

A Model Litigation Finance Contract

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ABSTRACT: Litigation financing is nonrecourse funding of litigation by a non-party for a profit. It is a burgeoning and controversial phenomenon that has penetrated the United States in recent years. Since “most of the important phenomena of modern litigation are best understood as results of changes in the financing and capitalization of the bar,” it is not surprising that litigation financing has been dubbed by RAND as one of the “biggest and most influential trends in civil justice” and by the Chamber of Commerce as “a clear and present danger to the impartial and efficient administration of civil justice in the United States.”

Despite the growing importance of the practice, there is an absence of information about or discussion of litigation finance contracting, even though all the benefits and risks embodied in litigation funding stem from the relationships those contracts shape and formalize. In this Article, we: (1) set out the efficiency and justice cases for a model contract; (2) build on previous work to make the case for using venture capitalism as an analog and starting point for modeling litigation finance contracts; (3) describe the ethical and economic challenges faced by the parties entering into litigation finance contracts and explain the contractual solutions we suggest in order to minimize and in some cases eliminate such pitfalls; (4) provide a model contract; and (5) conclude by mapping out a research agenda for the new field of litigation finance contracting.

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INTRODUCTION

Litigation financing is nonrecourse funding of litigation by a non-party for a profit. It is a burgeoning and controversial phenomenon that has penetrated the United States in recent years, after flourishing in other common law jurisdictions. Since changes to the financing and capitalization of the bar “affect the outcome[s] of cases,”¹ it is not surprising that litigation financing has been dubbed by the RAND Institute for Civil Justice as one of the “biggest and most influential trends in civil justice.”² Nor is it any surprise that it caught the attention of the leading daily press—as exemplified by the *New York Times* series “Betting on Justice”³ and *Fortune* magazine’s ongoing coverage⁴ of the high-profile financing of the even more high-profile Chevron–Ecuador litigation.⁵

Last but not least, one of the nation’s most powerful lobbying groups—the U.S. Chamber of Commerce—characterizes the practice as “a clear and present danger to the impartial and efficient administration of civil justice in the United States.”⁶ According to the Chamber, litigation funding can be expected to increase the volume of abusive litigation, undermine the control

1. See Stephen C. Yeazell, *Re-financing Civil Litigation*, 51 DEPAUL L. REV. 183, 183 (2001); see also Herbert M. Kritzer, *Fee Regimes and the Cost of Civil Justice*, 28 CIV. JUST. Q. 344, 344 (2009) (“The problem of costs in civil justice processes is an enduring issue. . . . All fee systems create a mix of positive and perverse incentives. Proposals to modify fee arrangements, either coming from reformers or from individual clients, typically fail to grasp the complexity of fee systems and how those systems interact with other aspects of the justice system.”).

2. *Third Party Litigation Funding and Claim Transfer*, RAND CORP., <http://www.rand.org/events/2009/06/02.html> (last modified Feb. 28, 2011).

3. See Binyamin Appelbaum, *Investors Put Money on Lawsuits to Get Payouts*, N.Y. TIMES (Nov. 14, 2010), <http://www.nytimes.com/2010/11/15/business/15lawsuit.html>; see also Peter Lattman & Diana B. Henriques, *Speculators Are Eager to Bet on Madoff Claims*, N.Y. TIMES DEALBOOK (Dec. 13, 2010, 9:21 PM), <http://dealbook.nytimes.com/2010/12/13/speculators-are-eager-to-bet-on-madoff-claims>; Susan Lorde Martin, Opinion, *Leveling the Playing Field*, N.Y. TIMES (Nov. 15, 2010), <http://www.nytimes.com/roomfordebate/2010/11/15/investing-in-someone-elseslawsuit/leveling-the-playing-field>.

4. Roger Parloff, *Have You Got a Piece of This Lawsuit?*, CNNMONEY (May 31, 2011, 5:00 AM), <http://features.blogs.fortune.cnn.com/2011/05/31/have-you-got-a-piece-of-this-lawsuit>; Roger Parloff, *Investment Fund: We Were Defrauded in Suit Against Chevron*, CNNMONEY (Jan. 10, 2013, 9:05 AM), <http://finance.fortune.cnn.com/2013/01/10/burford-capital-chevron-ecuador/>.

5. This ongoing litigation is the longest-running and largest-scale transnational environmental litigation in history. It stems from personal injuries and the pollution of the Ecuadorian Amazon as a result of oil operations conducted by Texaco, subsequently acquired by Chevron in 2001. In 2011, an Ecuadorian court issued an \$18 billion dollar judgment against Chevron. The award is the largest judgment ever imposed for environmental contamination. For a description and analysis of Burford Capital’s investment in the post-judgment phase of this litigation, see Maya Steinitz, *The Litigation Finance Contract*, 54 WM. & MARY L. REV. 455, 465–79 (2012).

6. U.S. CHAMBER INST. FOR LEGAL REFORM, STOPPING THE SALE ON LAWSUITS: A PROPOSAL TO REGULATE THIRD-PARTY INVESTMENTS IN LITIGATION 1 (2012), available at http://www.instituteforlegalreform.com/uploads/sites/1/TPLF_Solutions.pdf.

of plaintiffs and lawyers over litigation, deter plaintiffs from settling and thus prolong litigation, compromise the professional independence of attorneys, and more generally corrupt the attorney–client relationship.⁷

Consequently the big business lobby is advocating “a robust oversight regime to govern this type of [financing] at the federal level . . . [since the risks posed by this kind of financing] are simply too acute to be left to industry self-regulation.”⁸ Due to similar lobbying efforts, legislation to regulate at least some types of litigation funding is currently pending before twelve state legislatures—Illinois, Indiana, Iowa, Kansas, Louisiana, Missouri, Nevada, North Carolina, Rhode Island, South Carolina, Tennessee, and Texas.⁹ These, in turn, follow on the heels of Maine, which became the first state to pass legislation regulating litigation finance in 2008,¹⁰ followed shortly thereafter by Ohio, Nebraska, and Oklahoma, which also regulate lawsuit financing.¹¹

In addition to the public debate and legislative responses described above, state bar associations have also begun addressing the ethical dimensions of litigation funding. Both the New York City Bar Association and the American Bar Association have recently issued cautiously favorable final or draft opinions, respectively.¹² Thus, despite dissenting voices,

7. *Id.* at 1–2.

8. *Id.* at 2.

9. H.B. 2301, 98th Gen. Assemb., Reg. Sess. (Ill. 2013); H.B. 2300, 98th Gen. Assemb., Reg. Sess. (Ill. 2013); S.B. 378, 118th Gen. Assemb., 1st Reg. Sess. (Ind. 2013); H. Study B. 218, 85th Gen. Assemb., Reg. Sess. (Iowa 2013); S.B. 233, 2013 Gen. Assemb., Reg. Sess. (Kan. 2013); S.B. 166, 2013 Gen. Assemb., Reg. Sess. (La. 2013); H.B. 853, 97th Gen. Assemb., Reg. Sess. (Mo. 2013); S.B. 440, 97th Gen. Assemb., 1st Reg. Sess. (Mo. 2013); S.B. 361, 77th Gen. Assemb., Reg. Sess. (Nev. 2013); S.B. 648, 2013 Gen. Assemb., Reg. Sess. (N.C. 2013); H.B. 5599, 2013 Gen. Assemb., Reg. Sess. (R.I. 2013); S.B. 351, 2013 Gen. Assemb., Reg. Sess. (R.I. 2013); S.B. 788, 120th Gen. Assemb., Reg. Sess. (S.C. 2013); S.B. 1360, 108th Gen. Assemb., Reg. Sess. (Tenn. 2013); H.B. 1242, 108th Gen. Assemb., Reg. Sess. (Tenn. 2013); H.B. 1595, 83d Gen. Assemb., Reg. Sess. (Tex. 2013); H.B. 1254, 83d Gen. Assemb., Reg. Sess. (Tex. 2013); S.B. 1283, 83d Gen. Assemb., Reg. Sess. (Tex. 2013). A 2010 Delaware House Bill passed out of committee, but went no further. H.B. 422, 145th Gen. Assemb., Reg. Sess. (Del. 2010). We thank Eric Schuller from Oasis Legal Finance, LLC, for providing us this information.

10. Maine Consumer Credit Code Legal Funding Practices, ME. REV. STAT. tit. 9-A, §§ 12-101 to -107 (2008).

11. Non-recourse Civil Litigation Advances, OHIO REV. CODE ANN. § 1349.55 (West Supp. 2013); Nonrecourse Civil Litigation Act, NEB. REV. STAT. §§ 25-3301 to -3309 (Supp. 2012); Enrolled S.B. 1016, 2013 Gen. Assemb., Reg. Sess. (Okla. 2013) (to be codified at OKLA. STAT. tit. 14-A, §§ 3-701 to -717 (2013)).

12. The Ass’n of the Bar of the City of N.Y. Comm. on Prof’l Ethics, Formal Op. 2011-2 (2011) [hereinafter N.Y.C. Bar Opinion], available at <http://www.nycbar.org/ethics/ethics-opinions-local/2011-opinions/1159-formal-opinion-2011-02> (discussing third-party litigation financing); ABA COMM’N ON ETHICS 20/20, WHITE PAPER ON ALTERNATIVE LITIGATION FINANCE 17-40 (2011), available at http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111019_draft_alf_white_paper_posting.pdf; see also *infra* Part II.B.1 (providing a more detailed discussion on champerty).

litigation funding is growing globally and domestically at a fast clip¹³ and gaining acceptance.¹⁴

The size of the current market is difficult to gauge because most funders are private companies and confidentiality agreements govern much of the funding industry's activities. Estimates vary, but all indicate a large market. According to the New York City Bar Association, "[t]he aggregate amount of litigation financing outstanding is estimated to exceed \$1 billion."¹⁵ The potential market is much larger. One indicator of how much money could be invested in the future in the U.S. alone is the litigation fees of the "Am Law 200" firms, which are the gatekeepers for the large commercial claims that litigation funders are targeting. Those total fees are estimated to have been over \$84 billion in 2008.¹⁶ Another measure of market potential is the total dollar value of settlements entered into and judgments rendered each year, increased by the value of meritorious claims that are not being filed due to lack of funds. This figure is likely more than \$50 billion, which is a very conservative estimate of the annual amount paid to settle civil litigation.¹⁷

Potential market size, however, is an insufficient indicator of the dynamics driving the marketplace's rapid growth. Crucially, the emerging litigation finance industry is developing at a time when other investments with a similarly speculative profile have been discredited, leaving investors with an unmet demand. The insurance giant Lloyd's therefore projects that:

- Businesses should expect third party litigation funding to rise on both sides of the Atlantic, bringing increased risk as it can

13. LLOYD'S, LITIGATION AND BUSINESS: TRANSATLANTIC TRENDS 10 (2008), available at <http://www.lloyds.com/~media/6dab4dbcf6904aa7a2a5ffeba46f66co.ashx>. For perspectives on the global market, see, for example, CHRISTOPHER HODGES ET AL., LITIGATION FUNDING: STATUS AND ISSUES (2012), available at <http://www.csls.ox.ac.uk/documents/ReportonLitigationFunding.pdf> (examining the litigation funding market in England, Wales, and continental Europe); Jasminka Kalajdzic et al., *Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding*, 61 AM. J. COMP. L. 93 (2013) (discussing the litigation funding market in Australia, Canada, and the United States). See generally BURFORD GRP. LLC & BRIEFCASE ANALYTICS, INC., SUMMARY OF FINDINGS: 2012 LITIGATION FINANCING SURVEY (2012), available at <http://www.burfordcapital.com/wp-content/uploads/2012/12/Web-summary-2012-12-03-FINAL-REPORT.pdf>.

14. The 2012 edition of one of the most widely used civil procedure books now includes a section on third-party funding. See STEPHEN N. SUBRIN ET AL., CIVIL PROCEDURE: DOCTRINE, PRACTICE, AND CONTEXT 179–83 (4th ed. 2012). Arguably, inclusion in the mandatory first-year curriculum is as mainstream as it gets.

15. See N.Y.C. Bar Opinion, *supra* note 12.

16. Chris Johnson, *The Am Law 200's Haves and Have-Nots*, AM. LAW. (June 10, 2013), http://www.americanlawyer.com/PubArticleTAL.jsp?id=1202600856100&The_Am_Law_200s_Haves_and_HaveNots.

17. Stephen C. Yeazell, *Transparency for Civil Settlements: NASDAQ for Lawsuits?*, in CONFIDENTIALITY, TRANSPARENCY, AND THE U.S. CIVIL JUSTICE SYSTEM 143, 147 (Joseph W. Doherty et al. eds., 2012).

help to make litigation more achievable for stakeholders with worthwhile claims.

- Current economic conditions may actually accelerate the growth of third party litigation, with investors keen to find new opportunities for investing capital not correlated with volatile financial market performance.
- . . . Small and medium-sized businesses, which often find legal costs too high to justify litigation, may benefit most.¹⁸

Indeed, a broad range of plaintiffs¹⁹ bringing a wide variety of claims²⁰ stand to benefit from the development of markets in legal claims. This Article focuses on one type of plaintiff and claim: sophisticated plaintiffs such as companies or wealthy individuals bringing large commercial claims. We further break this category of plaintiffs down into two subtypes that we call “access-to-justice” plaintiffs—plaintiffs who could not access the courts but for third-party funding—and “corporate finance” plaintiffs—plaintiffs who seek financing in order to optimize their accounting, free up capital, or for other business reasons. One funder recently characterized both subgroups of plaintiffs and their motives for seeking funding:

They fall into two buckets. One contains large or financially liquid companies that want litigation financing as a financing

18. LLOYD’S, *supra* note 13, at 10 (explaining the lack of correlation of this asset class and the wider market: “the investment opportunities [litigation funding] provides are potentially independent of economic conditions, since the prospects of winning a case depend on its merits, not the economy”). For more details on the forces driving litigation finance globally, see, for example, Maya Steinitz, *Whose Claim Is This Anyway?: Third-Party Litigation Funding*, 95 MINN. L. REV. 1268, 1278–86 (2011).

19. Some non-corporate plaintiffs include divorcing couples, injured consumers, and injured workers. See, e.g., Susan Lorde Martin, *Financing Litigation On-Line: Usury and Other Obstacles*, 1 DEPAUL BUS. & COM. L.J. 85 (2002); Susan Lorde Martin, *Financing Plaintiffs’ Lawsuits: An Increasingly Popular (and Legal) Business*, 33 U. MICH. J.L. REFORM 57 (1999–2000) (examining the consumer claim market); Susan Lorde Martin, *Litigation Financing: Another Subprime Industry that Has a Place in the United States Market*, 53 VILL. L. REV. 83 (2008) [hereinafter Martin, *Another Subprime Industry*]; Susan Lorde Martin, *The Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed*, 10 FORDHAM J. CORP. & FIN. L. 55 (2004); Binyamin Appelbaum, *Taking Sides in a Divorce, Chasing Profit*, N.Y. TIMES (Dec. 4, 2010), <http://www.nytimes.com/2010/12/05/business/05divorce.html>.

20. There are various claim types. See, e.g., Cassandra Burke Robertson, *The Impact of Third-Party Financing on Transnational Litigation*, 44 CASE W. RES. J. INT’L L. 159 (2011) (discussing transnational litigation); Elizabeth Chamblee Burch, *Financiers as Monitors in Aggregate Litigation*, 87 N.Y.U. L. REV. 1273 (2012) (recognizing the claim of class actions, particularly internationally); Shyamkrishna Balganesh, *Copyright Infringement Markets*, 113 COLUM. L. REV. (forthcoming 2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2233065. Interviews by the authors with chief executives of litigation funding firms indicate that some firms are trying to develop litigation funding services for corporate defendants. See also Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367 (2009) (providing a theoretical argument in favor of such a market for legal claims by the Georgetown law professor and Chief Investment Officer of Burford Capital).

technique. Their motivation may be budgetary, it may be accounting management, it may be liquidity, but they could easily pay cash for their legal services if they wanted to. . . .

The other bucket contains businesses that—either for size, liquidity, or some other financial constraint—need financing to be able to pursue a litigation claim with the counsel of their choice. One classic example is a smaller technology company that is about to be outgunned on the legal front by a larger technology company that’s using a strategy of grinding them down by overspending.²¹

The current economic environment provides a tailwind to the litigation funding industry in other ways. Cost-cutting corporations are looking much more closely at their legal departments—traditionally viewed as loss centers—and asking their general counsel to minimize their effect on the bottom line.²² Shifting the cost of litigation to third-party funders is one way of doing so. Correspondingly, “Big Law” and other sectors of the legal profession have been modifying their business models and seeking to accommodate so-called alternative billing methods, including third-party funding.²³

Responding to this growing, dynamic, and important legal market, the last couple of years have seen a wave of academic writing in which scholars tackle multiple dimensions of both the ethics and economics of litigation funding.²⁴ This recent literature builds on four categories of earlier scholarship. First is the scholarship on funding of consumer claims, a long-standing practice also called “law lending.”²⁵ Second is early prospective–normative literature, arguing in favor of markets in legal claims.²⁶ Third is

21. Brian Zabcik, *Burford CEO Christopher Bogart: Litigation Financing Loses Its Mystery*, AM LAW LITIG. DAILY (Feb. 1, 2013), http://www.americanlawyer.com/digestTAL.jsp?id=1202586775024&Burford_CEO_Christopher_Bogart_Litigation_Financing_Loses_Its_Mystery.

