Legal finance 101
An introduction to using third-party litigation finance to unlock legal asset value
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Burford Capital is a leading global finance and investment management firm focused on law. Its businesses include litigation finance and risk management, asset recovery and a wide range of legal finance and advisory activities. Burford is publicly traded on the London Stock Exchange, and it works with law firms and clients around the world from its principal offices in New York, London, Chicago and Singapore.

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Since opening its business in 2009, Burford Capital has been committed to educating legal and finance professionals about using third-party capital to transform how they think about, pay for and manage legal cost and risk.

Legal finance—also called litigation finance or third-party litigation funding—is no longer a new concept, but even with the continued and dramatic growth of outside financing for commercial litigation and arbitration, education remains a priority. Empowering our counterparties to better understand legal finance helps us add value beyond the capital we commit—one of the reasons clients often cite for choosing Burford.

In that spirit, we have collected some of our most popular previously published articles on legal finance in the pages that follow. We encourage you to use these resources, along with Burford’s blog and Quarterly publication on legal finance to stay abreast of trends and best practices—or better yet, please call us to discuss how we can be of help.
Legal finance 101: Key concepts

The use of outside capital in the legal industry is becoming increasingly widespread: Research shows that use of litigation finance increased 414% between 2013 and 2017, and our own business experience suggests continued growth. And yet many lawyers and clients still lack direct experience with a tool that a leading GC call “essential”.

Below, we offer a primer on what litigation finance is, how it works and other factors lawyers should consider.

**Defining litigation finance**

With litigation finance, a litigant or a law firm uses the asset value of commercial litigation or arbitration to secure capital from a third party, either to finance the litigation or for more general business purposes.

In its most common form, litigation finance is provided on a single-case basis to pay for costs associated with commercial litigation or arbitration (lawyers’ fees, case expenses, etc.) in exchange for a portion of the ultimate award or settlement.

Often, this approach fulfills the needs of clients who can’t afford or don’t want to pay their lawyers by the hour, or of law firms that wish to offer clients flexible terms but can’t or don’t want to assume the entire contingent risk of doing so. Rather than pressuring its law firm of choice to take on this cost and risk, or being forced to work with a different firm, clients are able to leverage litigation finance as a hybrid or “synthetic contingency” that bridges the gap between client and firm. And, rather than having to forego service to a client, law firms can use litigation finance to manage risk and as a even as a new business tool.

Increasingly, however, litigation finance is used in ways resembling specialty corporate finance, as businesses ranging from startups to the Fortune 500, as well as law firms of all types and sizes, use litigation finance to move cost and risk off corporate balance sheets, free up capital for other business purposes and improve accounting outcomes, risk management and financial reporting. A particularly fast-growing area of litigation finance is portfolio-based finance, where multiple matters (both claims by plaintiffs and defense matters responding to claims) are combined in a single cross-collateralized financing arrangement.
How litigation finance works

- A litigant or law firm seeking financing will engage with a finance provider that will consider commercial legal matters as financeable assets.
- The finance provider will use the value of those legal assets and receivables to craft financial solutions based on financing a single case, portfolios of multiple cases or structures that are custom to the client or law firm.
- The capital provided may be used to pay fees and expenses associated with a case, or for entirely different business purposes.
- Although terms and structures vary, Burford's capital is almost always non-recourse—meaning that we do not earn an investment return if the underlying litigation is unsuccessful.
- Financing can be provided at any stage of proceedings—from before filing to appeal, for legal receivables awaiting payment and for matters in which judgment requires enforcement.

The cost and timing of litigation finance

As a general matter, because financing is most often provided on a non-recourse basis, pricing for litigation finance will be in proportion to the level of risk. This may reflect the stage of the litigation, the type of matter, likely duration or another factor; like litigation itself, risk is idiosyncratic.

In assessing a potential investment, the finance provider’s diligence function—which at Burford is an in-house team of experienced commercial litigators—will consider the range of factors that make up its risk profile.

The finance provider will assess the potential value of the underlying legal assets to craft financial solutions alongside the investment needed; Burford's investments range from $2 million to well over $100 million. We are extraordinarily flexible and approach every investment with terms tailored to meet clients’ needs.

Any terms offered by a litigation finance provider will be highly specific to the underlying matter or matters. Indeed, litigants and law firms should be skeptical of any off-the-shelf terms offered prior to diligence, as these will almost always vary (sometimes significantly) from initial terms.

Litigation finance products can be simple or complex. Regardless, finance providers should be able to respond quickly to the most common needs, such as financing a single case where a client needs capital to proceed or a law firm wants to offer alternative fee arrangements without taking all of the risk. Another common solution is monetizing or accelerating receivables to help clients or law firms recognize a legal asset according to their desired timetable. Crafting portfolios and other complex structures requires more upfront input but can ultimately create valuable time efficiencies. (See more on timing in the next chapter, “Getting to Yes”.)

Common questions: Control, work product and champerty

Lawyers without direct experience often have questions about the finance provider.

The most important way to conceive the role of the litigation financier is as a passive outside investor who in no way alters the attorney-client relationship. Litigation financiers have no rights to manage the litigation in which they invest, and they do not seek to stand in clients’ shoes. Just as a leasing company does not tell you how to drive your car, the litigation financier doesn’t drive the litigation. Nor do they get any rights to control settlement of the litigation, which remains wholly in the litigant’s purview.

Lawyers also regularly ask about the interaction of litigation finance and the protection of attorney work product. Parties seeking financing often disclose work product to potential financiers; otherwise, it’s unlikely financing would be forthcoming. Fortunately, the courts have consistently confirmed that work product shared with a litigation financier under a confidentiality agreement remains privileged.

Lawyers may also ask about champerty, maintenance and barratry. The short answer is that these ancient legal issues either do not exist or do not interfere with litigation finance as practiced by Burford in the jurisdictions in which we provide financing.

Lawyers can be assured that the overwhelming legislative and judicial trend is toward greater acceptance of litigation finance. (For more detail, see articles on work product protection and control later in this publication.)
Getting to “yes”: How to secure legal finance

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Emily Slater is a Managing Director at Burford, which she joined in 2010. She has reviewed hundreds of complex commercial litigation matters. Previously, she was a litigator at Debevoise & Plimpton LLP, where she specialized in bet-the-company litigation and regulatory investigations involving trillions of dollars in damages.
It’s human nature to want to start a journey knowing where you’re going, how you’ll get there and when you’ll arrive. And this line of inquiry is typical of our initial conversations with clients and law firms about litigation finance, when we are often asked:

1. What are Burford’s investment criteria?
2. What do I need to do to secure financing?
3. How long will it take?

The journey to litigation finance is more straightforward than it may seem to those who are new to the practice. We work hard to make that journey clear, even as we recognize that securing non-recourse financing for multi-million-dollar, high-stakes commercial litigation requires expertise and effort. But we strive to create clarity around the process because, as our experience and research confirm, its absence can frustrate clients and firms seeking external capital.

Burford is unique in conducting the entirety of our diligence and investment process in-house. Our goal is always to complete the process as efficiently as possible. And regardless of the outcome, we strive in every interaction to create an understanding on which we can build in the future. In that spirit, we offer this guidance that we hope will be useful in “demystifying diligence” for both new and seasoned users of litigation finance.

What are Burford’s investment criteria?
The best candidates for litigation finance meet the following criteria:

**Type of matter:** We invest in complex commercial litigation at any stage, including antitrust, securities, fraud, contract, patent and intellectual property, trade secret and other business tort matters, as well as international arbitration and asset recovery.

**Strong merits:** We receive returns only when cases succeed, so we will carefully assess the facts and legal merits of a claim, starting with an operative complaint or written summary.

**Counsel:** We value cases led by experienced litigation counsel with successful track records and a strategic approach. During initial review, we confirm that counsel has been retained and has performed an analysis of the factual background and legal issues of the case.

**Jurisdiction:** We invest in matters filed or expected to be filed in domestic courts in a common law jurisdiction or in an internationally recognized arbitration center.

**Capital requirement:** Clients, firms and Burford get the best value when the amount requested is at least $2 million. Most of our investments are between $4 and $10 million, and some are significantly larger.

**Damages:** Damages must be supported by solid evidence of loss, and should be large enough to support our investment and returns with the client keeping most of the litigation proceeds if the case goes well. Although the ratio of investment to expected recovery varies depending on the case, for an investment of $2 million, the expected compensatory damages should be around $20 million.
What do I need to do to secure financing?

At Burford, we work hard to provide the best expertise and client experience in addition to the largest pool of available capital. Ultimately, we approach the investment diligence process as a collaboration, not a transaction.

Clients and firms seeking financing can aid the process in four important ways:

• **Prepare a realistic budget:** Matters in which we invest must have sufficient funding to get to the finish line. That requires a realistic, conservative budget through trial. The most frequent reason we reject good cases is that the ratio of necessary investment to expected return is too narrow. To confirm that the economics of the litigation investment are workable, we rely on our counterparties to provide clear budgets that do not assume early settlement.

• **Organize documents:** Active diligence requires our review of the key documents underlying the dispute as well as financial information about the businesses involved. We can work more efficiently when our counter-parties provide documentation quickly.

• **Be responsive:** The most important way that clients and lawyers can aid the process is to respond quickly to questions and document requests—a commitment we make to our counter-parties.

• **Understand the risk profile of the case:** Burford is in the business of taking risk, but we invest in cases that have strong risk profiles (acknowledging that Burford may have a different risk tolerance from finance firms or lawyers).

Some of the characteristics we look for include:

• The case does not turn on a “he-said-she-said” credibility determination
• There is more than one viable legal theory that could lead to a recovery
• The legal theory is tested and has good support in statutory or caselaw
• The case theory makes sense in the commercial context of the transaction or course of dealing
• The damages theory can be reasonably extrapolated from past performance of the damaged company or there is an established contract, statutory or royalty rate
• The economics of the investment do not depend on the case settling early or on obtaining treble damages

How long will it take?

The timeframe to secure litigation finance depends on a variety of factors. Although we have financed cases in a matter of a few days, as a general rule, if cases are well worked up and information is provided in a timely fashion, commercial matters typically take about a month from initial case review to investment. Patent matters typically take 30–90 days (with matters past PTAB or dispositive motion practice taking less time and patents that have not yet been tested taking more).

A variety of factors influence how long the overall process takes, including:

• **Client and firm:** Again, the responsiveness of clients and law firms in answering questions and providing documents is among the most significant factors

• **Stage:** Matters with fewer unknowns (e.g., matters on appeal) require the least time (as little as a week to 10 days); yet-to-be-filed matters require more time

• **Case type:** International arbitration and patent matters typically require more time

• **Single-case or portfolio:** When a “going forward” portfolio is in place, the diligence process for new matters can be completed extremely quickly; for law firms, that provides speed that can be a significant advantage in competitive situations
CONFIDENTIALITY

• Because we execute a confidentiality agreement as the first step of our diligence process, our communications with lawyers and their clients generally are protected from discovery by the work product doctrine.

• For an overview of caselaw affirming work product protection for communications with outside providers of litigation finance, call Burford or visit our blog.

• Out of an abundance of caution, despite the strong caselaw, we are circumspect about what we request in the diligence process to avoid any risk of waiver.

• We do not request materials that are protected only by the attorney-client privilege.

HOW BURFORD’S DILIGENCE ADDS VALUE

Client: Receives an independent assessment of risk—insights that can give reassurance of the strengths of a case or highlight potential areas of weakness.

Lawyer: Receives an economic analysis that includes the risk/reward of taking on the case—insights that can make the firm’s practice more profitable.

QUESTIONS TO ASK WHEN DILIGENCING FUNDERS

How much available capital does the financier have to invest?

Does the fund have a defined exit period or sunset date?

What are its sources of capital, and how reliable are those sources of capital?

How quickly can it provide a final term sheet? (Pre-diliegence term sheets are almost always revised.)

Does it conduct its diligence in-house?
Portfolio financing: How to reduce litigation cost and risk across multiple matters

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Craig Arnott is Burford’s Managing Director responsible for its investments in the UK, continental Europe, Asia and Australia. He was previously a barrister at Sixth Floor Selborne and Wentworth Chambers in Sydney, and Head of Competition/Antitrust at Fried Frank Harris Shriver & Jacobson in London.
Single-case funding remains the most familiar form of litigation finance, but portfolio financing has experienced dramatic growth in recent years—due in no small part to its tremendous value for law firms and corporates. As reported in Burford’s 2017 Annual Report, portfolio and complex investments represented 87% of new capital committed in 2017.

This growth in portfolio financing is indicative of a maturing in the field of litigation finance more broadly. When we started the business in 2009, the presumption was that third-party funding was a solution most suited to single case matters, particularly those where the defining problem was one of financial imbalance (e.g., the “David v. Goliath” cliche). Now we know better: Many firms and clients need solutions not only for singular instances of financial need but also for reducing risk and cost across a range of litigation matters. Portfolio financing addresses this need.

Research affirms the relevance of portfolio financing to firms and clients. The business challenge ranked most critical by GCs surveyed as part of the 2017 Litigation Finance Survey was the need for new ways to finance litigation and legal costs; for private practice lawyers, the top business challenge was the pressure to be more competitive in bringing in new business. Portfolio finance addresses both of these obstacles—by unlocking capital that corporates can use to move legal costs off balance sheets and that firms can use to enhance their readiness to pursue new business opportunities.

So, how does portfolio financing work, and when is it best used? What follows is a primer on portfolio financing—an area of opportunity for many of the firms and clients we talk to at Burford.

**What is portfolio financing?**

As the name implies, portfolio financing is defined as a single investment in more than one case. In this model, capital is provided to finance multiple matters with a law firm or with a client that has multiple cases with one or more law firms. As in single case financing, a portfolio investment is almost always non-recourse (i.e., if the underlying matters are unsuccessful, the upfront investment is lost).

**Do matters within a portfolio need to be related?**

There is no requirement that matters within a portfolio be related—in fact diversity is preferred (see below). When funding a law firm portfolio, the matters may be on behalf of one or more plaintiffs in related or unrelated cases. When funding a portfolio with a client, the matters will of course be on behalf of one client, but can involve multiple types of matters in related or unrelated cases—both plaintiff and defense.

**How many matters comprise a portfolio?**

A portfolio may range in size from as few as two cases to all of a firm’s cases on which it is taking some contingency or alternative-fee risk, or for a corporate client, multiple related or unrelated matters, including claims as well as defense matters.

**How may portfolio financing be used?**

Clients and firms use portfolio financing to pay for all or partial fees and expenses, for expenses only, or for unrelated business purposes. One of the many advantages of portfolio financing is the inherent flexibility to use the capital across a variety of different matters, where it is needed most. If, for example, it emerges that one matter warrants more spend than expected, the client or firm is free to use capital from a portfolio investment toward that case, as opposed to another.
Even more useful for law firms and corporates, a portfolio investment can be used in ways that benefit the overall business. The investment not only reduces exposure and risk—it also frees up capital that can be used for pressing business needs—like hiring or reinvesting in the business.

**What are the advantages of portfolio financing?**

Among the key benefits of portfolio financing are flexibility in the use of capital, as well as reduction in overall risk, which typically results in lower cost of capital (see more below).

For firms, portfolio financing can reduce contingency risk—which enables them to take on more contingency matters without increasing total exposure.

For clients, portfolio financing is particularly advantageous for managing the impact of litigation on balance sheets and risk profiles; this can be hugely powerful for publicly traded companies concerned with the negative accounting impact of litigation on EBITDA.

**What does a funder look for when financing a portfolio?**

From a funder’s perspective, an ideal multi-case portfolio investment is as diverse as possible, with mostly uncorrelated cases involving different parties, different subject matter and different courts. As in any investment scenario, spreading risk across a range of matters reduces over-exposure in any one area.

**How are portfolio investment terms determined?**

Burford’s terms for portfolio financing vary widely, depending on the number of matters included in the portfolio and the strength and stage of each case. As a general rule, Burford’s capital will be less expensive on a portfolio basis than financing would be for any single case in the portfolio. A diverse portfolio reduces somewhat the risk of total loss of the investment, thus resulting in opportunities to provide more funding and/or lower pricing.

Ultimately, Burford’s terms for portfolio or single-case financing are based on our clients’ needs. For example, if a client values certainty, we may structure our returns as a multiple of our investment or an interest rate based return as opposed to a percentage of proceeds, which cannot be known until resolution of the matter. With portfolios, returns are often staggered as cases resolve at different times, so an interest rate or IRR-based return may be preferable.

**What do typical portfolio structures look like?**

Again, portfolios are by definition unique to the needs of our counterparties. However, three common portfolio structures are described below.

- **Monetization portfolios**
  Monetization portfolios are suited to companies or law firms that are seeking substantial upfront capital to be used for legal fees and expenses or other operating purposes, and that have substantial existing books of litigation at a variety of stages in the litigation process.

- **Risk-share portfolios**
  Risk-share portfolios are suited to law firms that want to invest in new business or expand their portfolio of at-risk matters, or to clients that wish to pursue additional recoveries without exceeding their optimal risk profiles; clients or firms will use the capital to pay a portion of fees or expenses as they are incurred, generally with matters early in the case lifecycle (similar to traditional litigation finance); risk-share portfolios can be made up of existing cases or be “open” portfolios where new cases the firm takes on can be added to the portfolio over time.

- **Expenses-only portfolios**
  Expenses-only portfolios address the financial burden that paying case expenses out of pocket can place on firms that take on high-stakes commercial litigation on a contingency basis; many firms are willing to take risk on fees, but want to hedge on out-of-pocket expenses, which can be 25% of case costs and do not generate ROI; expenses become more burdensome as case duration and expense fees increase dramatically over time; an expenses-only portfolio can help a firm manage risk and cash flow associated with case expenses.

**Are there particular kinds of matters that are suited for portfolio financing?**

Ideally, a combination of high, medium and lower risk matters provides a diverse portfolio. With particularly high risk matters, like patents and international arbitrations, Burford may be able to offer better terms using a portfolio structure rather than single-case financing.
“Many firms and clients need solutions not only for singular instances of financial need but also for reducing risk and cost across a range of litigation matters.”
Accounting for litigation:
How legal finance improves the corporate bottom line

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Christopher Bogart co-founded Burford Capital and serves as its Chief Executive Officer. He was previously EVP & General Counsel of Time Warner Inc., where he managed one of the largest legal functions in the world, and a senior litigator at Cravath, Swaine & Moore. He currently is a member of the Board of Overseers of the RAND Institute for Civil Justice.
Before I was a lawyer, I was a banker. After college, I worked for what is now JPMorgan Chase and was “credit trained” in its internal boot camp to teach new recruits accounting and finance. But I soon saw the light, moving on to law school and spending many years as a complex-case litigator.

