

Public Markets for Litigation Finance

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Motivation

Litigation finance markets

- Litigants sell future proceeds of their legal cases to investors.
- The industry is worth USD 20 bil.,¹ attracting specialized litigation and hedge funds.

The problem

Financing may induce more frivolous lawsuits and more breakdowns of settlement negotiations.

Through which mechanisms does financing affect settlement bargaining?

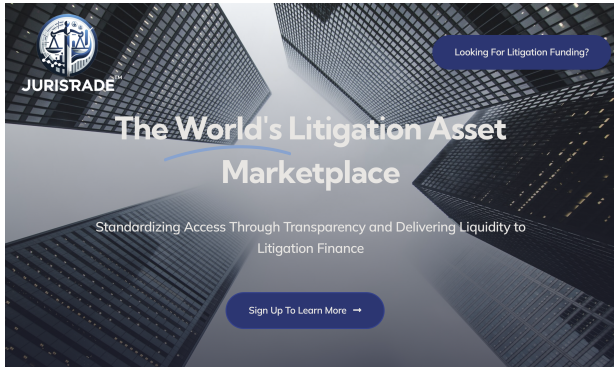
A potential solution

JurisTrade operates as a public platform for litigation. Public prices may inform bargaining.

Do public prices foster agreement?

¹ Annually, Research Nester (2025).

Industry background



JurisTrade website

Industry background

Financing contracts and agency problems

Non-recourse contracts allow investors to obtain a proportional share of net future proceeds, while litigants remain in control by law.

“[F]unders are incentivized to settle early for a discounted but secure amount [...]. And the plaintiff, who no longer bears the risk of a loss, may now have an incentive to resist a reasonable and rational early settlement [...].”

Steinitz (2013), The Litigation Finance Contract, William & Mary Law Review

Informative funding

Funders have data across many cases, and are better positioned to price claims than one-shot litigants. A public price is therefore informative.

Related literature

Litigation finance

Daughety & Reinganum (2014, AER); Spier & Prescott (2019, RAND);
Avraham & Wickelgren (2018, JLE); Antill & Grenadier (2023, JFE);
Dana & Spier (1993); Heyes, Rickman & Tzavara (2004); Choi & Spier (2018);
Landeo & Nikitin (2018); Grenadier & Grenadier (2026); Lera, Mahari & Strub (2023).

Financial contracting and bargaining

Perotti & Spier (1993, AER); Bolton & Oehmke (2011, RFS).

Information aggregation and real effects of financial markets

Hellwig (1980, JET); Admati (1985, ECMA); Bond, Edmans & Goldstein (2012, ARFE);
Goldstein (2023, RF).

Bargaining under incomplete information

Bebchuk (1984, RAND); Myerson (1984, ECMA); Cho & Sobel (1990, JET).

Preview of results

A unified framework with non-cooperative bargaining under risk aversion and endogenous financing in public markets with informative pricing.

Selling exposure to trial risk strengthens commitment and induces overselling, while more informative prices can increase issuance and the share of issues tried.

Contributions

- (i) Study public trading of litigation claims, a new development in litigation finance.
- (ii) Provide the first economic model to capture agency concerns raised in the legal literature.
- (iii) Examines the interaction of control rights and price informativeness

Settlement bargaining

We use the same bargaining environment throughout.

Environment

- Agents: plaintiff P , defendant D .
- Legal case: one issue, with defendant liability $\theta \in \{\theta_g, \theta_b\}$ and $\theta_g < \theta_b$.
- Information: liability θ is private to D , with $\psi = \Pr(\theta = \theta_g)$.
- Court award: $\theta + J$, where $J \sim \mathcal{N}(\mu_0, \sigma_0^2)$ is a common court factor.
- Preferences: CARA utility with parameter $\rho_j > 0$ for $j \in \{P, D\}$.

Settlement bargaining

- The defendant proposes a transfer in place of trial: $x \in \mathbb{R}$.
- The plaintiff accepts the transfer with probability $\pi \in [0, 1]$, otherwise the issue is tried.

Financing ("warm-up")

Consider the case with a representative investor.

Environment

- Agents: plaintiff P , defendant D , and a representative risk-averse investor I .
- Information: all agents share the prior $J \sim \mathcal{N}(\mu_0, \sigma_0^2)$. Only D observes θ .
- Actions: P makes a take-it-or-leave-it offer to sell a share $\gamma \in [0, 1]$ of Y to the investor at per-unit price p_{rep} .
- Asset:

$$Y = \begin{cases} x & \text{if the issue settles,} \\ \theta + J & \text{if it is tried.} \end{cases}$$

- Preferences: CARA utility with parameter $\rho_I > 0$ for the investor.