22. See Larry E. Ribstein, *The Death of Big Law*, 2010 WIS. L. REV. 749, 760, 769–71.

23. See *id.* at 798, 801–02 (discussing the rise of in-house counsel and litigation financing); see also Jonathan D. Glater, *Billable Hours Giving Ground at Law Firms*, N.Y. TIMES (Jan. 29, 2009), <http://www.nytimes.com/2009/01/30/business/30hours.html> (discussing pressures on the billable hour).

24. See, e.g., Michele DeStefano, *Nonlawyers Influencing Lawyers: Too Many Cooks in the Kitchen or Stone Soup?*, 80 FORDHAM L. REV. 2791 (2012); Stephen Gillers, *Waiting for Good Dough: Litigation Funding Comes to Law*, 43 AKRON L. REV. 677 (2010); Paul H. Rubin, *Third-Party Financing of Litigation*, 38 N. KY. L. REV. 673 (2011).

25. For example, see the writings of Susan Lorde Martin, *supra* note 19. See also Ari Dobner, Comment, *Litigation for Sale*, 144 U. PA. L. REV. 1529 (1996).

26. See, e.g., Michael Abramowicz, *On the Alienability of Legal Claims*, 114 YALE L.J. 697 (2005); Robert Cooter, *Towards a Market in Unmatured Tort Claims*, 75 VA. L. REV. 383 (1989); Jonathan T. Molot, *Litigation Finance: A Market Solution to a Procedural Problem*, 99 GEO. L.J. 65 (2010); Richard W. Painter, *Litigating on a Contingency: A Monopoly of Champions or a Market for Champerty?*, 71 CHI.-KENT L. REV. 625 (1995); Mariel Rodak, Comment, *It’s About Time: A Systems Thinking Analysis of the Litigation Finance Industry and Its Effect on Settlement*, 155 U. PA. L. REV. 503 (2006).

an analysis of the distinctive and long-standing markets in bankruptcy and patent claims in the United States.²⁷ Fourth is foreign and comparative scholarship discussing litigation funding as it operates in other jurisdictions and in international arbitration. This work builds on approximately two decades of experience with such funding in those jurisdictions.²⁸

However, despite the importance of the industry and the robust academic debate, there is a complete absence of information about or discussion of litigation finance contracting, even though all the benefits and risks embodied in litigation funding stem from the relationships those contracts shape and formalize. Part I explains the dearth of such discussion and elaborates on the great need for it.

The Article proceeds as follows. Part I sets out the efficiency and justice arguments for a model contract against the backdrop of the secrecy that is currently shrouding the industry. It then makes the case for using venture capitalism as an analog and starting point for modeling efficient and just contracting practices. Parts II and III then adapt venture capital (“VC”) solutions to analogous problems facing parties to litigation finance contracts. More specifically, Part II describes the ethical and economic challenges faced by the parties entering into litigation finance contracts and narratively explains the contractual solutions we have devised to eliminate or minimize such pitfalls. We also distinguish the needs of corporate finance plaintiffs and access-to-justice plaintiffs as relevant. Part III then provides model contracts for both plaintiff sub-types with provision-specific commentary.²⁹ For brevity’s sake, the access-to-justice contract is used as a base, and the handful of alterations necessary for corporate finance plaintiffs are highlighted throughout. Unsurprisingly, the access-to-justice version contains protective provisions designed to compensate for unequal bargaining power. These provisions are absent from the corporate finance version. However, the core deal is the same.

Part IV concludes with some thoughts on additional issues implicated by litigation funding contracting practices that are beyond the scope of this Article—such as regulatory and tax implications of funding arrangements

27. See, e.g., Bruce L. Beron & Jason E. Kinsella, *David vs. Goliath Patent Cases: A Search for the Most Practical Mechanism of Third Party Litigation Financing for Small Plaintiffs*, 38 N. KY. L. REV. 605 (2011); Robert D. Drain & Elizabeth J. Schwartz, *Are Bankruptcy Claims Subject to the Federal Securities Laws?*, 10 AM. BANKR. INST. L. REV. 569 (2002).

28. See, e.g., HODGES ET AL., *supra* note 13. One must be cautious when analogizing to other jurisdictions. In both Australia and the U.K.—the jurisdictions that pioneered litigation funding some twenty years ago—third-party funding was legalized to substitute for contingency fee litigation, which is very limited in both jurisdictions. Further, both jurisdictions follow the “British rule which requires the losing party to pay the winner’s attorneys’ fees.” Steinitz, *supra* note 18, at 1278 n.23. This rule radically changes litigation incentives and consequently limits access to justice. *Id.*

29. For brevity, we omit boilerplate provisions and those that relate to financing generally as opposed to litigation financing in particular.

and possible structures other than those modeled on venture capital. As such, the Conclusion maps out a research agenda for the new field of litigation finance contracting.

A METHODOLOGICAL NOTE

Given the tremendous ambition of this project and its multi-disciplinary nature—the contract requires in-depth analysis of the litigation process (civil procedure), finance, contract theory, corporate governance, legal ethics, economic analysis, and transactional skills, to name a few—we created a web-based platform for developing the contract and fostering the related policy debate.³⁰ In it we presented, on a rolling basis, our suggested provisions with commentary and invited scholars, funders, funding critics, and attorneys to comment on and influence the shape of the final model contract. This Article reflects such contributions.

I. THE NEED FOR A MODEL CONTRACT AND THE CASE FOR DRAWING ON VENTURE CAPITAL CONTRACTING PRACTICES

A. THE NEED FOR A MODEL CONTRACT

Litigation finance is an opaque industry. Outside the consumer, personal injury context that we do not consider, litigation financing contracts are confidential, and only in litigation have a few come to light.³¹ Litigation that reveals a contract or, more often, a contentious portion within a contract,³² is itself rare, as the contracts generally require arbitration to resolve disputes. The contract terms that have emerged can be controversial, particularly those that appear to give control of the claim to the funder, or those that give returns that strike some as unconscionable.³³

30. See MODEL LITIG. FIN. CONT., <http://litigationfinancecontract.com> (last visited Nov. 6, 2013).

31. See Steinitz, *supra* note 5, at 465–66 (citing *In re Parmalat Sec. Litig.*, 659 F. Supp. 2d 504 (S.D.N.Y. 2009), *aff'd in part, vacated in part*, *Parmalat Capital Fin. Ltd. v. Bank of Am. Corp.*, 412 F. App'x 325 (2d Cir. 2011); *Trust for the Certificate Holders of the Merrill Lynch Mortg. Investors, Inc. v. Love Funding Corp.*, 918 N.E.2d 889 (N.Y. 2009); *Anglo–Dutch Petroleum Int'l, Inc. v. Haskell*, 193 S.W.3d 87 (Tex. App. 2006)); *Funding Agreement Between Treca Financial Solutions and Claimants* (Oct. 10, 2010) (on file with authors); *id.* at sched. 4 (Intercreditor Agreement) (on file with authors); *Funding Agreement Between Satee GMBH, 88 Capital LLC, Jonaks Limited, Equitable Outcomes, Orin Kramer, and Claimants Minor* (2010) (Minor Funder Agreement) (on file with authors). For the sake of comparison, standard forms of consumer funding contracts, developed to comply with different states' consumer protection laws, were also analyzed. See *Purchase Agreement Between Oasis Legal Finance, LLC and Dean Plaintiff* (Sept. 13, 2010) (on file with authors).

32. See, e.g., *S & T Oil Equip. & Mach., Ltd. v. Juridica Invs. Ltd.*, 456 F. App'x 481, 482 (5th Cir. 2012); *Funding Agreement Between Treca Financial Solutions and Claimants*, *supra* note 31, § 23.2–4.

33. There are many examples relating to the return charged by the funder. See, e.g., *S & T Oil Equip. & Mach., Ltd. v. Juridica Invs. Ltd.*, Civil Action No. H–11–0542, 2011 WL 864837, at *2–5 (S.D. Tex. Mar. 10, 2011), *appeal dismissed*, 456 F. App'x 481 (5th Cir. 2012) (rejecting

Further, the contract secrecy has prevented reputation markets from emerging and has reduced claimants' bargaining power.³⁴ Last but not least, the lack of publicly available sample contracts both raises the transaction costs of entering into funding arrangements—as each plaintiff negotiates from scratch and in the dark—and, consequently, creates a barrier for claimants to actually access litigation funding. It also raises the cost for new market entrants who may compete with existing litigation funding firms and who may, through their competition, lower the costs of financing for the plaintiff.

By drafting this model contract, we hope to bring transparency to litigation finance contracting, promote more efficient and fair contracting practices, and reduce the transaction costs of entering into such arrangements. Further, reducing economic theory to contractual language makes issues more concrete. It is one thing to note that the attorney–client privilege complicates assessing an investment opportunity or monitoring a lawsuit that one is invested in. It is another to draft language maximizing information sharing while minimizing the risk of privilege waiver and preserving the litigation counsel's ethical obligations.

We acknowledge that drafting litigation funding contracts for large commercial disputes is and will remain a bespoke service. Still, a model contract will help lawyers and their clients spot the issues they must address and provide concepts—such as accelerating investments between milestones, imposing fiduciary duties on funders, or requiring certain representations

arguments that the funding agreement was unconscionable); *Kraft v. Mason*, 668 So. 2d 679, 683–84 (Fla. Dist. Ct. App. 1996) (noting that the plaintiff brought suit against her brother to enforce repayment of a litigation finance advance she had made to fund his prosecution of an antitrust lawsuit and the court rejected the brother's usury defense); *Odell v. Legal Bucks, LLC*, 665 S.E.2d 767, 772–76 (N.C. Ct. App. 2008) (rejecting arguments that funding agreement constituted an illegal gaming contract or, in the alternative, constituted champerty and maintenance); *Rancman v. Interim Settlement Funding Corp.*, 789 N.E.2d 217, 217–21 (Ohio 2003) (stating that the plaintiff challenged the contract's enforceability as usurious/unconscionable and the court struck down the contract as champertous); *Anglo-Dutch Petroleum Int'l, Inc.*, 193 S.W.3d at 90 (rejecting arguments that funding agreements were usurious loans, unregistered securities, and against public policy). Examples relating to the funder's level of control include the landmark Australian case, *Campbells Cash & Carry Pty. Ltd. v. Fostif Pty. Ltd.* (2006) 229 CLR 386 (Austl.), in which the Australian High Court permitted the funder broad control, and the English Court of Appeal's equally groundbreaking decision, *Arkin v. Borchard Lines Ltd.*, [2005] EWCA (Civ) 655, [2005] 4 Costs L.R. 643 (Eng.), in which it established that third-party funding is acceptable, even desirable, to increase access to justice, but fell short of sanctioning the transfer of control to funders. See *Abu-Ghazaleh v. Chaul*, 36 So.3d 691, 693–94 (Fla. Dist. Ct. App. 2009) (finding the level of control given the funder sufficient to treat it as a real party in interest).

34. On the centrality of reputational markets and their effect on bargaining in funding agreements, see Steinitz, *supra* note 5, at 511 (citing Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067, 1086–88 (2003); D. Gordon Smith, *Venture Capital Contracting in the Information Age*, 2 J. SMALL & EMERGING BUS. L. 133, 157–62 (1998) (discussing the characteristics of the reputation market for venture capitalists)).

from the counterparty—that can be tailored for each deal. Similarly, a model contract provides a framework for the kind of legal and economic analysis that should go into modifying the model contract for individual use, drafting a contract from scratch, or negotiating off of a draft contract developed by a funder. Thus, our goal is to create a commercially reasonable document that serves as a starting point for relatively sophisticated parties, represented by their own counsel, to negotiate an individualized contract.

As an additional benefit, drafting contract language makes latent commercial issues more visible and facilitates comparison of deal structures. For example, what are the tax implications of the venture-capital-type deal we model? What happens to investors if the plaintiff goes bankrupt and the proceeds of the funded litigation become part of the estate? Would an alternative deal structure, such as effectively incorporating the claim,³⁵ have more advantages than the VC model? Is the incorporation approach possible or barred by champerty concerns? How does either VC or incorporation stack up against the more traditional nonrecourse loan structure on all the issues? We revisit such issues in the Conclusion as suggestions for further research.

B. THE VENTURE CAPITAL ANALOGY

Prior scholarship has generally focused on the analogies between litigation finance, on the one hand, and contingency fees and insurance on the other. While such analogies have merit, they also have their limitations, as illustrated below, and can, at times, mislead. The Model Contract builds instead on an economic–theoretical foundation that was developed by one of the authors in a previous article that analyzed the parallels between litigation finance and venture capital financing.³⁶

1. Contingency Fees and Insurance: Limited Analogies

Discussions of contingency fees and insurance provide powerful, yet incomplete analogies to litigation finance. Contingency fee attorneys are first and foremost precisely that: attorneys. Although contingency fee attorneys can have significant conflicts of interest with their clients (or with a class), they have myriad ethical and legal constraints on their actions that

35. See Maya Steinitz, *Incorporating Legal Claims* (forthcoming).

36. Steinitz, *supra* note 5, at 479–82. That article relies heavily on analyses of venture capital contracting practices and their economic analysis. See generally Gilson, *supra* note 34; Paul A. Gompers, *Grandstanding in the Venture Capital Industry*, 42 J. FIN. ECON. 133 (1996) [hereinafter Gompers, *Grandstanding*]; Paul A. Gompers, *Optimal Investment, Monitoring, and the Staging of Venture Capital*, 50 J. FIN. 1461 (1995). It also relies, though to a lesser degree, on Ronald J. Gilson et al., *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice, and Doctrine*, 110 COLUM. L. REV. 1377 (2010) [hereinafter Gilson et al., *Braiding*], and Ronald J. Gilson et al., *Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration*, 109 COLUM. L. REV. 431 (2009).

work to resolve these conflicts in their clients' favor. For example, attorneys owe their clients duties of loyalty and zeal and must avoid conflicts or get informed client consent to them. Litigation funders are not similarly constrained.

A funder's objective is to maximize profits for the benefit of its investors.³⁷ The funder also has a relationship with the plaintiff. These competing loyalties have a concrete consequence: in some scenarios, a funder may have objectives extrinsic to the claim, leading it to push for outcomes for its own benefit that disadvantage the plaintiff. We discuss funder–plaintiff conflicts further in Part II. The point here is simply that to analogize too closely to contingency fee arrangements is to oversimplify the complexities of the relationships involved. Nonetheless, on issues such as unconscionability of fees/investment returns and control of the claim, cases and scholarship relating to contingency attorneys can be instructive.

Insurers who fund and, at times conduct, the defense of their insured are also a limited analog, even though that relationship is commercial rather than attorney–client. First, the insurer finances a defense and counterclaim; most litigation finance is on the plaintiff side.³⁸ Second, the insurer can subrogate the insured, making their interests united in a way not matched in litigation finance.³⁹ Third, insurers and the insurance they provide do not, generally speaking, have access-to-justice implications. Finally, in contrast with litigation finance, insurance is a heavily regulated industry.⁴⁰ For example, insurers have capitalization requirements that ensure they can fulfill their obligations under a policy.⁴¹

Nonetheless, the insurer–insured relationship can provide some insight into litigation finance. Litigation finance functions partially as after-the-event insurance in that it shifts risk to the financier (as insurance shifts risk to the insurer). Similarities can be found particularly with regard to the attorney–client privilege, control/influence over attorney selection and settlement decisions, and moral hazard and the need to require the plaintiff's cooperation.⁴²

37. CFA INST., ASSET MANAGER CODE OF PROFESSIONAL CONDUCT 5 (2d ed. reprinted 2010), available at <http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2009.n8.1> (“Managers must . . . [p]lace client interests before their own.”).

38. See *supra* notes 19–21 and accompanying text (examining plaintiffs' claims and motives for acquiring financing services). Insurance is by definition on the defense side, with narrow exceptions such as after-the-event insurance.

39. See Michelle Boardman, *Insurers Defend and Third Parties Fund: A Comparison of Litigation Participation*, 8 J.L. ECON. & POL'Y 673, 691 (2012).

40. See John Patrick Hunt, *Rating Dependent Regulation of Insurance*, 17 CONN. INS. L.J. 101, 103–07 (2010–2011) (discussing the role of and justification for solvency regulation).

41. *Id.* at 104.

42. See Steinitz, *supra* note 18, at 1295–96.

2. The Analogy Between Litigation Finance and Venture Capital

Venture capital provides a more powerful analogy. First and foremost, venture capitalists and litigation funders have a similar risk profile: they invest in high-risk assets with the hope that, even if many of their investments fail, a handful will be wildly successful.⁴³ Critically, in both cases, success hinges, to a great degree, on the efforts of others—entrepreneurs and claimants, respectively. Information asymmetry abounds and may actually increase during the life of the investment as more information about the asset is revealed.⁴⁴

The similarities reach past risk. Venture capitalists and litigation funders have similar (mid-length) investment timelines; they represent pools of investors' capital; and their profitability is measured across a portfolio of investments, not a single investment.⁴⁵ These factors, as well as others, can misalign the incentives of funder and funded in both venture capital and litigation financing, creating agency problems.

Simultaneously, though, most venture capitalists and litigation funders have specialized expertise, reputations, connections, and other valuable input that they can offer as non-cash contributions to the success of the investment.⁴⁶ In fact, in both types of funding, these non-cash contributions can be paramount.⁴⁷ In the litigation context, these contributions are likely of most value to access-to-justice plaintiffs, but they can benefit even the repeat-player, deep-pocketed corporate finance type.

The next Part presents the specific challenges that create the extreme uncertainty, information asymmetry, and agency problems in litigation finance and presents, in narrative form, the contract solutions we have devised in order to solve, or at least minimize, these problems.

