Exton Advisors

Myth Busting: DBA funding in practice

Tom Steindler · Wednesday, February 23rd, 2022

In our last blog post, we looked at the different alternative fee structures that law firms can employ and how they operate.

Today, we bring to life a typical Damages Based Agreement (DBA) to enable law firms to get a tangible sense of what the returns for them and their client look like in practice.

If a case is suitable for litigation funding, it generally follows that it could be suitable for the law firm to consider acting under a DBA.

The potential for the significant success fees that can flow from these outcome-based retainers is attractive to most law firms, but we often hear they cannot afford to take on the risk across several cases – or even on a single case.

To overcome this challenge, litigation funders and insurers offer various products that allow firms to offer DBAs whilst ensuring they receive an agreed level of fees, no matter the result in the case.

These allow the law firm the opportunity to share in the risk and reward of a claim with their clients, whilst hedging the downside in the event of a loss – a key factor allowing many firms to move forward with this type of arrangement.

Another benefit is the simplicity of the relationship between the law firm and the client, as the funding agreement is made between the law firm and the funder, whilst the client is not party to the agreement.

Single case financing for the law firm

In this scenario, the funder agrees to pay some of the law firm's fees, as well as disbursements, until the conclusion of the claim. Payment of 50% of the lawyer's usual hourly rate is typical.

This means the law firm receives some cash flow during the life of the claim whilst also taking a share of the client's damages if the case is successful. In commercial litigation cases, the law firm cannot take more than 50% of the damages award.

The funder's investment is typically non-recourse so if the claim is unsuccessful, they lose their investment.

Whilst structures can vary dramatically, the funding agreement is often structured so that the funder receives their investment back plus a multiple of their investment and/or a percentage of the law firm's contingent fee proceeds. The most suitable arrangement will vary depending on the value (or forecasted value) of the claim.

An Example Damaged Based Agreement

Let's take a look at the returns for each of the funder, law firm and client in an example DBA.

In this example, the law firm is acting on behalf of its client in a commercial litigation matter,

pursuing the counterparty for breach of contract. Damages are valued at approximately £75,000,000.

The law firm decide to take this case on contingency and agree to enter into a DBA, sharing the risk with a funder who agrees to cover 50% of the law firm's usual hourly rate, along with Counsel's fees and other disbursements. A budget of £2,500,000 is agreed and paid by the funder to the law firm as the case proceeds.

A 30% success fee is also agreed between the law firm and the claimant, with any success fee proceeds to be shared between the law firm and the funder. In this example, it is agreed that the funder will receive its invested capital back (£2,500,000) plus 2x the invested capital plus 25% of the remaining balance, with the remainder of the success fee going to the law firm.

At the conclusion of the case the client receives a damages award of £50,000,000. This means that there is £15,000,000 in DBA income (the 30% success fee).

The return of the funder's investment (£2,500,000) will usually take first priority in the waterfall and so will be the first item paid from the success fee. Next up is the funders 2 x invested capital plus 25% of the remaining balance totalling £6,875,000. The net income to the law firm then, which is the balance of the 30% success fee, is £5,625,000.

Let's look at the alternative for the law firm charging full hourly rate fees and no success fee. A total of £5,000,000 in fees and expenses (some of which will be counsel's fees and disbursements). With a DBA arrangement the law firm has earned a total of £8,125,000 (£2,500,000 in fees plus a £5,625,000 success fee) amounting to additional income of more than £3,000,000.

The final balance of £35,000,000 of the damages award is returned to the client.

Portfolio financing solutions

A portfolio arrangement enables multiple cases to be financed through a single facility agreement, often providing for a streamlined diligence process. Portfolios typically consist of a minimum of three or four cases which can either all be identified at the outset (and can each be at different stages) or added to the portfolio over time. The capital is used to pay a portion of fees or expenses as they are incurred.

There are various ways this can be structured and achieved, along with a sliding scale of commitment levels, but a key benefit is the fact that pricing can be significantly reduced in circumstances where the funders return is cross collateralised across several matters.

At Exton Advisors we are also able to structure innovative facilities which allow for portfolios of contingency fee matters to be built up over a period of time. For example, it might be that the funders pricing (success fee) starts at single-claim levels, but is reduced for each contingency fee matter that is added to the portfolio so that the firm quickly benefits from a lower cost of financing across the claims. We are also seeing credit agreements and other structured finance solutions create real options for law firms. The secret is to consider the options available on the market and to tailor the arrangement specifically to meet your client's needs.

Here we bring to life a typical Damages Based Agreement (DBA) to enable law firms to get a tangible sense of what the returns for them and for their client look like in practice.

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