increased dramatically since the first days the phenomenon took hold in Australia and in the United Kingdom. It was not until the early to mid-2000s that this funding phenomenon really took root in the U.S., with many American courts and legislatures either abolishing or modifying restrictions relating maintenance, champerty and barratry. In recent years, however, following the growth of the U.S. litigation funding market into the world's largest, the pendulum has begun to swing back, with many courts and state legislatures implementing new restrictions. Several efforts at federal regulation of the industry have been, and continue to be, made to curtail the industry.

Notwithstanding this recent push towards regulation, the U.S. litigation funding market has grown to substantial size. At the end of 2025, there were estimated to be 39 active litigation funders in the U.S. making U.S.$2.9 billion's worth of new deal commitments.[3] Along with a diversity of investor types (dedicated funders, multi-strategy investment funds and *ad hoc* funders),[4] litigation funding can generally be broken down into two large categories: commercial funding (relating to controversies among commercial entities); and consumer funding (relating to cases brought by individual consumers, typically personal injury, etc.). Within each category there are a variety of case types, structures, nuances, controls, confidentiality issues and due diligence issues that need consideration.

Litigation funding is, for the most part, "non-recourse", meaning that the funder's return is paid entirely from the proceeds of the underlying litigation or from contingency fees to be received by plaintiff's counsel. Because the funder's entire investment may be lost upon an unfavorable litigation outcome, the need for the funder to successfully assess the myriad risks involved in each case cannot be overstated. A key factor often overlooked in recent years is duration risk. Court timetables can dictate how long it takes to resolve a dispute and this, together with other factors (settlement negotiations and mediations, etc.) are often outside litigants' control. Increasingly, funders consider possible exit routes prior to resolution of the litigation – hence, not unlike the syndicated loan market, a nascent secondary market has emerged whereby primary funders may exit certain of their deals through a secondary sale. Another hedge for funders developed over the past few years is litigation insurance; in many cases, funders now have the ability to purchase a policy to provide protection against the risk that their cases will be lost or extend indefinitely.

This chapter primarily focuses on commercial litigation funding and explores:

- the key players in the market for litigation funding;
- the legal and regulatory regimes in the U.S. and England;
- the key legal ethical issues relevant to attorneys whose fees are paid by funders;
- the common transaction structures and common issues that may arise during the course of negotiating and documenting a litigation funding arrangement; and
- the treatment of litigation funding under the U.S. tax regimes.

2 Key Players and Benefit to Each

2.1 Plaintiffs

On a basic level, plaintiffs benefit in three ways: (i) by having a third party pay their legal fees and expenses, it allows certain injured parties access to the courts not otherwise available – allowing them to bring meritorious cases when contingency counsel is unavailable; (ii) in certain cases, claimants may be able to obtain capital infusions beyond the amount necessary to pay out-of-pocket litigation costs (often referred to as a "monetization"); and (iii) in either case, up-front funding allows a plaintiff to mitigate the risk of losing the litigation, essentially "selling" some portion of the risk to the funder.

2.2 In-house legal departments

While healthy corporate enterprises would generally have capital necessary to fund their own litigations, obtaining third-party financing allows them all the benefits of pursuing meritorious litigation while reducing the drag on earnings caused by the need to self-fund lengthy, ongoing litigation. In addition to mitigating the risk of a poor litigation outcome, funding allows corporate enterprises to smooth out their financial results by spreading income from a lengthy litigation claim over several financial periods. The use of funding can transform the legal department from an enterprise cost to an income producing unit.

2.3 Contingency law firms

Law firms that generate a large portion of their income from contingent cases use litigation funding to (i) fund their current cost of operations when their cases are expected to be lengthy, and (ii) reduce the risk to the law firm of one or more litigation losses.

2.4 AmLaw 200 law firms

Historically, the largest law firms did little to no plaintiff work and of that, none on contingency. As the competition for talent and overall profitability has grown, many firms are seeing the benefits of both plaintiff work and alternative fee arrangements that include a contingent component. As with the more traditional plaintiff firms, "Big Law" firms are finding that partnering with litigation funders can be beneficial, both in smoothing earnings cashflow and in mitigating the risk of litigation loss.