My point in sharing this personal history? That I was unusually financially literate for a young litigator. Even so, as an outside lawyer, I never paid the slightest attention to how my clients treated my fees and their litigation claims as an accounting and financial statement matter.

That changed when I became the global general counsel of Time Warner. My financial knowledge came to the fore—and I discovered why CFOs are allergic to lawyers in general and litigators in particular.

*The accounting treatment of litigation*

A bit of background is in order. When a company is owed money by someone, that almost always creates a balance sheet asset—a receivable. Money spent to collect that receivable is often added to its asset value, or capitalized, rather than flowing through the P&L and reducing profits. This makes sense for receivables, and many assets work similarly. If I have a clever idea for a new business, the money I spend pursuing it will also be capitalized. Instead of hitting the P&L, it will create an asset on the balance sheet.

Sadly, for reasons understood only by green-eyed members of the accounting profession, litigation does not follow these rules. Indeed, litigation claims receive precisely the opposite accounting treatment.

To start, as a company pursues a litigation claim, the money it spends doing so is not capitalized. Rather, it is immediately expensed, flowing through the P&L and reducing operating profits. Moreover, those expenses just vanish into thin air, as opposed to creating a balance sheet asset. Indeed, a pending litigation claim—despite having legal status as an asset, or a “chose in action”—is affirmatively not an asset for accounting purposes. It is found nowhere on financial statements or even in the notes.

To add insult to injury, when a significant litigation claim succeeds, the associated income from the claim is often not treated as operating income on the P&L. Instead, it’s put “below the line” as a non-operating or one-off item because, in the accountants’ view, litigating claims is not the core business of the company. This is bad on a number of levels.

*The business impact of litigation*

Obviously, companies want to maximize profits and minimize expenses. Taking on expenses as a litigation matter proceeds and then not later recognizing the income from the win is about as far away from corporate happiness as it is possible to be.
Moreover, investors and stock market analysts are by nature superficial. They have to be, in order to cover multiple, complex companies. Thus, they want to look at the balance sheet and see the company’s assets. When an asset isn’t there, they don’t credit it. And litigation claims don’t show up on the balance sheet, which means they are not credited by the market for their potential value. This accounting result makes no sense—companies show receivables on the balance sheet even when their collection is highly uncertain and deeply risky. Litigation claims are just the same, but the accounting rules make them invisible. That hurts companies with large, high-quality claims.

That’s not all. Not only does a company fail to create a litigation asset when it brings a claim, when it pays for lawyers directly it actually reduces its total asset value because the cash paid to the lawyers flows out of the cash account on the balance sheet... into oblivion.

**An alternative to paying for litigation on balance sheet**

It’s no surprise, then, that a significant reason our clients say they turn to litigation finance is to manage the adverse accounting impact of bringing litigation. Using litigation finance turns the accounting issues on their head:

- When a litigation financier pays the costs of proceeding, those costs do not flow through the company’s P&L, preserving the company’s profitability from its operations
- Working with an outside funder also enables the company to husband its cash to use for other purposes—and to avoid it flowing out of the company’s coffers and thus reducing its asset value
- As a result, when the company wins its claim, the very first time its financial statements are impacted by being a litigant is when it has a positive cash and income event

This obviously yields a far happier accounting outcome for clients. Yes, it comes at a cost: Burford’s capital is expensive—as is any funder’s. But keep in mind that the price tag reflects the fact that we absorb the ever-present risk of loss in litigation, and as any trial lawyer will tell you, there are no sure things in litigation. However, the benefits far outweigh the costs, which is why Burford has worked with more than 88 of the AmLaw 100.

Having a tool that can solve otherwise intractable accounting woes can make you a hero—to your CFO, or, if you’re an outside lawyer, to your client.
“Having a tool that can solve otherwise intractable accounting woes can make you a hero—to your CFO, or, if you’re an outside lawyer, to your client.”
Do the math: The cost of self-finance vs. outside finance of litigation

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Aviva Will is Senior Managing Director in charge of Burford’s underwriting and investment team and has reviewed many hundreds of billions of dollars’ worth of commercial litigation. She has particular expertise in antitrust and international arbitration matters, and in financing through bespoke portfolio models. Previously, she was senior litigation manager and Assistant General Counsel at Time Warner, Inc. and a senior litigator at Cravath, Swaine & Moore LLP.
In the course of Burford’s many years in business and after talking to thousands of lawyers about financing billions of dollars of fees and expenses associated with commercial litigation and arbitration, it’s been my experience that quantifying and comparing the relative costs and benefits of financing models is the most effective way to talk about legal finance. After “doing the math” the decision to use legal finance seems simple.

Clients and law firms that use litigation finance, who “get it,” are united less by their need for cash than they are by their understanding of the comparative benefits of working with a finance partner versus paying out of pocket. They understand that litigation finance is really just a specialized form of corporate finance.

The many variables associated with complex commercial litigation make it nearly impossible to provide off-the-shelf pricing, and no single comparison will apply to every scenario. However, for the purposes of educating in-house and law firm lawyers about the relative advantages outside financing versus self-financing, we offer the following hypothetical comparisons.

These four case studies include one client financing example and three law firm examples.
Case study: Company addresses negative accounting impact of litigation

ACME Co. is a company engaged in the manufacture, distribution and sale of widgets. Several of the company’s suppliers are acting as a cartel and have infringed on antitrust laws—so ACME Co. considers whether to bring a competition claim against its suppliers.

Given the type of case and the jurisdiction, ACME Co.’s general counsel estimates the total cost to litigate the claim to be $5 million spread over the course of five years, with an estimated potential recovery of $70 million in damages. By all accounts, ACME Co. has a viable, NPV-positive legal claim with strong legal merits, substantiated damages, defendants that can afford the judgment awarded and sufficient cost-to-damages ratio given the expected duration.

ACME Co.’s general counsel recommends moving forward with the claim. However, the general counsel’s budget is already under considerable stress, and ACME Co. also needs to consider the negative impact of litigation spending on ACME’s P&L and market value. Thus, ACME Co.’s external

### WITHOUT LITIGATION FINANCE

| 1 | Creation of a legal claim | Claim can’t be recorded as an asset on the balance sheet | The legal claim asset worth approximately $70 million cannot be recognized |
| 2 | Necessary legal expenditures | Costs can’t be capitalized, but must be expensed each period | Annual legal costs of $1 million, reducing ACME Co.’s operating profit by $5 million over five years |
| 3A | Successful claim | Seen as an exceptional event that isn’t core to the company’s business activities | The market reaction to the news is far less than hoped, but the company does have $70 million to redeploy in the business |
| 3B | Unsuccessful claim | Questions from the Board of Directors about the capital seemingly wasted on the unsuccessful claim | ACME Co. regrets that it pursued the claim on its own, shouldering the risk by itself |
counsel recommends the company consider using litigation finance. ACME Co. contacts a third-party litigation-finance provider, explains its case and receives the following proposal:

- The litigation finance provider will pay the entire cost of the $5 million budget
- In exchange, the litigation finance provider receives its outlay back and 25% of the net proceeds from the lawsuit, if successful

After receiving the proposal, the accounting team at ACME Co. conducts the following analysis:

**WITH LITIGATION FINANCE**

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<th>Step</th>
<th>Description</th>
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<td>1</td>
<td>Creation of a legal claim</td>
<td>Opportunity to monetize legal assets</td>
</tr>
<tr>
<td>2</td>
<td>Necessary legal expenditures</td>
<td>Up to 100% of legal costs covered</td>
</tr>
<tr>
<td>3A</td>
<td>Successful claim</td>
<td>Upside participation in the outcome if the claim is ultimately successful</td>
</tr>
<tr>
<td>3B</td>
<td>Unsuccessful claim</td>
<td>Downside exposure mitigated if the claim is ultimately unsuccessful</td>
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Litigation finance eliminates the need for ACME Co. to choose between sacrificing company profits or foregoing a valuable legal claim that will potentially bring a significant sum of cash into the business. Instead, ACME Co. can pursue a profit-generating legal claim while enabling the company to realign budgets so that more cash can be allocated to value-increasing activities—effectively turning the legal department from a cost center to a profit center.

ACME Co. no longer has to bear the cost of litigation and its negative accounting impact, and in addition, can invest the capital it would have used for legal fees back into growing the business.

ACME Co. reports better operating margins than it would if it were funding the legal claim itself.

ACME Co. receives net proceeds of $48.75 million, almost 70% of the original damages estimate.

No impact on corporate balance sheet because litigation finance provider bears cost, revenue neutral outcome.
Case study: Hourly firm takes on risk

A respected law firm that works almost exclusively on an hourly-fee basis is approached by the former co-owner of an international energy company with a breach of contract dispute after his former partners failed to share profits resulting from their venture. The firm thinks the claim has strong legal merits, and estimates potential damages at $70 million.

The potential client—which is talking to other, competing law firms—does not have the means to pay the firm’s hourly fees for the duration of the litigation. Firm management is unwilling to expose the firm to the risk of taking the case on full contingency, although it is willing to consider a reasonable discount to its regular fees with a corresponding uplift from any award.

The partner assigned to the case does not want to lose the opportunity to work with the client, and she contacts a third-party litigation finance provider.

She receives the following proposal:

- The law firm can accept the case on a fully contingent basis, and the litigation finance provider will finance $4 million of the $5 million budget, with the firm risking $1 million
- In exchange, upon successful resolution of the case, the litigation finance provider receives its investment back, the firm receives its $1 million investment and uplift and the finance provider receives the remaining contingency

After reviewing the proposal, the law firm determines that the financing arrangement bridges the gap between the firm’s hourly model and the client’s budget issues, enabling the firm to pursue a strong case that will add value to the business.

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<tr>
<th>WITHOUT FINANCING</th>
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<tr>
<td>The firm fails to work with the client</td>
<td>$0</td>
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<tr>
<td>$0</td>
<td>The law firm establishes a relationship with a new client and generates new business for the firm without upending its hourly model</td>
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Case study: Improving tax outcomes to increase firm profits

A law firm that does a mix of hourly and contingent fee work is approached by one of its existing corporate clients with a new case. Because the client has already exhausted most of its litigation budget for the year, the client asks the firm to take the case on risk.

Based on the case’s merits and expected damages, the firm decides that it is willing to risk its hourly fees. But the firm’s CFO has been exploring finance solutions to help the firm run more efficiently. The CFO has concerns about the negative tax implications of the firm’s practice of self-financing expenses. Unlike salaries and overhead, expenses are not tax deductible, meaning partners effectively cover the cost using after-tax dollars—ultimately reducing firm profits.

A litigation financier gives the firm CFO a proposal that will ease the burden of paying ongoing expenses while enabling the firm to keep most of its contingency from a successful case outcome:

- The litigation finance provider will contribute $3 million of financing to be used only to pay out of pocket litigation expenses
- In exchange, the litigation finance provider receives its outlay back and a 1.5x multiple return on its invested capital, collected only from future case proceeds

The financing frees up capital that the firm can reinvest in its business at year-end, as expected. But the firm’s CFO also recognizes another advantage of the arrangement: By dedicating outside capital to cover expenses, partners no longer have to contribute after-tax dollars to cover case costs—which (at a 39.6% top marginal tax rate) the CFO expects to increase firm profits by $5 million in the current year.

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<tr>
<td>The firm’s partners spend income from other cases to cover this client’s expenses</td>
<td>In addition to avoiding the risk of a $5 million loss on expenses, the firm preserves cash to distribute as profits and invest in firm, with added tax savings</td>
</tr>
<tr>
<td>$5 million in pre-tax income paid out by partners to cover $3 million for the current year’s expenses</td>
<td>Not having to contribute $3 million from profit results in a tax savings of $2 million</td>
</tr>
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</table>
**Case study: Contingency firm seeks efficiency**

A leading IP boutique has historically represented its clients on full contingency. But recent developments in the space have resulted in a heightened risk environment, making the firm reconsider its willingness to absorb pure contingency risk.

Concerned that the firm may soon have to choose between taking on too much risk or turning down good clients, a partner requests a proposal from a third-party litigation finance provider:

- The litigation financier will provide $15 million in non-recourse portfolio financing, which is half of the expected $30 million needed to pursue a portfolio of three IP claims with different clients, each with a total budget of $10 million and expected proceeds in excess of $150 million across the cases.

- With the IP boutique having secured a 40% interest in the proceeds of each case in exchange for full contingency arrangements, the litigation finance provider will receive 50% of the law firm’s contingent proceeds generated by the three cases.

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<th>OUTCOME</th>
<th>WITHOUT FINANCING</th>
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</thead>
<tbody>
<tr>
<td>Successful claim</td>
<td>The case entitles the IP boutique to its entire contingency</td>
<td>The case entitles the boutique to its fees plus a significant win</td>
</tr>
<tr>
<td></td>
<td>Total case proceeds of $150 million entitle the firm to $60 million</td>
<td>Resulting proceeds of $150 million entitle the firm to $45 million—$15 million in fees and $30 million in contingent proceeds</td>
</tr>
<tr>
<td>Unsuccessful claims</td>
<td>The firm spends years investing an enormous amount of its resources in the case</td>
<td>The firm mitigates its downside exposure by engaging the funder to bear half the costs</td>
</tr>
<tr>
<td></td>
<td>$30 million in firm resources must be written off as a loss</td>
<td>$15 million in revenue even if all three cases result in total losses</td>
</tr>
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</table>

The firm does the math and determines that financing enables the firm to mitigate 50% of its downside risk and generate $15 million in fees as the cases are litigated, all while giving up only 25% of its proceeds if the claim is successful ($15 million). Financing enables the boutique to fund legal fees and expenses for new IP matters, ensuring that the firm can balance its risk without sacrificing opportunities to continue growing its practice.

The financing arrangement also supports new business: With less of its risk tied up in these cases, the firm can pursue new business with competitive terms and further diversify its book of cases.
“After ‘doing the math’ the decision to use legal finance seems simple.”
Reimagining corporate legal finance: Innovation vs. cost-cutting

Mark Klein

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Mark Klein is General Counsel and is responsible for Burford’s global corporate legal initiatives and is based in New York. Prior to joining Burford, Mr. Klein spent 13 years at UBS in a wide range of corporate roles, including Managing Director and General Counsel of its Infrastructure & Private Equity business. Most recently, he was a General Counsel and Chief Compliance Officer at Marketfield Asset Management, a large US-registered investment adviser.
The cost-cutting corporate has, since the 2008 recession, become the reigning cliché in the legal world. According to the entirely cynical stereotype, the corporate’s aim is to cut costs, regardless of impact, and to squeeze law firm partners for discounts, regardless of benefit.

The cliché is unfair. And yet there is enormous pressure on corporates to manage legal costs—and that pressure has not decreased since the recession. It has become a permanent part of the legal landscape, and general counsel are now expected to be financially accountable just like any other function that reports to the CEO. The problem is that litigation, unlike most other corporate functions, is inherently unpredictable.

There are better and worse ways to manage litigation costs. The worse ways emphasize cost-cutting for the sake of cost-cutting, without regard to result, quality or performance. The better ways embrace innovation. Below are a few positive examples of what that innovation looks like. This trend broadly can be characterized as the evolution of litigation finance into full-fledged corporate finance.

*Moving costs off balance sheets*

Burford worked with a FTSE 20 company to craft a groundbreaking portfolio that provided $45 million in litigation financing. The financing arrangement encompassed a portfolio of pending litigation matters and addressed the need that companies of all sizes have for financial alternatives to paying by the hour for legal services.

The announcement of the deal was lauded for innovating how a corporate legal department manages litigation expense. Previously, the company had been paying for the significant legal fees and expenses associated with litigation out of its own revenues, thus reducing operating profits.

Burford sees continued appetite for this kind of transaction precisely because of the multiple corporate benefits provided by the structure of the arrangement. Among those benefits, the client can use Burford’s capital either to relieve legal expense budget pressure or for corporate purposes unrelated to the litigation matters. Additionally, capital is provided on a non-recourse basis, entitling the client to book it as income received, without waiting for the result of the underlying litigation matters.

More and more, in-house counsel see the value of innovating how they finance litigation, and deals like this show how easy and straightforward Burford can make it for them. Equally, financial executives are increasingly aware of the accounting and finance benefits of this approach, including the value of moving risk from corporate balance sheets, and the tremendous benefit of recognizing income from a claim when it’s advantageous to the business instead of when it’s convenient to the courts.
**Defense financing**

As inside lawyers—and CFOs and CEOs—know all too well, the costs of defending against litigation often interfere with the progress of the business. Defending litigation diverts money from doing things that will advance the business, destroys carefully planned budgets and hurts the P&L. What many legal and business leaders do not yet realize is that litigation finance works just as well for the defense of weak claims as it does for the prosecution of meritorious ones.

Sometimes, companies defending litigation ask their lawyers to consider an alternative fee agreement. But this doesn’t always work out—either because the firm is unwilling to offer a reduction in hourly fees, or else because the reduced rates simply aren’t attractive enough to the corporate client. When companies are defendants, litigation finance does exactly what law firms do with alternative fee arrangements, but with greater flexibility, paying the entire cost of defending against a weak claim in exchange for the same kind of multiplier or uplift based on predefined success. Financing defense claims works best as part of a portfolio-based structure which also includes proactive claims.

**Claims monetization**

Some businesses may not require external capital to fund ongoing legal matters and yet still benefit from litigation financing. Companies have the option to monetize pending legal claims to raise capital that can then be used for corporate purposes completely unrelated to the litigation.

As an example, an international power generation business had all of its assets in Bolivia expropriated by that government. The company had, and pursued, a good arbitration claim. But those claims take several years to adjudicate, and in the interim the company no longer had the cash flow from those former assets. The company did not need capital to pay its lawyers; rather, it needed capital to continue to grow its business. A litigation financing arrangement gave immediate value to a pending claim otherwise ignored by traditional capital sources such as banks. As a result, the company was able to continue growing its business while its case was ongoing.