II. CONSTRAINTS, CHALLENGES, AND CONTRACT SOLUTIONS

In order to develop a robust model contract, we begin with a hypothetical fact pattern and certain assumptions we have made. The assumptions allow us to highlight the various litigation-finance-specific challenges a contract must address. We adopt solutions from VC, applying those in a straightforward manner where appropriate and modifying where necessary. Nuanced modifications are necessary, especially to staged funding, which is at the heart of The Model Contract, to reflect the

43. See generally John H. Cochrane, *The Risk and Return of Venture Capital*, 75 J. FIN. ECON. 3, 4 (2005) ("This paper measures the expected return, standard deviation, alpha, and beta of venture capital investments.").

44. Steinitz, *supra* note 5, at 488 (citing Gilson, *supra* note 34, at 1076–77).

45. See *id.* at 489–90.

46. *Id.* at 498–500 (citing Gilson, *supra* note 34, at 1071–72); see also Christopher B. Barry et al., *The Role of Venture Capital in the Creation of Public Companies: Evidence from the Going-Public Process*, 27 J. FIN. ECON. 447, 449–51 (1990).

47. See *supra* note 46 and accompanying text.

economic, regulatory, and normative differences between litigation and startup companies as asset classes. Finally, we describe conceptually our proposed contract solutions, distinguishing between access-to-justice and corporate finance solutions as needed. The actual provisions are in Part III.

A. *FACT PATTERN AND ASSUMPTIONS*

As noted in the Introduction, a broad range of funding scenarios, with different types of funders, claimants, claims, and jurisdictions, are emerging in the global marketplace.⁴⁸ Given that diversity, drafting a universal model contract is impossible. We must make certain assumptions about the nature of the claim, the characteristics of the funder and the claimant, and the governing law of the contract. That said, our goal is to suggest contractual arrangements that are as broadly applicable as possible. Our assumptions are set out in the following paragraphs.

The Funder. We assume the funder is a specialized litigation finance company. As such, our funder is a “repeat player,” which will often have greater bargaining power and sophistication, as it relates to litigation and its funding, than access-to-justice claimants, though the difference likely does not exist with corporate finance plaintiffs.⁴⁹ Regardless of plaintiff type, the funder may have a strategic interest in the outcome of a case beyond winning the case at hand.⁵⁰ Its judgment is further influenced by portfolio management concerns.⁵¹ In addition, our funder is susceptible to the pressures of a reputational market, should one develop.⁵² Finally, our funder is typically founded and managed by attorneys and wishes to be actively involved in litigation strategy and conduct, monitoring and making other non-cash contributions.⁵³

The Claimant and Claim. We assume the claimant is a corporation or an otherwise sophisticated business party or a wealthy, sophisticated individual seeking to bring a commercial claim. We are not considering tort cases, divorce cases, and other consumer litigation finance. While some of the contract issues are similar, other important aspects, such as public policy, are not.

48. See Steinitz, *supra* note 18, at 1302–03 (providing a typology of funding scenarios).

49. See *id.* at 1271 (arguing that litigation funding may change the balance of power between weak and strong litigants).

50. *Id.* at 1300–01, 1312, 1315–16 (citing Marc Galanter, *Why the “Haves” Come Out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC’Y REV. 95, 97–103 (1974)).

51. See *id.* at 1312.

52. See Steinitz, *supra* note 5, at 502 (citing Gilson, *supra* note 34, at 1090).

53. We are not considering passive funding arrangements such as in *Anglo–Dutch Petroleum International, Inc. v. Haskell*, 193 S.W.3d 87, 104 (Tex. App. 2006) (“The agreements do not contain provisions permitting [the funder] to select counsel, direct trial strategy, or participate in settlement discussions, nor do they permit [the funder] to look to Anglo–Dutch’s trial counsel directly for payment.”).

Another advantage of assuming a commercial claim relates to remedies. Money generally resolves commercial claims, but tort compensation can involve elements that, while costly, are not monetary in nature. Examples include medical treatment and monitoring, and environmental cleanup. Divorce cases may involve injunctions to resolve such issues as child custody or domestic violence. Litigation funding's potential to commodify claims by monetizing such remedies or eschewing them for straight damages is less problematic in the commercial context.

Just as we hew to commercial claims over personal claims, we focus on plaintiffs over defendants. That choice reflects the nonexistence, at the moment, of a market in defenses. Last, defense funding is so similar to insurance that the scholarly gap is much narrower.

Choice of Law. The doctrines of champerty, usury, and unconscionability affect the enforceability of litigation finance contracts.⁵⁴ The scope of the attorney–client privilege and work-product doctrine impacts contractual remedies to information asymmetry. In the United States, these doctrines are all creatures of state law and vary widely. Needing, therefore, to relate the contractual provisions to state law, we picked the law of the State of New York. We chose New York because its champerty doctrine is generally accommodating of litigation finance,⁵⁵ it is a premier commercial center, and its courts are well-regarded.

One should note that while litigation finance contracts often invoke foreign law⁵⁶ and current contracting practice often involves selection of international arbitration as a dispute resolution mechanism,⁵⁷ these selections are not always the optimal arrangements for a given contract. Most notably, such choices may structurally disadvantage the plaintiff relative to the funder, or vice-versa.

B. OVERCOMING CHAMPERTY: THE NEW YORK EXAMPLE

1. The Challenges

Litigation finance is prohibited by the champerty doctrine and thus is illegal in those jurisdictions that still enforce it. Broadly speaking, champerty is financing someone else's litigation for profit.⁵⁸ The prohibition against champerty arose in medieval England as a way to protect small property owners from the predations of feudal lords, based on the idiosyncratic

54. See, e.g., Dobner, *supra* note 25, at 1543–46 (providing an overview of champerty's development); Martin, *Another Subprime Industry*, *supra* note 19, at 86–87 (discussing usury); see also cases cited *supra* note 33.

55. See *infra* Part II.B.

56. See, e.g., Steinitz, *supra* note 5, at 478 (describing the choice of law arrangement in the Chevron–Ecuador investment: the provisions of the agreement were governed by English law, except for Burford's security interest, which was perfected under New York law).

57. *Id.*

58. See BLACK'S LAW DICTIONARY 262 (9th ed. 2009).

political economy of the time.⁵⁹ America inherited champerty when the colonies imported English common law, with each state developing the doctrine differently. In recent years, some states have discarded the doctrine while others have reaffirmed it.⁶⁰ New York does not have a common law prohibition on champerty, but it does have a statutory bar against transferring claims in order to profit by instigating litigation that otherwise would not have been filed.⁶¹ This obviously prohibits a stock-exchange-type market in claims that the original potential plaintiffs are not interested in pursuing, and some business models have been found champertous under the statute.⁶²

Nonetheless, New York's courts have interpreted the statute as imposing a very narrow prohibition. The key element is the instigation of the litigation; the profit element has been interpreted in the jurisprudence as incidental.⁶³ In fact, in New York the prohibition is so narrow that even the purchase of a claim that the funder had no relationship to, before any litigation has been filed, and then filing suit to profit from it, is not necessarily champertous. For example, New York courts have held that purchasing a defaulted bond and trying to collect on it via litigation is not champerty, regardless of the profits derivable from the suit, because it is merely enforcing a right via litigation when other methods of vindicating the right—e.g., demanding payment—have failed.⁶⁴

59. See Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61, 125–26 & nn.262 & 264 (2011); Steinitz, *supra* note 18, at 1287.

60. See Sebok, *supra* note 59, at 98–120 (surveying and analyzing the law of maintenance, champerty, and assignment in all fifty-one jurisdictions, and concluding that the answer to the question of how states determine whether and to what degree non-lawyer third parties may support meritorious litigation is complex and that confusion reigns over the doctrine and its application).

61. N.Y. JUDICIARY LAW § 489 (McKinney 2005).

62. In a recent case, the court found a partnership between a law firm and a company champertous because the firm was “buying” distressed debt, suing on the debt, and remitting the proceeds less a fee to the original debt holders. In essence, the firm was buying the right to sue on the debt, not the underlying debt. See *Justinian Capital SPC ex rel. Blue Heron Segregated Portfolio v. WestLB AG*, 952 N.Y.S.2d 725, 733–34 (Sup. Ct. 2012).

63. See *SB Schwartz & Co. v. Levine*, 918 N.Y.S.2d 171, 172–73 (App. Div. 2011) (summarizing the champerty doctrine). Similarly, the Southern District of New York found champertous an agreement that transferred a legal claim in order for the assignee to sue on it. *Am. Optical Co. v. Curtiss*, 56 F.R.D. 26, 31–32 (S.D.N.Y. 1971). The fact that the assignee would be competitively helped by the suit's success and thus indirectly profit was not central. See *id.* at 29–30. The focus was the fact that the very purpose of the assignment was to have the assignee sue on the claim, and that neither the suit nor the assignment would have happened otherwise. *Id.* at 30.

64. *Elliott Assocs. v. Banco de la Nacion*, 194 F.3d 363, 372 (2d Cir. 1999). In such a case, the right to file suit is incident to the bond purchased; the transaction is not the sale of a “naked” claim. Anthony Sebok, *Incorporating the Claim*, MODEL LITIG. FIN. CONT. (Feb. 4, 2013), <http://litigationfinancecontract.com/incorporating-the-claim/>.

Similarly, New York courts permit business models based on funding plaintiffs in exchange for a part of their eventual litigation recoveries, provided their suits were already in existence and control of the suit remained with the plaintiffs.⁶⁵ New York courts reach this result because they frequently distinguish between a claim and its proceeds⁶⁶ and because New York doctrine focuses on transfers for the sole purpose of initiating litigation where no prior right to the underlying claim exists or the transfer is not part of a larger complex transaction.⁶⁷ The assignment of proceeds, rather than the underlying claim, is closely analogous to a typical litigation finance scenario, and allowing it underscores New York's litigation-finance-friendly doctrine. Nonetheless, perhaps it is possible to have a champertous assignment of proceeds even if the underlying claim has not been transferred.⁶⁸

65. *Echeverria v. Estate of Lindner*, No. 018666/2002, 2005 WL 1083704, at *4-8 (N.Y. Sup. Ct. Mar. 2, 2005). The timing of the lawsuit is significant in champerty analysis in New York because the prohibition is against initiating litigation. However, "litigation" means more than the suit; assignments of claims or counterclaims for filing in an existing suit are champertous. *See id.* In addition, a judge held (and remanded) it would be champerty if after receiving financing the plaintiff filed new claims and counterclaims, provided the financiers were strangers to the underlying claim. *Richbell Info. Servs., Inc. v. Jupiter Partners L.P.*, 723 N.Y.S.2d 134 (App. Div. 2001); *see also Ehrlich v. Rebco Ins. Exch., Ltd.*, 649 N.Y.S.2d 672 (App. Div. 1996). This result is potentially problematic for litigation financiers regardless of deal structure.

66. *See Fahrenheit v. Sec. Mut. Ins. Co.*, 788 N.Y.S.2d 546 (App. Div. 2004).

67. Commentators disagree on whether a funder must have a pre-existing interest in the transferred claim to avoid champerty, when the transfer was for the purpose of initiating litigation and the expectation was of proceeds greater than could otherwise be had. From both perspectives, commentators are responding to the Court of Appeals for the Second Circuit in the recent, seminal case, *Trust for the Certificate Holders of the Merrill Lynch Mortgage Investors, Inc. Mortgage Pass-Through Certificates, Series 1999-C1 v. Love Funding Corp.*, 556 F.3d 100 (2d Cir. 2009). *See, e.g., Lawrence V. Gelber & David J. Karp, Champerty Clarified*, L.J. NEWSL., May 2010, available at http://www.srz.com/files/News/a95db2b9-c157-4245-87ea-14bf89d30b5c/Presentation/NewsAttachment/0892cf66-49ba-4524-813f-16a72636b36a/Gelber_Karp_The_Bankruptcy_Strategist_May_2010_Champerty_Clarified.pdf (noting that the issue is not whether the claim purchaser had a pre-existing interest but whether the purchase was to enforce a right or to profit from litigating the claim).

68. New York's anti-champerty statute prohibits transferring a claim directly or indirectly, thus if no claim transfer is occurring it is hard to see how champerty can be involved. Nonetheless, it is also hard to see why the assignment of proceeds is not the indirect transfer of a claim. Indeed, champerty is commonly understood as financing a claim in exchange for a profitable share of the proceeds. Regardless, New York cases distinguish between claim transfer and proceed transfer in personal injury cases. It is not clear if the distinction in the commercial context has the same bounds. In *Fahrenheit*, a commercial case, the judge did treat transferring proceeds as different than transferring a claim. *Fahrenheit*, 788 N.Y.S.2d 546. However, the existence of profit may have been a concern there in a way it has not in personal injury cases. In *Fahrenheit*, an insurer loaned \$45,000 to the plaintiff in exchange for \$45,000 of the policy proceeds the plaintiff sought via the lawsuit. *Id.* at 547. As a result, no profit was involved. While the judge did not cite that factor in distinguishing between the transfer of proceeds and the transfer of a claim in that case, the judge did note that the proceeds assigned were equal to the

Reflecting this generally permissive state of New York law, the New York City Bar Association's 2011 formal opinion on the ethics of third-party litigation finance acknowledged that the Bar was "aware of no decision finding non-recourse funding arrangements champertous under New York law."⁶⁹

2. The Model Contract Solutions

To avoid champerty issues, The Model Contract does not involve claim transfer. The funder gains influence over the litigation, but not control. In addition, the financing method focuses on the litigation proceeds, rather than the claim per se. Specifically, The Model Contract has claimants sell what we call "Litigation Proceed Rights" to funders.⁷⁰ A Litigation Proceed Right entitles its holder to one percent of the claim's proceeds. Litigation Proceed Rights are a direct analogy to the shares in a startup purchased by venture capitalists and allow the relatively direct importation of several standard clauses of stock sale and purchase agreements. Litigation Proceed Rights are privately offered securities that cannot be transferred without the plaintiff's consent, and then only if the transferee becomes a full party to the funding contract.⁷¹ Coupled with the private nature of the financing and the sophistication of our assumed funder(s), this approach should create a minimum of securities law issues.⁷²

Unlike typical venture capital securities that convert into common stock and often involve myriad control and other non-cash rights,⁷³ litigation proceed rights are only redeemable for cash, if and when the proceeds are

loan amount. *Id.* Perhaps that fact was relevant to the judge's finding that the transaction was non-champertous.

69. N.Y.C. Bar Opinion, *supra* note 12.

70. For a comprehensive discussion of the use of securities to facilitate litigation funding, see Steinitz, *supra* note 35.

71. These features minimize the securities regulation implications. Because we assume funders are specialized litigation finance firms, the "Accredited Investor" requirement is also met.

72. Richard Painter, *The Model Contract and the Securities Laws, Part I*, MODEL LITIG. FIN. CONT. (July 15, 2013), <http://litigationfinancecontract.com/the-model-contract-and-the-securities-laws-part-1/> [hereinafter Painter, *Part I*]; Richard Painter, *The Model Contract and the Securities Laws, Part II*, MODEL LITIG. FIN. CONT. (July 18, 2013), <http://litigationfinancecontract.com/the-model-contract-and-the-securities-laws-part-ii/>; Richard Painter, *The Model Contract and the Securities Laws, Part III*, MODEL LITIG. FIN. CONT. (July 22, 2013), <http://litigationfinancecontract.com/the-model-contract-and-the-securities-laws-part-iii/>; Richard Painter, *The Model Contract and the Securities Laws, Part IV*, MODEL LITIG. FIN. CONT. (July 25, 2013), <http://litigationfinancecontract.com/the-model-contract-and-the-securities-laws-part-iv/>; Maya Steinitz, *The Model Contract and the Securities Laws, Coda*, MODEL LITIG. FIN. CONT. (July 29, 2013), <http://litigationfinancecontract.com/the-model-and-the-securities-laws-coda/>.

73. VC securities convert into equity in the startup, and they can involve a large number of rights beyond cash flow. Steven N. Kaplan & Per Strömberg, *Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 REV. ECON. STUD. 281, 308-12 (2003).

received. No control rights are included with litigation proceed rights. The profit comes from the difference between the risk-discounted purchase price of litigation proceed rights and their redemption value. These features make the rights more akin to speculative bonds than the equity that venture financiers acquire, and they again support a non-champertous result.⁷⁴

The Recitals of The Model Contract state that the funder wishes to invest with Plaintiff “to facilitate the prosecution of its claim and to profit if the claim is successful.”⁷⁵ This declaration should not make otherwise non-champertous provisions problematic.

While The Model Contract minimizes champerty risk under New York law, this area of law remains unsettled and parties are advised to proceed with caution. And, regardless of deal structure, champerty risk would be further reduced if the financing occurs after the suit has been filed and no new claims are asserted after the financing closes. In that scenario, it is hard to see how the financing produced litigation that would not otherwise exist.

C. OVERCOMING INFORMATION BARRIERS AND ASYMMETRY

1. The Challenges

Litigation financiers face a systemic information asymmetry problem like that faced by venture capitalists. They both invest their money in developing an asset they are unfavorably positioned to understand relative to the asset’s original owners. In the litigation context, the original owners are the plaintiff and its attorney.⁷⁶ The plaintiff is most familiar with the facts and documents of the case. Moreover, the plaintiff knows its predisposition to cooperate, and its effort and active participation is necessary to win, including its truthfulness, cooperation, and good judgment.⁷⁷ Litigation financiers cannot easily access this information and, thus, it is difficult for them to vet litigations for possible investment *ex ante*⁷⁸ and to monitor *ex post*. These asymmetries may result in leaving worthy plaintiffs without funding or in depriving funded litigations from valuable non-cash contributions by the funder, such as monitoring and strategy development.

74. Speculative bonds (junk bonds) are rated BB or lower to reflect their high default risk. While the analogy to litigation proceed rights is not strict—because the bonds pay until they don’t, rather than not paying until they do—pricing is similar because the risk–reward analysis is similar (high yield, high risk of worthlessness) and because future cash, rather than control rights, is the asset purchased.