2.5 Dedicated funders

Dedicated litigation funders are experts at finding, underwriting and managing funding opportunities. For successful firms, litigation can be a highly profitable, risk-adjusted, non-market correlated source of investment return. Inevitably, some litigations will fail and, hence, funders' portfolios must spread the risk over many investments in order to ensure that revenue from successful investments is sufficient to outweigh the inevitable losses to be taken on the failed ones.

2.6 Multi-strategy investment firms

Investing in litigation is highly specialized. Still, some hedge funds and private equity funds now include litigation funding as one of the investment strategies available to their clients, who may be attracted by the high, non-market correlated level of returns. Many have found it difficult, however, to compete without investment professionals dedicated to the litigation space. More recently, many of these investment firms have outsourced this skill set by partnering with dedicated litigation funding firms.

2.7 Litigation insurance

An industry in litigation-related insurance has emerged over the past several years, in some cases competing with funders and in other cases partnering with funders. In the English litigation system (where the losing party typically pays the winning party's legal costs), an "after the event" ("ATE") insurance product has emerged, hedging the risks of court orders to pay the other side's costs in the event of unsuccessful litigation outcomes. Some funders have their own insurance products available, and others partner with specialist insurer providers. ATE insurance is a notoriously expensive product reflecting litigation risk. It does, however, serve to insulate the insured party from a requirement to post security for defendant's litigation costs (where defendants try to thwart a claim by asserting that the plaintiff cannot afford to pay the defendant's costs if the claim were to fail). Having such insurance in place positions the plaintiff to progress to trial without fear of being unable to pay for a required costs security order.

In both the U.S. and England, general litigation insurance is also available, whereby a policy can be purchased by any party with a stake in a litigation to protect against an adverse outcome or prolonged litigation duration. Unlike litigation funding transactions in which the funder provides capital, insurers are paid a premium (which can be deferred or contingent) by the claimholders. If certain loss parameters relating to the underlying claim are met, the insurance company makes a payment to the claim holder/policy holder. In many cases, litigation funders are, themselves, customers of insurance companies, insuring their own portfolio of litigation finance assets.

3 Regulation of Funding Agreements

3.1 United States

An overall picture of the legal position for the U.S. is highly complex. Litigants and litigation funders need to consider several issues including the governing law of the funding agreement, the venue of any litigation, and the jurisdiction(s) in which a judgment may be enforced. New York law in particular is discussed below, as it is a significant financial markets hub, as well as examples of other patterns of behavior in state-level regulation.

3.1.1 Champerty and compensation caps

Some U.S. states maintain a negative view of champerty, such as Alabama and Mississippi.[5] Others, such as California, have never strictly had a prohibition against it. Where champerty and maintenance are applicable, funders should take care not to maintain control over the conduct of the litigation.[6]

New York has a statutory prohibition on champerty, which limits the assignment of claims with the "sole purpose" of bringing a lawsuit. Historically this has been interpreted fairly narrowly. In addition, the statute includes a safe harbor for investments over $500,000. While there are no direct controls on how much litigation funders may charge, a New York usury statute[7] caps interest on loans at 16% for loans below U.S.$250,000, or 25% between U.S.$250,000 and U.S.$2.5 million. However, litigation funding provided on a non-recourse basis is for the most part not subject to the usury statute.[8]

Some states have begun to directly regulate litigation funding, notably with regard to the financing of consumer litigation. Typically, points include: minimum disclosure requirements to consumers; registration of the funder with a state authority; and control of levels of fees the funder charges.[9] The recent New York Consumer Litigation Funding Act applies to consumer cases where the funded amount is under U.S.$500,000. These types of disclosure, registration and fee requirements are following a similar trend in the commercial finance, factoring and merchant cash advance lending markets.

3.1.2 Disclosure of funding arrangement in proceedings

In many state and federal courts, disclosure to the court and opposing litigant of the identity of other parties with a financial interest in the litigation is often required as a matter of course.[10] Some jurisdictions remain resistant to requiring any disclosure of interested parties.[11] While no specific rule of court has been implemented in New York, the state court system began a consultation on the matter in 2024, particularly with regard to personal injury and wrongful death litigation.[12]

In late 2024, the U.S. Judicial Conference's Advisory Committee on Civil Rules formed a subcommittee to consider whether litigation funding agreements should be generally required to be disclosed in some manner in federal court proceedings.[13] Since that time, several congressional legislative efforts to require disclosure of funding in all federal litigation have been proposed and there is reason to believe that that some level of disclosure of funding will be enacted in coming years. Most proposed legislation requires disclosure of the existence of funding, whether the funder has the ability to control the conduct of the litigation and whether the funders are organized outside of the U.S.