**Conclusion**

Fundamentally, the modern general counsel is one-part lawyer and one-part business executive. Armed with a complete understanding of the financial implications of paying for litigation-related expenses out of pocket, an informed inside lawyer can explore financing arrangements that enable the litigation department to pursue meritorious claims, defend against unmeritorious ones and potentially generate income for the business. In short, by becoming familiar with all of the potential uses of litigation financing, savvy corporates are redefining success in the legal department.
“By becoming familiar with all of the potential uses of litigation financing, savvy corporates are redefining success in the legal department.”
Not all “funders” are created equal: What lawyers need to know—and diligence—about capital providers

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Katharine Wolanyk is Managing Director of Burford Capital, and leads its IP business as well as its Chicago office. Her experience spans the business, legal and engineering sectors, with roles including President of Soverain Software, an attorney at Latham & Watkins LLP and a systems engineer at Hughes Aircraft company. She writes and speaks frequently on IP issues, and was named a World’s Leading IP Strategist by Intellectual Asset Management (IAM) from 2015 through 2018.
Commercial litigation finance has seen explosive growth in the past decade as clients react positively to having more choices and more flexibility around managing litigation cost. That is all to the good and represents a long-overdue sea change in the legal market. But just as lawyers have needed to deal with many other changes and evolutions in their worlds as they continue to advise their clients, the move into litigation finance will require the kind of thought and investigation in which lawyers specialize.

Why must lawyers diligence these issues?

When working with litigation finance partners, clients need to focus on two fundamental issues.

First, in transactions when some capital is to be paid in the future, clients must be confident that capital will be available to them at the point when it is needed. This is fundamentally a question of structural diligence. Does the financier have its own capital, or does it need to get that capital from somewhere else? If the capital must be called, are the capital sources firmly bound to provide it, or are there any “outs” in their investment arrangements? Are the capital sources institutional, and are they “good for it”? It isn’t enough to believe a press release; it bears reminding that litigation finance firms (with terrific people and good reputations) have failed.

Second, even when capital availability is not an issue—such as when the client is receiving all the capital up front—clients need to focus on the size and structure of their financial providers to assess their stability and incentives and the materiality of the investment to them. This is important because if your transaction is material to the financier, there are inevitably contractual provisions in your arrangement that will—if it comes under pressure—permit the financier to act in a manner that may be inconsistent with your interests.

Why does scale matter?

Much of the media’s early focus has been on the sheer size of the market and its leading providers. Size is indeed important, and—as repeatedly affirmed by The Wall Street Journal and several others—Burford has led this industry in growth and is the world’s largest litigation finance provider by a considerable margin.

The reason size matters is that litigation investing is inherently risky. Some litigation cases will inevitably fail, regardless of how strong they appeared originally. Failures not only result in financial losses for the financier, but can affect investor confidence and continuing capital availability. If the investors in a callable capital fund get nervous about performance, they may well stop providing more capital, even if they have committed to do so.

Thus, it is highly desirable to work with a capital provider to which your transaction is not material—one with such a large and diversified portfolio that individual losses have ceased to matter. That doesn’t
necessarily mean that you should only work with the largest capital provider, but it does mean that you should think very hard about working with providers lacking sufficient scale to remain resilient if something goes amiss in their portfolio.

It is also important to understand a financier’s structure and capital strategies. Many capital providers run multiple distinct strategies with separate capital sources, even if they like to use their aggregate capital base as a headline number to try to demonstrate scale—but clients need to parse those claims. Only the provider’s size with respect to the dedicated capital relevant to you matters. This is just common sense, but it is all too often elided in the litigation finance space.

Publicly listed litigation financiers

There is an inherent benefit in working with a publicly listed litigation finance firm: You are easily able to analyze the firm’s audited financials and diligence the financial condition and the scale of your counterparty—in contrast to private firms that choose not to provide verifiable information about their finances and operations. Burford—listed on the London Stock Exchange—elected to be public for just those reasons of transparency, and it is easy to compare asset size and market capitalization among public firms.

Listed companies function as conventional operating businesses with perpetual life and our own balance sheets. Our capital is ours permanently; we do not need to give it back to investors. We are audited by Ernst & Young and, as a listed firm, when we make public statements about size or returns, we take on securities liability for the accuracy of those statements.

Private “institutional” funds

The next layer of litigation finance capital comes from dedicated firms that hold themselves out as having capital from institutional investors, that are organized along private equity fund principles and that are registered with and regulated by securities regulators like the US Securities and Exchange Commission or the UK Financial Conduct Authority.

There are a number of these firms in the US and UK. The common thread of these firms is that they are regulated by their local securities regulator (for the benefit of investors, not users of their capital).

Among the fundamental differences between these firms and publicly listed firms is that private fund managers speak in terms of “assets under management” or “AUM.” That is a term of art in the private funds world (indeed, there is a lengthy

“We are now well beyond the time when litigation finance was considered a new concept, and lawyers are fortunate in having many choices of finance partners.”
definition of AUM promulgated by the SEC) and it most certainly does not equate to real assets of the kind that listed firms have on their audited and publicly disclosed balance sheets.

There are other important points to note about private funds:

• Funds tend to have a finite period of time in which to invest the capital committed to them (the “investment period”), after which the capital is no longer available
• Funds are, by their nature, not permanent—they return capital to investors and terminate; new funds are only raised if both the manager and the investors desire
• Commitments are of a fixed amount, and once all spent, the fund is done and there is no ability to draw more capital from investors—even if a case needs more money
• Once done, a fund is gone, with nothing left to satisfy liabilities (such as adverse costs or indemnities)

There is nothing wrong with a private fund structure—many hundreds of billions of dollars are invested around the world in such structures. But careful diligence is needed.

Private unregulated funds

There are also a number of “funders” that are not registered with the SEC or the FCA, and these firms tend not to provide any public information about their structure, size or capital base.

Without conducting extensive diligence, clients simply cannot know how they stand vis-à-vis such firms. Having a charming and well-pedigreed client-facing representative does not translate automatically into financial reliability. Some such firms rely on personal, private capital or ad hoc capital sources. Lawyers advising clients need to be particularly vigilant when dealing with such firms to meet their basic professional obligations to their clients.

There is no competitive advantage to secrecy, so lawyers must presume that a firm that declines to provide verifiable information publicly about its financial reliability likely has something to hide.

Brokers

In addition to capital providers, the litigation finance industry has attracted a number of brokers, some of whom act simply as professional go-betweens. Others make the role more opaque, suggesting they have capital themselves (when in fact they go out and seek piecemeal capital once they have landed an assignment). Because litigation finance is not itself traditionally regulated, intermediaries are not regulated either, unlike, for example, broker dealers in the US and litigation insurance brokers in the UK. There is no industry norm around the use of brokers or the amount and payment of their fees; most of our transactions do not involve them. Any interaction with a broker needs to be the subject of diligence and clear agreements.

Making the right choice

We are now a number of years beyond the time when litigation finance was considered a new concept, and lawyers are fortunate in having many choices of finance partners. They are also duty bound to make the right choice for their clients based on careful diligence. We regularly suggest that litigators involve their corporate and funds colleagues in transactions and increase their level of diligence. No one wants to be the lawyer who steers a client towards the next financial disaster. Lawyers—whether as principals or representing clients—need to focus on these issues more than we generally see occurring in this new and more complex world of law and finance.
After we say yes: How case monitoring works

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Christopher Catalano is a Director of Burford's underwriting and investment arm. Based in New York, he oversees the management of Burford's legal investments. Prior to joining Burford, Mr. Catalano was a Vice President and Assistant General Counsel at JPMorgan Chase & Co. He has been a litigator at Kirkland & Ellis, Wilson Sonsini Goodrich & Rosati, and O’Melveny & Myers.
Burford devotes great resources to shepherding a potential investment from initial client contact to signed capital provision agreement. Prior Quarterly articles have described the process of “getting to yes” in detail, including the legal and financial risk assessment and terms negotiation undertaken by our underwriting team. But the law firms and companies we fund are also understandably eager to understand what happens “after we say yes”—and although Burford is by definition a passive capital provider, we devote significant resources to monitoring our investments. I offer below an overview of our approach to case monitoring, with the caveat that it is not an entirely routine process. Litigation by its nature does not move quickly. Cases may resolve at idiosyncratic and unpredictable times, or they may unfold entirely predictably. Either way, once Burford invests, we are in an ongoing business relationship that requires regular care and tending. Done well, case management and monitoring can help us maximize returns and develop stronger relationships with counterparties. Through this additional effort that occurs post-closing, we can improve results for our counterparties and investors by being prepared for case events before they occur, rather than reacting when it might be too late. Indeed, Burford’s ability to be flexible and to add value “after we say yes” is a benefit of working with us and sets us apart from more transactionally-minded “funders.”

**What to expect during case monitoring**

In monitoring the progress of the case, the team at Burford does the obvious things such as receiving electronic docket notices and reviewing the pertinent filings. We track court deadlines so that we know what the lawyers and court are doing and when. We draft monthly summaries of the investment’s status and prospects that are reviewed by senior Burford management and quarterly ones that are reviewed by Burford’s board of directors. We also do less obvious things, like speaking at least monthly with our counterparties about how the case is shaping up substantively, about what challenges they see ahead, and about ideas for successfully resolving it. We regularly offer to (and do) comment on draft briefs. We join the panel on moot courts for motions or appeals. In short, we provide expert eyes and ears that can be beneficial for the case. Where some litigation...
finance providers ask for superficial, procedural status updates from their counterparties, we dig in and do our own substantive analysis so that we have the most complete possible picture of where the case is headed and when and on what terms it may be resolved.

But we do not foist ourselves upon our counterparties. Some of our counterparties may wish simply to provide the fairly minimal information required by our agreements. Others, however, actively seek out and benefit from our assistance. For example, we have participated in moot courts where the judges that ultimately heard the case asked the same hard questions that we’d asked and for which we’d helped the lawyers prepare.

We also track the legal spend and compare it to the stage that the case is in. Whether we fund all the capital at closing or fund tranches over time, the money we provide is the fuel that powers the litigation claim from which we hope to achieve our return. If discovery has just started and the lawyers have spent half the commitment, that’s a problem. We try to head off those issues before they arise by regularly reviewing legal bills and consulting with the counterparty on how they plan to bring the case to a successful conclusion with the money that has been allocated. Indeed, while we and our counterparties try to agree upon sufficient capital commitments during the underwriting process, budget management is not something that comes naturally to most lawyers. We can and do help them. For example, we do not wait for the lawyers to ask for more money—by then, it can be too late to avoid contributing capital that may not make economic sense.

Case study: Helping an insolvent estate maximize its assets

Monitoring and communication with the client can pay dividends to all concerned. In one of our now-resolved portfolio investments, our assistance in managing the budget helped the client resolve the cases effectively and profitably. We were funding the trustee of an insolvent estate. The estate had a pool of money, some claims against third parties, and some claims against the estate. Our capital funded the trustee’s administrative costs as well as legal fees and expenses in litigating the affirmative and defensive claims. Because there were ten different matters that evolved at different rates and pertained to different subjects, we were able to consult with the trustee and its lawyers on reallocating budgets from those cases that had resolved or where money would not be as well spent, to those that would give all concerned the most “bang for the buck.” Having resolved or de-prioritized the less consequential matters, the trustee focused its efforts on resolving the remaining big-ticket claim against the estate, reaching a settlement that paid our return and took the trustee off risk. At bottom, this kind of consultation stems from seeing the claim as an asset that can be effectively—or ineffectively—turned into money.
CASE MONITORING TOOLS

Burford uses tools to monitor and manage our investments and add value for our counterparties:

• We offer our consulting expertise at critical junctures

• We help counterparties keep an eye on how to use the money spent on a case to maximize potential returns

NO CONTROL OVER CASES

For the vast majority of our investments, we are a passive capital provider and do not manage the underlying claim.

• We do not direct our counterparty to settle a case

• We do not direct our counterparty to settle a case for a particular amount

• We do not withhold contractually required funding

CASE MONITORING TEAM

Fundamental to good case monitoring is an expert team committed to an ongoing business relationship with our counterparties.

• The person who underwrote the case is responsible for day-to-day investment monitoring

• More senior staff provide assistance and coaching

• All of Burford’s underwriting and investment team are seasoned litigators with relevant expertise
A Vice President of Burford’s underwriting and investment arm in New York, Andrew Cohen was a litigator at Debevoise & Plimpton where he specialized in litigation and regulatory matters involving financial institutions and complex products, as well as IP matters relating to trademark disputes.
In recent years, the law has even more strongly reinforced the protection under the work product doctrine of documents created in connection with litigation finance, or produced to litigation finance providers over the course of diligence and investment.

The work product doctrine, generally speaking, protects from disclosure any materials prepared in anticipation of litigation. As a policy matter, it makes perfect sense: To allow a litigation opponent to obtain an adversary’s work product is inimical to the adversarial system as a whole. The protection is so fundamental that, in comparison to the attorney-client privilege, which is typically waived upon disclosure to any third party, the work product protection survives disclosure to third parties, provided that the disclosure does not substantially increase the opportunity for an adverse party to obtain the protected materials.

As applied to the litigation finance context, the analysis is simple. A party seeking financing must provide diligence materials to the potential financier in order to convince the financier that the litigation merits an investment. Those materials, typically, are subject to the work product protection, because they were created for and provided to the potential financier as a consequence of the litigation. Similarly, the deal documents embodying a finance transaction were created because of the litigation, and the terms of such agreements reflect the information provided in work product protected documents, such as lawyers’ mental impressions, theories and strategies about the underlying litigation. It follows that documents provided to and created by litigation financiers in the course of diligencing, closing and monitoring a finance transaction should be protected by the work product doctrine. The alternative would create a world where a party needing financing would be faced with a Hobson’s choice of either obtaining the desired capital and turning over its work product to its adversary or foregoing the capital in order to protect its trial strategy and its lawyers’ mental impressions.

As we noted in 2015—and it is even truer today—courts that have considered these issues have overwhelmingly found in favor of extending the work-product “umbrella” to litigation finance providers, and have protected work product provided to litigation financiers from disclosure to adversaries. In addition to the Devon, Mondis, Walker Digital, Miller, Carlyle, and CIT cases we have previously discussed in these pages, a number of decisions have come down recently further solidifying the work product protection as applied to litigation finance documents.

“Courts that have considered these issues have overwhelmingly found in favor of extending the work-product ‘umbrella’ to litigation finance providers.”

In the IOTC case (In re: Int’l Oil Trading Co., LLC, No. 15-bk-21596 (S.D. Fla. Bankr. Apr. 28, 2016) (order granting in part and denying in part third motion to compel)), a bankruptcy court was faced with motions to compel discovery relating to communications between a creditor and the creditor’s litigation funder (the bankrupt entity was a judgment debtor who had avoided payment for five years). In addition to finding that the communications were protected by the attorney-client privilege (despite the presence of the third-party funder, who was deemed in this situation to share a common interest with the creditor), the court also held that the communications were protected by the work product doctrine. The court explained that communications relating to litigation finance are a link in the chain “in furtherance of rendition of legal services” and thus subject to work product protection. Similarly, the litigation funding agreement itself was subject to work product protection, “as it was entered into with the intent to facilitate litigation.”

The court in Viamedia (Viamedia, Inc. v. Comcast Corp., No. 16-cv-05486 (N.D. Ill. Jun. 30, 2017) (order denying motion to compel)) followed the long line of cases holding that documents disclosed in the course of securing litigation finance remain subject to the work product protection. In denying the motion to compel discovery, the court observed that “while Defendants point out that funders could disclose information to certain individuals and organizations (e.g., their accountants and attorneys), the Court cannot conclude that Viamedia’s disclosure made it substantially more likely that its work-product protected information would fall in the hands of its adversaries.”

This is an important thread that runs through the work product jurisprudence: “[T]he point of the protection is not to keep information secret from the world at large but rather to keep it out of the hands of one’s adversary in litigation.”

More recently, in the Lambeth case (Lambeth Magnetic Structures, LLC v. Seagate Tech. (US) Holdings, Inc., No. 16-cv-00538 (W.D. Pa. Dec. 19, 2017) (order denying motions to compel)), the court extended the work-product protection to communications with potential litigation financiers in the period of time leading up to litigation. Unsurprisingly, the court found that the communications with litigation financiers were for the purpose of preparing for litigation. And because the communications “took place during a period when Lambeth actually and reasonably foresaw litigation,” the protection applied.

One reminder of the legal maxim “hard cases make bad law” is the recent order in Acceleration Bay LLC v. Activision Blizzard, Inc., No. 16-cv-00453 (D. Del. Feb. 9, 2018), in which a court upheld a Special Master’s order allowing discovery into the plaintiff’s communications with a prospective litigation funder, over work product objections. The facts here are messy: Defendants alleged that plaintiffs at first failed to log documents relating to litigation finance, despite a previous order requiring them to be produced. The conversations occurred, according to the court, prior to the litigation having been filed or even the underlying patents having been acquired by the plaintiff, and the court makes no reference to an operative non-disclosure agreement. Perhaps in its eagerness to reach a certain outcome on these facts, the court compounded the bad facts by applying the wrong standard to determine whether the communications were work product—the “primary purpose” test (which applies in the Fifth Circuit) rather than the “because of litigation” test (which applies in the Third Circuit). The result is an outlier opinion, in conflict with the law of the court’s own circuit, and in conflict with other Delaware courts. Outliers notwithstanding, a wealth of caselaw has time and again demonstrated that litigation finance fits squarely within the work product protection. This is the right result as a policy matter, and it is a result that should give comfort to litigants and counsel pursuing litigation finance.
DECISIONS CITED:


Control: A common question about legal finance

David Perla

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David Perla is a Managing Director responsible for overseeing Burford’s global origination and marketing efforts and is based in New York. An entrepreneur and legal industry leader with expertise in building high-growth legal and technology-driven businesses, he was named a Top 50 Innovator of the Last 50 Years by The American Lawyer.
Among the handful of what I would call “peace of mind” questions that lawyers new to commercial litigation finance routinely ask me when they are considering financing for their clients or their firms, probably the most common is some form of the following: “What impact does working with a provider of litigation finance have on control of litigation and settlement decisions?”

I’m pleased to be able to answer, very simply, “None.” As a provider of commercial litigation finance, we exert no control over litigation related decisions or settlement. Control of these decisions remains precisely where it belongs: With the client.

Questions about control have arisen more frequently in recent years for a variety of reasons. The first reason is a happy one: Use of commercial litigation finance has grown significantly. Lawyers trying a new tool are understandably eager to inquire about its impact, and the data suggest that lawyers are indeed acting out of caution rather than fear. For example, only one out of four US lawyers surveyed who have never used litigation finance in the past cite concern about loss of control as a reason not to use it in the future; a far more typical concern is whether lawyers believe they have matters suitable for financing.