Timeline



Warm-up: Bargaining

The bargaining stage is a signaling game and exhibits a multiplicity of PBE.

Trial CE for a given type and belief: $\bar{x}_{P,\theta} = \theta + \mu - \frac{1}{2}(1 - \gamma)\rho_P\sigma^2$

Proposition 1

Fix γ and the common belief about J . The unique equilibrium surviving D1 is separating:

- Defendant bad type offers $x_b = \bar{x}_{P,b}$. Plaintiff accepts with probability 1.
- Defendant good type offers $x_g = \bar{x}_{P,g}$. Plaintiff accepts with probability

$$\pi_g = \frac{e^{\rho_D \bar{x}_{D,b}} - e^{\rho_D \bar{x}_{P,b}}}{e^{\rho_D \bar{x}_{D,b}} - e^{\rho_D \bar{x}_{P,g}}} < 1$$

Standard result: Asymmetric information leads to bargaining breakdown. → Legal friction.

Robustness: Our results hold under Random offer bargaining and Myerson neutral solution (1984).

Warm-up: Comparative statics

We consider the effect of changing the financing share γ .

Lemma 1

Both equilibrium offers rise and the acceptance probability falls in the financing share:

$$\partial_{\gamma} x_b > 0, \quad \partial_{\gamma} x_g > 0, \quad \partial_{\gamma} \pi_g < 0.$$

Intuition

- Offers: Selling lowers the effective risk aversion $(1 - \gamma)\rho_P$, raising the plaintiff's CE.
- Acceptance: π_g is set by the bad type's binding incentive constraint.

Key insight: Selling more γ commits the plaintiff to bargain tougher. $\rightarrow$ More legal friction.

Warm-up: Financing

TIOLI offer price with γ for investors: $p_{\text{rep}} = -\frac{1}{\rho_I \gamma} \log \mathbb{E}[e^{-\rho_I \gamma Y(\gamma)}]$

Definition 1

Holding the trial probability fixed, the risk-minimizing share is

$$\gamma_{\text{rep}}^{\text{risk}} = \frac{\rho_P}{\rho_P + \rho_I}.$$

Proposition 2

With the representative investor, the optimal share is unique and exceeds the risk-minimizing share: $\gamma_{\text{rep}}^{\text{risk}} < \gamma_{\text{rep}}$.

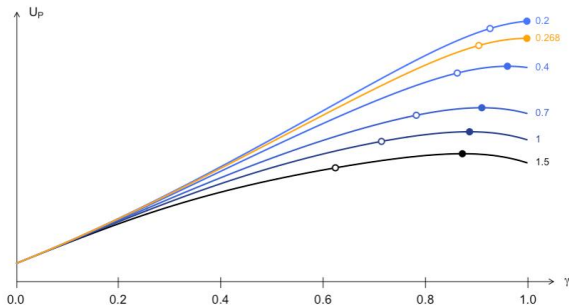
Key insight: The price penalty from overselling is dominated by the commitment benefit.

→ **A financial friction increasing the legal friction.**

Warm-up: Full sale

Proposition 3

For any upper bound $\bar{\gamma} < 1$, there is a unique threshold $\bar{\rho}_I$ such that the plaintiff sells the entire claim to the representative investor, $\gamma_{\text{rep}} = \bar{\gamma}$, if and only if $\rho_I \leq \bar{\rho}_I$.



- $U_P(\gamma)$ for several investor risk aversions ρ_I .
- Open circles: the risk-minimizing share γ^{risk} . Filled dots: the optimum γ_{rep} .

General case: Financing

The case now consists of a continuum of issues $k \in [0, 1]$.

Environment

- Agents: plaintiff P , defendant D , an underwriter, and a continuum of investors of mass 1.
- Liability: a mass ψ of issues has type θ_g and the remaining mass has type θ_b .
- Asset:

$$Y = \int_0^1 Y_k dk, \quad Y_k = \begin{cases} x_k & \text{if issue } k \text{ settles,} \\ \theta_k + J & \text{if it is tried.} \end{cases}$$

- Actions: P sells a share $\gamma \in [0, 1]$ of Y through the underwriter to the investors.
- Market information: investors observe $s_i = J + e_i$ with $e_i \sim \mathcal{N}(0, \frac{1}{\tau_e})$, and trade at p_{pub} .
- Noise trading: aggregate noise-trader demand $z \sim \mathcal{N}(0, \frac{1}{\tau_z})$.
- Investor preferences: CARA utility with $\rho_I > 0$ for the investors.