3.2 United Kingdom – England

In English litigation, financial support can take various forms, most particularly:

- insurance indemnities (see ATE insurance above) protecting against orders to pay legal costs;
- fee arrangements with law firms known as "*conditional fee agreements*" where part of a law firm's fee is only payable upon a successful result, or damages-based agreements where payment of fees is met from a percentage of the proceeds recovered in the event of success (particularly used for bulk small claim work); and
- third-party funding of litigation in exchange for later payment upon certain triggers.

3.2.1 Champerty and control of the litigation

For some time now, champerty has been lawful in England within certain bounds, with particular considerations including:

- The extent to which the funder controls the outcome of the litigation – can the litigant settle without seeking permission of the funder or give instructions to legal representatives?
- Whether the funder is motivated to inflame the dispute because of the amounts of profit involved or, more seriously, has encouraged or participated in manufacturing evidence.

If an agreement falls foul of champerty, it is liable to be unenforceable by the funder.

Funders often require an independent legal assessment both on the merits of the claim but also on the strength of a settlement proposal. In order to avoid champerty concerns, a funder should not have a unilateral veto over or right to direct a settlement. The Association of Litigation Funders ("ALF") produced a Code of Conduct in 2011 in consultation with the Civil Justice Council, which has been a model for scoping litigation funding agreements in England. In particular, the ALF Code of Conduct recommends that where a funder and litigant are in dispute over whether the litigant should agree a settlement "*a binding opinion shall be obtained from a Queen's Counsel who shall be instructed jointly or nominated by the Chairman of the Bar Council*".

Specifically, for antitrust representative claims, the Competition Appeal Tribunal also has a role in approving settlements which can constrain funders.[14]

3.2.2 Requirements of enforceable damages-based agreements

Third-party litigation funding agreements where the funder's remuneration is based on the financial benefit to the funded party are damages-based agreements (see above) which need to comply with the Damages Based Agreements Regulations 2013 (the "DBA Regulations").[15] Damages-based agreements are also prohibited for opt-out collective proceedings before the Competition Appeal Tribunal.[16]

On 2 June 2025, the Civil Justice Council issued a report on litigation funding with a variety of recommendations including the removal of third-party funding from the DBA Regulations. By December 2025, the UK government had announced an intention to make light reforms of third-party funding regulation including removal of third-party funding from the DBA Regulations with prospective effect, although no bill is yet before Parliament.

While that legislation remains in development, and given any reform may not be retroactive, the DBA Regulations remain relevant to third-party funding in England.

A key requirement of the DBA Regulations is that the agreement must provide a written explanation of the basis of the calculation of the payment rate.[17] Further, caps are set on the share of net payments based on damages "*ultimately recovered*" at first instance ranging from 25% in personal injury, 35% in employment, and 50% in all other cases.[18]

Agreements under which the funder receives a multiple of the amount of its funding, even if triggered by success in the claim, do not appear to need to comply with the DBA Regulations.[19] Funding agreements which provide for payment to the funder either on the basis of damages recovery or on some other basis in the alternative should sever the provisions based on damages recovery so alternative payment terms are enforceable without the need to be compliant with the DBA Regulations.[20]

3.2.3 Costs exposure for funders and funding costs recoverability for litigants

In English litigation, the court has the power to order a third party to pay costs.[21] Third-party funders are at risk of having adverse costs orders made against them[22] and this is more likely where the funder is shown to have controlled the litigation or where their agreements are deemed champertous.[23]

By contrast, arbitrators under English law have no jurisdiction to make costs orders against litigation funders.