75. See *infra* Part III (The Model Contract).

76. See Steinitz, *supra* note 5, at 488.

77. *Id.*; cf. Gilson, *supra* note 34, at 1076–77 (explaining that venture capitalists face a similar information asymmetry between themselves and the companies in which they invest).

78. See *supra* note 5 and accompanying text.

a. *The Attorney–Client Privilege: The New York Example*

The attorney–client privilege worsens the information asymmetry by creating an incentive not to disclose information to funders.⁷⁹ The attorney–client privilege is, generally, extended to communication between a client and an attorney for the purpose of seeking legal advice, and it can be waived if the communication is disclosed to a third party. Waiver does not occur if the client and the third party are united by a “common legal interest.”⁸⁰ A common commercial interest is universally deemed insufficient,⁸¹ but courts differ, even within New York, on whether the common legal interest must be similar or identical.⁸² Waiver of the privilege can damage plaintiff’s chances of winning the claim, an undesirable outcome from both the plaintiff’s and funder’s perspectives.

In a litigation-financing life cycle, the existence of a common legal interest must be analyzed in three different contexts: communication between plaintiff and potential funders; communication between plaintiff and a retained funder; and communication between a funder and investors, whether shareholders in the funder, investors in a litigation-backed security, or investors purchasing part of the funder’s investment in the particular claim. We refer to that last category of investors as “secondary funders,” and see them as akin to reinsurers.

New York judges are unlikely to find a common legal interest between *potential* funders and plaintiffs or between investors in litigation-backed securities and plaintiffs.⁸³ Disclosure of privileged information to such

79. N.Y. C.P.L.R. 4503(a)(1) (McKinney 2007).

80. N.Y.C. Bar Opinion, *supra* note 12 (discussing common-interest doctrine in New York).

81. *Stenovich v. Wachtell, Lipton, Rosen & Katz*, 756 N.Y.S.2d 367, 378 (Sup. Ct. 2003) (finding that the common interest was commercial, not legal, and thus the privilege was not preserved); *see Aetna Cas. & Sur. Co. v. Certain Underwriters at Lloyd’s London*, 676 N.Y.S.2d 727, 733–34 (Sup. Ct. 1998) (finding that the business and personal communications were not protected under the common-interest doctrine).

82. A recent case summarizing both lines of cases, and coming out on the substantially similar side is *GUS Consulting GmbH v. Chadbourne & Parke LLP*, 858 N.Y.S.2d 591, 593 (Sup. Ct. 2008).

83. The crucial questions are (1) whether a common interest exists at all, as the two parties are on opposite sides of the transaction, and if so, (2) whether it is a common legal or commercial interest. The federal district court in Delaware upheld a ruling by a magistrate judge that no common interest linked potential funders and litigants. *Leader Techs., Inc. v. Facebook, Inc.*, 719 F. Supp. 2d 373, 376 (D. Del. 2010). In other investor contexts, courts do not hesitate to find privilege waiver. *See Int’l Honeycomb Corp. v. Transtech Serv. Network, Inc.*, No. 90 CV 3737 (CBA), 1992 WL 314897, at *1–2 (E.D.N.Y. Oct. 9, 1992) (noting that disclosure to potential investors in the company waived privilege); *see also Corning Inc. v. SRU Biosystems, LLC*, 223 F.R.D. 189, 190–91 (D. Del. 2004) (finding that disclosure to past potential third-party acquirer waived privilege). *But see Devon IT, Inc. v. IBM Corp.*, Civ. A. No. 10-2899, 2012 WL 4748160, at *1 n.1 (E.D. Pa. Sept. 27, 2012) (determining that communications with potential litigation funder who became funder waived neither work-product protection, nor, because of a common interest, attorney–client protection). When the

parties almost certainly waives the privilege. Similarly, based on cases in the reinsurance context, disclosure to secondary funders risks waiver, but the analysis will be fact-specific and dependent on how involved in the case the secondary funder is.⁸⁴ Any disclosure to investors in a publicly traded litigation finance company of course waives the privilege.⁸⁵

The central question is whether retained funders and plaintiffs share a privilege-protecting common legal interest. While there are no New York cases on point,⁸⁶ cases in other jurisdictions have come out both ways.⁸⁷ Federal courts have filled this vacuum,⁸⁸ but incoherently. One line of cases suggests plaintiffs and their funders would benefit from a common legal interest; another line of cases does not.⁸⁹ The New York Legislature has also

disclosure is very limited, such as a general summary of legal opinions, the privilege is not waived. *See Furminator, Inc. v. Kim Laube & Co.*, No. 4:08CV00367 ERW, 2009 WL 5176562, at *1–2 (E.D. Mo. Dec. 21, 2009). As a general matter, the common-interest doctrine is to be narrowly construed. *See Gulf Islands Leasing, Inc. v. Bombardier Capital, Inc.*, 215 F.R.D. 466, 471 (S.D.N.Y. 2003). Further, under New York law, the doctrine can only apply with respect to “legal advice in pending or reasonably anticipated litigation in which the joint consulting parties have a common legal interest.” *Aetna*, 676 N.Y.S.2d at 732.

84. *See, e.g.*, *N. River Ins. Co. v. Columbia Cas. Co.*, No. 90 Civ. 2518 (MJL), 1995 WL 5792, at *7–8 (S.D.N.Y. Jan. 5, 1995) (finding no common interest between insurer and reinsurer). *North River Insurance Co. v. Columbia Casualty Co.* has spawned a long line of cases examining the question of whether ceding insurers and reinsurers have a common interest as a fact-based one that cannot be assessed categorically. *See, e.g.*, *Fireman’s Fund Ins. Co. v. Great Am. Ins. Co. of N.Y.*, 284 F.R.D. 132, 140–41 (S.D.N.Y. 2012); *Am. Re-Ins. Co. v. U.S. Fid. & Guar. Co.*, 837 N.Y.S.2d 616, 621 (App. Div. 2007).

85. Disclosure to shareholders of a closely held, private corporation likely would constitute waiver as well. However, unlike with public companies, attorney work product could be shared with such shareholders pursuant to a confidentiality agreement.

86. The New York Court of Appeals has not decided a case applying the common-interest doctrine in a civil context, much less a litigation finance one. Indeed, it has only decided one in the criminal context, over twenty years ago. *See People v. Osorio*, 549 N.E.2d 1183 (N.Y. 1989).

87. *See Berger v. Seyfarth Shaw LLP*, No. C 07-05279 JSW (MEJ), 2008 WL 4681834 (N.D. Cal. Oct. 22, 2008) (finding that the funder and the plaintiff had a common commercial—not legal—interest and that the exception to waiver did not apply). *But see Devon IT, Inc.*, 2012 WL 4748160 (finding that the communications with the potential funder, who became the funder, waived neither work-product protection, nor, because of a common interest, attorney-client protection).

88. *See U.S. Bank Nat’l Ass’n v. APP Int’l Fin. Co.*, 823 N.Y.S.2d 361, 363 (App. Div. 2006) (noting that “the federal courts have been instructive” in the applicability “of the common interest doctrine in the context of an attorney-client communication” (citing *United States v. Schwimmer*, 892 F.2d 237, 243–44 (2d Cir. 1989); *Gulf Islands Leasing, Inc.*, 215 F.R.D. at 470; *Lugosch v. Congel*, 219 F.R.D. 220, 236 (N.D.N.Y. 2003), *vacated and remanded on other grounds sub nom. Lugosch v. Pyramid Co. of Onondaga*, 435 F.3d 110 (2d Cir. 2006))).

89. *See GUS Consulting GmbH v. Chadbourne & Parke LLP*, 858 N.Y.S.2d 591, 593 (Sup. Ct. 2008) (summarizing both lines of cases where one line holds the common legal interest must be identical, while the other holds the interest can be substantially similar). The “identical interest cases” also often note that having an interest in the same outcome in the case is insufficient to create a common legal interest. *See Gulf Islands Leasing, Inc.*, 215 F.R.D. at 472–73. Furthermore, a concern shared by parties regarding litigation does not establish by itself that the parties hold a common legal interest. *See, e.g.*, *SR Int’l Bus. Ins. Co. v. World Trade Ctr.*

failed to address the issue despite two different lobbying efforts by the New York City Bar Association, and thus it has left the doctrinal development to the common law.⁹⁰

Without embracing the generous extension of the common-interest doctrine reflected in some cases, we believe funders and plaintiffs should be able to communicate without waiving privilege. We view litigation funders as real parties in interest, and they should therefore be seen as akin to co-clients of the plaintiff's litigation counsel, entitled to the protection of the privilege in their own right,⁹¹ whether or not both the plaintiff and the funder have entered attorney-client relationships with the counsel. Conceptual support for such analysis can be found in the insurance context, where the insurer—which funds a litigation, but also subrogates the funded party, and has a duty to defend—is usually deemed a co-client and afforded the privilege.⁹² Moreover, a Florida court held that a litigation funder that

Props. LLC, No. 01 Civ. 9291 (JSM), 2002 WL 1334821, at *3-4 (S.D.N.Y. June 19, 2002); *In re* FTC, No. M18-304 (RJW), 2001 WL 396522, at *5 (S.D.N.Y. Apr. 19, 2001); *Shamis v. Ambassador Factors Corp.*, 34 F. Supp. 2d 879, 893 (S.D.N.Y. 1999), *reargued*, 187 F.R.D. 148 (S.D.N.Y. 1999). The other line, regarding a substantially similar common interest, has been used to apply the waiver exception even when the communicators are otherwise adverse. *See GUS Consulting GmbH*, 858 N.Y.S.2d at 593 (“The Appellate Division, First Department has implicitly adopted the latter approach, finding that the required ‘interlocking relationship’ existed between a plaintiff and a non-party despite the fact that they were a debtor and creditor.” (citing 330 Acquisition Co. v. Regency Sav. Bank, F.S.B., 783 N.Y.S.2d 805 (App. Div. 2004))). If the New York Court of Appeals were ever to rule and take the identical interest approach, it is very hard to imagine the waiver exception applying.

90. In 1998, the Council on Judicial Administration of the New York City Bar Association advocated for the New York Legislature to adopt changes to the Civil Practice Law and Rules to enshrine the common-interest doctrine for both attorney-client privilege and work-product doctrine, noting that a limited common-interest doctrine had been recognized for attorney-client privilege and anticipating it would apply to work product. *See* COUNCIL ON JUDICIAL ADMIN., ASS'N OF THE BAR OF THE CITY OF N.Y., RECOMMENDATION THAT STATE CIVIL COURTS ADOPT THE COMMON INTEREST PRIVILEGE (1998), available at http://www2.nycbar.org/Publications/reports/show_html_new.php?rid=8.

91. Indeed, the common-interest doctrine originated to facilitate communication in representation of multiple clients. *See Shamis*, 34 F. Supp. 2d at 893; *Int'l Ins. Co. v. Newmont Mining Corp.*, 800 F. Supp. 1195, 1196 (S.D.N.Y. 1992). A minority of New York courts would end the doctrine there. *See N. River Ins. Co. v. Columbia Cas. Co.*, No. 90 Civ. 2518 (MJL), 1995 WL 5792, at *3 (S.D.N.Y. Jan. 5, 1995); *N. River Ins. Co. v. Phila. Reinsurance Corp.*, 797 F. Supp. 363, 366-67 (D. N.J. 1992).

92. Merely being insurer-insured may not be enough in New York. *See N. River Ins. Co.*, 1995 WL 5792. However, a common interest exists between insured and insurer when the insurer picks the lawyer. *See Goldberg v. Am. Home Assurance Co.*, 439 N.Y.S.2d 2, 5 (App. Div. 1981); *Liberty Mut. Ins. Co. v. Engels*, 244 N.Y.S.2d 983, 985-86 (Sup. Ct. 1963), *aff'd*, 250 N.Y.S.2d 851 (App. Div. 1964). In cases distinguishing reinsurer-insurer (no common interest) from insurer-insured, opinions frequently note the duty to defend between insurer-insured. *See Am. Re-Ins. Co. v. U.S. Fid. & Guar. Co.*, 837 N.Y.S.2d 616, 621 (App. Div. 2007) (“[T]he relationship between an insured and insurer stands in stark contrast to a relationship between an insurer and a reinsurer. . . . [W]e find the common interest doctrine inapplicable.”).

had significant control over the litigation was a real party in interest.⁹³ Nonetheless, it is not obvious that, without subrogation, a funder and a plaintiff can be conceptualized as the attorney's co-clients, particularly since review of existing litigation funding contracts reveals that, at times, parties actually disclaim co-client status. The analogy is also weakened by conflicts of interest between the funder and plaintiff that could make it ethically impossible for an attorney to represent both.

In sum, under New York law, sharing attorney–client privileged material with potential funders would almost certainly waive attorney–client privilege; sharing it with a funder *may* waive the privilege and must be done with caution; and sharing it with most secondary investors almost certainly waives the privilege.

b. The New York Work-Product Doctrine

While information protected only by the attorney–client privilege cannot be shared without risking waiver, the resulting information asymmetry problem can be substantially addressed by sharing attorney work product. In a narrow sense, “attorney work product” has different definitions under the federal doctrine and New York doctrine (which one applies depends on the case). Federally, “work product” includes the materials prepared for litigation that we are referring to; New York’s definition of “work product” more closely mirrors the normal attorney–client privilege. However, when considering a second category of material protected in New York—trial preparation materials—the scope of what is protected is essentially the same as under the federal definition. Combining both “attorney work product” and “trial preparation materials,” New York protects an attorney’s “mental impressions, conclusions, opinions or legal theories” or other “work product” as well as materials “prepared in anticipation of litigation or for trial by or for another party, or by or for that other party’s representative.”⁹⁴ This formulation mirrors the federal one.⁹⁵

Fortunately for litigation finance, both federal and New York case law reflect a permissive approach to sharing work product with third parties without waiving the protection. The New York Court of Appeals explains its approach in terms of intent: “The qualified privilege governing trial

93. Analyzing whether a litigation funder counted as a real party in interest under a fee-shifting statute, a Florida district court of appeal concluded the funder was indeed the real party in interest because the funder had the right “to approve the filing of the lawsuit; controlled the selection of the plaintiffs’ attorneys; recruited fact and expert witnesses; received, reviewed and approved counsel’s bills; and had the ability to veto any settlement agreements.” *Abu-Ghazaleh v. Chaul*, 36 So.3d 691, 693 (Fla. Dist. Ct. App. 2009).

94. N.Y. C.P.L.R. 3101(c) & (d)(2) (McKinney 2005).

95. FED. R. CIV. P. 26(b)(3)(A). The New York definition of what is protected under “work product” is really analogous to what is protected federally under the attorney–client privilege; it is the “trial preparation materials” that are the analog to the federal work-product protection. *Id.* R. 26(b)(3).

preparation materials ‘is waived upon disclosure to a third party where there is a likelihood that the material will be revealed to an adversary, under conditions that are inconsistent with a desire to maintain confidentiality.’”⁹⁶ Under that standard, work product can be shared freely with all three categories of litigation financiers—potential funders,⁹⁷ actual funders, and secondary funders—provided that the work product is shared pursuant to a confidentiality agreement and the information recipients are not associated with the opposing side.

2. The Model Contract Solutions

The Model Contract deploys multiple devices to reduce information asymmetry without waiving the privilege (absent informed consent). The most basic is structuring the financing as a sale of securities, which places the plaintiff under the burden of the anti-fraud provisions of the securities acts and, therefore, has the helpful effect of incentivizing the plaintiff toward disclosure.⁹⁸ In addition, specific provisions impose disclosure duties and facilitate information sharing. These provisions are included in both versions of The Model Contract.

First, various definitions, representations, warranties, and other provisions of The Model Contract are designed to ensure that the plaintiff shares all material non-privileged information and work-product-protected information before and throughout the funding. Attorney–client protected information is not shared prior to funding, and sharing during the funded litigation requires informed client consent that waiver may occur through such disclosure.

Second, the plaintiff and funder agree that the common legal interest exists and that information will be shared to further that common interest. While not dispositive (parties cannot create a privilege by agreement that does not otherwise exist) courts consider such agreement necessary when analyzing whether a common interest exists, though it need not have been written.⁹⁹ Additionally, The Model Contract defines a category of

96. *People v. Kozlowski*, 898 N.E.2d 891, 906 (N.Y. 2008) (quoting *Bluebird Partners, L.P. v. First Fid. Bank, N.A.*, N.J., 671 N.Y.S.2d 7, 12 (App. Div. 1998)).

97. *See Fractus, S.A. v. Samsung Elecs. Co.*, No. 6:09cv00203, 2011 U.S. Dist. LEXIS 110936 (E.D. Tex. Jan. 20, 2011) (pitching materials to potential investor in patent litigation protected under work-product doctrine).

98. The securities laws would not apply if the plaintiff is structured in certain ways. Michael Kaufman, *Structuring the Issuer*, MODEL LITIG. FIN. CONT. (May 28, 2013), <http://www.litigationfinancecontract.com/structuring-the-issuer-2>; Painter, *Part I, supra* note 72. However, the application of the securities laws, from our perspective, is a feature, not a bug.

99. *See SEC v. Wyly*, No. 10 Civ. 5760(SAS), 2011 WL 2732245, at *2 (S.D.N.Y. July 5, 2011) (“The party asserting the common interest r[u]le bears the burden of showing that there was ‘an agreement, though not necessarily in writing, embodying a cooperative and common enterprise towards an identical legal strategy.’” (quoting *Denney v. Jenkens & Gilchrist*, 362 F. Supp. 2d 407, 415 (S.D.N.Y. 2004))). However, only communications otherwise protected by

information as “common interest material,” underscoring the parties’ belief. The goal is to facilitate a ruling in favor of a common interest without unduly risking the privilege by blindly relying on one.