General case: Financing

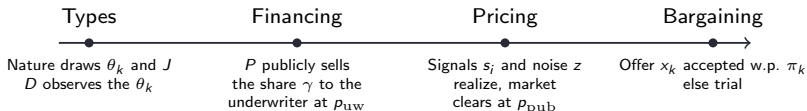
Environment (cont'd)

- Underwriting: with exogenous fee $\phi \in [0, 1]$ on revenue, giving plaintiff price

$$p_{uw} = (1 - \phi) \mathbb{E}[p_{pub}].$$

- Underwriter preferences: risk neutral (reduced form), and uninformed with prior (μ_0, σ_0^2) .

Timeline



Private market benchmark

The price is not known to the litigants. All else is equal.

Bargaining: Continuum case

We use symmetric issue-wise PBE, where there is no signaling across issues.

Lemma 2

Fix γ and a common belief $J \sim \mathcal{N}(\mu, \sigma^2)$. The structure of Proposition 1 survives issue by issue, where the share of issues that end in trial is $T = \psi(1 - \pi_g)$, and

$$\bar{x}_{P,\theta} = \theta + \mu - (1 - \gamma)\rho_P T \sigma^2,$$

and the proceeds are normal, $Y \sim \mathcal{N}(\bar{\theta} + \mu - (1 - \gamma)\rho_P T \sigma^2(1 - T), T^2 \sigma^2)$.

- Only the share T of tried issues carries the court risk σ^2 into the proceeds.
- The continuum removes issue-specific risk, so Y is normal and the market can be solved in closed form.

Public market: Financing

The public price reveals $\xi = J + (\rho_I/\tau_e)z$, and all agents update to $J \mid p_{\text{pub}} \sim \mathcal{N}(\mu_{\text{pub}}, \frac{1}{\tau_{\text{pub}}})$.

Lemma 3

Fix γ . There is a unique linear noisy REE with

$$p_{\text{pub}} = \bar{\theta} + (1 - T)(\mu_{\text{pub}} - (1 - \gamma)\rho_P T \sigma_{\text{pub}}^2) + T p_J, \quad p_J = \frac{\tau_0 \mu_0 - \rho_I T \gamma}{\tau_{\text{pub}} + \tau_e} + \frac{\tau_e + \tau_\xi}{\tau_{\text{pub}} + \tau_e} \xi.$$

The underwriter bears the pricing risk with $p_{\text{uw}} = (1 - \phi)\mathbb{E}[p_{\text{pub}}]$.

Definition 2

At a fixed trial mass, the share minimizing the plaintiff's cost of trial risk in the public market is

$$\gamma_{\text{pub}}^{\text{risk}} = \frac{\rho_P}{\rho_P + \tilde{\rho}_I}, \quad \tilde{\rho}_I \equiv 2\rho_I \frac{\tau_{\text{pub}}}{\tau_{\text{pub}} + \tau_e}.$$

Public market: Overselling

The plaintiff keeps the news risk on what he retains and pays the fee:

$$U_P(\gamma) = \mathbb{E}Y - \frac{1}{2} [\tilde{\rho}_I \gamma^2 + \rho_P (1 - \gamma)^2] T^2 \sigma_{\text{pub}}^2 - \frac{1}{2} \rho_P (1 - \gamma)^2 (\sigma_{\text{pri}}^2 - \sigma_{\text{pub}}^2) - \phi \gamma \mathbb{E}[p_{\text{pub}}].$$

Proposition 4

If, at $\gamma_{\text{pub}}^{\text{risk}}$,

$$\phi \mathbb{E}[p_{\text{pub}}] \leq \rho_P (1 - \gamma_{\text{pub}}^{\text{risk}}) (\sigma_{\text{pri}}^2 - \sigma_{\text{pub}}^2),$$

the plaintiff oversells relative to the risk-minimizing share, $\gamma_{\text{pub}} > \gamma_{\text{pub}}^{\text{risk}}$.

Key insight: Overselling survives if the fee stays below the value of news hedging.

Public market: Price informativeness

Consider the informativeness $\tau_\xi = \tau_e^2 \tau_z / \rho_I^2$ and the noise composition $\chi \equiv \tau_e / \tau_z$.

Proposition 5

Let γ_{pub} be interior and suppose $\rho_I < \rho_P$.

- (i) At a fixed χ , the share is locally strictly increasing in the informativeness of the price, $\partial \gamma_{\text{pub}} / \partial \tau_\xi > 0$, if

$$\gamma_{\text{pub}} \leq (2 - T_{\text{pub}}) / (2 + T_{\text{pub}}).$$

- (ii) At a fixed τ_ξ , the share is strictly increasing in the noise composition, $\partial \gamma_{\text{pub}} / \partial \chi > 0$.

Intuition (i)

- News: A more informative price induces more news risk, making selling more attractive.
- Trial: Less risky trials mean fewer settlements, eroding the value of commitment.
- When the share sold is small relative to the trial share, the news effect dominates.