The dichotomy is reversed for recoverability of the costs of funding for the funded party. In English litigation, a successful party cannot recover the costs it incurs in obtaining third-party funding from the losing party (though it can recover its legal costs of the litigation). In arbitration, however, tribunals have awarded parties these costs.[24]

3.2.4 Disclosure of the funding arrangement in proceedings

In the regulated field of competition collective actions before the Competition Appeal Tribunal, a lead claimant will be required *de facto* to reveal litigation funding arrangements in order to demonstrate the financial viability of their position to run the claim.[25]

In litigation more generally, there are no rules requiring disclosure of litigation funding agreements. Disclosure of litigation funding can become an issue in the context of security for costs orders,[26] or where a party ordered to pay costs fails to do so. It can be beneficial for settlement purposes at the outset of a claim for a claimant to disclose that its claim is supported by a third-party litigation funder. This is because most funders will have access to expert independent lawyers and will only fund cases where there are strong prospects of success and recovery. Disclosing that a claimant has funding therefore demonstrates both strength of claim and depth of pocket to fund to trial.

3.2.5 Transfers of claims as an alternative approach?

In English law, it is permissible to make a legal assignment of one's claim. However, equitable assignments of claims (where the claim to some extent remains with the assignor) remains a grey area by comparison. Assignment of claims in bankruptcy by the liquidators or administrators (bankruptcy trustees), is a popular and growing area amongst bankruptcy trustees and funders in the UK. The bankruptcy trustee has a statutory power to sell all property of the company[27] and, therefore, issues of champerty do not arise, but careful consideration should be given prior to assignment if the bankruptcy trustee is to avoid a challenge to their conduct.[28]

It is also possible to assign the proceeds of a claim for appropriate value and a damages-based agreement is an example of this where the service provider obtains an interest in a portion of proceeds of a claim in exchange for advance funding to pursue the claim. Note the need to comply with the DBA Regulations.

4 Legal Ethical Issues

4.1 United States

4.1.1 Confidentiality and privilege

The attorney-client privilege and the work product doctrine provide for confidentiality of communications that can be threatened by cooperation with a litigation funder. Common interest privilege generally protects those privileges, but federal district and state courts' treatment of the issue is not uniform. In particular, some courts have ruled that litigation analysis prepared in order to be shared with funders may be unprotected where the primary purpose of the analysis was securing funding rather than furtherance of the litigation itself.[29]

Best practice demands that claimholders and funders enter into non-disclosure agreements as a necessary step to protecting privilege. Particular care on a case-by-case basis is required to establish what kinds of documents and communications can be shared to ensure privilege is respected in the relevant jurisdiction.

4.1.2 Fee sharing; attorney-client relationship interference

Although a very limited number of U.S. jurisdictions, most notably Arizona, permit some level of investment by non-attorneys in law firms and the sharing of legal fees by attorneys with non-attorneys, most have ethical rules for lawyers that prohibit such activities. These rules are especially relevant to law firms that are receiving funding backed by their contingency fees. While a recent, non-binding New York City Bar Association opinion expressed concern that these arrangements may constitute prohibited fee-sharing, New York State and other courts have generally disagreed. And although there can be disagreement as to the circumstances under which a funder's investment return constitutes fee sharing, all jurisdictions prohibit the ability of funders to control the underlying litigation or otherwise interfere with the attorney-client relationship.

While not constituting litigation finance in the strictest sense, a recent related trend is the investment by private equity firms in law firms through the use of structures knows as management service organization (or "MSO's"). Essentially, this involves splitting a law firm into two parts: (i) the part that practices law and advises clients directly; and (ii) all other parts, including management, accounting, back-office, etc. The private equity investor's investment vehicle (the MSO) acquires the non-legal portion, runs the law firm and receives a servicing fee in return. To avoid violation of the fee-sharing and non-attorney control rules, MSO servicing agreements should prohibit interference with the law firm side of the enterprise. However, U.S. Bar Associations have, understandably, expressed concern that the prominent role played by MSO's in law firm management may make it practically difficult to avoid interference in the management of client legal matters.

4.2 United Kingdom – England

4.2.1 Confidentiality and privilege

In England, legal professional privilege broadly exists in two relevant forms: legal advice privilege; and litigation privilege. The fundamental point is the need to keep communications confidential to retain privilege. At the due diligence phase prior to funding, non-disclosure agreements confirming the confidentiality of information passing to a potential funder are common. Where a funding agreement is in place, common interest privilege can apply to extend the privilege and has been discussed by the courts in the analogous ATE insurance context.[30]

Note that, in civil law systems, lawyers are under obligations of professional secrecy – they are not to reveal their client confidences. In some systems, those obligations have been explicitly held to be unable to extend to litigation funders.[31]

5 Types of Financing/Commonly Negotiated Terms

Given the underlying litigation, the legal, regulatory and business needs of parties can vary; litigation finance transactions tend to be structured in a number of different ways.