However, there’s another less happy factor driving the discussion of control, and that is the willful misuse of this topic as the justification for unnecessary disclosure of litigation finance, almost exclusively by the US Chamber Institute for Legal Reform (ILR), a separately incorporated affiliate of the US Chamber of Commerce.

Without the benefit of facts, the ILR argues that providers of litigation finance “anonymously ‘pull the strings’ of a lawsuit,” in the words of Lisa A. Rickard, its president. This asserted control serves the purpose of seeming to justify the ILR’s advocacy of mandatory and comprehensive disclosure of litigation finance in all civil litigation—not just the fact that financing is being used but also the identity and terms of the financing provided. Not only is there no rationale for mandatory disclosure of litigation finance to single claimants in commercial litigation—it’s also clear that doing so would result in a less just, more costly and burdensome judicial system. Anyone who has spent time in courtrooms where high-stakes commercial matters are being litigated has witnessed demands for disclosure of irrelevant information as a mechanism of delay, frolic and detour. Mandatory disclosure would make the problem worse—adding to the extraordinary cost of litigation and slowing down an already overburdened system.

Thus, in addition to ensuring that lawyers new to litigation finance understand that loss of control is not an issue about which they should be concerned, it’s also essential to ensure that control is not falsely exploited to justify unnecessary disclosure. For both these reasons I explore the issue in depth below; although I speak from the US perspective and cite its rules, the same lessons apply in other jurisdictions in which Burford operates.

In litigation finance, control resides with the client

When a client or a law firm decides to work with Burford as a litigation finance provider, doing so does not in any way impact control. Burford is never in control of the litigation, and each deal is set up to make that explicit. We do not control strategy, settlement or other litigation-related decision-
making. We may not direct our counterparty to settle a case at all, or for a particular amount. We may not withhold contractually required funding for strategic reasons. We are passive investors, again almost always on a non-recourse basis, meaning that our return depends upon the successful outcome of the relevant matters.

This is very different than the role played by another type of financial provider that does exert control: Insurers. In commercial litigation, insurers set limits upon settlement outcomes and thus often control litigation-related decision making for the defendants they insure, something that providers of commercial litigation finance do not do. Even before Federal Rule 26 was amended in 1970 to require disclosure of indemnity insurance policies, in many cases plaintiffs and judges simply assumed that final say over settlement did not lie with the defendant, but its insurer. (See Fed. R. Civ. P. 26(a)(1)).

Because we do not control the litigation, but risk losing our investment in the event of a bad outcome, we are of course very careful in our investment decisions, and therefore our diligence process—the process we go through before committing capital—is critical. In addition to evaluating the merits of a claim, we also evaluate the merits of the other players in the case. For example, we consider the quality of counsel and the motivations of the client. We must be confident in counsel's ability to pursue the case and comfortable with the client controlling the course of the litigation. Whether or not we end up committing capital, clients and law firms often find that our diligence process helps them better understand and manage their legal assets. Lawyers and clients report that the second look from a neutral and experienced team often serves to strengthen their case.

Once we make the decision to invest in matters, we structure deals that keep control with the client (unless we are expressly purchasing a claim in jurisdictions where that is permitted, which of course includes the right to control its prosecution). Because we do not control the legal assets in which we invest but stand to lose our investment if matters are unsuccessful, in addition to being highly selective, we also structure deals to incentivize all parties to make rational decisions.

*If control is not at issue, why is it still an issue?*

Again, as a commercial litigation finance provider, we exert no control over litigation related decisions or settlement. Control of these decisions remains wholly with the client.

This seems a simple answer to the question of control—and yet, control is a topic we are frequently called upon to address. While we stand ready to educate clients and lawyers about working with Burford and our peers, and to put their minds to rest about this and any other perceived obstacle to using litigation finance, the ILR's unrelenting attempts to exploit the issue of control are in a different category. Let’s be clear: The ILR is opposed to litigation finance because it is opposed to litigation, including meritorious litigation. Having utterly failed to make the case for getting rid of litigation finance, it has focused on making litigation finance more burdensome to use. That is why it has strenuously lobbied for mandatory disclosure of litigation finance in all civil litigation, and that is why it continues to seek to exploit the issue of control—regardless of its failure ever to cite a single example of commercial litigation finance in the US where control was an issue.
With $3.3 billion invested in and available to invest in the legal market, Burford and its staff of over 100 works with law firms and clients around the world.

Lawyers choose Burford because we have more capital and more capacity to invest quickly and efficiently than any other firm in the industry. We utilize a respected team of more than 50 lawyers who are experienced, fast and easy to work with.

We benefit from a lower cost of capital that we pass on to firms and clients, and we’re publicly traded and trusted as a strategic partner that always acts with consummate professionalism.

Please contact us to learn more. Email any of our staff at firstinitiallastname@burfordcapital.com.
Formal Opinion 2018-5: Litigation Funders’ Contingent Interest in Legal Fees

TOPIC: Law firm finance; obligation to avoid fee-splitting with nonlawyers.

DIGEST: A lawyer may not enter into a financing agreement with a litigation funder, a non-lawyer, under which the lawyer’s future payments to the funder are contingent on the lawyer’s receipt of legal fees or on the amount of legal fees received in one or more specific matters.

RULES: 5.4(a)

QUESTION: May a lawyer enter into a financing agreement with a litigation funder, a non-lawyer, under which the lawyer’s future payments to the funder are contingent on the lawyer’s receipt of legal fees or on the amount of legal fees received in one or more specific matters?

OPINION:

This opinion addresses whether the New York Rules of Professional Conduct (the “Rules”) permit a lawyer to enter into an agreement with a litigation funder, a non-lawyer, under which the lawyer’s future payments to the litigation funder are contingent on the lawyer’s receipt of legal fees or on the amount of legal fees received in one or more specific matters. For the following reasons, we conclude that such an arrangement violates Rule 5.4’s prohibition on fee sharing with non-lawyers.

I. Background on Litigation Funding

In the litigation-finance industry, entities (often referred to as “litigation funders”) extend financing to litigators or their litigation clients under which repayments are contingent on the outcome of the litigation. The number of lawyers and clients benefitting from litigation funding has increased substantially over the last several years. It is now common for litigants and their lawyers to contemplate or obtain litigation funding. Without litigation funding, some lawsuits arguably could not be filed or maintained. In this respect, litigation funding may expand access to the courts to litigants who would otherwise be financially unable to pursue their legitimate claims. Litigation funding may also advance fairness by levelling the dispute-resolution field between parties with deep pockets and those with limited resources.

Prior opinions of this and other ethics committees have addressed litigation funding arrangements between the funder and the client. Under typical client-funder arrangements, the funder agrees directly with the lawyer’s client to provide funding for a specific matter and the

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client agrees to make future payments if the client prevails. When the client is the plaintiff in a civil lawsuit, the amount of the client’s future payments to the funder may depend on the amount of the client’s recovery. Client-funder arrangements of this nature do not implicate Rule 5.4, which forbids a lawyer from sharing legal fees with a non-lawyer, because the lawyer is not a party to the arrangement and payments are made by the client out of the client’s recovery and do not affect the amount of the lawyer’s fee. See NYCBA Formal Op. 2011-2 (2011) (“It is not unethical per se for a lawyer to represent a client who enters into a non-recourse litigation financing arrangement with a third party lender.”); see also NYSBA Ethics Op. 666 (1994) (lawyer may refer client to lender who will commit to provide financial support during pendency of case).³

This opinion, however, addresses litigation funding arrangements between the funder and the lawyer or law firm. Lawyer-funder agreements may take various forms. As discussed below, the fee-sharing rule does not forbid a traditional recourse loan requiring the lawyer to repay the loan at a fixed rate of interest without regard to the outcome of, or the lawyer’s receipt of a fee in, any particular lawsuit or lawsuits. That is the case regardless of whether the loan is or is not secured by some kind of collateral. However, the fee-sharing rule forbids two alternative arrangements – first, where an entity’s funding is not secured other than by the lawyer’s fee in one or more lawsuits, so that it is implicit that the lawyer will pay the funder only if the lawyer receives legal fees in the matter or matters; and second, where a lawyer and funder agree, whether in a recourse or non-recourse arrangement, that instead of a fixed amount or fixed rate of interest, the amount of the lawyer’s payment will depend on the amount of the lawyer’s fees – for example, where the agreement sets a payment rate on a sliding scale based on the total legal fees or total recovery in the case or portfolio of cases.

II. The Rule against Fee-Sharing with Non-Lawyers

Rule 5.4, titled “Professional Independence of a Lawyer,” includes four provisions that regulate lawyers’ business relations and other interactions with non-lawyers,⁴ including provisions forbidding law firms from having non-lawyer partners or owners.⁵ Rule 5.4(a) addresses fee-

³ As we cautioned in Opinion 2011-2, however, lawyers must still be cognizant of the risks of client-funder transactions, including the risk of compromising confidentiality, any possible waiver of attorney-client privilege, and any potential impact on a lawyer’s exercise of independent judgment. See NYCBA Formal Op. 2011-2.

⁴ See, e.g., Rule 5.4(c) (prohibiting a lawyer from allowing a third party “to direct or regulate the lawyer’s professional judgment”); Rule 5.4(d)(3) (prohibiting a lawyer from allowing a non-lawyer to “direct or control the professional judgment of a lawyer”). Other provisions of the Rules are similarly designed to protect lawyers’ independence from third parties. See, e.g., Rule 1.8(f) (prohibiting “interference with [a] lawyer’s independent professional judgment”); Rule 2.1 (requiring a lawyer to “exercise independent professional judgment”); see generally Bruce A. Green, “Lawyers’ Professional Independence: Overrated or Undervalued?,” 46 Akron L. Rev. 599 (2013).

⁵ Rule 5.4(b) (“A lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law.”); Rule 5.4(d) (forbidding the practice of law in any entity in
sharing with non-lawyers. Subject to three exceptions not implicated here, Rule 5.4(a) provides that “[a] lawyer or law firm shall not share legal fees with a nonlawyer.”

As the title of Rule 5.4 reflects, the fee-sharing restriction is intended “to protect the lawyer’s professional independence of judgment.” Rule 5.4 Cmnt. [1]; see also NYCBA Formal Op. 2014-1 (2014) (“The purpose of the fee-sharing prohibition is to remove incentives for nonlawyers to interfere with the professional judgment of lawyers in legal matters, and to remove incentives for nonlawyers to engage in other objectionable conduct.”); Jacoby & Meyers, LLP v. Presiding Justices, 852 F.3d 178, 192 (2d Cir. 2017) (noting that Rule 5.4(a) serves New York’s interest in maintaining “independence” in the legal profession); Roy D. Simon and Nicole Hyland, Simon’s New York Rules of Professional Conduct Annotated, at 1420 (“[t]he purpose of the rule against fee sharing is to remove any incentive for nonlawyers to engage in undesirable behavior such as (1) interfering with a lawyer’s professional judgment in handling of a legal matter, (2) using dishonest or illegal methods . . . in order to win cases . . . or (3) encouraging or pressuring a lawyer to use such improper methods.”).

The fee-sharing restriction is of long standing. In 1928, drawing on precedent dating back to the 1700s, the ABA adopted Canon 34 of the Canons of Professional Responsibility, which provided that “[n]o division of fees for legal services is proper, except with another lawyer, based upon a division of service or responsibility.” Roy Simon, “Fee Sharing Between Lawyers and Public Interest Groups,” 98 Yale L.J. 1069, 1079–80 (1989). In 1969, the ABA re-codified this principle as DR 3-102(A) of the Model Code, which provided that “[a] lawyer or law firm shall not share fees with a nonlawyer.” Id., 98 Yale L.J. at 1082. New York’s implementation inserted the word “legal” before “fees,” but otherwise made no changes to the Model Code. See NY Code of Prof. Responsibility, DR 3-102(A). The first clause of Rule 5.4(a) is identical to DR 3-102(A).

Rule 5.4(a) has generally been interpreted to forbid business arrangements in which lawyers agree to make payments based on the receipt of legal fees or the amount of legal fees in particular matters. For instance, in NYSBA Op. 917 (2012), the ethics committee opined that a lawyer could not compensate a non-lawyer marketing professional based on the amount of fees paid by clients whom the non-lawyer professional obtained for the firm. In NYSBA Ethics Op. 992 (2013), the committee concluded that a lawyer may not compensate a business owner for marketing services based on a percentage of fees from a particular matter. Its opinion explained: “Payment of a percentage of firm profits for a specific matter is tantamount to fee sharing and is not permitted.” The opinion noted that although Rule 5.4(a)(3) permits lawyers to establish retirement plans for nonlawyer employees based on “a profit-sharing arrangement,” even nonlawyer employee retirement plans may not be “tied to profit from a particular case or cases.”

which a nonlawyer owns an interest). On the early history of restrictions on lawyer-nonlawyer collaborations, see Bruce A. Green, “The Disciplinary Restrictions on Multidisciplinary Practice: Their Derivation, Their Development, and Some Implications for the Core Values Debate,” 84 Minn. L. Rev. 1115 (2000).
Many other opinions reflect the same general principle. See, e.g., NYSBA Ethics Op. 1062 (2015) (law firm attempting to raise money on a “crowdfunding” website would violate Rule 5.4 (a) if investors were to receive a percentage of the firm’s revenues); NYCBA Formal Op. 2015-1 (2015) (law firm may not pay professional employer organization for administration services based on percentage of fees the firm generates); NYCLA Ethics Op. 697 (1993) (lawyer may not agree to pay landlord percentage of firm’s revenues as office rent); NYSBA Ethics Op. 633 (1992) (lawyer may not enter into payment arrangement with non-lawyer based on “percentage of volume of business developed”); NYSBA Ethics Op. 565 (1984) (lawyer may not compensate marketing agency based on “volume of business developed”); cf. In re Friedman, 196 A.D.2d 280 (1st Dept. 1994) (attorney violated DR 3-102(A) by agreeing to pay private investigator in part based on success of litigation); In re Shapiro, 90 A.D.2d 22 (1st Dep’t 1982) (disciplinary proceeding against attorney who, inter alia, paid salary to non-lawyer employee contingent on total fees earned); see generally Simon & Hyland, supra, at 1419 (“If the nonlawyer’s income depends in any way on the lawyer’s receipt of legal fees in a specific case or cases, then the lawyer is violating Rule 5.4(a).”).

III. The Application of Rule 5.4(A) to Certain Litigation Funding Arrangements

Lawyer-funder arrangements do not necessarily involve impermissible fee sharing under Rule 5.4(a). The rule is not implicated simply because the lawyer’s payments to a funder come from income derived from legal fees. But Rule 5.4(a) forbids a funding arrangement in which the lawyer’s future payments to the funder are contingent on the lawyer’s receipt of legal fees or on the amount of legal fees received in one or more specific matters. That is true whether the arrangement is a non-recourse loan secured by legal fees or it involves financing in which the amount of the lawyer’s payments varies with the amount of legal fees in one or more matters. Rule 5.4(a) has long been understood to apply to business arrangements in which lawyers’ payments to nonlawyers are tied to legal fees in these types of ways. See Part II, supra.

No New York ethics committee has yet addressed the rule’s application specifically to litigation funding arrangements. However, we see no meaningful difference between payments for financing, on the one hand, and payments for goods and services, on the other, that would call for a different interpretation of “fee sharing” when a lawyer’s payments to a provider of funding,

6 The Rules do not define what it means to “share” a “legal fee,” but the cases and opinions cited herein leave no doubt that Rule 5.4(a) does not forbid payments from income derived from legal fees. An interpretation to the contrary would be unrealistic, since all or virtually all of lawyers’ income ordinarily derives from legal fees and therefore all payments they make for nonlawyer salaries, services, etc., ordinarily derive from legal fees. See Preamble [6] (“The Rules of Professional Conduct are rules of reason. They should be interpreted with reference to the purposes of the legal representation and of the law itself.”).

7 Further, a litigation-funding arrangement involves impermissible fee sharing where the arrangement in effect makes the lawyer’s payments contingent on the receipt or amount of fees, regardless of how the arrangement is worded. For example, Rule 5.4(a) applies equally regardless of whether the lawyers’ future payments are explicitly contingent on the receipt of fees or are contingent on the client’s success which in turn will result in legal fees.
rather than a provider of goods or services, are contingent on the lawyer’s receipt of fees in a particular matter.\textsuperscript{8} Rule 5.4(a) must therefore be read to foreclose a financing arrangement whereby payments to the funder are contingent on the lawyer’s receipt of legal fees.\textsuperscript{9} A non-recourse financing agreement secured by legal fees in a matter – i.e., an arrangement in which it is contemplated that the lawyer will make future payments only if the lawyer recovers fees – constitutes an impermissible fee-sharing arrangement regardless of how the lawyer’s payments are calculated. Likewise, a financing arrangement constitutes impermissible fee sharing if the amount of the lawyer’s payment is contingent on the amount of legal fees earned or recovered. Further, Rule 5.4 is equally applicable when the lawyer’s payment to the funder is based on the recovery of legal fees in multiple matters (\textit{e.g.}, a portfolio of lawsuits against the same defendant or involving the same subject matter) as opposed to a single matter.

For purposes of Rule 5.4, a non-recourse funding arrangement in which the lawyer’s payments are contingent on the lawyer’s receipt of legal fees, or a funding arrangement in which the lawyer’s payments depend on the amount of legal fees received in a matter, is different from the traditional “recourse” loan agreement described above in which a lawyer’s payments are \textit{not} contingent on the receipt or amount of legal fees in particular matters.\textsuperscript{10} To be sure, the lawyer in both scenarios will pay the lender from the firm’s revenues (i.e. legal fees). But, given the long line of prior opinions, it matters that in the former scenario the lawyer’s payments are tied to the lawyer’s receipt of fees in one or more matters. Rightly or wrongly, the rule presupposes that

\textsuperscript{8} Several other states have also reached a similar conclusion. \textit{See} Prof’l Ethics Comm’n Me. Bd. of Overseers of the Bar, Op. 193 (2007) (“[P]ayment on a non-recourse loan to finance litigation in a contingency fee case, where the lawyer is obligated to repay the loan only if a fee results in the case, constitutes sharing legal fees with a non-lawyer in violation of the rule.”); State Bar of Nevada Op. 36 (2007) (“Any loan obtained for purposes of litigation funding must be a ‘recourse’ loan that counsel is obligated to pay.”); Utah Bar Ass’n Adv. Op. 97-11 (1997) (“[A]n attorney may not finance the costs of a contingent-fee case in which a non-recourse promissory note is secured by the attorney’s interest in the contingent fee.”); \textit{see also} Va. State Bar Standing Comm. on Legal Ethics, Advisory Op. 1764 (2002) (“not[ing] a basic ethical problem” in a proposed financing agreement that called for a “finance company to receive a portion of the attorney’s legal fee”).