Third, the plaintiff represents that it has fully disclosed all material information and that all information is complete and correct, and it warrants that it will continue to thus keep the funder informed of material changes.

Fourth, the funder represents that it does not have any contractual obligations to monetize its interest within a time frame that will jeopardize the claim. This provides the plaintiff with some information on the organizational structure of the firm and the ensuing incentives.¹⁰⁰

Finally, staged funding, discussed in detail below, reduces information asymmetries by tying the funder’s increase in risk—the release of additional capital—with the revelation of information. This aligns incentives because plaintiffs are not guaranteed funding. Bad faith, e.g., failure to disclose, will backfire. Staged funding thus reinforces the pro-disclosure incentives created by the securities laws.¹⁰¹

D. MINIMIZING CONFLICTS OF INTEREST

1. The Challenges

Litigation financing creates conflicts between the funder and the plaintiff and can create or exacerbate existing conflicts between the plaintiff and its attorney. While some conflicts may persist throughout the litigation, two phases are particularly prone to conflict. The first is the negotiation of the funding agreement itself. The second is the decision of when (and by implication, for how much) to settle.¹⁰²

the privilege are covered. *Id.* Moreover, as discussed *supra* Part II.C.1.a, whether the common interest exists will be assessed on the facts.

100. In addition to reducing information asymmetry, this representation also reduces conflicts. On the effects of the funder’s organizational structure on conflicts, see Steinitz, *supra* note 5, at 496–501.

101. While it may seem that the securities laws and litigation are incompatible because material information might need to be withheld to protect privilege, several litigation-backed securities have traded successfully without giving rise to fraud claims. See Steinitz, *supra* note 35. Under The Model Contract, issues are less likely to arise because the private placement approach enables work product to be shared, something that cannot be done with a publicly traded security.

102. For a more elaborate description of the conflicts of interest, see Steinitz, *supra* note 18, at 1291–92, 1323–25 and Steinitz, *supra* note 5, at 481–88. For specific state rules, see N.Y. RULES OF PROF’L CONDUCT R. 1.2(d), 1.6(a), 1.7(a), 1.8(e)–(f), 2.1 & 5.4(c) (2012). The Model Rules of Professional Conduct provide more general rules. See MODEL RULES OF PROF’L CONDUCT R. 1.0(e) (2009) (defining informed consent); *id.* R. 1.6–1.11 (covering confidentiality, conflicts of interest, duties to former clients); *id.* R. 2.1 (defining counsel as “advisor”); *id.* R. 2.3 (covering counsel’s evaluation of a matter for use by a third party). These are the rules addressed in the New York City Bar’s formal 2011 opinion on the ethics of third-party litigation finance. See N.Y.C. Bar Opinion, *supra* note 12 (discussing third-party litigation

a. Referrals and Repeat Play Between Funder and Attorney

A funder may wish to offer an attorney a referral fee to steer clients its way. Or, as repeat players, the funder and attorney may have an ongoing relationship (e.g., referring different matters to each other at different times). Such relationships may distort an attorney's incentives, leading her to refer a client to a suboptimal funder, e.g., one that is not the cheapest, most competent, most liquid, and so forth¹⁰³ Any repeat play (or prospect of repeat play) between the funder and attorney may also create an incentive for the attorney to comply with a funder's wishes regarding case management rather than the client's. An attorney may also wish to own or invest in a litigation finance firm, which would similarly align its interest with the funder rather than her client.

New York rules strive to resolve these conflicts in favor of the client. A New York attorney has a duty to "exercise independent professional judgment and render candid advice."¹⁰⁴ A New York attorney is under a direct duty to maintain such independence despite being paid by a third party, and she is prohibited from representing a client if "there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests."¹⁰⁵

Precisely how these rules apply in the context of litigation funding may depend on who is asked: the New York State Bar Association or the New York City Bar Association. In the mid-1990s, the New York State Bar stated that while lawyers can refer clients to litigation funders, they cannot receive referral fees or own part of the funding company.¹⁰⁶ However, in 2011, the New York City Bar treated an attorney's receipt of referral fees and ownership in a funding company as possibly open questions.¹⁰⁷

financing). The American Bar Association's draft opinion on the ethics of third-party litigation financing discusses conflicts of interest in light of the Model Rules of Professional Conduct. See ABA COMM'N ON ETHICS 20/20, *supra* note 12.

103. A part owner of a consumer litigation funder recently pled guilty to a kickback scheme in which the defendant steered certain investment opportunities to a broker who connected plaintiffs to the funder and the broker then kicked back part of the referral fees it received for steering plaintiffs to the funder. See *Former Part-Owner of Litigation Funding Company Admits Defrauding Business Partners in \$869,492 Kickback Conspiracy*, FBI (June 17, 2013), <http://www.fbi.gov/newark/press-releases/2013/former-part-owner-of-litigation-funding-company-admits-defrauding-business-partners-in-869-492-kickback-conspiracy>.

104. N.Y. RULES OF PROF'L CONDUCT R. 2.1.

105. *Id.* R. 1.7(a)(2).

106. See N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Op. 666 (73-93) (1994), available at <http://www.nysba.org/CustomTemplates/Content.aspx?id=5318>. The New York State Bar reiterated its assessment that a lawyer cannot be an owner of the financing company or receive a referral fee from it. N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Op. 769 (2003), available at <http://www.nysba.org/CustomTemplates/Content.aspx?id=5409>.

107. The New York City Bar Association's take on referral fees relates to the whole industry, not just the commercial claims context, but even so it notes that such fees may be unethical:

More generally, financial relationships, interests, and the potential conflicts involved mean the lawyer must fully inform the client and seek its consent, as well as recommend that the client seek independent counsel.¹⁰⁸

b. Billing Structures and Payment Schemes

Funders often shape how litigation counsel gets paid, creating incentives that can distort the attorney's judgment and advice.¹⁰⁹ For example, attorneys are often given a financial incentive to settle early, perhaps earlier than the client might wish to settle and for a relatively low settlement value. In addition, attorneys are often required by funders to have "skin in the game," working on at least a partial contingent fee basis.¹¹⁰ A well-known critique of contingency fees is that it incentivizes attorneys to settle early, but the concern can be more acute in funded litigation given the nuances the pay structure may reflect. The attorney's percentage "take" may depend on whether the matter settled before trial, settled during a trial, or went all the way to a verdict. Alternatively, funders require attorneys to accept a reduced hourly rate, at times with a promise of "uplift" (bonus) for a successful outcome.¹¹¹ Other billing arrangements are possible, each with its own set of conflicts.

When making a referral, the lawyer is barred from accepting a referral fee from the company if the fee would impair the lawyer's exercise of professional judgment in determining whether a financing transaction is in the client's best interest and would compromise the lawyer's ethical obligation to provide candid advice regarding the arrangement; even where the fee is permitted, the lawyer may be required to remit the fee to the client.

N.Y.C. Bar Opinion, *supra* note 12; N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Op. 671 (40-94) (1994), available at <http://www.nysba.org/CustomTemplates/Content.aspx?id=4866> (stating that the lawyer is prevented from receiving a referral fee where the amount of the product or service purchased depends on attorney advice). Interestingly, N.Y.C. Bar Opinion, *supra* note 12, does not cite the New York State Bar's opinions more clearly on point (Opinions 666 and 769, *see supra* note 106), even though N.Y.C. Bar Opinion, *supra* note 12, cites Opinion 666 in a different footnote on a different issue. The ABA is somewhat more permissive than the New York City Bar. The ABA's analysis of the referral fee and related issues leads to the conclusion that informed client consent may be sufficient to address the problem. *See* ABA COMM'N ON ETHICS 20/20, *supra* note 12, at 18-19, 28-29. The ABA opinion notes that a repeat business relationship might also create a conflict that requires informed client consent to resolve. *See id.*

108. *See* N.Y. LAWYER'S CODE OF PROF'L RESPONSIBILITY DR 5-101 (2007); *see also* ABA COMM'N ON ETHICS 20/20, *supra* note 12, at 18-19 (discussing Model Rule 1.7(a)(2)).

109. The ethical ramifications of the funder's influence in structuring the attorney's compensation structure is outside the scope of this Article, not least because that influence is embodied in the attorney retention agreement, not the funding contract. The basic issue is highlighted here simply to note the source of conflicts.

110. Jonathan Wheeler & Felicity Potter, *Welcome to the Party*, 158 NEW L.J. 1491, 1491 (2008).

111. *Id.*

Early settlement pressure can be further exacerbated because litigation funders, like venture capitalists, have a similar interest in “early harvesting” of their investments. This is so because they manage portfolios of cases and because they periodically need to go back to the markets to raise additional funds based on past performance.¹¹² Publicly traded funders may also have short-termism problems, being evaluated on a quarterly performance basis.¹¹³

The converse conflict is also possible: a funder wants to settle at an optimal or rational opportunity, but a plaintiff, who no longer bears the cost or who is emotionally invested in the conflict, may wish to protract the litigation.

Attorneys’ incentives to pressure or avoid pressuring a client to settle early are ameliorated by ethical obligations that render such pressure unethical. Settlement-pressure conflicts of interest also implicate rules that are aimed at ensuring that an attorney exercises independent judgment, free from influence by financial considerations. The New York City Bar Association’s Opinion frames tensions surrounding settlement decisions in terms of “control” of the lawsuit and suggests these issues may be resolved purely by disclosure and client consent:

While a client may agree to permit a financing company to direct the strategy or other aspects of a lawsuit, absent client consent, a lawyer may not permit the company to influence his or her professional judgment in determining the course or strategy of the litigation, including the decisions of whether to settle or the amount to accept in any settlement.¹¹⁴

However, not all authorities agree informed client consent is sufficient. The ABA draft opinion notes that even if giving settlement authority to the funder may be permissible as a matter of contract law and champerty, the resulting restriction on the lawyer’s independent judgment could be great enough that the lawyer could not ethically participate in the litigation.¹¹⁵

We believe that the conflict over control of the claim can be resolved if the funder pays fair value for control. And thus, as a normative matter, the funder should be able to pay for control of a claim (perhaps only in the commercial claim context this Article focuses on), and we do not think the

112. Steinitz, *supra* note 5, at 489; *see also* Gilson, *supra* note 34, at 1074–75; *see also* Gompers, *Grandstanding*, *supra* note 36, at 133–38.

113. *See, e.g.*, Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 J. CORP. L. 265 (2012).

114. N.Y.C. Bar Opinion, *supra* note 12.

115. *See* ABA COMM’N ON ETHICS 20/20, *supra* note 12, at 25.

current regulatory regime (including New York's champerty doctrine¹¹⁶) makes bargaining for total control practical.

c. Portfolio Concerns

Another potential source of conflict is the funder's focus on its portfolio of cases versus the plaintiff's focus on its single case. Funders' portfolio concerns may drive them to litigate to create favorable precedent, rather than optimally resolve the case at hand.¹¹⁷ While this conflict is probably the exception rather than the rule, the specialization of funders in particular areas of law and examples of such strategic behavior by insurance companies, the plaintiffs' bar, and hedge funds investing in awards against sovereigns, makes the conflict plausible.¹¹⁸ Beyond investing in precedent, new funders in particular might wish to avoid a reasonable settlement in order to win a symbolic victory for reputational gains, for example, to raise capital for successive funds, as has been documented in the VC context, or to force higher settlement in future cases based on a credible threat to litigate through trial and appeals.¹¹⁹ Portfolio concerns also mean that a funder may underinvest in the case at hand, as optimizing the portfolio involves weighing the comparative value of cases within a portfolio and assessing the comparative marginal utility of investing in any one of them. The plaintiff, on the other hand, wants optimal investment in its own case.

The most dramatic conflict of interest that can arise from the funder's portfolio management is the possibility that the funder invests in both sides of the same litigation. This conflict is unlikely unless the case involves a large claim and equally large counterclaim, such that the profit from either side swamps the cost of financing both. In that scenario, the dual investment would simply function as a hedge.

d. Funders' Duty to Its Investors

Although funders do not have a fiduciary duty to the plaintiff, they do have a duty to their investors to maximize profit. That can lead to two additional conflicts. First, as noted earlier, funders can push for monetary remedies over non-monetary ones such as injunctive relief, declaratory relief, a public apology, a change of an internal policy, or a change in the

116. In New York, champerty is tied to claim transfer, and claim transfer may occur if control transfers, even if the case caption or other indicia of ownership do not change.

117. Steinitz, *supra* note 18, at 1312–14. For example, Mitu Gulati and Robert Scott describe how hedge funds that purchased sovereign debt strategically litigated to have the *pari passu* clause in cross-border sovereign debt contracts reinterpreted to benefit their portfolio of such cases. See MITU GULATI & ROBERT E. SCOTT, THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN 157–59 (2012).

118. Steinitz, *supra* note 18, at 1314–18.

119. See Zsuzsanna Fluck et al., Venture Capital Contracting: Staged Financing and Syndication of Later-Stage Investments (Nov. 26, 2006) (unpublished manuscript), available at http://www.bi.no/oslofiles/ccgr/fluck_garrison_myers.pdf.

law.¹²⁰ Second, funders can profit not only from the litigation, but also from their access to the plaintiff's sensitive information. Absent contractual protection, nothing stops the funder from selling the information or otherwise profiting from it to the plaintiff's disadvantage.

The best tool to minimize the conflicts created by profit concerns (portfolio or otherwise) in favor of the plaintiff is a fiduciary duty. Creating such a duty would not be a panacea as it would be offset by the funders' duty to its shareholders, but it would go a long way. A fiduciary relationship between funder and plaintiff could be created by courts if they find that financiers—specifically, principals or staff lawyers who are licensed attorneys—are acting as the plaintiffs' attorneys when they invest in and manage lawsuits. However, this issue has not yet been brought before a New York (or other) court. Similarly a fiduciary relationship could be imposed if another regulatory body of law that imposes fiduciary duties (e.g., financial regulation) is held to apply. To date, no such regulation has been imposed, leaving it up to the private ordering of the parties. Because of the fiduciary duty's potency, a funder may simply refuse its imposition through contract. As an alternative, plaintiffs can negotiate for a duty to act reasonably and in good faith.¹²¹

2. The Model Contract Solutions

To address these conflicts, The Model Contract provides the following:

First, The Model Contract imposes a number of representations on the funder disclaiming conflicts. The funder represents that it has not paid a referral fee to the litigation attorney; that the litigation attorney does not own any part of the funder; and that any other financial relationships it has or has had with litigation counsel and any defendant are fully disclosed on a schedule so that the plaintiff may give informed consent to the conflicts. The funder further represents that it has not invested adversely to the plaintiff and that it is not bound by fund liquidation or other internal requirements to stop financing the claim after a few years.

Second, we suggest the plaintiff seek independent counsel—from an attorney who is not the litigation counsel and who has no ties to the funder—on the funding agreement prior to its execution and on settlement offers. To memorialize independent counsel's role during negotiation, The Model Contract has the plaintiff represent it received independent counsel about the terms of the agreement and about the relationships, if any,

120. An example is Burford's investment in the Chevron-Ecuador dispute, which penalized plaintiffs for receiving clean-ups rather than funds by requiring them to pay the funder for its pro-rated share of such a remedy. *See Funding Agreement Between Treca Financial Solutions and Claimants*, *supra* note 31; *see also supra* note 5.

121. *See generally* Anthony J. Sebok & W. Bradley Wendel, *Characterizing the Parties' Relationship in Litigation Investment: Contract and Tort Good Faith Norms*, 67 VAND. L. REV. (forthcoming 2013) (discussing good faith in litigation funding).

between the funder and litigation counsel and between the funder and any defendant before entering the agreement. Both of these plaintiff-protective provisions may not be useful to the corporate finance plaintiff who as a repeat player may have an ongoing relationship with a funder. Thus, The Model Contract makes these provisions the default in the access to justice version and optional in the corporate finance version.

Third, The Model Contract allows the funder to acquire influence but not control over the plaintiff's settlement decision by requiring the plaintiff to give prior notice to the funder of settlement offers and to give good faith consideration to the funder's analysis of the settlement offer. However, the plaintiff retains control of the settlement decision. We strike this balance to avoid the potential ethical and champerty issues of ceding greater control to the funder, but nonetheless give the funder an opportunity to monitor, protect, and maximize its investment.

Fourth, The Model Contract requires strict confidentiality and limits information sharing to protect plaintiff's sensitive information.

Fifth, The Model Contract protects the plaintiff's interest in seeking non-monetary remedies by excluding them from the definition of the term "Award," the proceeds of which are shared with the funder.

Sixth, The Model Contract contains a representation and warranty that the funder has not and will not sell part or all of its interest in the claim without the plaintiff's written consent. This is meant to prevent securitization of litigation which, if it were to occur, would create insurmountable conflicts, and to prevent the plaintiff from having to rely on a stranger for further funding.

Seventh, The Model Contract provides language for a comprehensive solution in the form of a fiduciary duty between the funder and the plaintiff and a weaker but viable alternative of a duty to act reasonably and in good faith. The fiduciary duty approach is the default in the access-to-justice case; the good faith duty is the default in the corporate finance case.

Finally, staged funding aligns funders' and plaintiffs' interests and further reduces conflict, as discussed in detail below.