5.1 Loan *vs* purchase

Some transactions appear to be loans, seemingly creating a creditor/debtor relationship between the claimholder and the funder. In this structure, the proceeds of the underlying litigation constitute the "collateral", securing the obligation of the claimholder to repay the debt.[32] Some courts (and the Internal Revenue Service ("IRS")), however, have ruled that for arrangements where the obligation to repay the loan is "non-recourse", in that it is wholly conditional upon success in the underlying litigation (or contingent fees claims), these arrangements are not truly "debt". For an obligation to constitute debt, it must include an unconditional obligation to pay. Rather, these agreements may be deemed to constitute a sale of an interest in future proceeds. More often, however, parties avoid the loan structure altogether and characterize the deals as outright purchases of the proceeds of litigation or contingent legal fee claims (which avoids otherwise potentially applicable usury statutes, discussed in section 3.1).

5.2 Prepaid forward purchase agreements

A danger for many funders of having an investment characterized as a "purchase" is that the funder may be deemed to have acquired a direct interest in the litigation claim itself rather than merely a right to the future proceeds. This can have negative consequences for the funder from a tax perspective (see section 7) and may be deemed a prohibited interference with the underlying litigation. For that reason, many funding transactions are characterized as "prepaid forward" purchases, in which the upfront purchase price is deemed a "prepayment" and actual settlement of the sale does not occur until the litigation proceeds are realized at a future date. As discussed in the Taxation section below, in certain cases, using a prepaid forward structure may afford the funder capital gains treatment with respect to the investment.

5.3 Single case *vs* portfolio

While the funding of single cases is common, the funding of portfolios of cases is increasingly prevalent. In a portfolio arrangement, the funder funds either a collection of cases to be brought by a single claimant, or a collection of contingency cases brought by a single law firm. The benefit to the funder is that the cases are typically cross-collateralized, such that proceeds of all cases flows into a single waterfall to repay the funding. In that way, a winning case in the portfolio can more than compensate for the losses resulting from a losing case in the same portfolio. This arrangement reduces the funder's risk of loss and allows the funder to provide more favorable financing terms than would be offered in a single-case funding.

5.4 Upfront funding *vs* drawdown

When litigation funding is used by the claimholder to pay legal fees and expenses, it is common to see a structure whereby the funder delivers funds to the claimholder over time, as the fees and expenses are incurred. In these circumstances, the funder will often pay these fees and expenses to the law firm or other service provider directly. But in cases where the funds are being used by the claimholder or law firm for purposes other than paying ongoing litigation expenses (a monetization), a single upfront payment is common.

5.5 Payment waterfall

At the heart of a litigation finance agreement, regardless of structure, is the payment waterfall, which dictates how proceeds of the litigation claim or legal fees, as applicable, will be allocated. The waterfall tends to be the most heavily negotiated part of any business arrangement and waterfall structures can vary widely. For plaintiff funding, proceeds are usually shared between the claimholder and the funder but, to the extent plaintiff's counsel is working on a full or partial contingency, counsel may also get its upside as part of the waterfall. In a typical scenario, the funder is repaid first (including its return) with the balance being remitted to the claimholder. In some cases, the funder's return is expressed as a multiple of funded amount (i.e. 2×, 3×, etc.) and in others, the funder's return is expressed as a percentage of the proceeds obtained (see section 3.2 regarding enforceability of different approaches in England).