\textsuperscript{9} This opinion does not read Rule 5.4(a) to forbid funding arrangements in which the lawyer’s debt obligation is secured by current or future accounts receivable but repayment is not contingent on the receipt or amount of fees. For example, a recourse debt that is not contingent on the amount of legal fees – \textit{e.g.}, a promise to repay a loan with interest over a particular period of time – does not constitute impermissible fee sharing simply because the debt is secured by accounts receivable in one or more matters. In the case of a recourse loan, there is no implicit or explicit understanding that the debt will be repaid only if legal fees are obtained in particular matters, and the creditor may seek repayment out of all of the law firm’s assets. Nor do we believe the fee-sharing rule forbids funding arrangements in which the timing of the lawyer’s payments is determined by the resolution of a matter – \textit{e.g.}, where the lawyer’s payment obligation does not begin until a matter is resolved – but the amount of lawyer’s payment obligation does not itself depend on whether, or in what amount, legal fees are obtained.

\textsuperscript{10} It is important to note that this opinion does not address legal fees that have been earned and that are subject to collection but that have not yet paid. We do not question the State Bar ethics committee’s conclusion in NYSBA Ethics 608 (1975) that a lawyer employing a collections agency to collect earned but unpaid legal fees may compensate the collections agency based on a percentage of the recovery.
when nonlawyers have a stake in legal fees from particular matters, they have an incentive or ability to improperly influence the lawyer.\textsuperscript{11}

There is room to argue whether the prohibition on fee sharing is overbroad. One might argue that the rule sweeps more broadly than necessary to serve its purpose of protecting lawyers’ independence, or whether there are adequate contractual means or other alternative means of preventing litigation funders from encroaching on litigators’ exercise of independent professional judgment. But that is a matter to be decided by the state judiciary, which periodically reviews the Rules, or by the state legislature. Nothing in the language, history or prior interpretations of Rule 5.4(a) supports an interpretation carving out litigation funding arrangements.\textsuperscript{12}

\textbf{IV. Conclusion}

Under Rule 5.4(a), a lawyer may not enter into a financing agreement with a litigation funder, a non-lawyer, under which the lawyer’s future payments to the funder are contingent on the lawyer’s receipt of legal fees or on the amount of legal fees received in one or more specific matters.

\textsuperscript{11} Of course, even under a recourse loan, a law firm that receives no legal fees and therefore has no income may be unable to make payments to a funder or to others to whom the law firm is in debt. Likewise, a law firm whose debt exceeds its incoming legal fees and other assets may be unable to meet its financial obligations. One might therefore argue that any creditor has an incentive to encroach on lawyer independence and that there is no reason to single out those particular creditors who have a stake in lawyers’ fees in particular matters. But 90 years of ethics rules and opinions interpreting them have at least implicitly assumed either that there is a meaningful difference or that the distinction has another justification (such as that rules cannot realistically prevent lawyer insolvency).

\textsuperscript{12} We recognize that several New York courts have upheld litigation funding agreements in the face of public-policy challenges. See \textit{Hamilton Capital VII, LLC, I v. Khorrami, LLP}, 2015 N.Y. Slip Op. 51199(U) (Sup. Ct. N.Y. County Aug. 17, 2015) (distinguishing between fee-sharing agreements and a credit facility giving lender a security interest in law firm’s accounts receivable); \textit{Lawsuit Funding, LLC v. Lessoff}, 2013 WL 6409971 (Sup. Ct. N.Y. County Dec. 4, 2013) (refusing to use Rule 5.4(a) to invalidate a settlement agreement on public policy grounds where lawyer agreed to repay lender a set amount from lawyer’s fees in eight other lawsuits); see also \textit{Heer v. North Moore St. Developers, L.L.C.}, 140 A.D.3d 675, 676 (1st Dep’t 2016) (rejecting law firm-defendant’s argument that N.Y. Judiciary Law barred collection agency’s motion to intervene, as § 474 permits “litigation loans obtained by law firms and secured by their accounts receivable”). However, insofar as the lawyers’ payments to funders in these cases depended on the receipt of legal fees in particular matters, the judicial decisions enforcing the lawyers’ contracts do not necessarily establish that Rule 5.4 applies differently to litigation funding arrangements than to other business arrangements. Regardless of whether the funding arrangements were forbidden by Rule 5.4, New York courts could be expected to enforce the arrangements, because lawyers who violate the Rules cannot ordinarily invoke their own transgressions to avoid contractual obligations. See \textit{Marin v. Constitution Realty, LLC}, 28 N.Y.3d 666, 672 (2017) (rejecting lawyers attempts to “use the ethics rules as a sword” to render an agreement unenforceable).
GUIDE TO LITIGATION FINANCING

NAVIGATING THE WORLD OF LITIGATION FINANCE
This Guide will help senior executives and their outside legal counsel understand their options regarding litigation financing. Some of the questions that are answered inside include:

How can litigation financing be used?  
(see page 2)
What are common elements of financing transactions?  
(see page 3)
What cases make good candidates for financing?  
(see page 4)
How much does financing cost?  
(see page 6)
What is the process for exploring and consummating financing?  
(see page 10)
What are the key factors a financing provider considers?  
(see page 11)
Why work with a broker to pursue financing?  
(see page 13)
OVERVIEW OF LITIGATION FINANCING

Litigation financing can be an attractive tool for managing major expenditures for litigation and hedging the risk of an adverse outcome. Numerous companies and law firms have taken advantage of litigation financing as this relatively new form of capital has begun to enter the mainstream. However, while most lawyers and many business executives are aware of the concept, many misconceptions exist alongside a generally low level of substantive knowledge about this financial tool. This Guide is intended to help senior executives and their outside legal counsel determine whether litigation financing is right for their organizations.

WHAT IS LITIGATION FINANCING?

Litigation financing refers to a transaction in which a third party, that is neither a party to a legal claim nor their legal counsel, provides capital to a party to a legal claim (or their legal counsel) in exchange for a financial interest in the outcome of the legal claim. The signature feature of this form of capital is that repayment of the financing is contingent upon a successful outcome of the underlying legal claim.

In this Guide, the term litigation financing refers only to commercial litigation financing (as opposed to consumer litigation financing). An entirely separate area exists that deals with the financing of consumer claims (e.g., personal injury, medical malpractice, etc.). In the commercial litigation financing industry, larger transactions take place between sophisticated parties, where the subject matter of the underlying legal claims is usually commercial in nature (e.g., intellectual property infringement, antitrust, securities, breach of contract, fraud, business torts, etc.)

HOW CAN LITIGATION FINANCING BE USED?

In its classic application, litigation financing is a tool that enables companies—plaintiffs or defendants—facing large litigation budgets to defer these costs to the successful outcome of their case—and to avoid the costs entirely if the case resolves unsuccessfully. Companies can therefore tie their expenditures to their satisfaction with the result obtained, similar to engaging a law firm on a contingent fee basis, without requiring their preferred law firm to deviate significantly from its financial model.

A tool that enables companies—plaintiffs or defendants—facing large litigation budgets to defer these costs to the successful outcome of their case—and to avoid the costs entirely if the case resolves unsuccessfully.
The uses and possible structures of litigation financing are myriad, limited mainly by the creativity of the financing providers and recipients. Indeed, financing is often used for working capital needs entirely unrelated to a claim.

**WHAT ARE COMMON ELEMENTS OF FINANCING TRANSACTIONS?**

In this specialized capital market, financing transactions are bespoke. Each transaction is negotiated, structured, and priced individually. However, common elements of financing transactions include:

- Financing provider’s repayment is secured by and contingent upon a successful outcome of the claim;
- $500,000 to $10 million financing available for individual claims (larger amounts may be available for portfolios of claims);
- Financing may be a fixed amount or may be tied to other benchmarks such as legal fees and expenses actually incurred;
- Pricing may be based on the amount of capital provided, on the size of the recovery in the underlying claim, or some combination of the two; in most instances the pricing is graduated and increases in some fashion the longer the financing is outstanding;
- Capital may be available in a lump sum or may be drawn down over time; and
- Financing provider has passive role in management and decision-making in the legal claim, with strict prohibitions against interference with the representing lawyer’s exercise of their independent professional judgment.

**IS FINANCING ONLY AVAILABLE TO PLAINTIFFS?**

Financing is available to both plaintiffs and defendants, although the market for defendant-side financing is still in the early stages of development. Plaintiff-side financing is much more common, largely because of the relative ease of defining “success” on the plaintiff-side. Defendant-side transactions are structured similarly to reverse contingent fees, whereby the capital provider receives an interest in the differential between a defendant’s exposure and the amount of the claim that is ultimately paid.
WHAT TYPES OF CASES ARE FINANCED?

On the defendant-side, any type of claim is eligible. On the plaintiff-side, only cases involving commercial damages claims are eligible, for example:

- intellectual property infringement
- breach of contract
- business torts
- trade secrets
- domestic and international arbitration
- antitrust
- securities
- fraud
- employment
- bankruptcy and creditor’s rights
- tax

IS LITIGATION FINANCING AN ALTERNATIVE TO CONTINGENT FEES?

Litigation financing can be a very effective substitute for contingent fees primarily because capital providers have greater capacity and broader diversification than many law firms. These advantages often allow capital providers to price transactions more efficiently than law firms and to maintain more consistent appetites for these types of investments. However, litigation financing and contingent fees are not mutually exclusive. Litigation financing is used frequently in conjunction with a contingent fee or hybrid contingent fee engagement.

HOW CAN LAW FIRMS USE LITIGATION FINANCING?

Litigation financing can enable a law firm that seeks some exposure to contingent fee revenues to augment its capacity for these risk-sharing engagements. When a law firm engages on a contingent fee basis, it is making an investment of its unbilled time and often out-of-pocket expenses. Many firms are not ideally configured to make these types of investments because they dilute partner distributions and/or require the firm to take on debt. Litigation financing enables firms to hedge their exposure to these types of engagements individually and/or expand their portfolios of these engagement in a capital-neutral manner, thereby achieving lower aggregate risk through the added diversification.

WHAT CASES MAKE GOOD CANDIDATES FOR FINANCING?

This analysis is entirely dependent upon the situation. Any company would be attracted to the benefits of financing—avoiding expensive legal budgets unless and until they reach a favorable resolution of the claim—but both the benefits and downsides must be analyzed on a case-by-case basis. Good candidates for a litigation financing transaction often involve large (relative to the party’s perspective) legal budgets where the case is strong and where a successful outcome has significant financial upside.
More objective criteria for financing include:
- Financing request in excess of $500,000
- Claim value in excess of $5,000,000
- Ratio of claim value to financing request in excess of 5:1

It is important to note that litigation financing is not always an “all or nothing” proposition. Often it makes sense to implement financing for a portion of the overall budget, and these types of transactions are common in today’s market. The bottom line: for major cases, where a party is sensitive to the legal budget and/or outcome risks, or otherwise wishes to monetize a portion of the claim’s contingent value, a financing scenario is probably worth exploring.

WHY SEEK FINANCING IF MY COMPANY HAS ADEQUATE RESOURCES?

Well-capitalized companies have many resources with which to finance legal budgets, but the ability to tie litigation expenditures to a successful outcome—to pay based on how satisfied they are with the results—is attractive to most business people, regardless of their company’s size. And aside from contingent fee engagements, this feature is only available in the litigation financing market.

For legal matters that fall outside a company’s routine legal budget, litigation financing enhances the ability to manage these extraordinary expenses and to hedge risk. When a company uses its own capital for these extraordinary expenses, it is foregoing some alternative use of that capital, where the alternative use is usually an investment in its core business. For most companies, litigation is a noncore area where risks are rewards are not well understood, and companies typically do not enjoy a relative informational advantage in making litigation investments versus investments in their core business.

WHEN IS THE RIGHT TIME TO SEEK FINANCING?

Financing is available at any stage in a case’s lifecycle, from pre-complaint through the appellate process. Often it is desirable to arrange financing near the inception of a case when the budget and strategy are being formulated. However, financing is frequently obtained after the claim is well underway. Financing is only practically feasible after the party and their lawyers have performed a significant amount of research on the merits and financial viability of the assertion or defense of the claim.

For major cases, where a party is sensitive to the legal budget and/or outcome risks, or otherwise wishes to monetize a portion of the claim’s contingent value, a financing scenario is probably worth exploring.
HOW DOES FINANCING IMPACT A COMPANY’S CREDIT RATING OR SHAREHOLDERS?

Litigation financing neither adversely impacts the credit rating of the company nor dilutes the company’s shareholders. On the contrary, most creditors would view litigation financing’s contingent-repayment feature as a net enhancement of the credit because a company’s liquidity is preserved instead of being drained by an investment in litigation and any liability to repay the financing will be offset by a positive cash flow (on the plaintiff-side) or a savings relative to the company’s exposure (on the defendant-side). Also, despite the equity-like risks assumed by the financing providers, existing shareholders are not diluted by litigation financing transactions.

WHAT IS THE ACCOUNTING TREATMENT OF LITIGATION FINANCING?

The answer can vary depending on how the transaction is structured. Litigation finance transactions are often structured off-balance-sheet, where financing proceeds are drawn directly to pay outside legal counsel. In that case, the portion of the legal budget that is financed does not appear as an expense in the company’s financial statements (similarly to how these foregone expenditures would not be recognized if a company engaged a law firm on a contingent fee basis). Also, if structured properly, the financing proceeds would not be taxable as income. In terms of the repayment, on plaintiff-side financings, the repayment liability coincides with an as-yet-unrecognized inflow or revenue item (e.g., a recovery in the legal claim), so the liability to repay the financing provider would be offset by a surplus cash flow; on defendant-side financings, liability to repay the financing is often netted against the reserves already in place for the company’s potential liability in the claim. This offsetting feature means that the sum of the legal budget financed plus the financing costs is significantly less acute than if a company had self-financed the entire legal budget. Of course, the more exotic the financing structure, the more complex the accounting and tax treatment is likely to be.

HOW MUCH DOES FINANCING COST?

Financing costs are analyzed and negotiated on a case-by-case basis and are based upon a variety of factors, including a capital provider’s perceived risk of an adverse outcome and length of time the financing may be outstanding. Since capital providers assume the risk of an adverse outcome, their profits on successful financings must be sufficient to offset their losses on unsuccessful ones. Capital providers strive to generate private equity-like returns (e.g., 20%-plus annualized returns) for their investors. In order to achieve these returns, providers are typically seeking multiples of their capital invested in successful cases ranging from 2x to 4x. So the financing costs for $1 million in financing outstanding might range from $1 million to $3 million, but the costs are really best viewed as a reduction in the upside (or the substantial savings) in a successful resolution of the claim. And, of course, a provider receives nothing in cases that are unsuccessful.
OVERVIEW OF LEGAL & ETHICAL ISSUES

Various commercial law and legal ethics issues may be implicated by litigation financing. Over the last decade, a significant body of law has developed concerning litigation financing, and several courts and ethical bodies have rendered opinions on this subject. Although this body of law continues to develop, these opinions offer guidance as to the parameters governing these transactions. If properly structured, litigation financing transactions are permissible and enforceable in every state. Those who are knowledgeable and experienced about the legal and ethical issues of litigation financing should be consulted in connection with any transaction. Generally, the issues which may be implicated are:

— Confidentiality and privilege waivers
— Champerty and related issues
— Legal ethics issues
  · Independence of professional judgment
  · Conflicts of interest
  · Confidentiality

WILL DISCLOSURES TO A FINANCING PROVIDER BE DISCOVERABLE?

As long as a nondisclosure agreement is in place prior to information that is protected by the work product doctrine being conveyed to a financing provider, that information should remain confidential and not be discoverable by the opposing party. However, disclosure of information that is confidential solely due to the attorney-client privilege (and not also the work product doctrine, which affords a broader and less easily waived protection) is likely to result in a waiver of the privilege. Reputable financing providers do not seek information that is confidential due solely to the attorney-client privilege.

Even though existing case law unanimously supports the position that work product protection extends to any information conveyed to a financing provider (or related third party) as long as an NDA is in place, some opposing parties may be inclined to attempt to obtain such information through discovery anyway, resulting in expenditures on a satellite discovery dispute. These expenses should simply be built into the legal budget and weighed against the benefits of financing.
IS THE COURT OR OPPOSING PARTY ENTITLED TO KNOW ABOUT FINANCING?

There is no affirmative duty to disclose the existence of a financing arrangement to the court or to the opposing party, although it should be noted that there is virtually no law directly on this subject yet. Any party seeking information about how a party’s litigation budget is being financed would have to demonstrate that this information was relevant to the issues in the case. The mere fact that a party has provided financing does not make them a real party in interest in the litigation. Any provider of capital to a company—or for that matter, any party with any financial interest in the company—has a direct or indirect financial interest in the outcome of a major litigation matter.

WHAT DUTIES DOES MY LAWYER HAVE TO A FINANCING PROVIDER?

Lawyers have no professional obligations whatsoever to the financing provider and do not render legal services or provide opinions to them. Most financing agreements contain provisions in which the client instructs its legal counsel to provide routine information to the financing provider, so that the provider can monitor the status of its investment and compliance with the financing agreement.

WHAT CONTROL DOES A FINANCING PROVIDER HAVE OVER THE CASE?

Reputable financing providers do not control the management or decision making in the case, including decisions regarding settlement or disposition of the claim. Reputable financing providers explicitly state this lack of control in their financing documents.

WHAT IS CHAMPERTY?

Champerty is an ancient doctrine originating in medieval England that was designed to prevent feudal lords from waging their wars through the court system. Champerty involves an “officious intermeddler” paying the expenses of another’s lawsuit in exchange for a portion of the recovery—at first glance, this may sound a bit like litigation financing. However, courts have applied champerty narrowly in the modern era, limiting it to situations in which frivolous litigation is instigated by a third party and/or where the third party is heavily involved in the management of the case; reputable litigation financing providers do neither. Many states have abolished champerty, drastically limited its scope, or never adopted it in the first place. Even for states where champerty laws are in effect, champerty is subject to a choice of law which provides structural latitude for avoiding champerty and related issues.
WHAT LEGAL ETHICS ISSUES SHOULD MY LAWYER CONSIDER?