*E. STAGING THE FUNDING OF LITIGATION*¹²²

1. The Challenges

Staged funding in venture capital aligns the entrepreneur's interest with the funder's by making the entrepreneur's access to capital dependent on meeting the funder's contractually stated expectations. Whether or not the entrepreneur is meeting those expectations is assessed at points in time called "milestones," a concept we explain further below. If the funder is

122. Maya Steinitz, *How Much Is That Lawsuit in the Window? Pricing Legal Claims*, 66 VAND. L. REV. 1889(2013) (discussing the theory underlying staged funding and claim valuation).

satisfied when the milestone is reached, it may invest further; if not, it does not. Staged funding also aligns the funder with the entrepreneur, because as the company develops and its value builds, the funder is incentivized to continue funding at milestones in order to realize the benefit it has bargained for.

As a matter of risk management and agency control, staged funding is well suited for litigation investment. However, the adaptation of staged funding to litigation finance must be done with great care to account for the differences between litigation and start-up companies, which are quite different assets. We extensively discuss the important economic and structural differences between venture capital and litigation finance elsewhere.¹²³ These differences, in a nutshell, include the fact that the “markets” to which plaintiffs sell are comprised of judges and juries who render a judgment or a defendant who makes a settlement offer. These markets cannot be expanded and the “product” cannot be scaled-up or otherwise significantly modified.¹²⁴ More generally, claim value does not grow by orders of magnitude, as it might in the case of a start-up company, but rather moves up and down unpredictably with its ultimate value capped by the value of the harm underlying the cause of action.¹²⁵ Other differences include the fact that ventures have competitors whereas litigants have opponents and the fact that litigants face a timeline that is wholly externally dictated (by rules of procedure and a judge). There are also societal differences, the different needs of the two plaintiff types, and the challenges both pose for mapping staged funding onto litigation finance. These latter differences are our focus here.

Unlike startup companies, litigation is partially a public good, dependent on the state for its existence and effectiveness far more so than a business idea turned into a company. Litigation resolves disputes, determining culpability, harm, rights, and remedies. Startup companies may provide jobs, useful products—even economically transformative ones—and otherwise be socially important. Nonetheless their existence and function are categorically different from litigation.

123. See *id.*; Maya Steinitz & Abigail C. Field, *Staging Litigation Funding*, MODEL LITIG. FIN. CONT., <http://litigationfinancecontract.com/staging-litigation-funding/> (last visited Nov. 9, 2013).

124. See Steinitz, *supra* note 122; Steinitz & Field, *supra* note 123.

125. On the nonmonotonic and discontinuous nature of settlement values, see generally Steinitz, *supra* note 122, which, in turn, builds on earlier works that bring financial theory of options analysis to bear on the analysis of the option to settle. See, e.g., Oren Bar-Gill, *Pricing Legal Options: A Behavioral Perspective*, 1 REV. L. & ECON. 203 (2005); Bradford Cornell, *The Incentive to Sue: An Option-Pricing Approach*, 19 J. LEGAL STUD. 173 (1990); Joseph A. Grundfest & Peter H. Huang, *The Unexpected Value of Litigation: A Real Options Perspective*, 58 STAN. L. REV. 1267, 1272–82 (2006); Robert J. Rhee, *The Effect of Risk on Legal Valuation*, 78 U. COLO. L. REV. 193 (2007).

When a venture capitalist ceases funding a startup simply because another investment in its portfolio potentially offers better returns, even if the consequence is that the startup fails, society is and should be indifferent. Not so with most categories of litigation. As a general normative matter, plaintiffs with meritorious claims who wish to bring them should not be blocked by the invisible hand of the market. However, there is one type of litigation in which this kind of market discipline can be justified: commercial claims brought by corporations or wealthy individuals; that is, precisely the kind of claims we explicitly assumed when drafting The Model Contract.

Commercial claims are generally only about money. When a case is fundamentally about money damages, it is easiest to view it as an investment opportunity that can be abandoned for better opportunities. Other forms of litigation that currently receive financing, such as divorce cases, involve many issues beyond money, particularly when the couple has children. Staged funding of such litigation, with its ability to eliminate a plaintiff's ability to continue its claim, is hard to justify normatively.

Beyond identifying the claim type's influence on the appropriateness of staged funding, contracting parties need to recognize the importance of claimant type. Access-to-justice plaintiffs are in a very vulnerable bargaining position vis-à-vis funders, particularly now when the market for litigation funding is opaque and underdeveloped compared to the venture capital market. Corporate finance plaintiffs, in contrast, need not fear staged funding.

The fundamental difference in bargaining power, coupled with the normative concern that meritorious claims brought by willing plaintiffs should be resolved by the plaintiff rather than by market discipline, implies that staged funding should not be adopted identically for both types of plaintiffs. And indeed, the funding terms in the two versions of the models differ. Ramifications of those differences also show up in provisions related to milestones and termination rights.

In venture capital, milestones mark the startup's progress through various stages of development, each stage revealing new information.¹²⁶ The information revealed is of three sorts: first, about the performance of the underlying asset; second, about the effectiveness of the agents developing the asset; and third, about the larger context from which the asset's value ultimately derives. The amount of each type of information revealed at a given milestone varies depending on the milestone, but the point of designating the milestone is to recognize that material information has been

126. See Maya Steinitz, *Milestones Generally and in the Model Contract*, MODEL LITIG. FIN. CONT. (Jan. 25, 2013), <http://litigationfinancecontract.com/milestones-generally-and-in-the-model-contract-2/>.

revealed, creating a meaningful opportunity for funders to reassess their commitment to the investment and the accuracy of the investment's price.

As a general matter, at milestones funders can either refuse further funding, "exiting" the investment, or provide an additional infusion of the capital that the funders committed at the outset, either on the same terms or on new ones based on a re-pricing of the asset. The re-pricing, in turn, is based on the new information that has been revealed.

An example of a good milestone in litigation is the close of discovery, when the evidentiary record to be used in the litigation is complete. It is a discrete point in time at which all of the information revealed during discovery can be incorporated into pricing. If a funder exited a litigation investment after the close of discovery, it is plausible that the plaintiff could find another funder, particularly if a transparent market develops. In fact, milestones could facilitate the development of that market, enabling funders to develop expertise as early and late-stage litigation funders.¹²⁷

At least that is how staged funding works in theory: invest at one milestone, reach the next milestone, and invest again or exit. In the real world, funding invested at one milestone can run out before the next milestone is reached. In venture capital, the parties simply negotiate "bridge financing," or even an entirely new round of funding, or the investment ends. That approach would also work for corporate finance plaintiffs, as they can prevent any disruption in the litigation by self-funding while the negotiations are ongoing. Access-to-justice plaintiffs, however, would be doubly vulnerable to funders during negotiations. Not only do they need the financing, but in between milestones they may face deadlines imposed by the court or other litigation-specific constraints¹²⁸ that make it impossible for them to engage in lengthy negotiations or find other funders soon enough.

In venture capital parlance, the plaintiffs are confronted with a "hold-up" problem and potentially forced to accept lopsided terms.¹²⁹ The venture capital solution to hold-up is syndication—creating a competition among funders to drive prices up—which is not a sufficient solution for access-to-justice plaintiffs unless the litigation finance market develops to the point where plaintiffs could reliably have multiple funders participate in each round of negotiations. Until such time, other solutions are needed.

127. Indeed, funders already specialize by stage to some extent. Some are focused on appeals or enforcement actions, for example.

128. Steinitz, *supra* note 122; Steinitz & Field, *supra* note 123.

129. For more on hold-up, see Steinitz, *supra* note 122 and Steinitz & Field, *supra* note 123. Research shows, specifically, that staged funding by monopolistic VC funds (as opposed to syndicates of funders) produces sub-optimal outcomes—meaning companies fail that would have succeeded if not held-up. Steinitz, *supra* note 122; Steinitz & Field, *supra* note 123. The same sources identify research that shows that the entrepreneur's ownership share increases with the value of the project when later stages of the investment are syndicated. Steinitz, *supra* note 122; Steinitz & Field, *supra* note 123.

2. The Model Contract Solutions

For both plaintiff types, The Model Contract's core adaptation is structuring the financing as a series of securities sales to the funders, with the sales occurring at the investment milestones at prices negotiated at each such milestone. The securities are "shares" in the litigation proceeds.¹³⁰ At the outset, the plaintiff and funder agree on the potential value of the litigation, the funder "commits" a certain amount of capital that it is willing to invest at each milestone, and the plaintiff and funder negotiate the price of the initial investment. At each investment milestone thereafter, the purchase price of the next batch of securities is negotiated anew to incorporate the information received at that point.

This adaptation treats the entire litigation as a single funding round. In a VC-staged funding round, the investor will "commit" a certain amount of capital to the round but only invest a part of it at each milestone closing within the round. This approach makes sense for litigation funding in that the analogy between litigation finance and venture capital is strongest at the "seed" or "early" stage of VC funding. The single-funding-round approach is modified, however, by The Model Contract's provision for the re-pricing of the "shares" at investment milestones.

Each purchase price is based on an "Initial Claim Value"—a number negotiated at the outset—and a "Risk Discount Factor" that is negotiated to reflect the uncertainty that the Initial Claim Value will be realized, or realized in a timely way. Unless the "Claim" has proved much less valuable than expected, the Initial Claim Value plays no other role; a Litigation Proceed Right-holder gets one percent of the actual proceeds.

The suggested provisions identify only one investment milestone after the initial investment: the close of discovery. Parties can negotiate for more. Critically, the re-pricing focuses not on the value of the claim, but on the risk discount applied to the Initial Claim Value. The Initial Claim Value is unlikely to have changed, unless new claims have been added or original ones dropped. At the completion of discovery however, the parties can better assess the risk that the claim will fail to lead to a favorable settlement or judgment. As a result, they can decide whether a "share" should cost twenty percent of its agreed potential value (high risk) or fifty percent (low risk) or any other number.¹³¹

The transaction costs of re-pricing at the discovery closing should be low, because the focus is on the change in the information about risk more than it is on valuing the claim. That said, if during discovery a plaintiff found information enabling it to make new, valuable claims, the parties could

130. See *supra* Part II.B.2.

131. The value can also be affected by the negotiation process. If a syndicate of funders bid at the discovery milestone closing, the risk discount should be less than if there is no syndicate even though the revealed information is the same in both scenarios.

negotiate a new claim value and amend the contract accordingly, and vice versa. While the transaction costs would rise, the milestone would still further its purpose of allowing parties to more accurately price the investment.

Although this basic deal applies to both types of plaintiffs, The Model Contract provisions then diverge. For the access-to-justice plaintiff, the suggested provisions address the bargaining disparity in between milestones by preventing a funding shortfall in between milestones. The funder is required to finance through to the next milestone, even if the initially invested capital falls short, unless the funder brings in a replacement financier or is willing to surrender all value already purchased. Mechanistically, The Model Contract requires the accelerated investment of capital “committed” to financing at the next milestone and the investment of new “supplemental” capital if committed funding is nearly spent but the milestone/completion of the Claim has not been reached.¹³²

Acceleration and supplementation are justified by the differences between claims brought by access-to-justice plaintiffs and startup companies, discussed above, and their effect is tempered by the fact that the funder can still exit at the milestone or before, if it is willing to find a replacement funder or lose its sunk costs (i.e., investment to date). The Model Contract assumes the funder will want a discounted purchase price for “shares” purchased with the supplemental investment but that the discount is not required for an accelerated investment as that capital is not “new” capital; however, parties can customize these terms.

Returning to provisions that apply to both plaintiff types, The Model Contract reduces the extreme uncertainty by providing limited downside protection to both funder and plaintiff. If the Claim is revealed to be much less valuable than expected, by an otherwise acceptable settlement offer or

132. If the capital invested is spent prior to the milestone because of relative incompetence or padded billing of the litigation counsel, it may be appropriate to have the litigation counsel forego fees or take litigation proceed rights in lieu of payment, rather than have the accelerated investment of committed capital. See Edward A. Reilly, Jr., *4 Thoughts on “Funding Through to Milestones: Accelerated and Supplemental Investments,”* MODEL LITIG. FIN. CONT. (Jan. 31, 2013, 5:33 PM), <http://litigationfinancecontract.com/funding-through-to-milestones-accelerated-and-supplemental-investments/#comments>.

For a real world example of an access-to-justice funding that highlights the appropriateness of the VC analogy and many of the provisions herein, consider the financing of Crystallex International Corporation’s arbitration against Venezuela. That deal involved staged financing pegged to litigation related milestones, the acceleration of committed capital to bridge a funding shortfall between milestones, and the issuance of a special class of stock to give the funders control rights if sufficient financing was used. See *Management’s Discussion and Analysis for the Year Ended December 31, 2012*, CRYSTALLEX INT’L CORP. 5 (Aug. 16, 2013), http://www.crystallex.com/files/KRY%202012%20Year%20end%20MDnA_v001_u9xz34.pdf. This example is discussed in detail in Steinitz, *supra* note 35.

by a final judgment, then the funder is issued additional “shares.”¹³³ If possible, the funder is issued sufficient “shares” to gain the value expected by owning the funder’s original number of “shares” of proceeds worth the Initial Claim Value. This type of re-pricing is limited, however, by the plaintiff’s downside risk protection—its right to a minimum recovery.

We set a minimum plaintiff recovery because of the public policy concern—indeed, one of the main critiques of litigation funding—that plaintiffs will be exploited¹³⁴ and that funders profiteer from others’ actionable injuries.¹³⁵ By providing a minimum, the parties reduce the risk that courts will refuse to enforce the finance agreement on grounds such as unconscionability.¹³⁶ While corporate finance funders are not as vulnerable, we believe it is good practice in every contract to set the minimum recovery as it is a basic deal term.

While the plaintiff’s minimum recovery will be heavily negotiated, the standard for minimum recovery set by the courts in the contingency fee context is a logical guideline.¹³⁷ This minimum also minimizes the risk of buyers-remorse-type satellite litigation in which plaintiffs decide, after having received the funding and an award actually having been rendered, to challenge the enforceability of the finance agreement.¹³⁸

133. The VC analog for conserving the initial bargain and limiting the funder’s downside risk as value changes over time are conversion-price, anti-dilution provisions. See Michael A. Woronoff & Jonathan A. Rosen, *Understanding Anti-Dilution Provisions in Convertible Securities*, 74 *FORDHAM L. REV.* 129 (2005). Other types of anti-dilution provisions can be used. For example, Robert Rhee has suggested using a time-triggered provision to reflect the time value of money. Robert J. Rhee, *Litigation Financing and Time Dilution*, *MODEL LITIG. FIN. CONT.* (Jan. 23, 2013), <http://litigationfinancecontract.com/litigation-financing-and-time-dilution/>.

134. See Ronen Avraham & Abraham L. Wickelgren, *Third Party Litigation Funding—A Signaling Model* (Univ. of Tex. Sch. of Law, Law & Econ. Research Paper No. 521, 2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2302801 (discussing a consumer funding case in which the plaintiff settled for \$150,000 but ended up with \$111 because the third-party funder walked away with the bulk of the recovery).

135. The underlying theory of such critiques being that legal claims are a unique, personal kind of asset. See generally Sebok, *supra* note 59. This idea is quite intuitive in the context of tort and divorces cases, which are increasingly receiving third-party funding. See generally *id.*

136. See *supra* notes 33 and 134 (discussing cases concerning unconscionability of funders’ returns).

137. No ceiling is set under Rule 1.5 of the New York Rules of Professional Conduct, which instead offers a balancing test. See N.Y. RULES OF PROF’L CONDUCT R. 1.5 (2012). Contingency fees of forty and fifty percent have been upheld. See *Quinones v. Police Dep’t of N.Y.*, No. 10 Civ. 6195 (JGK) (JLC), 2012 WL 2148171 (S.D.N.Y. Apr. 12, 2012); *Ross v. Mitsui Fudosan Inc.*, No. 97 Civ. 0975 PKL RLE, 1999 WL 799534, at *2 (S.D.N.Y. Oct. 6, 1999) (“Courts have found forty or fifty percent contingency fee agreements conscionable in certain circumstances, such as when the litigation is complex, lengthy or specialized in knowledge.”); *Lawrence v. Miller*, 901 N.E.2d 1268, 1272 (N.Y. 2008) (finding that a forty percent fee was not unconscionable as a matter of law, but the amount of the fee should be proportionate to the value of services rendered).

138. Since it is easier to sign away *X* percentage of nothing *ex ante* than to actually pay *X* percentage of something once a settlement or court victory is won, hindsight litigation to

Importantly, the suggested terms state that the purpose of this type of re-pricing is strictly to preserve the economic equilibrium of the bargain, not to allow for renegotiating that equilibrium *ex post*. Re-pricing is mechanistic because the expected value that the re-pricing aims to replicate is known; the actual value and how much it deviates from the expected value is known; and how many additional “shares” can be issued is known at any given time. Therefore, this risk-management re-pricing should not increase transaction costs significantly.¹³⁹

The Model Contract makes it easier for plaintiffs to optimize their funding level by making fundraising transparently linked to claim proceeds. While the plaintiff will have to strike a difficult balance when deciding how many “shares” to offer at each closing, the ability to offer some and then more, and then more still, makes it easier for the plaintiff to avoid over-selling at the outset. The plaintiff does not have to decide at the outset how much of its potential proceeds it is willing to give up. This flexibility should help protect the financing arrangement from unconscionability concerns and buyers’-remorse litigation. We presume, based on the analogy to the contingency fee case, that a plaintiff will not want to sell more than one third of the total “shares” in its proceeds. But the plaintiff may well succeed at selling significantly less than one-third of the proceeds while still funding its whole claim. Or the plaintiff may end up selling every “share” it can until it reaches the limit imposed by the minimum recovery.