Public market: Price informativeness

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$$\gamma_{\text{pub}} \leq (2 - T_{\text{pub}}) / (2 + T_{\text{pub}}).$$

- (ii) At a fixed τ_ξ , the share is strictly increasing in the noise composition, $\partial \gamma_{\text{pub}} / \partial \chi > 0$.

Intuition (ii)

- At fixed price informativeness, the trial risk and the trial mass are constant.
- A higher χ raises τ_e , so investors know more than the price reveals.
- Investors demand a lower risk premium to take on exposure, encouraging the plaintiff to sell more.

Effects on the legal system

Let c be the filing cost and G its cdf with full support on $\mathbb{R}$. Write G_0 , G_{pri} and G_{pub} for the masses filed without, with private and with public financing, and T_0 for the trial mass without financing.

Proposition 6

Suppose the plaintiff finances the case, privately or publicly. Financing then

- (i) increases the number of cases filed, $G_0 < G_{\text{pri}}, G_{\text{pub}}$,
- (ii) increases the share of issues that go to trial, $T_0 < T_{\text{pri}}, T_{\text{pub}}$.

Effects on the legal system

Proposition 7

More issues go to trial with a public market than with a private one, $T_{\text{pri}} < T_{\text{pub}}$,

(i) if and only if

$$\frac{\rho_D + (1 - \gamma_{\text{pub}})\rho_P}{\tau_{\text{pub}}} < \frac{\rho_D + (1 - \gamma_{\text{pri}})\rho_P}{\tau_{\text{pri}}},$$

(ii) if the price is sufficiently informative, $\tau_{\xi} > \tau_{\text{pri}} \rho_P / \rho_D$.

Intuition (i)

- The ordering depends on the ratio of overselling to informativeness.
- More informative prices make trial less risky. Selling more also increases commitment.

Effects on the legal system

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(ii) if the price is sufficiently informative, $\tau_{\xi} > \tau_{\text{pri}} \rho_P / \rho_D$.

Intuition (ii)

- More informative prices make trial more attractive to the defendant.
- To prevent the bad type from mimicking the good type, more trial is necessary.

Extension: Market selection

The plaintiff chooses the market before the financing stage.

Proposition 8

For a cap $\bar{\gamma} \in (0, 1)$, let γ_{pub} denote the public-market maximizer on $[0, \bar{\gamma}]$. If $\gamma_{\text{pub}} = \bar{\gamma}$, the plaintiff strictly prefers the private market whenever $\bar{\gamma}$ is sufficiently close to one.

Intuition

- Retained risk: Near full sale, trial risk and news risk on the plaintiff's stake vanish.
- Price information: Only the public price informs the litigants. It raises the trial mass and the investors' discount, so the private market pays more.

Conclusion

Financing hardens bargaining, increasing both case filings and trials.

Public prices inform litigants, but news risk can increase issuance and trials.

An economically rich environment of “corporate” control and financing.

Real effects of finance on litigants’ actions, with feedback into financing itself.

Extensions

- Investor attraction and syndication in private markets
- The effect of financing on equilibrium selection under the persuasiveness criterion

Extension: Syndication in private markets

Underwriter attracts mass of investors m at cost $\kappa(m)$

- Given γ , the underwriter chooses the mass m to maximize $\phi \gamma p_{\text{pri}} - \kappa(m)$.
- Market price: $p_{\text{pri}} = \mathbb{E}Y - \frac{\rho_I}{m} \gamma T^2 \sigma_{\text{pri}}^2$, each investor holding γ/m .

Let $\gamma_{\text{fix}}(m)$ be the plaintiff's optimum in a fixed-mass benchmark and $\gamma_{\text{sy}}^{\text{risk}}(m) = \rho_P / (\rho_P + 2\rho_I/m)$ the risk-minimizing share.

Proposition 9

Consider some equilibrium $(\gamma_{\text{sy}}^{\text{eq}}, m_{\text{sy}}^{\text{eq}})$. Suppose the fee ϕ is small enough that the plaintiff oversells at the fixed-mass benchmark, $\gamma_{\text{fix}}(m_{\text{sy}}^{\text{eq}}) \geq \gamma_{\text{sy}}^{\text{risk}}(m_{\text{sy}}^{\text{eq}})$. If $\gamma_{\text{fix}}(m_{\text{sy}}^{\text{eq}}) < 1$, the plaintiff sells strictly beyond his fixed-mass optimum: $\gamma_{\text{sy}}^{\text{eq}} > \gamma_{\text{fix}}(m_{\text{sy}}^{\text{eq}})$.

Key insight: The underwriter is incentivized to spread exposure of a riskier asset across more investors. Hence, the costly effects of selling a larger share are offset.

→ The plaintiff sells more.