6 The Underwriting Process – What do Funders Look For?

It is often said that litigation funders end up funding less than 3% of opportunities presented to them. Due to the confidential nature of most funding transactions, there is no precise measure of this figure, and the nonrecourse nature of these deals makes it a particularly risky investment asset class and, consequently, the "pickiness" of funders is understandable. Beyond considering the risk that a court or arbitrator will fail to find the relevant defendant liable, prudent funders must examine a number of additional factors and risks that may thwart a positive outcome, including:

- Merits of the claim? Is the funder able to access sufficient information from the plaintiff or law firm to make that determination? For example, most UK market funders would look for an independent analysis of the merits from a King's Counsel and will typically look for 60% chance of success. Due to the funder's general lack of control, it must rely on the funded party's own self-interest to maximize return. For this reason, cases in which plaintiffs with emotional or non-economic motives, such as divorce cases, may not be ideal. Will an angry plaintiff refuse a reasonable settlement offer, thereby extending costly litigation and ultimately harming the funder's interest?
- Will a verdict or settlement beneficial to the plaintiff result in non-cash proceeds? A defendant agreeing to make a business concession or to give the plaintiff illiquid private equity may not be a positive outcome for the funder.
- What is the time to collection? A funder's return on a litigation victory that takes 18 months looks a lot different if the same litigation victory takes more than five years.
- What is the ratio of expected damages to funders total return? If possible, a funder wants to avoid a situation in which, as a litigation progresses, it becomes clear that the funder will be taking the lion-share of the proceeds (and as discussed above, this can even potentially render the funding agreement unenforceable). A plaintiff's resulting lack of motivation could seriously harm the funder's chances of achieving a positive outcome.
- Recoverability of damages. Is the defendant solvent? If necessary, does the defendant have assets against which a verdict could be easily enforced? What would be the cost of pursuing any ancillary enforcement proceedings?

- If the potential defendant is a domestic or foreign governmental entity, what is the source of its assets for collection? How would sovereign immunity from execution on judgments and awards affect recoverability from those assets?
- Caliber of the lawyers leading the case? Do they have a good case strategy? Are they willing to work on a partial contingency such that they are sufficiently motivated and have some "skin in the game"? Is there good law for the plaintiff in the jurisdiction in which the proceedings will be held?
- How will current or future judicial or legislative regulation impact the ability to collect the full investment return?

7 Taxation

The U.S. federal income tax treatment of a litigation funding arrangement is not certain. The alternatives for tax treatment are highly fact-specific and, in part, depend on how the parties legally structured the financing. The typical categories for U.S. tax treatment of a litigation funding arrangement include variable prepaid forward contract, loan, partnership or present sale. There is no one treatment that is desired across all funders and the tax consequences of each category and whether optimal for the parties will depend on each party's own tax circumstances.

That said, most litigation funders tend to prefer variable prepaid forward contract ("VPFC") treatment. A forward contract is a derivative contract for the future sale of property on terms that are negotiated in the present. The buyer in an VPFC pays the seller purchase price in advance of the forward sale and, as relevant for litigation finance purposes, the value of the property is variable.[33] Structured properly, for U.S. tax purposes, the VPFC does not give rise to tax until the forward contract is settled.[34] Accordingly, the seller reports income at the conclusion of the case and, assuming the other requirements for capital gains treatment are met, a buyer subject to U.S. tax reports capital gains (presently, subject to lower rates of U.S. tax) from the receipt of proceeds.[35] A non-U.S. buyer typically is not subject to U.S. tax, including U.S. withholding tax, on the settlement of an VPFC as the gain is generally treated as not connected with a U.S. trade or business and as such, does not give rise to "effectively connected income" and further, is usually treated as non-U.S. source, including in the context of an investor that invests through a partnership.[36] The resulting tax treatment of an VPFC is in stark contrast to a loan, which generally gives rise to U.S. source interest income where the borrower is in the U.S. and also can raise questions of whether a non-U.S. investor is engaged in a U.S. trade or business potentially subjecting the non-U.S. investor to U.S. tax and tax reporting obligations. Partnerships and deemed partnership arrangements can also produce potential U.S. taxation for non-U.S. investors as generally, partners will be treated as engaged in the underlying business of the partnership with the possibility of producing U.S.-source income therefrom.[37] Additionally, care should be exercised in considering the non-U.S. tax treatment of any such arrangement as it is possible that non-U.S. tax laws may view the litigation funding arrangement as other than an VPFC for tax purposes.

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We are appreciative of the input and guidance on tax-related matters that we received from Christine Lane. Christine is a partner and is co-chair of the Crowell Tax Group.

Endnotes

1 For brevity and consistency's sake, we shall use "litigation funding" throughout this chapter when referring to the structure of the funding and "litigation funder" when referring to the third party providing the funds.