There is still unallocated residual risk: it is possible that the plaintiff will run out of “shares” to sell and money to conduct the claim. However, the risk that plaintiffs’ funding demands will exceed what funders want to invest mid-litigation is present in all structures.¹⁴⁰ In such scenarios, the parties can

challenge the deal terms is not uncommon. *See, e.g.*, *S & T Oil Equip. & Mach., Ltd. v. Juridica Invs. Ltd.*, 456 F. App’x 481 (5th Cir. 2012); *Kraft v. Mason*, 668 So.2d 679 (Fla. Dist. Ct. App. 1996); *Odell v. Legal Bucks, LLC*, 665 S.E.2d 767, 772–73 (N.C. Ct. App. 2008); *Rancman v. Interim Settlement Funding Corp.*, 789 N.E.2d 217 (Ohio 2003); *Anglo–Dutch Petroleum Int’l, Inc. v. Haskell*, 193 S.W.3d 87 (Tex. App. 2006).

139. *See, e.g.*, J. LUIS GUASCH, GRANTING AND RENEGOTIATING INFRASTRUCTURE CONCESSIONS: DOING IT RIGHT (2004), available at <http://crgp.stanford.edu/events/presentations/gcr2/Guasch3.pdf>; Philippe Aghion & Patrick Bolton, *An Incomplete Contracts Approach to Financial Contracting*, 59 REV. ECON. STUD. 473 (1992); James Bergin & W. Bentley MacLeod, *Efficiency and Renegotiation in Repeated Games*, 61 J. ECON. THEORY 42 (1993); Arthur J. Robson, *Duopoly with Endogenous Strategic Timing: Stackelberg Regained*, 31 INT’L ECON. REV. 263 (1990).

140. And current incremental funding practices, to the extent that the Burford–Ecuador deal is representative, *see supra* note 5, seems to leave this risk completely (rather than partially) unaddressed. There is reason to believe that incremental funding practices in the market currently are no more sophisticated than what can be gleaned from the Burford–Ecuador investment. Burford is “the largest and most experienced international dispute funder in the world’ . . . so we’re not looking here at some aberrational outlier . . . [And,] we can be assured that Burford’s conduct probably represents the very best practices the young industry has to offer.” Roger Parloff, *Have You Got a Piece of this Lawsuit?*, CNNMONEY (June 28, 2011, 2:06 PM), <http://features.blogs.fortune.cnn.com/2011/06/28/have-you-got-a-piece-of-this-lawsuit->

agree that the funder will bear the risk and will continue funding without receiving additional “shares” in order to receive some value for its sunk costs; that the plaintiff will bear the risk by selling more “shares” and reducing its minimum (and thus, potentially, create an unconscionability or buyer’s remorse problem); or that they share the risk.

The next Part sets out The Model Contract (excluding boilerplate or otherwise typical finance provisions). For brevity, we provide both the access-to-justice and corporate finance contracts in an integrated fashion. Specifically, we lay out the access-to-justice contract, and after each provision that would be deleted or modified for the corporate finance plaintiff, we highlight the deletion or state the modification. (For visual simplicity, we do not attempt to correct the section numbering to reflect the deletions/alterations.) In addition, while the contract is drafted for one funder, it can be easily adapted for multiple funders. Where the inclusion of multiple funders would require more drafting changes than conforming ones, we have included relevant language.

III. THE MODEL CONTRACT

This Litigation Finance Agreement (Agreement) is dated as of [date], and is by and between [Plaintiff’s name] (Plaintiff) and [Funder’s name] (Funder).

The Plaintiff has a valid and substantial claim against the Defendant(s). The Funder wishes to invest with the Plaintiff to facilitate the prosecution of its claim and to profit if the claim is successful. The Funder agrees that its financing is nonrecourse; the litigation proceed rights it shall purchase represent no value if there are no proceeds of the litigation.

Now, therefore, it is agreed as follows:

1.0 Definitions

Acceleration Event: The balance of the Litigation Account falls below [\$] and the Litigation Counsel in good faith reasonably believes the amount remaining in the Litigation Account is insufficient to finance the conduct of the Claim through to the Milestone Event marking the next Closing. [Despite such certification, an Acceleration Event has not occurred if the Plaintiff and [Funder/Funders holding a majority of issued Litigation Proceed Rights] agree the funding shortfall is due to Attorney Waste, as defined in the Retainer Agreement, between the Plaintiff and Litigation Counsel entered [date]. In such case, the related provisions in the Retainer Agreement shall apply.]

2/. Anthony Sebok has noted that the Burford–Ecuador deal contained “nothing unusual from [the] point of view of the litigation finance world” in its contract. Daniel Fisher, *Litigation-Finance Contract Reveals How Investors Back Lawsuits*, FORBES (June 7, 2011, 7:12 AM), <http://www.forbes.com/sites/danielfisher/2011/06/07/litigation-finance-contract-reveals-how-investors-back-lawsuits/> (internal quotation marks omitted).

Comment: The optional “Attorney Waste” language is one way to protect the funder from the risk that litigation counsel fails to effectively use funds because he knows he can force additional funding.¹⁴¹ However, this definition must be very narrow to cover only obvious waste, or else it creates a conflict between the plaintiff and the attorney.¹⁴²

Corporate Finance Version Comment: *This provision should be deleted as corporate finance plaintiffs do not need the bargaining power protection of Accelerated Investments.*

Award: The total monetary amount owed the Plaintiff on account of or as a direct or indirect result of the Claim, whether by negotiation, arbitration, mediation, lawsuit, judgment, settlement, or otherwise. For the avoidance of doubt, “Award” includes both cash and the monetary value of non-cash assets at the time the Award is paid, and it excludes the value of injunctive, declaratory, or other non-monetary relief.

Comment: This definition should be customized to the claim. The definition should be very broad to capture the full monetary value, but minimize claim commodification by excluding the cash equivalent value of remedies that were not intended to be fungible with cash, such as injunctive relief.

Claim: The lawsuit [filed by the Plaintiff/the Plaintiff will file] against [name] arising from [name’s] breach of [specify], including any refile, counterclaim, appeal, settlement, enforcement action, arbitration, or other action or process related to the lawsuit, whether primary, ancillary, or parallel.

Comment: Investing after the lawsuit has been filed should further reduce the risk of a champerty finding under New York law. Generally, this provision should be customized to reflect the claim.

Closing: Any or all of the following events, as context requires:

Acceleration Closing: The sale and purchase of Litigation Proceed Rights thirty (30) days after an Acceleration Event.

Defendant[s]: [Name(s) of defendant(s)].

Discovery Closing: The sale and purchase of Litigation Proceed Rights eight days after the Conclusion of Discovery.

Initial Closing: [Date the Initial Investment is made, location/other description.]

[Supplemental Closing: The sale and purchase of Litigation Proceed Rights thirty (30) days after a Supplemental Investment Event.]

141. This is an example of “braiding”— the intertwining of two or more contracts such that each contract includes provisions that operate as implicit terms in support of the arrangements contained in the other. See Gilson et al., *Braiding*, *supra* note 36, at 1386, 1422–23. On the braiding of the litigation finance contract and the retention agreement, see Steinitz, *supra* note 5, at 512–15.

142. Kenneth A. Linzer, *Conflicts Created by the Funding Terms in the Model Contract*, MODEL LITIG. FIN. CONT. (Apr. 29, 2013), <http://litigationfinancecontract.com/conflicts-created-by-the-funding-terms-in-the-model-contract/>.

Comment: If more investment milestones are negotiated, they will need their own closing definitions. Supplemental Investments, and all their related terms (such as Supplemental Closings) are optional as the parties may not wish to allocate this risk ex ante.

Corporate Finance Version Comment: *The Acceleration and Supplemental Closings should be deleted as corporate finance plaintiffs do not need the bargaining power protection of Accelerated or Supplemental Investments.*

Committed Capital: [\$], the total amount pledged to finance the conduct of the entire Claim through to the Conclusion of the Claim [as set forth in Exhibit [X]].

Comment: If multiple funders are involved, the Exhibit becomes necessary to identify how much each is willing to invest and when. Funders and Plaintiff should use their expertise to determine how much capital is likely to be needed for the whole claim and ensure that the amount committed is at least that number.

Common Interest Material: Any discussion, evaluation, negotiation, and any other communication and exchanges of information relating to the Claim in any way, whether written or oral, between or among the Plaintiff, Litigation Counsel, Funder, and/or Funder's Representatives, *provided* that such communication would be protected by attorney-client privilege between Litigation Counsel and the Plaintiff, work-product doctrine, or other discovery protection if not disclosed to a third party lacking a common legal interest.

Comment: The more traditional way of defining this material would have the language after "provided" simply state that the material was subject to one of the discovery privileges, a restriction that narrows the otherwise sweeping language before "provided." However, if the definition is contingent on the material actually being protected by such privilege and a judge were later to rule a common legal interest did not exist, so that waiver occurred and none of the material was so protected, the definition would be invalidated. If the definition were invalidated, the ramifications elsewhere in the contract might produce material consequences.

Conclusion of the Claim: The final resolution of the Claim, whether by settlement, the entry of a non-appealable final judgment against the Plaintiff, or the enforcement of a final, non-appealable judgment in favor of the Plaintiff.

Confidential Information shall mean:

(i) the Common Interest Material;

[(ii) discussions and negotiations related to this Agreement, including drafts of this Agreement;]

[Alternate: (ii) this Agreement, including: (a) its existence and the existence of the financing it provides; (b) its terms; (c) the parties to it; and (d) any discussions and negotiations related to this Agreement, including drafts of this Agreement;]

(iii) to the extent not already covered as Common Interest Material, the Claim, including: (a) the information, of any type, relevant to

understanding the Claim; (b) the parties', Litigation Counsel's, or Funder's Representatives' strategies, tactics, analyses, or expectations regarding the Claim or Award; and (c) any professional work product relating to the Claim or the Award, whether prepared for the Plaintiff, Litigation Counsel, the Funder, or the Funder's Representatives.

(iv) [Add customized provisions.]

Notwithstanding the foregoing, information is not Confidential Information that (a) was or becomes generally available to the public other than by breach of this Agreement; (b) was, as documented by the written records of the receiving party, known by the receiving party at the time of disclosure to it or was developed by the receiving party or its representatives without using Confidential Information or information derived from it; (c) was disclosed to the receiving party in good faith by a third party who has an independent right to such subject matter and information; or (d) is required to be disclosed by law.

Comments: 1. We included information common to all situations; parties must customize the definition to meet their needs. Plaintiffs must take great care with this definition, and, if they wish, add an additional defined category of Proprietary Information because absent explicit contractual protections, nothing prevents the Funder from profiting by misusing the Plaintiff's sensitive information. 2. Although parties can agree to keep the contract confidential, we believe it is likely discoverable under New York law.¹⁴³ Even if discoverable, however, its admissibility at trial may be a different question.

Costs: Costs are the expenses incurred by or on behalf of the Plaintiff for conducting the Claim and complying with the terms of this Agreement and include: professional fees, whether for attorneys, advisors, experts, or witnesses; and procedural fees relating to court, arbitration, or other process, including filing and arbitrator fees; provided that the amounts in each case are approved by Litigation Counsel.

Comment: Plaintiffs may be advantaged by having the Funder monitor these invoices, particularly for Litigation Counsel's own work. However, privilege issues may arise.

Exiting Funder: A Funder that decides to stop funding the Claim prior to the Conclusion of the Claim.

Expected Value: The result of multiplying one percent (1%) of the Initial Claim Value by the number of Litigation Proceed Rights that Funder owns.

Funder[s]: [Name(s).]

Funder's Representatives: [Name of counsel] and any successor counsel or supplemental counsel the Funder retains to represent its interests regarding the Claim and this Agreement.

143. See Maya Steinitz, *Discoverability of Funding Contracts*, MODEL LITIG. FIN. CONT. (Feb. 8, 2013), <http://litigationfinancecontract.com/discoverability-of-funding-contracts/>.

Independent Counsel: [Name of counsel] and any successor or supplemental counsel retained by the Plaintiff to advise on this Agreement's terms, amendments, and assignments, on settlement proposals and on privilege issues. Such counsel has and shall have no direct or indirect economic relationship with the Funder prior to the Conclusion of the Claim.

Comment: This role could be played by the Litigation Counsel provided potential conflicts are disclosed to the Plaintiff and waived by it. Like minimum plaintiff recovery, this predominantly protects plaintiffs but also provides funders with protection—indeed, a defense, against “buyers’-remorse” litigation.

Corporate Finance Version Comment: *This provision is optional for corporate finance plaintiffs, not least because such companies have sophisticated in-house counsel who would typically play this role.*

Initial Claim Value: [\$.]

Comment: This is a negotiated amount that reflects the good faith expectations of the parties ex ante of what a reasonably favorable verdict or settlement would bring.

Investment: Any or all of the following as context requires:

Accelerated Investment: The amount of money the Funder invests at an Acceleration Closing.

Discovery Investment: The amount of money the Funder invests at the Discovery Closing.

Initial Investment: The amount of money the Funder invests at the Initial Closing.

Supplemental Investment: The amount of money the Funder must invest at a Supplemental Investment Closing.]

Comment: If any other investment milestones are included, they will need their own definition. Supplemental Investments are optional as the parties may not wish to allocate this risk ex ante.

Corporate Finance Version Comment: *The Acceleration and Supplemental Investments should be deleted as corporate finance plaintiffs do not need the bargaining power protection they provide.*

Litigation Account: [Identify bank account.] The Litigation Account is subject to the Escrow Agreement by and among [parties], dated [date] “Escrow Agreement.” Pursuant to the Escrow Agreement, the Escrow Agent (as defined therein) shall use the funds in the Litigation Account to pay the Costs and its fee.

Comment: The Escrow Agreement should contain the right, if any, of the Funder to review and/or approve invoices prior to the Escrow Agent’s payment of them. In addition it should contain notice provisions tied to the Acceleration and Supplemental Investment Events, if those concepts are used.

Litigation Counsel: [Counsel name] and any successor or supplementary counsel retained by the Plaintiff to conduct the Claim.

Litigation Proceed Right: The right to receive one percent (1%) of the Proceeds.

Litigation Proceed Right Certificate: A document in the form of Exhibit [] (i) reflecting ownership of a certain number of Litigation Proceed Rights; (ii) bearing a legend stating that the certificate and the rights it represents may not be transferred without the express, written consent of the Plaintiff and then only if the transferee becomes a party to this Agreement; (iii) acknowledging the rights and obligations created by Subsection 5.6 of this Agreement; and (iv) certifying the existence of a perfected senior security interest in the Proceeds Account [and in the Claim].

Comment: Although this financing is nonrecourse, after the Proceeds have been received by the Plaintiff but before they are disbursed to the Funder, there is a brief possibility that the Plaintiff could convert money due to the Funder. This security interest is intended to thwart that possibility; however, the securities fraud liability that would result from such conversion should be a sufficient deterrent.

Litigation Proceed Right Purchase Price: Each Litigation Proceed Right purchased at a Closing shall cost an amount equal to one percent (1%) of the Initial Claim Value multiplied by the relevant Risk Discount Factor.

Milestone Events: The following events: (a) Completion of Discovery; (b) Motion to Dismiss Milestone; (c) Summary Judgment Milestone; and (d) Judgment Milestone.

Completion of Discovery: The date as defined by court order.

Judgment Milestone: The date at which the judge enters a verdict as a judgment.

Motion to Dismiss Milestone: The entry of an order resolving a motion to dismiss against the Plaintiff.

Summary Judgment Milestone: The entry of an order resolving a summary judgment motion against the Plaintiff, *provided that* the motion is dispositive of [the entire Claim]/[identify material issues/causes of action].

Comment: Parties should choose milestones carefully, balancing the competing goals of allowing the Funder to manage its investment by exit, the Plaintiff to manage the risk of losing funding at a particularly destabilizing moment, and both to manage value by incorporating new pricing information and minimize transaction costs. Exit-only milestones such as the Motion to Dismiss and Summary Judgment Milestones are necessary because of the Accelerated and Supplemental Investment provisions. Those milestones ensure that a Funder can terminate on notice pursuant to Subsection 6.1 and eliminate any chance that a Plaintiff that chooses to use its remaining funds to pursue an appeal the Funder does not support will not cause the Funder to make Accelerated or Supplemental Investments.

Corporate Finance Version Comment: *Because corporate finance plaintiffs do not need the bargaining power protection of Accelerated or Supplemental Investments, the Motion to Dismiss and Summary Judgment Milestones are not necessary for them and should be deleted.*

Plaintiff: [Name(s).]

Proceeds: (i) Any and all value received to satisfy the Award, if the Award results from settlement or other negotiated agreement, and (ii) any and all value received to satisfy the Award, less any state, federal, or international taxes owed on such value, if the Award is a judgment, order, or other determination by an independent party, such as a court or arbitrator.

Comment: The binary definition is intended to highlight that the parties need to allocate the tax burden associated with the Proceeds. In a negotiated outcome, the Plaintiff has discretion to structure the resolution in a tax-advantaged way. With a judgment, the Plaintiff may not have such freedom (although it may be able to negotiate payment of the judgment in a tax-advantaged manner). Thus the Litigation Proceed Rights are worth one percent (1%) of the gross Proceeds in a negotiated outcome and one percent (1%) of the tax-net Proceeds in a judgment outcome. This default should be customized as the parties prefer.

Proceeds Account: [Specify account], which is governed by the Control Agreement among the Plaintiff, Funder, and [the financial institution in which the deposit account is located] dated as of [same date or earlier as this Agreement.] As provided in the Control Agreement, the Plaintiff may not access the funds in the Proceeds Account until after the Funder is paid the value of its Litigation Proceed Rights, whether from the Proceeds Account or from any other source owned or controlled by the Plaintiff. As specified in the Control Agreement, the Control Agreement shall terminate upon the Funder's receipt of the value of its Litigation Proceed Rights.