More detailed information on these topics can be provided by experts in this area, however, the basic framework for lawyers is to ensure that they:

- Maintain their independence of professional judgment;
- Exercise reasonable caution to protect their clients’ confidentiality; and
- Avoid (or adequately disclose) any conflicts of interest.
OVERVIEW OF FINANCING PROCESS

The process for exploring and consummating financing is complex and can be time consuming. Due to the risks assumed by the capital provider and the sophistication of the subject matter, the process is very similar to raising capital in the venture capital or private equity market. While this process may seem daunting, careful preparation and alignment with knowledgeable partners can increase the chances of a successful transaction and significantly expedite the process.

WHAT IS THE PROCESS FOR EXPLORING AND CONSUMMATING FINANCING?

To consummate a litigation financing transaction, a company needs to prepare the appropriate documents, develop a targeted list of financing providers, schedule meetings with providers, and negotiate term sheets and financing documents. Companies should begin the process by assembling a synopsis of the financing opportunity it intends to offer. This synopsis should include a detailed memorandum discussing the legal claim (including strengths of the opposing party’s position and how these will be refuted), financial projections for the budget and probable outcome(s), and a due diligence package (including legal and factual analyses, material documents and pleadings, expert reports, CVs and relevant experience of litigation counsel, parameters of engagement with counsel, et cetera). Next, the company needs to identify the financing providers likely to be suitable for the transaction based on case type, size of transaction, case status, jurisdiction, and intended transaction structure. Financing providers are inundated with low quality opportunities and may not prioritize review of an opportunity unless it is presented by a party with whom the provider has a relationship.

Through personal contacts, referrals, or a broker, the company would attempt to schedule initial meetings with potential litigation financing providers, usually over the phone or at the providers’ offices. If the initial meeting is successful, more in-depth meetings will be scheduled, an NDA would be executed, and more detailed disclosures (such as the due diligence package) would be made to the potential financing providers. Depending on the content of the due diligence package, the potential providers may make additional due diligence requests. If a provider wishes to develop a transaction, it will provide a preliminary term sheet (typically non-binding) outlining the general terms of financing. The company and its advisors would then negotiate and execute the term sheet, which usually provides for financing subject to a more exhaustive due diligence review. Companies can save significant time and effort, and many more potential financing providers can be contacted, by using an experienced broker to manage this process.
WHAT IS THE TIME COMMITMENT REQUIRED TO EXPLORE AND CONSUMMATE FINANCING?

The entire process, from initial exploration to consummation of litigation financing, usually requires three to six months (especially if the process is not being managed by an experienced broker). Company executives involved in the litigation’s management and their outside legal counsel should expect to be heavily engaged during this entire process, if a company attempts to manage the process itself. Using an experienced broker can cut management’s and outside legal counsel’s time commitment significantly and can compress the overall timetable to one to three months. If the timeline is a primary point of sensitivity (more so than pricing or other financing terms), an experienced broker can arrange financing on a significantly shorter timetable (some transactions have been consummated inside of two weeks).

HOW DO FINANCING PROVIDERS CONDUCT THEIR DILIGENCE?

The diligence conducted resembles the vetting that an experienced law firm would perform prior to accepting an engagement on a contingent fee basis. They will review pleadings, document production and discovery, attorney work product, expert reports, damages models and other financial information relevant to the economic viability of the claim. They will interview litigation counsel and key executives with the company. Sometimes they will interview key fact witnesses.

WHAT ARE KEY FACTORS A FINANCING PROVIDER CONSIDERS?

Key factors include:

- strength and novelty of legal theory
- amount and demonstrability of damages claimed
- credibility of key fact and expert witnesses
- financial wherewithal of defendants to pay claim
- financial motivations of the parties (including legal counsel)
- adequacy and reasonability of legal budget
- jurisdictional factors such as the judge, jury pool, and appellate courts
- reasonability of the parties
- likelihood the parties will behave rationally
- “skin in the game” of both the company and its outside legal counsel.

CHARACTERISTICS OF THE FINANCING MARKET

The market for litigation financing is:

- **FRAGMENTED** - numerous providers operate in the market; some focus exclusively on this market while others are multistrategy capital providers or ad hoc participants;
- **DIFFERENTIATED** - each provider has its own investment criteria, approach, and transactional preferences;
- **FLUID** - many new entries (and exits) occur each year, and providers’ appetites for transactions vary depending on their capital raise/deployment cycles;
- **OPAQUE** - no publication of pricing or terms occurs and no centralized exchange exists; also, many providers maintain extremely low profiles, making their identification challenging; and
- **INEFFICIENT** - due to various structural reasons, most potential recipients do not negotiate simultaneously with multiple potential capital providers (unless they are working with an experienced broker); proposed terms can vary significantly from provider to provider, and absent a competitive environment, significant inefficiencies can occur.

WHO ARE THE FINANCING PROVIDERS?

The management teams of most litigation financing providers are composed of former commercial litigators who are sometimes complemented by financial executives. Generally, these teams are highly credentialed professionals, often with prestigious law firm and/or Wall Street pedigrees.
PROVIDERS LIKE “SKIN IN THE GAME”

Litigation financing providers prefer to see both companies and their outside legal counsel have a significant stake in the outcome of the claim to ensure strong alignment of incentives. Providers understand that their purpose is largely to limit companies’ exposure to these expenditures. They tend to view a company’s stake in the ultimate outcome as ample financial interest, especially when the company’s resources are limited with respect to its legal budget. However, few factors are more persuasive to a provider of litigation financing than a risk-sharing or performance-based engagement with the representing law firm.

HOW DO FINANCING PROVIDERS OPERATE?

Litigation financing providers earn a profit by selecting cases that are likely to result in a successful outcome such that the profits earned on successful cases more than offset capital invested in unsuccessful cases. These financing providers usually act as the general partner of a fund that invests capital on behalf of investors (typically, institutional investors and family offices) who are the fund’s limited partners.

A provider typically charges its limited partners an annual management fee based on the capital invested or committed to the fund (usually 1-2%) plus a performance fee equal to a percentage (usually 20%) of the profits earned by investing the fund’s capital. Most funds’ organizational documents have clear parameters that dictate the types of investments the general partner may make with the fund’s assets, often placing restrictions on the case types, case stages, or financing structures in which the fund may invest. Also, a fund usually has a limited deployment period in which the fund’s capital may be invested in new financing opportunities, after which time the provider begins returning investors’ capital as the cases that were financed mature. Financing providers often feel significant pressure to deploy capital in a new fund and then experience diminished appetite for new transactions as they approach full deployment.

CAVEAT EMPTOR: COUNTERPARTY RISK

Unfortunately, even at this stage in the development of the litigation financing market, certain “capital providers” present themselves to prospective financing recipients as if they have ample financial resources, when, in fact, they do not. If they are presented with an opportunity, they will attempt to raise capital to finance it—sometimes from legitimate litigation financing providers—without ever disclosing their lack of capital adequacy to the prospective financing recipient. These bad actors subject their counterparties to unreasonable fundraise and execution risks by not being candid about their financial resources. It is therefore critical to understand the reputation, experience, and financial resources of any prospective capital provider.
WHY WORK WITH A BROKER TO PURSUE FINANCING?

Pursuing a litigation financing transaction without the advice of an independent expert places a company at significant risk of an inefficient, protracted, and ultimately unsuccessful financing process. An experienced broker will be familiar with the information a provider will expect to receive and will present it in a manner that will both resonate with the potential providers and streamline the entire process. Also, a broker can bring more potential providers into the discussions and create a competitive environment for the transaction, which increases the chances of consummating a transaction and obtaining the most favorable financing terms. Using a broker will also substantially reduce the time that company representatives and outside legal counsel must spend pursuing financing and can eliminate unnecessary delays and inefficiencies in the process. A broker can also provide valuable insights into the legal and ethical parameters that govern these transactions and protect a company from agreeing to onerous terms that can limit its flexibility and autonomy to manage its case. Litigation financing transactions are highly sensitive, consequential transactions, and there is simply no substitute for experience.

WILL FINANCING PROVIDERS PURSUE OPPORTUNITIES THAT INVOLVE A BROKER?

All credible litigation financing providers will participate in quality opportunities that are marketed by an experienced broker. Generally, providers derive significant benefits from the efficiencies that an experienced broker brings to the process, even though the process subjects them to competitive pressures. Financing providers do not wish to work with inexperienced brokers who add little value to the process due to their lack of expertise in litigation financing and/or their lack of attention to vetting opportunities before presenting them to the market.

HOW MUCH DOES IT COST TO ENGAGE A BROKER?

Pursuing litigation financing through a broker is very cost effective. The vast majority of a broker’s fees (roughly 90%-95%) are payable only upon successful consummation of a transaction. These fees usually range from 4%-7% of the financing proceeds and are paid directly out of the proceeds, so the company does not incur substantial out-of-pocket costs. The remainder of the fees is paid as a nominal retainer.
Westfleet Advisors is composed of an experienced team of litigation financing professionals. As former capital providers, our team has participated in the financing of more than 1,000 complex litigation matters. We are committed to delivering transparency and efficiency in order to increase the utility of the emerging litigation financing market.
Litigation Funding and Confidentiality: A Comprehensive Analysis of Current Case Law

FEBRUARY 2019
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I. INTRODUCTION

As the use of litigation funding has increased, especially in commercial disputes, the single legal issue that causes the most concern among lawyers for clients contemplating using funding is the availability, extent, and reliability of confidentiality afforded the communications necessary with funders. Indeed, this same concern is also very prominent in the minds of lawyers and parties facing parties they believe may be the beneficiaries of litigation funding.

Despite this obvious concern, to our knowledge, no one has systematically reviewed all the publicly-available decisions on the subject of confidentiality of information and documents about litigation funding and attempted to draw reasoned conclusions. Until fairly recently, the number of these decisions has been small, but these decisions now appear to number more than thirty. These decisions now comprise a sufficient body of law to permit a thorough analysis that will allow lawyers – whether representing clients contemplating using funding or clients opposing apparently funded parties – to provide their clients more informed advice and to guide their own actions either in protecting their clients’ confidential information or considering attempts to obtain confidential information from opponents. That is the purpose of this article.

Negotiating and obtaining commercial litigation financing for a case requires that a funder and a client discuss confidential information about the case. Before a litigation funder invests in the case, the prospective funder signs a non-disclosure agreement and then conducts due diligence, evaluating the value of the case based on documents and analysis provided by the client, who we will refer to as the plaintiff\(^1\) for simplicity. If the funder decides to invest in the case after seeing its strengths and weaknesses, the funder and plaintiff will consummate a funding agreement. Like the due diligence documents shared with prospective funders, the funding agreement probably includes sensitive information related to litigation strategy, such as the maximum amount of funding offered for the case or attorneys’ opinions. Upon financing the plaintiff, the funder will probably

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\(^1\) The client is often a plaintiff in an already-filed suit, but could also be a party contemplating filing a lawsuit or a defendant in a suit. We believe our research and analysis in this article would generally apply regardless of whether the client receiving funding is a claimant who has not yet filed suit, a plaintiff in a pending suit, or a defendant facing a claim in litigation. Nevertheless, these issues most frequently arise in a context where the funded party is or becomes a plaintiff in litigation.
continue to communicate with the plaintiff about the budget, strategy, and developments in the case. Naturally, the plaintiff and the funder will want to keep all these communications confidential and protected from discovery during litigation.

If the defendant believes the plaintiff sought or obtained funding, then he may seek to obtain discovery of two kinds of documents discussed above: the funding agreement and “non-deal documents.” We include within “non-deal documents” all communications besides the contract to provide funding. This might include due diligence materials shared with the funder before the plaintiff and funder agree on funding, communications reflecting negotiations between funder and client over funding terms, and communications after agreement is reached, such as discussions with the funder about mundane administrative matters, litigation strategy, and budgeting. Once the defendant seeks discovery of the funding agreement and non-deal documents, the court either denies the defendant’s request, compels the plaintiff to produce all the requested discovery, or compels production of only some of the requested information, excluding privileged or work-product material or material it concludes are not within the scope of permissible discovery. The court may analyze the scope of permissible discovery, as well as work-product and privilege issues, separately for the funding agreement and non-deal documents.
Many commentators apparently believe that lawyers cannot predict whether a court will compel discovery of information shared with a commercial litigation funder because few decisions exist on the issue.\(^2\) Indeed, no appellate court has ruled on precisely this issue. However, after analyzing thirty-two trial court decisions, we found courts most often deny or limit discovery of funding agreements and communications with funders, as shown by Figure 1. Occasionally, a court allows discovery of funding documents in unusual cases, but courts so far have not found this minority of decisions persuasive.

This paper summarizes the outcomes of the discovery decisions we found and then explores the reasoning behind these decisions. Section II summarizes the outcomes and the clear trend toward

protecting funding documents from discovery. Section III discusses why relevance to a claim or defense, attorney-client privilege, and the work-product doctrine have protected information shared with funders in these cases. A few courts have compelled discovery of information shared with funders, but after analyzing a properly-raised work-product claim, only two judges have concluded that sharing information with a funder under normal commercial funding conditions waives all work-product protection. Section IV gives special attention to several exceptional cases where a judge allowed discovery. It explains why courts have not found these cases persuasive and why future courts likely will not find these cases as persuasive as the majority of decisions denying discovery of funding documents.

II. SUMMARY OF DISCOVERY DECISIONS

After an extensive search of the federal dockets and major legal databases, we found over thirty opinions or orders on motions to compel discovery of information shared with litigation funders. We identified 32 of these cases as directly deciding this issue and divided those cases into three general categories. In Category One, no discovery was allowed in 17 cases and very limited discovery was allowed in 1 case. Courts in Category Two, comprising 8 cases, allowed discovery of the funding agreement or non-deal documents but limited it by redacting work-product or by denying discovery of work-product. Category Three contains 6 cases where the court granted the defendant’s request for significant, unredacted discovery of the funding agreement or non-deal documents (or, in one old state court case, both).

This article aims to capture the big picture of discovery decisions on litigation funding documents. Of course, the highly fact-specific nature of discovery decisions necessarily makes it challenging to summarize and categorize them without oversimplifying outcomes. Still, we attempt to focus on whether litigation funding documents are protected from discovery based on attorney-client privilege, work-product protection, or a lack of relevance. For this reason, we did not count some cases in this summary or in the accompanying Figures.

We excluded two cases because the decisions involved other procedural issues rather than an analysis of a privilege or work-product objection to discovery.4 Also, we note below, but excluded from this summary, a case involving a patent monetization consultant, whose situation differs somewhat from commercial litigation financing.5

**Category One – No or Limited Discovery Allowed.** First, in eighteen cases, courts denied the defendant’s request for discovery of information shared with funders. In sixteen of these cases, the court refused to compel any discovery of the funding agreement or other information shared with a litigation funder.6 In another case, the court did not discuss discovery of the funding agreement and allowed very limited discovery of a few non-deal documents, which were redacted.7 Furthermore, in the eighteenth of these cases,

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4 We excluded Hologram USA, Inc. v. Pulse Evolution Corp., No. 2:14-cv-00772-GMN-NJK, 2016 U.S. Dist. LEXIS 87323, at *4-5, 7 (D. Nev. July 5, 2016) (denying discovery due to a failure to timely object) and Bray & Gillespie Mgmt. LLC v. Lexington Ins. Co., No. 6:07CV222-ORL-35KRS, 2008 WL 5054695 (M.D. Fla. Nov. 17, 2008). In Bray, an early case addressing this issue, the court rejected the plaintiff’s blanket objection to discovery on procedural grounds, and the court held it would resolve the discovery objection on a question by question basis in the future.


the court granted a motion to quash a subpoena served on the funder, a non-party in the case.\textsuperscript{8}

\textit{Category Two – Limited Discovery Allowed.} Second, in eight of the 32 decisions, the court held some, but not all, of the material shared with funders constituted work-product that deserved protection from discovery. In five of these cases, the court only allowed discovery of the funding agreement in redacted form to protect work-product in that document.\textsuperscript{9} In three other of these cases, the court remained silent as to discovery of the funding agreement, but compelled discovery of non-deal documents.\textsuperscript{10} As discussed below in \textsection{III}, the courts in Categories One and Two limited discovery of the funding agreement and non-deal documents because they were not relevant, protected by attorney-client privilege, or protected by the work-product doctrine.

\textit{Category Three – Significant Discovery Allowed.} In six exceptional cases, courts compelled significant discovery of usually privileged information. In most of these cases, there was not much case law on this issue at the time of decision, or the plaintiff failed to raise all the usual objections. \textsection{IV} discusses the facts, procedural history, and historical context that make these six cases not as representative of the overall case law as the twenty-two other cases in Categories One and Two. In two cases in Category Three, the court compelled production of the funding agreement without any


\textsuperscript{10} Odyssey Wireless, Inc. v. Samsung Elecs. Co., Ltd, No. 315CV01735HRBB, 2016 WL 7665898, 2016 U.S. Dist. LEXIS 188611 (S.D. Cal. Sept. 20, 2016); Morley v. Square, Inc., No. 4:10CV2243 SNLJ, 2015 WL 7273318, 2015 U.S. Dist. LEXIS 155569 (E.D. Mo. Nov. 18, 2015). As in the cases compelling disclosure of the redacted funding agreement, both the Odyssey and Morley courts allowed for redaction of privileged information or work-product in the non-deal documents produced. The Ala. Aircraft Indus. court held that “providing a draft complaint to a litigation funding source does not waive the work-product privilege,” but the court allowed discovery of two emails with a funder where only attorney-client privilege was claimed, Ala. Aircraft Indus. v. Boeing Co., No. 2:16-mc-01216-RDP, at *31, 33, 49 (N.D. Ala. Feb. 9, 2018). We categorized that case here and with the cases allowing only redacted discovery because the emails did not appear to be about obtaining litigation funding nor was work-product protection asserted for them. \textit{See id.}
information redacted.\(^\text{11}\) In three other cases, the court compelled production of non-deal documents, without addressing discovery of the funding agreement.\(^\text{12}\) In one 2004 Massachusetts case, Conlon v. Rosa, the court allowed discovery of the redacted funding agreement and non-deal documents.\(^\text{13}\)

Overall, the majority of cases we found did not allow much, if any, discovery of information shared with litigation funders. Moreover, the change in results over time is significant. As illustrated by the increase in the blue bars in Figure 2, over time, courts appear to be moving towards the conclusion that funding agreements and non-deal documents contain a substantial amount of protected work-product.\(^\text{14}\) Most decisions allowing significant discovery of the funding agreement and non-deal documents in the face of a strong work-product argument by the plaintiff were decided several years ago, before the decision in Miller v. Caterpillar in 2014, the leading decision in this area.\(^\text{15}\) The Acceleration Bay decision in 2018 was a noticeable exception to this trend, but it involved unusual facts and did not distinguish prior cases in a way likely to prompt other courts to depart from the current majority view.