2 *Osprey, Inc. v Cabana Ltd. P'ship*, 532 S.E.2d 269, 273 (S.C. 2000) (quoting *In re Primus*, 436 U.S. 412, 424 n.15 (1978)).

3 https://www.westfleetadvisors.com/wp-content/uploads/2024/03/WestfleetInsider2023-Litigation-Finance-Market-Report.pdf

4 *Id.*

5 See, e.g., *Wilson v Harris 688 So 2d 265* (Ala Civ App 1996) (litigation funding contract void as akin to gambling).

6 See, e.g., *Charge Injection Technologies, Inc v EI DuPont de Nemours and Co*, 2016 WL 937400, at *4-*5 (Del Super Ct 9 March 2016).

7 New York Consolidated Laws, Banking Law – BNK § 14-a.

8 See New York City Bar Association's Committee on Professional Ethics ("NYCBA") Formal Opinion 2011-2; *Lynx Strategies LLC v Ferreira*, 957 NYS2d 636 (NY Sup Ct 2010) (third-party investment for share of proceeds is not usury); but see *Echeverria v Estate of Lindner*, 2005 NY Slip Op 50675(U), at *8–9 (NY Sup Ct 2005) (non-recourse agreement was a 'loan', not an investment, because recovery was certain under strict liability statute and interest rate was, therefore, usurious).

9 A Government Accountability Office study provides a list of state laws as of 2022: GAO, Third-Party Litigation Financing: Market Characteristics, Data and Trends, December 2022, Appendix III: State Laws Addressing Third-Party Litigation Financing. Available at: https://www.gao.gov/assets/gao-23-105210.pdf. More recent laws include: Montana: SB 269, Establish consumer protections and disclosures in litigation financing (signed into law May 2, 2023); West Virginia: SB 850, Updating Consumer Credit and Protection Act (signed into law March 9, 2024); and Indiana: HB 1160, Civil proceeding advance payment contracts and commercial litigation financing (signed into law March 13, 2024).

10 E.g., District of Delaware, Standing Order Re: Third Party Litigation Funding Arrangements, April 18, 2022. Available at https://www.ded.uscourts.gov/sites/ded/files/Standing%20Order%20Regarding%20Disclosure%20Statements.pdf; N.D. of California, Standing Order for All Judges, Updated Nov. 30, 2023, paragraph 17. Available at https://cand.uscourts.gov/wp-content/uploads/2023/03/Standing_Order_All_Judges-11-30-2023.pdf

11 *Lower48 IP LLC v Shopify*, Inc., Case No. 6:22-cv-00997-DAE, Dkt. 36 (W.D. Tex. Nov. 2, 2023) (citing *Trustees of Purdue Univ. v STMicroelectronics N.V.*, No. 6:21-cv-00727-ADA, Dkt. 250 (W.D. Tex. Jan. 18, 2023); *Mullen Indus. LLC v Apple Inc.*, No. 6:22-cv-00145-ADA, Dkt. 64 at p. 5 (W.D. Tex. Oct. 19, 2022)).

12 https://www.nycourts.gov/LegacyPDFS/rules/comments/pdf/LitigationFinancingAgreements.pdf

13 https://www.reuters.com/legal/government/us-judicial-panel-examine-litigation-finance-disclosure-2024-10-10

14 Competition Appeal Tribunal Rules, Rule 94.

15 *R (on the application of PACCAR Inc & Ors) v Competition Appeal Tribunal & Ors* [2023] UKSC 28. Under a damages based agreement, a service provider (typically the law firm but note below) is remunerated from a percentage of the proceeds of litigation, specifically, "the amount of that payment is to be determined by reference to the amount of the financial benefit obtained [by the litigant]". Section 58AA(3), Courts and Legal Services Act 1990.

16 Section 47C(8) Competition Act 1998.

17 DBA Regulations, Section 3.

18 DBA Regulations, Section 4.

19 *Sony Interactive Entertainment Europe Ltd & Anr v Alex Neill Class Representative Ltd* [2025] EWCA Civ 841.

20 *Zuberi v Lexlaw Ltd* [2021] EWCA Civ 16; *Alex Neill Class Representative Limited v Sony Interactive Entertainment Europe Limited et al.* [2023] CAT 73.