III. WHY COURTS DENY DISCOVERY OF FUNDING DOCUMENTS

Among other requirements for discovery in Federal Rule of Civil Procedure 26, a document must be relevant to a party’s claim or defense to be discoverable. Relevant information might still not be discoverable if it is protected by the attorney-client privilege or the work-product doctrine. As discussed in the three sections below, courts deny requests for discovery of litigation funding agreements and non-deal documents because these documents are not relevant, are protected by attorney-client privilege, or are protected work-product. When a plaintiff discloses privileged information or work-product to a third-party, that disclosure may lead to waiver of attorney-client privilege or work-product protection, but exceptions and limits on waiver allow funding documents to retain these protections.
Figure 3 illustrates how often a court has found each of these grounds persuasive when deciding to limit, at least to some extent, a defendant’s request for discovery of funding documents. Although each of these three grounds alone has sufficed to deny discovery of any funding documents, courts most often deny or limit discovery of funding documents because the work-product doctrine protects the documents. Accordingly, the few courts permitting discovery of funding documents did so most often due to a finding of no attorney-client privilege, as shown by the grey area Figure 3’s third column.

A. The Requirement of Relevance for Funding Documents to be Discoverable
As a threshold matter in federal court, a party may only discover a “nonprivileged matter that is relevant to any party’s claim or defense.”16 Defendants have argued funding documents are relevant to determine:

- the adequacy of class counsel;17
- if the plaintiff no longer has standing because the patent or claim was transferred;18
- whether funders are indispensable parties or witnesses;19
- whether a funder declined to take a case because the patent in an infringement suit is invalid;20
- whether the plaintiff’s claims are barred under the statute of limitations; and21
- “possible bias issues” with jury members and witnesses.22

The relevancy threshold is fairly low, allowing for expansive discovery.23 Hence, most courts do not deny discovery of funding documents on this basis. Nevertheless, in six cases, courts denied some discovery requests because the funding agreement or communications with funders were not relevant.24

In three intellectual property cases out of the Northern District of California and in one business dispute, courts found the defendants’ requests for funding documents not relevant. In

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21 Doe, 2014 WL 1715376, at *2 (finding the funding documents relevant and contrasting the statute of limitations issue here with Miller where the documents were not relevant).

22 Micron, 2019 WL 118595, at *1.

23 For example, information “need not be admissible in evidence to be discoverable.” Fed. R. Civ. P. 26(b)(1).

Telesocial, for example, the court simply stated that the defendant “did not show any relevance to the claims.”²⁵ In VHT, Inc. v. Zillow Group, Inc., the defendant made several unsubstantiated and speculative arguments, such as that an agreement to assign recovery in the case would be relevant to whether the plaintiff “has standing to pursue its copyright infringement claims.”²⁶ Even after allowing the defendant to file amended counterclaims, the court found that “[n]othing more than speculation supports [the defendant’s] arguments,” which consisted of “imaginable hypotheticals.”²⁷ Therefore, the requested litigation funding information was “disproportional to the needs of the case,” so the court denied the defendant’s motion to compel.²⁸

In class actions, defendants have argued litigation funding documents are relevant to the defendant’s determination of the adequacy of class counsel under Federal Rule of Civil Procedure 23(g).²⁹ This argument has not always been successful in persuading a court to allow discovery. For example, in Kaplan v. S.A.C. Capital Advisors, L.P., the Southern District of New York found “purely speculative” all the reasons the defendants claimed they were entitled to discovery, including the claim that “the funding agreements ‘could cause class counsel’s interest to differ from those of the putative class . . .’”³⁰ “The plaintiffs’ admission that they have entered into a litigation funding agreement does not, of itself, constitute a basis for questioning counsel’s ability to fund the litigation adequately.”³¹ The court denied the defendants’ motion to compel production of

²⁶ VHT, 2016 U.S. Dist. LEXIS 172373, at *3-4.
²⁷ Id. at *4.
²⁸ Id.
²⁹ See Kaplan, 2015 U.S. Dist. LEXIS 135031, at *16-17. See also Gharabe, 2016 U.S. Dist. LEXIS 103594, at *3-4. This issue arises is especially likely to arise in class actions in the Northern District of California because that district has adopted a standing order making the disclosure required for class action under Civil Local Rule 3-15 include disclosure of “any person or entity that is funding the prosecution of any claim or counterclaim.” See https://www.cand.uscourts.gov/filelibrary/373/Standing_Order_All_Judges_1.17.2017.pdf. A survey of disclosure rules for litigation funding can be found in a Memorandum by Patrick A. Tighe in the Advisory Committee on Civil Rules, Agenda Materials, Philadelphia, PA, April 10, 2018, at 209, available at http://www.uscourts.gov/sites/default/files/2018-04-civil-rules-agenda-book.pdf.
³¹ Id. at *17.
litigation funding documents. In Gbarabe v. Chevron Corp., a class action (and a very unusual case) discussed in Section IV below, the Northern District of California ordered production of the entire funding agreement, unredacted, but unlike in Kaplan, the plaintiff in Gbarabe conceded the relevance of the funding agreement “to the class certification adequacy determination” and also did “not assert that the agreement is privileged.”

B. The Applicability of Attorney-Client Privilege to Funding Documents

The attorney-client privilege protects confidential communications, oral or written, between a client and his lawyer who is providing him legal advice. The party asserting the privilege bears the burden of proving the privilege applies to the documents sought in discovery. “Since the purpose behind the attorney-client privilege is to encourage full disclosure to one’s lawyer by assuring confidentiality,” the client or attorney waives the privilege if he destroys confidentiality of the communications by disclosing their content to a third-party. However, courts recognize various exceptions to this general rule of automatic waiver for breaches of confidentiality. The party asserting the privilege also bears the burden of proving an exception to waiver of the privilege if a disclosure broke the confidentiality required.

In commercial litigation funding cases, the attorney-client privilege may not apply to the funding agreement because that is a contract between the client and a third party, not a confidential communication from client to lawyer. Similarly, attorney-client

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32 Id. at *17-18.
34 Miller, 17 F. Supp. 3d at 731.
37 In re Intl Oil Trading Co., 548 B.R. at 831 (“As a threshold matter, the Funding Agreement is primarily a contract, not a communication. Under both federal and Florida law, attorney-client privilege applies only to communications, not to contracts.”).
Privilege generally may not attach to non-deal documents or communications that were not shared between the attorney and client.\textsuperscript{38} If the information shared with a funder is privileged, then sharing that information with the litigation funder waives the privilege unless an exception applies. There are two potentially applicable exceptions to this waiver of attorney-client privilege: the common interest doctrine and the less frequently used agency exception to waiver.

1. The Common Interest Doctrine

The common interest doctrine “allows communications that are already privileged to be shared between parties having a “common legal interest” without a waiver of the privilege. It does not broaden the overall applicability of attorney-client privilege. Rather, it preserves “an already-existing privilege” that would otherwise be waived by disclosure.\textsuperscript{39} In litigation funding cases, this doctrine is the most commonly analyzed exception to waiver of attorney-client privilege. Some courts insist on a “common legal interest” in contrast to a common commercial interest, whereas others define the interest more broadly as a “common enterprise.” Overall, there is a split in how courts define the “common interest” required. This divergence in the case law has led directly to divergent results in the cases we reviewed: four of the eight cases we found analyzing the issue concluded that the doctrine applies to funding documents.\textsuperscript{40}

i. The Narrow View: “A Common Legal Interest”

Some courts narrowly define the common interest doctrine as “an exception to ordinary waiver rules designed to allow attorneys for different clients pursuing a common legal strategy to communicate with each other.”\textsuperscript{41} We found four cases where the doctrine was held not to apply to funding documents because the court required and did not find a “common legal interest” between the funder and plaintiff.\textsuperscript{42}

\textsuperscript{38} See Miller, 17 F. Supp. 3d at 731; see also Ala. Aircraft Indus. v. Boeing Co., No. 2:16-mc-01216-RDP, at *31, 33 (N.D. Ala. Feb. 9, 2018) (permitting discovery because the attorney-client privilege did not apply to a client’s emails with a funder, which were not about obtaining funding).

\textsuperscript{39} Schacknow, supra note 35, at 1468.

\textsuperscript{40} See Walker, Devon, Rembrandt, and In re International Oil Trading Co. discussed below for cases finding the common interest exception applies.

\textsuperscript{41} Pac. Pictures Corp. v. United States Dist. Court, 679 F.3d 1121, 1129 (9th Cir. 2012) (a case not involving commercial litigation funding).

\textsuperscript{42} Acceleration Bay, 2018 U.S. Dist. LEXIS 21506, at *6-9; Cohen, 2015 WL 745712, at *4; Miller, 17 F. Supp. 3d at 732-33; Leader, 719 F. Supp. 2d at 376.
In analyzing the discoverability of non-deal documents, the seminal *Miller* decision held that a “shared rooting interest in the “successful outcome of a case...is not a common legal interest” because the doctrine is designed to facilitate seeking legal advice or litigation strategies, which a prospective funder does not offer.\(^{43}\) The District of Delaware reached the same conclusion in patent infringement suits in 2010 and in 2018.\(^{44}\) A federal court applying New York law described a plaintiff’s relationship with litigation funders as “inherently financial,” so the common interest exception did not apply to the waiver of privilege for funding documents.\(^{45}\)

Nonetheless, some courts apparently requiring a “common legal interest” have found the doctrine applies to litigation funding documents. Two short orders from federal courts in 2012 and 2013 state that the common interest doctrine provided an exception to the rule of waiver for privileged funding documents.\(^{46}\) In both of those cases, a common interest and non-disclosure agreement was in place.\(^{47}\) A few cases have cited these orders to support the conclusion that funding documents are privileged and not discoverable; but since 2013, however, we could not find any case that has protected funding documents on the ground that the funder and client have a “common legal interest.”

**ii. The Broader View: a “Substantially Similar Legal Interest” or a “Common Enterprise”**

Other courts view the common interest doctrine more broadly, as illustrated in two decisions on denying discovery of funding documents. In *Rembrandt Techs., L.P. v. Harris Corp.*, a Delaware state court held that an agreement to enforce patents created a “common legal interest binding the parties” because they shared a

\(^{43}\) *Miller*, 17 F. Supp. 3d at 732-33.

\(^{44}\) *Acceleration Bay*, 2018 U.S. Dist. LEXIS 21506, at *6-9; Leader*, 719 F. Supp. 2d at 376.


\(^{46}\) *Walker*, No. 11-309-SLR, at 2 (holding that a patent monetization consultant and the plaintiff had a “common legal interest,” even though the consultant was clearly “not a law firm and was not retained to provide legal services”); *Devon*, 2012 WL 4748160, at *1 (holding that the common interest doctrine, which requires a “a shared common interest in litigation strategy,” applies where the funder and plaintiff have a common interest in the successful outcome of the case).

\(^{47}\) *Walker*, No. 11-309-SLR, at 2; *Devon*, 2012 WL 4748160, at *1. The *Acceleration Bay* decision suggests that a written common interest agreement would be necessary but not necessarily sufficient for a common legal interest to exist with a litigation funder. 2018 U.S. Dist. LEXIS 21506, at *8-9.
“substantially similar” legal interest. In re International Oil Trading Co. noted this split among federal courts on how broadly to define “common interest.” Without any precedent binding it to one approach, the court chose to adopt the more expansive “common enterprise” approach, which it found more compelling and consistent with Florida law. The common interest exception alone sufficed for the court to deny the defendant’s motion to compel discovery of non-deal documents.

2. Agency Doctrine

The agency doctrine, sometimes called the Kovel doctrine, operates in the same way as the common interest doctrine – as an exception to a waiver of attorney-client privilege. It “protects from discovery the necessary communications with” non-attorney professionals, such as an accountant. Like the common interest exception, courts are split over how narrowly to limit the kinds of non-lawyer professionals the exception can cover. In contrast to the more widely analyzed common interest doctrine discussed above, only one court has analyzed the applicability of the agency doctrine to waiver of attorney-client privilege for funding documents, though there is some academic support for applying it.

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50 Id. at 833. The court also found the agency exception and work-product doctrine protected the non-deal documents. Id. at 835, 837. The court held the funding agreement was protected by the work-product doctrine, though this was overcome for part of the agreement as discussed below. Id. at 839.

51 Id. at 833; see United States v. Kovel, 296 F.2d 918 (2d Cir. 1961) (the first case to articulate this exception and applying the exception to an accountant).

52 In re Int’l Oil Trading Co., 548 B.R. at 834; DeStefano, supra note 2, 331-341 (2014).

53 In re Int’l Oil Trading, 548 B.R. at 833-35. The court in Cohen v. Cohen alluded to the agency exception to waiver, but the court did not address it because the plaintiff withdrew any privilege argument. 2015 WL 745712, at *2 n.1. Also, the plaintiff in Viamedia argued for the agency exception, but the attorney-client privilege issue was not reached by the court since discovery was denied on the basis of work-product protection. Mem. of Law in Support of Pl. Viamedia, Inc.’s Opp’n to Def.’s Mot. To Compel Pl. to Produce Docs., at 10-11, May 17, 2017, Case No. 1:16-cv-05486, ECF No. 117.

See Ani-Rae Lovell, Note, Protecting Privilege: How Alternative Litigation Finance Supports an Attorney’s Role, 28 Geo. J. Legal Ethics 703, 704 (2015) (arguing “that sharing documents with alternative litigation finance firms should not constitute waiver of attorney-client privilege under the Kovel doctrine if the party can demonstrate that” the funder’s involvement “bolsters several of the recognized roles of the modern attorney.”) But see Giesel, Alternative Litigation Finance and the Attorney-Client Privilege, supra note 35, at 139-140 (observing that most courts have a narrow view of the Kovel agency doctrine, so they will rarely apply it to litigation funders).
In addition to holding the common interest doctrine applied to funding documents, *In re International Oil Trading Co.* held the agency doctrine applied to communications with a litigation funder.\(^{54}\) As with the common interest doctrine discussed above, the court chose to apply the “broader approach to the “agency exception,”” which it found consistent with Florida law, federal law, and the purpose of the exception.\(^{55}\) The court interpreted Florida law as protecting communications with any party who assists the client in obtaining legal services.”\(^{56}\) And some federal courts have applied the agency exception “to professionals with whom communication may be necessary for the provision of legal advice.”\(^{57}\) “Litigation funders may be essential to the provision of legal advice in” cases brought by a creditor with little money against well-funded debtor.\(^{58}\) Thus, the agency exception applies to a waiver of attorney-client privilege for non-deal documents shared with a litigation funder.\(^{59}\)

Thus, the agency exception provides a relatively new approach courts may take when analyzing the discoverability of funding documents, but most courts will probably continue to decide the issue more easily on the grounds of work-product protection, as discussed below. Neither party in *In re Int'l Oil Trading Co.* addressed the agency exception. Now, plaintiffs may consider the agency exception yet another argument that could only bolster their case. They should, however, be cautious about how they make all these arguments together. For instance, arguing that the plaintiff and funder have a common legal interest may be undermined by simultaneously arguing the funder serves as an independent non-attorney professional (who would not have the same legal interest in the way joint parties do).\(^{60}\)

### C. Work-Product Protection for Funding Documents

If a court does not consider funding documents protected by attorney-client privilege, they could still be protected by the work-product doctrine, as codified in the Federal Rules of Civil Procedure for example. Rule 26(b)(3) states that a party may not ordinarily

\(^{54}\) *In re Int'l Oil Trading Co.*, 548 B.R. at 835.

\(^{55}\) *Id.* at 834-35.

\(^{56}\) *Id.* at 834.

\(^{57}\) *Id.* at 834.

\(^{58}\) *Id.* at 835.

\(^{59}\) *Id.*

\(^{60}\) DeStefano, *supra* note 2, at 352.
“discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative (including the other party’s attorney, consultant, surety, indemnitor, insurer, or agent).” The majority of federal courts broadly interpret “prepared in anticipation of litigation” as requiring that the documents were prepared “because of” litigation. A small minority of federal courts (most notably the Fifth Circuit) require the “primary motivating purpose” for creating the documents was litigation.\(^{61}\) As with the assertion of attorney-client privilege, the party asserting the privilege – here, the plaintiff – bears the burden of proving the documents satisfy the appropriate test.

Courts often hold that the work-product doctrine protects at least some material in the funding agreement and usually all non-deal documents.\(^{62}\) Of the thirty-two cases we found, twenty courts have held that the work-product doctrine provided at least some protection for the information in documents shared with litigation funders.\(^{63}\) It did not matter whether the material was prepared before litigation is filed.\(^{64}\) Nor did it matter that the funding documents serve a “business purpose” because the “documents simultaneously also are litigation documents.”\(^{65}\) The court in Miller explained that an alternative rule

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\(^{61}\) See DeStefano, supra note 2, at 355 n.239 (listing the Circuits that use the “because of” test and citing articles identifying the two tests); Giesel, *Alternative Litigation Finance and the Work-Product Doctrine*, supra note 2, at 1101. Also, the Wright & Miller treatise prefers the “because of” test, and it states that “the test should be whether, in light of the nature of the document and the factual situation in the particular case, the document can fairly be said to have been prepared or obtained because of the prospect of litigation.” 8 Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure § 2024* (3d ed. 2017).

\(^{62}\) A recent decision noted several courts have concluded funding documents are protected work-product. See Viamedia, 2017 U.S. Dist. LEXIS 101852, at *6.


\(^{64}\) See *Ala. Aircraft Indus. v. Boeing Co.*, No. 2:16-mc-01216-RDP, at *49 (N.D. Ala. Feb. 9, 2018) (citing *Miller* and holding a draft complaint shared with a funder was protected work-product); *Mondis*, 2011 WL 1714304, at *3.

\(^{65}\) *Carlyle*, 2015 WL 778846, at *9; see *Lambeth*, 2018 WL 466045, at *5 (“Even if the Court were to . . . consider the relationships to be commercial, the materials nonetheless fall within work-product immunity because they were communications with Plaintiff’s agents and in anticipation of litigation.”); see also *Miller*, 17 F. Supp. 3d at 735. (“Materials that contain counsel's theories and mental impressions
denying work-product protection for “dual purpose” documents would undermine the work-product doctrine by allowing discovery of attorneys’ mental impressions and litigating strategies – “precisely the type of discovery that the Supreme Court refused to permit in Hickman,” the seminal decision recognizing work-product protection.66

Several courts have found that funding documents satisfy the narrower “primary motivating purpose” test for work-product protection.67 However, the District of Delaware in Acceleration Bay recently denied work-product protection for communications with a funder because it applied the Fifth Circuit’s “primary motivating purpose” test, not the Third Circuit’s “because of” litigation test.68 Here, the choice of the “primary motivating purpose” test led the court to conclude the communications were primarily for the purpose of obtaining a loan since litigation had not commenced at that time.69

Besides Acceleration Bay, we found two other cases that explicitly rejected work-product protection for funding documents.70 In 2008, the district court in Bray rejected blanket assertions of work-product protection during a deposition.71 In 2010, the court in Leader upheld a magistrate’s decision to allow discovery of non-deal documents as not clearly erroneous, but it did not analyze the work-product doctrine apart from claims of attorney-client privilege.72

created to analyze [the plaintiff’s] case do not necessarily cease to be protected because they may also have been prepared or used to help [the plaintiff] obtain financing.”).

66 See Miller, 17 F. Supp. 3d at 735 (quoting United States v. Adlman, 134 F.3d 1194, 1199 (2d Cir.1998)).


69 Id. A few years before, the Delaware Chancery Court predicted the choice of test “may be outcome-determinative.” Carlyle, 2015 WL 778846, at *8 (citing DeStefano, supra note 2, at 355–61). Until Acceleration Bay, we had not found a decision where the choice of test changed the outcome of a case.

70 Bray and Leader.

71 Bray, 2008 WL 5054695.

72 Leader, 719 F. Supp. 2d at 376.
The work-product doctrine has eroded slightly in several other cases allowing discovery of redacted funding agreements and redacted non-deal documents. For discovery of funding agreements, four decisions compelled production of the funding agreement while allowing the plaintiff to redact core opinion work-product.\textsuperscript{73} The discovery allowed in these cases was minimal because the courts treated the funding agreements’ strategically valuable terms (such as financial terms and possibility of success) as work-product. For discovery of non-deal documents, three decisions allowed discovery of non-deal documents with work-product redacted.\textsuperscript{74} These courts granted work-product protection for funding documents, but the protection was not absolute for the entirety of the documents. Except for the decisions finding a “substantial need” as discussed below, these decisions do not clearly explain why they chose to permit discovery with redaction instead of completely denying discovery all discovery.

1. Exceptions to Work-Product Protection: Waiver and “Substantial Need”

If funding documents constitute work-product, a defendant can still obtain discovery of the documents if he shows an exception to work-product protection applies. The two main exceptions to work-product protection here are when the disclosure of work-product to a funder (or prospective funder) “substantially increased” the likelihood of the defendant obtaining it, or the defendant has a “substantial need” for these documents. In the cases we found, only the second exception, “substantial need,” has led to discovery of funding documents protected by the work-product doctrine. Even if the court allows some discovery under one of these exceptions, the

\textsuperscript{73} Elenza, Inc. v. Alcon Labs., No. N14C-03-185 MMJ CCLD (Del. Super. Ct. June 14, 2016); In re Int’l Oil Trading Co., 548 B.R. at 839; Charge Injection, 2015 WL 1540520, at *4-5 (citing Carlyle); Carlyle, 2015 WL 778846, at *9-10 (“the terms of the final agreement–such as the financing premium or acceptable settlement conditions–could reflect an analysis of the merits of the case”). One court allowed discovery of a funding agreement with redaction, but the court did not cite work-product protection as its rationale for limiting discovery. Queens, No. 2:14CV53-JRG-RSP (E.D. Tex. Apr. 10, 2015) (ordering, in a cursory opinion, the plaintiff to produce funding agreements with the “dollar amounts” and “percentages” redacted) (excluded from number of decisions eroding work-product because the court did not refer to the work-product doctrine as the basis for its decision).

\textsuperscript{74} Odyssey Wireless, 2016 U.S. Dist. LEXIS 188611, at *20-24 (allowing discovery of patent valuations, as discussed below); Morley, 2015 U.S. Dist. LEXIS 155569, at *10; Doe v. Soc’y of Missionaries of Sacred Heart, 2014 WL 1715376, at *4-5 (The defendant requested documents to support its statute of limitations defense, and the discovery allowed here appears to have been extremely limited, which is why we classified this case in Category One).
court “must protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of a party’s attorney or other representative concerning the litigation.”

i. Waiver of Work-Product Protection by Disclosure to Third Party

First, work-product protection may be waived if the materials are disclosed to a third-party. However, unlike the automatic waiver for attorney-client privilege, the “disclosure of a document to third persons does not waive the work-product immunity unless it has substantially increased the opportunities for potential adversaries to obtain the information.”

Also, the “party asserting waiver has the burden to show that a waiver occurred.” “The reason for this difference [between waiver of attorney-client privilege and work-product] is the work-product doctrine’s roots in the adversarial process—the point of the protection is not to keep information secret from the world at large but rather to keep it out of the hands of one’s adversary in litigation.”

Courts have not found work-product protection waived by disclosure to a litigation funder. In fact, the defendants in the recent Viamedia case did not even “argue that Viamedia waived the work-product doctrine by disclosing documents to litigation funding firms under” a non-disclosure agreement. In most of the cases we found, the plaintiff executed a non-disclosure agreement or confidentiality agreement prior to sharing non-deal documents, such as due diligence materials, with a funder. This has reassured courts that disclosures to a funder “did not substantially increase the likelihood that an adversary would come into possession of the materials.”

Even the lack of a confidentiality agreement, oral or written, “may not be fatal to a finding of non-waiver” because “a prospective funder

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77 Miller, 17 F. Supp. 3d at 737.
79 Glover, supra note 2, at 925-26 (citing cases).
81 Mondis, 2011 WL 1714304, at *3.
would hardly advance his business interests by gratuitously” sharing due diligence materials with the defendant.\(^8\)

**ii. The “Substantial Need” Exception to Work-Product Protection**

Second, work-product may be discoverable if the party seeking discovery “shows that it has substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means.”\(^8\) Two courts have found a defendant’s substantial need for some information overcame work-product protection for some, but not all, information in funding documents.\(^8\) Both cases limited the discovery to protect the most valuable strategic information.

*In re Int’l Oil Trading Co.* held that the non-deal documents and funding agreement were both protected work-product.\(^8\) The debtor failed to demonstrate a substantial need for the non-deal documents, which the court considered “rarely discoverable” opinion work-product.\(^8\) The debtor did, however, successfully demonstrate a substantial need for the funding agreement because the debtor argued it was key to determining whether the creditor transferred some or all of his claim in exchange for financing.\(^8\) Recognizing that “some terms of a litigation funding agreement represent an assessment of risk based on discussions of core opinion work-product of the case,” the court ordered discovery of the funding agreement, but allowed the creditor to redact attorney opinions from it.\(^8\)

Similarly, in *Odyssey Wireless*, the defendants demonstrated a substantial need for the plaintiff’s valuation of patents at issue in the infringement suit because they had no other information on the plaintiff’s valuation of the patents, which was crucial information for their damages case.\(^8\) The court held all the funding documents

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\(^8\) *Miller*, 17 F. Supp. 3d at 738.
\(^8\) Fed. R. Civ. P. 26(b)(3).
\(^8\) However, the defendant in *Charge Injection*, for example, failed to demonstrate under Delaware law substantial need for the payment terms in the plaintiff’s funding agreement. *Charge Injection*, 2015 WL 1540520, at *5.

\(^8\) *In re Int’l Oil Trading Co.*, 548 B.R. at 837, 838.

\(^8\) *Id.* at 838.

\(^8\) *Id.* at 838-39.

\(^8\) *Id.* at 839.

requested were protected work-product except for the portions on the valuation of the patents.\textsuperscript{90}

In conclusion, the work-product doctrine provides strong protection against discovery of funding documents, and it is the most common ground on which courts hold funding documents are not discoverable. There is some concern among academic commentators that “work product protection may not be enough in cases where [a funder] demands confidential information beyond what was created by attorneys” for due diligence, but we did not see that reflected in any of the cases we found.\textsuperscript{91} In practice, the work-product doctrine suffices to protect funding documents from discovery because “[r]eputable financing providers do not seek information that is confidential due solely to the attorney-client privilege.”\textsuperscript{92}

IV. EXCEPTIONAL CASES

We found six cases where a court compelled extensive discovery of litigation funding documents, but where the unusual circumstances of the cases distinguishes them from the trend of cases upholding objections to such discovery requests. Not surprisingly, these cases have never been cited affirmatively and followed when a court has decided whether funding documents are protected by the work-product doctrine.\textsuperscript{93} In the two cases discussed first below, only the funding agreement was discovered. In the four other of these six exceptional cases, the courts allowed significant discovery of non-deal documents and some discovery of the funding agreement.

A. Discovery of the Funding Agreement

Discovery of the entire, unredacted funding agreement was allowed in two cases, but neither case analyzed work-product protection for the funding agreement.

\textsuperscript{90} Id.

\textsuperscript{91} Jihyun Yoo, Note, Protecting Confidential Information Disclosed to Alternative Litigation Finance Entities, 27 Geo. J. Legal Ethics 1005, 1012 (2014); accord Schacknow, supra note 35, at 1479 (citing Yoo).

\textsuperscript{92} Charles Agee, Guide to Litigation Financing, https://www.americanbar.org/content/dam/aba/administrative/litigation/materials/2015_spring_leadership_meeting/guide_to_litigation_financing_may_2014_charles_agee.authcheckdam.pdf

\textsuperscript{93} In its attorney-client privilege analysis, Acceleration Bay cites Leader, but it does not cite any of these litigation funding cases in its section analyzing work-product protection. Acceleration Bay, 2018 U.S. Dist. LEXIS 21506, at *5-9.
In *Gbarabe v. Chevron Corp.*, a class action, the court compelled production of the unredacted funding agreement in order to allow the defendant to determine the adequacy of class counsel, who were solo practitioners. In its objection to the discovery, class counsel conceded the relevance of the agreement and did not claim the agreement was privileged. Several aspects of *Gbarabe* distinguish it from the usual discovery dispute over litigation funding documents. First, class counsel did not raise several strong objections to discovery – that the documents were privileged and not relevant. In another earlier class action, for example, the Southern District of New York denied the defendant’s discovery request for funding documents because the request was not relevant under Rule 26. Second, class counsel had already voluntarily turned over a redacted version of the funding agreement. Third, class counsel here appeared to be “solo practitioners” who were “dependent on outside funding to prosecute the case.” Thus, *Gbarabe* is not representative of most commercial litigation funding cases or even of funding in class actions. No court has cited it yet, and the opinion does not provide a strong basis for future defendants to obtain the same result without the presence of the special facts in *Gbarabe*.

Four years ago, *Cobra Int’l, Inc. v. BCNY Int’l, Inc.* held, without any discussion, that the plaintiff’s funding agreement was not privileged and was relevant for the defendant to determine whether the plaintiff transferred ownership of the patent at issue in the infringement suit. The court did not explicitly discuss work-product protection for the funding agreement or whether portions of the agreement could be redacted. Again, we could not find any

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95 *Id.*
96 *Kaplan*, 2015 U.S. Dist. LEXIS 135031, at *17-18
97 *Id.* at 4.
98 *Id.* at 4.
99 In fact, Judge Illston, who permitted discovery in *Gbarabe*, recently denied a defendant’s request for discovery as to litigation funding because it was not relevant to the intellectual property case. *Micron*, 2019 WL 118595, at *2.
101 *Id.*
decision citing Cobra. Like Gbarabe, its silence on work-product protection suggests it has minimal significance for future cases.

B. Discovery of Non-Deal Documents, Including Diligence Materials

A court has allowed significant discovery of non-deal documents in four cases. Three cases, most of which were decided several years ago, focused on the lack of attorney-client privilege protection. Only one case, Acceleration Bay, concluded neither attorney-client privilege nor work-product protection applied to non-deal documents after separately analyzing both doctrines.

1. Attorney-Client Privilege Did Not Apply to Non-Deal Documents in Conlon, Cohen, and Leader

Most of the cases allowing significant discovery were among the oldest cases we found. Conlon v. Rosa was a 2004 action in Massachusetts state court against a zoning board. This was not a typical commercial litigation finance case because apparently the plaintiff’s tenant funded the zoning challenge to prevent the tenant’s business competitor from opening a store nearby. The court ordered production of the funding agreement in redacted form, the plaintiff’s lease with its funder, and some related documents. This discovery decision is hard to separate from the specific circumstances of the parties, whose relationship was unlike that typical of the commercial litigation finance industry.

In two cases, courts held non-deal documents were discoverable, without redaction, because they were not privileged. In Cohen v. Cohen, a divorce case where the court applied New York law, the plaintiff withdrew her claim that emails with her funder constituted work-product, and the court permitted discovery of emails between the funder and the plaintiff because the communications with the funder waived any applicable attorney-client privilege. The lack of a work-product claim here probably contributed significantly to the court’s decision to allow discovery.

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103 Id. at *2-5.
104 Id. at *12.
In the 2010 Leader v. Facebook decision, the district court judge upheld as not clearly erroneous a magistrate’s decision to allow discovery of information shared with a prospective funder. The Leader court acknowledged that the law at that time was unsettled on how broadly to define the common interest exception to waiver of the attorney-client privilege.\textsuperscript{106} As in Gbarabe, Cobra, and Cohen above, work-product protection was not discussed apart from attorney-client privilege.\textsuperscript{107}

Leader has had minimal influence on the subsequent litigation funding discovery disputes we found. A bankruptcy court in Florida expressly distinguished Leader and chose not to follow its approach.\textsuperscript{108} The District of Delaware recently cited Leader in its analysis of the common interest doctrine in Acceleration Bay, which is discussed below. However, the District of Delaware has not followed Leader in cases involving patent monetization consultants, suggesting a possible shift or split within the District on this issue. In Intellectual Ventures v. Altera, Judge Stark, who was the then magistrate judge earlier upheld in Leader, granted attorney-client privilege protection to some communications with a consultant because a sufficient common interest existed between the plaintiff and the consultant who helped “review, evaluate, and negotiate deals in order to assist [the Plaintiff] in acquiring patents.”\textsuperscript{109} Likewise, the court in Walker Digital found a sufficient common interest existed with a patent monetization company to preserve attorney-client privilege or work-product protection for documents shared with that company.\textsuperscript{110} Thus, when considered alongside the many decisions we found since Leader, Leader was one early decision that does not represent the current position of most courts or even, perhaps, the District of Delaware.

\textsuperscript{106} Leader Techs., Inc. v. Facebook, Inc., 719 F. Supp. 2d 373, 376 (D. Del. 2010).
\textsuperscript{107} See id.
\textsuperscript{108} See, e.g., In re Int'l Oil Trading Co., 548 B.R. at 832-33.
2. Neither Attorney-Client Privilege Nor Work-Product Protection Applied to Non-Deal Documents in Acceleration Bay

Besides the cursory denial of work-product protection in Leader, the recent decision in Acceleration Bay was the only decision we found where a court explicitly denied a plaintiff’s claim of work-product protection for funding documents and allowed significant discovery of non-deal documents without redaction. Courts are still unlikely to allow discovery of litigation funding documents after Acceleration Bay because it dealt with an unusual application of the law to uncommon facts.

To begin with, the facts of Acceleration Bay were uncommon because the plaintiff and funder had not yet executed a common interest or non-disclosure agreement during their communications about funding. More importantly, as discussed in Section III above, the court in Acceleration Bay did not apply the controlling “because of litigation” test used in the Third Circuit. Instead, it applied the Fifth Circuit’s “primary motivating purpose” test for work-product, and it applied that test more narrowly than several prior decisions involving discovery of funding documents. Surprisingly, the court’s work-product analysis did not cite to any of the opinions we identified above that specifically address why funding documents qualify as work-product. In addition, the court held that the funding documents did not qualify for attorney-client privilege because their disclosure to the funder breached the required confidentiality. The absence of a common interest between the prospective funder and future plaintiff, as evidenced (in part) by the lack of any written agreement at the time of the communications, prevented the common interest exception from curing that breach. The court’s finding of no common interest is consistent with some prior decisions, but there is a split of authority on this issue.

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111 Acceleration Bay, 2018 U.S. Dist. LEXIS 21506, at *8. Additional facts specific to this case, as noted in the Special Master’s opinion, are that the plaintiff initially claimed there were no responsive documents to produce and did not log the funding communications as privileged. No. 1:16-cv-00454-RGA, ECF No. 327, at *4-7 (Nov. 22, 2017).

112 See supra note 67 and accompanying text (citing cases from the Fifth Circuit and a case from the Eleventh Circuit).


114 Id. at *7-9 (citing Leader to support the conclusion that there was no common legal interest).

115 See supra note 40 and accompanying text.
Although there are now numerous decisions on attorney-client privilege and work-product protection for funding documents, the decision in Acceleration Bay suggests courts may still be unfamiliar with the issue. Furthermore, plaintiffs should execute a common interest and non-disclosure agreement with funders before sharing confidential information.

V. CONCLUSION

Work-product protection has consistently been the strongest ground for denying discovery of funding documents, and we expect courts to continue to follow the approach in Miller and its progeny. Although some courts have departed from this approach, their work-product analysis (or lack thereof) remains the minority view and has yet to persuade courts.
APPENDIX A

Decisions Concerning Discoverability of Litigation Funding Agreements and Documents Related to Litigation Funding
(Revised as of February 11, 2019)


Leader Techs., Inc. v. Facebook, Inc., 719 F. Supp. 2d 373, 376 (D. Del. 2010).


APPENDIX B

Decisions Concerning Discoverability of Litigation Funding Agreements and Documents Related to Litigation Funding – Organized by Jurisdiction
(Revised as of February 11, 2019)

STATE COURTS (AND FEDERAL COURTS APPLYING STATE LAW)

Delaware


Florida

Massachusetts

New York
FEDERAL COURTS
Listed alphabetically according to the state where the court sits.

Alabama

California


Delaware
Leader Techs., Inc. v. Facebook, Inc., 719 F. Supp. 2d 373, 376 (D. Del. 2010).


Florida


**Illinois**  


**Missouri**  

**New York**  


**Ohio**  

**Pennsylvania**  


Texas


Washington
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