21 Civil Procedure Rules, Rule 46.2.

22 *Arkin v Borchard Lines Ltd & Ors* [2005] EWCA Civ 655.

23 See examples such as *Chapelgate Credit Opportunity Master Fund Ltd v Money & Ors* [2020] EWCA Civ 246; *Laser Trust v CFL Finance Ltd* [2021] EWHC 1404 (Ch); *Various Claimants v Mercedes-Benz Group AG & Ors* [2024] EWHC 695 (KB).

24 *Tenke Fungurume Mining SA v Katanga Contracting Services SAS* [2021] EWHC 3301 (Comm); *Essar Oilfields Services Ltd v Norscot Rig Management Pvt Ltd* [2016] EWHC 2361 (Comm).

25 Section 47B(8) Competition Act 1998; Rule 78 Competition Appeal Tribunal Rules. See, e.g., *Coll v Alphabet Inc. & Ors* [2022] CAT 6.

26 Where a party argues that the other party should provide funds in advance in escrow for fear that they may otherwise be unable to fulfil the court's costs orders later.

27 See Schedule 1 and Schedule 4 to the Insolvency Act 1986.

28 Note Section 168(5) Insolvency Act 1986, which allows "any person aggrieved by an act or decision" of a liquidator, to make an application to court for the act or decision to be reversed or modified and see decision in *Re Edengate Homes (Butley Hall) Limited (in liquidation)* [2022] EWCA Civ 626.

29 E.g., *Acceleration Bay Llc v Activision Blizzard*, No. 16-453-RGA, 2018 U.S. Dist. LEXIS 21506 (D. Del. Feb. 9, 2018) at *6.

30 *Winterthur Swiss Insurance Company & Anr v AG (Manchester) Ltd & Ors* [2006] EWHC 839 (Comm).

31 In France, for example, a Paris Bar Council Resolution stipulates that lawyers are not to independently advise, discuss or meet with a litigation funder without the involvement of the underlying client. Conseil de l'Ordre, Paris Bar, Resolution of 17 February 2017. Available at: https://www.avocatparis.org/system/files/publications/resolution_financement_de_larbitrage_par_les_tiers.pdf. Practically, the funded party has to keep the litigation funder informed in such a scenario, and the funder would need its own counsel to receive any legal advice on the matter. Orders for disclosure of documents to litigation opponents are generally rarer in civil law systems. Even where made, they may allow refusal to disclose documents on a similar confidentiality basis as privilege in order not to undermine professional secrecy. For example, in Qatar, a court may decline to order disclosure if a party shows that it has a "legitimate interest" to withhold documents, which could include any duties of confidentiality the party owes such as between lawyers and third party funders. Article 233 of Law No. 13 of 1990, Civil and Commercial Procedure Code.

32 Other issues relating to a loan structure lie in whether the underlying claims need to be part of the collateral package *versus* a narrow collateral description which only encumbers litigation proceeds. See, Sepinuk, Stephen L., Identifying What Portion of a Settlement Payment is Proceeds of a Settlement, *The Transactional Lawyer*, Vol 10 (October 2020). Available at https://accfl.memberclicks.net/assets/docs/Transactional%20Lawyer%20%282020-10%29.pdf

33 IRS Rev. Rul. 2003–7, 2003-1 C.B. 363 (while the ruling addresses an VPFC in the context of a stock transaction, the elements described in the ruling are often cited as the factors required by the IRS to support VPFC treatment in the context of litigation finance arrangements).

34 See IRC Section 1234A.

35 IRC Section 1222(1), (3) prescribes the requirements for capital gain treatment, including that a capital asset must exist to receive capital gains treatment. See also IRC Section 1234A.

36 See IRC Sections 865, 871, 881 and 882. Importantly, the facts and circumstances of each litigation finance arrangement must be considered to reach the determination that a non-U.S. investor will not be subject to U.S. tax.

37 *Id.*

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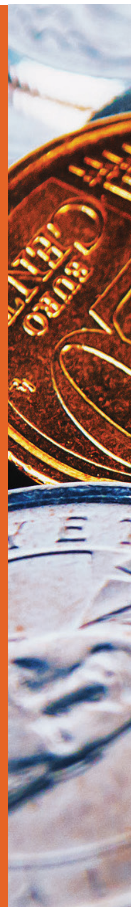

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