Comment: This account is empty until the Proceeds are received, and then they are deposited in this account for disbursement. To make the security interest in the account effective, the parties have to enter a "control agreement" which makes clear the Plaintiff has no control over the account and the financial institution should instead take direction from the Funder.¹⁴⁴

[Proprietary Information:]

Comment: If either party has a subset of Confidential Information that it believes is so sensitive it must be destroyed or returned rather than kept secret for a fixed number of years after the Agreement's termination, they should define it here. Two corollary provisions are then necessary. First, add Proprietary Information to the Confidential Information definition, and, second, insert under "Common Interest and Confidentiality" language to the effect that notwithstanding the Non-Disclosure provision of Subsection 4.2, Proprietary Information must be destroyed or returned after the Agreement is terminated.

¹⁴⁴ For an alternative approach to securing an interest in the proceeds, see Max Volsky, *Creating and Perfecting Security Interests in a Claim: Part I, Purpose and Creation*, MODEL LITIG. FIN. CONT. (Aug. 12, 2013), <http://litigationfinancecontract.com/creating-and-perfecting-security-interests-in-a-claim-part-i-purpose-and-creation/>; Max Volsky, *Part 2, Perfecting Security Interests: Notice to the Attorney, and the Uniform Commercial Code*, MODEL LITIG. FIN. CONT. (Aug. 29, 2013), <http://litigationfinancecontract.com/part-2-perfecting-security-interests-notice-to-the-attorney-and-the-uniform-commercial-code/>.

Qualified Replacement Funder: A Funder which (a) agrees to become a party to this Agreement; (b) commits at least as much capital to financing the Claim as the Exiting Funder is withdrawing by exiting; and (c) is an Accredited Investor as defined in Rule 501 of Regulation D promulgated under the 1933 Securities Act.

Comment: This provision ensures that the private placement exception to the securities laws applies.

Re-pricing Event: The issuance of additional Litigation Proceed Rights to existing owners of Litigation Proceed Rights as a result of a Re-pricing Milestone.

Re-pricing Milestone: The following are the Re-pricing Milestones: (1) A proposed settlement that has a value less than the Initial Claim Valuation by at least [33%], and (2) the Judgment Milestone, if the Judgment has a value less than the Initial Claim Valuation by at least [33%].

Comment: Thirty-three percent (33%) is an arbitrary value; parties should negotiate their own percentages.

Risk Discount Factor: The number, less than one, that one percent (1%) of the Initial Claim Value is multiplied by to set the Litigation Proceed Right purchase price at the Closing.

Acceleration Closing Risk Discount Factor: The Risk Discount Factor used at the Closing immediately prior.

Discovery Closing Risk Discount Factor: [0.40] [OR a number to be negotiated in the [60] days prior to the Discovery Milestone].

Initial Closing Risk Discount Factor: [0.20.]

[Supplemental Closing Risk Discount Factor: The Risk Discount Factor used at the Closing immediately prior.]

Comment: The lower the number, the bigger the return when Litigation Proceed Rights are cashed in. Because funding a claim is riskiest at the beginning, the Initial Closing Risk Discount Factor should be relatively low, conferring a risk premium if the Claim is successful, while the coefficient at the Close of Discovery should be higher, to reflect the dramatic increase in information about the Claim's value. (If the new information is unfavorable, presumably a funder will exit or demand a lower number.) The bracketed numbers are arbitrary and should be negotiated by the parties. If other investment milestones are negotiated, they will need their own Risk Discount Factors. Supplemental Investments are optional because the parties may not wish to allocate the risk ex ante, and if not used, the corresponding Risk Discount Factor should be deleted.

Corporate Finance Version Comment: Because corporate finance plaintiffs do not need the bargaining power protection of Accelerated or Supplemental Investments, the corresponding Risk Discount Factors should be deleted.

[Supplemental Investment Event: A Supplemental Investment Event occurs when the balance of the Litigation Account has fallen below [\$], all Committed Capital investments have been made, and the Litigation Counsel in good faith reasonably believes the amount remaining in the Litigation

Account is insufficient to finance the conduct of the Claim through to the next Milestone Event or the Conclusion of the Claim, whichever comes sooner. [Despite such certification, a Supplemental Investment Event has not occurred if the Plaintiff and the Funder agree the funding shortfall is due to Attorney Waste, as defined in the Retainer Agreement. In such case, the related provisions in the Retainer Agreement shall apply.]

Comment: This provision is optional, as the parties may simply wish not to allocate the risk ahead of time.

Corporate Finance Version Comment: *This provision should be deleted because corporate finance plaintiffs do not need the protection of Supplemental Investments.*

2.0 Representations and Warranties

2.1 Plaintiff's Representations and Warranties

2.1.1. Common Interest: The Plaintiff has received [Independent/Litigation] Counsel's advice regarding the common-interest doctrine in New York.

2.1.2 Full Disclosure: The Plaintiff represents that, as of the date of this Agreement, the Plaintiff has provided the Funder all material information relating to the Claim, excluding information protected solely by the attorney–client privilege.

Comment: By using a securities approach, the anti-fraud provisions of the securities laws apply, strengthening this duty. While there is obvious tension between the securities laws' disclosure requirements and the confidential duties imposed by litigation, publicly traded securities tied to litigation have demonstrated that the tension can be resolved.¹⁴⁵

2.1.3. Fully Informed: The Plaintiff represents that it [and its Independent Counsel] [has/have reviewed] the disclosures by the Funder in Schedules A, B, and C, and the Plaintiff does not object to the conflicts or potential conflicts described therein.

Corporate Finance Version Comment: *This representation may need to be tailored or deleted for the corporate finance plaintiff as it may not find all of the schedules—or any of them—necessary.*

2.1.4 No Impairment:

2.1.4.1 Other than as already disclosed to the Funder, the Plaintiff has not taken any action (including executing documents) or failed to take any action, which

(a) would materially and adversely affect the Claim, or

(b) would give any person or entity other than the Funder an interest in the Award or the Proceeds.

2.1.4.2 The Plaintiff agrees and undertakes that

¹⁴⁵ See, for example, securities whose only value derives from the possibility that a lawsuit is successful that have been traded on the NASDAQ. These are discussed at length in Steinitz, *supra* note 35.

(a) it will not institute any action, suit, or arbitration separate from the Claim arising from the same facts, circumstances or law giving rise to the Claim;

(b) it will not take any step reasonably likely to have a materially adverse impact on the Claim or the Funder's share of any Proceeds; and

(c) it will not take any step that would give any person or entity an interest in the Claim, Award, or potential Proceeds except as otherwise permitted by this Agreement.

Comment: Funders must have certainty that they are getting what they bargain for and that the Plaintiff is not selling "damaged goods." Funders should customize this language as necessary, given the Claim, to provide that certainty.

2.1.5 Solvency: The Plaintiff has no bankruptcy proceedings outstanding or written notice of potential proceedings against it.

2.1.6 Independent Counsel: The Plaintiff represents that its Independent Counsel advised it about the terms of this Agreement.

[Alternate:

2.1.6 Advice on this Agreement: The Plaintiff represents that, based on the disclosures in schedules A, B, and C and the Funder's representations in this Agreement, and based on the Plaintiff's discussion of the schedules and representations with Litigation Counsel, the Plaintiff is comfortable relying on Litigation Counsel's advice regarding the terms of this Agreement and has so relied.]

*Comment: If Independent Counsel is not used, Litigation Counsel must ensure as a matter of professional ethics that the Plaintiff is fully aware of any potential conflicts created by the funding arrangement and consents to them.*¹⁴⁶

Corporate Finance Version Comment: Subsection 2.1.6 should be deleted as unnecessary; again, in-house counsel should serve this function.

2.1.7 Completeness and Accuracy: The Plaintiff represents that as of the date of this Agreement,

(a) all material information it and Litigation Counsel provided to the Funder is true and correct, and

(b) all its representations and warranties in this Agreement are true and correct.

2.2 Funder's Representations

2.2.1 Funds: The Funder represents that it is fully capitalized and has and will continue to have sufficient funds available to fulfill its obligations under this Agreement.

Comment: This provision is important to Plaintiffs because unlike regulated insurers, funders need not insure they have the capital to honor their commitments. Further, funders have an incentive to recycle capital to successor funds.

2.2.2 Fully Informed: The Funder has thoroughly reviewed all the information about the Claim provided to it.

¹⁴⁶. See *supra* note 102.

2.2.3 **No Conflicts of Interest:**

2.2.3.1 The Funder has not, as of the date of this Agreement:

(a) paid a referral fee to Litigation Counsel in connection with the Claim, the Plaintiff, or this Agreement;

(b) entered any transaction with Litigation Counsel that has or would make Litigation Counsel a part owner of the Funder;

(c) contracted with any other party or potential party to the Claim other than has been disclosed on Schedule A;

(d) engaged in negotiations with any other party or potential party to the Claim other than has been disclosed on Schedule B; or

(e) entered into any relationship with the Plaintiff's Litigation Counsel [or Independent Counsel] that potentially conflicts with the Plaintiff's interests regarding the Claim other than has been disclosed on Schedule C. For the avoidance of doubt, Schedule C at a minimum details the Funder's history of engaging such counsel or paying such counsel referral fees, including approximate dates, total fees paid, and the nature of the engagement; and, whether such counsel has an ongoing financial connection to the Funder other than those created by this Agreement or the Retainer Agreement.

2.2.3.2 The Funder will not, prior to the Conclusion of the Claim, pay a referral fee to Litigation Counsel in connection with the Claim, the Plaintiff, or this Agreement; transfer or agree to transfer any ownership in the Funder to Litigation Counsel; or engage in any activity that would have been disclosed on Schedules A, B, or C if it had occurred as of the date of this Agreement. This provision shall survive the termination of this Agreement if the Agreement is terminated prior to the Conclusion of the Claim.

2.2.3.3 The Funder does not have a duty, contractual obligation, or other requirement to monetize its interest in the Claim within any particular time frame or which would require the Funder to cease funding the Claim. For the avoidance of doubt, the preceding sentence does not include a fiduciary duty that would require the Funder to cease funding the Claim because of the Funder's assessment of the merits of the Claim.

[Alternate:

2.2.3.3 According to its Partnership Agreement, the Funder must liquidate the investments and return capital to investors [X] years from the effective date of this Agreement.]

Comment: These provisions are designed to eliminate or minimize the relevant conflicts of interest, or allow the Plaintiff to give informed consent to them.

Corporate Finance Version Comment: *Subsection 2.2.3 should be tailored or deleted, as corporate finance plaintiffs might not care about some or all of the above conflicts. Indeed, such plaintiffs might have an ongoing relationship with a funding firm that is akin to its relationships with outside counsel.*

2.2.4 No Waiver of Privilege:

2.2.4.1 As of the date of this Agreement, the Funder and the Funder's Representatives have not disclosed any Common Interest Material to anyone without the prior written consent of the Plaintiff; and

2.2.4.2 Notwithstanding Subsection 4.2, the Funder and the Funder's Representatives shall not disclose any Common Interest Material to anyone without prior written consent of the Plaintiff. For the avoidance of doubt, this prohibition prevents disclosure without prior written consent to the Funder's investors and/or any party to whom the Funder wishes to transfer part or all of its interest in the Claim. If consent is given, the Funder shall enter into an agreement with such secondary recipients to preserve the confidentiality of the Common Interest Material on terms no less restrictive than those set forth in this Agreement for Confidential Information. This provision shall survive the termination of this Agreement and remain in effect until the Conclusion of the Claim.

Comments: 1. If the Funder stops funding the Claim, nothing (other than Subsection 2.2.4.2 above) stops the Funder from using the information against the Plaintiff's interests in the Claim. 2. Section 4.2 allows disclosure of Confidential Information as necessary to perform under this Agreement; this provision intends to exempt Common Interest Material from that provision and protect privilege in line with the other provisions.

2.2.5 Secondary Market Financing:

2.2.5.1 The Funder represents that as of the date of this Agreement it has not sold or entered negotiations to sell part or all of its interest in the Claim or the Proceeds to anyone.

2.2.5.2 The Funder will not securitize its interest in the Claim or the Proceeds.

Comment: Securitization creates a significant moral hazard and public policy concerns.¹⁴⁷

3.0 Additional Covenants

3.1 Covenants of Plaintiff

3.1.1 Representations Remain True: The Plaintiff covenants that all of its representations and warranties shall continue to be true throughout the term of this Agreement.

3.1.2 Duty to Cooperate: The Plaintiff covenants to cooperate in the prosecution of the Claim. Specifically, the Plaintiff [will/will cause its officers, executives, and employees to] promptly and fully assist Litigation Counsel as reasonably necessary to conduct and conclude the Claim. For the avoidance of doubt, such assistance includes all actions any Plaintiff may reasonably expect undertaking such as: submitting to examination; verifying statements under oath; and appearing at any proceedings. The examples in

147. See Steinitz, *supra* note 18, at 1282-85.

the preceding sentence are illustrative and do not limit the Plaintiff's duty to cooperate in any way.

*Comment: Insurance contracts have very broad duty-to-cooperate provisions to address the agency problem insurers face with their insured. The provisions are appropriate in litigation finance contracts for the same reason.*¹⁴⁸

3.1.3 Duty to Inform: The Plaintiff agrees and undertakes to keep the Funder fully informed about the progress of the Claim. Specifically,

(a) Non-Privileged Information: The Plaintiff hereby irrevocably instructs Litigation Counsel, and if further instructions are needed, undertakes to instruct Litigation Counsel, to provide the Funder's Representatives with all material non-privileged information as soon as practicable, regardless of the information's source, confidentiality, or form, unless the Funder already possesses or controls such information.

(b) Attorney Work Product: Acknowledging that this Agreement contains provisions requiring the parties to protect the confidentiality of any Confidential Information disclosed to it and that such information includes attorney work product, the Plaintiff hereby irrevocably instructs its Litigation Counsel, and if further instructions are needed, undertakes to instruct its Litigation Counsel to provide the Funder's Representatives with all material attorney work product relating to the Claim as soon as practicable.

(c) Attorney-Client Privileged Information:

Relying on the parties' agreement that they share a common legal interest and that communicating attorney-client privileged information to the Funder in the furtherance of that interest does not waive the privilege, the Plaintiff undertakes to share such information on a topic-by-topic basis, *provided that* neither the Plaintiff nor Litigation Counsel shall disclose attorney-client protected information to the Funder or the Funder's Representatives unless (i) the Plaintiff has discussed with [Litigation Counsel/Independent Counsel] the information to be shared, the reason for the sharing, and the probable consequences if the sharing is ultimately held to waive the privilege; and (ii) the Plaintiff has given written consent to such information sharing.

Comments: Arguably, the anti-fraud requirements of the securities laws render (a) unnecessary, however it is prudent to include it. One of the advantages of the private placement approach is that (b) is possible. As New York common-interest doctrine develops, (c) may need modifying. While waiving the privilege would not advantage Funders, and while the Plaintiff's attorneys should engage in this process for ethical reasons even absent a contract provision, the language of (c) creates information asymmetry risk.

¹⁴⁸. See 1 ALLAN D. WINDT, INSURANCE CLAIMS & DISPUTES: REPRESENTATION OF INSURANCE COMPANIES & INSURED § 3:2 (5th ed. 2007) ("Liability policies always contain a requirement that the insured cooperate with the insurance company in its investigation, defense, settlement, or other handling of a claim against the insured.").

3.1.4 No Change in Litigation Counsel Without Funder Notice: The Plaintiff agrees and undertakes that it will not engage a new attorney or law firm to conduct the Claim, either as replacement or supplemental Litigation Counsel, without giving the Funder [X] days' prior notice and without giving good faith consideration to the Funder's response, if any. For the avoidance of doubt, "engage" in the immediately preceding sentence means "execute a retainer agreement or other contract to employ such attorney or law firm."

*Comment: This provision and Subsection 3.1.5 give the Funder significant influence over the conduct of the Claim, though short of control. We believe this right to influence should be paid for either by a direct payment that is not reimbursable if the Claim is successful or by a lower percentage payout/higher Risk Discount Factor than otherwise warranted.*¹⁴⁹

3.1.5 Funder Participation in Settlement Decision Making:

(a) The Plaintiff will immediately notify the Funder upon receiving a settlement offer, providing the Funder with the complete details of the offer in such notice. The Plaintiff will not respond to the settlement offer until after giving good faith consideration to the Funder's analysis of the offer, *provided that* the Funder communicates its analysis within [X] days of receiving notice of the offer.

(b) The Plaintiff will not make a settlement offer without first notifying the Funder of the proposed offer, including its complete details, and giving good faith consideration to the Funder's analysis, *provided that* the Funder communicates its analysis within [X] days of receiving the proposed offer.

3.1.6 Independent Counsel: The Plaintiff will obtain Independent Counsel before agreeing to any material amendment to this Agreement and before engaging replacement or supplemental counsel to conduct the Claim.

3.2 Covenants of the Funder:

3.2.1 Fiduciary Duty: The Funder agrees and undertakes to be a fiduciary to the Plaintiff in regards to the Funder's actions, analysis, and advice regarding the Claim and the conduct of the Claim for so long as the Funder has a financial interest in the Conclusion of the Claim.

Comment: While this provision would go a long way toward minimizing conflicts of interest, it would be a major change to current contracting practice.

[Alternate:

3.2.1 Good Faith Dealings: The Funder agrees it will act reasonably and in good faith toward the Plaintiff in every action the Funder takes in relation to the Claim and Funder's performance under this Agreement. For the avoidance of doubt, and without limiting the foregoing, pressuring Plaintiff

149. Control premiums exist in other contexts and, importantly, in VC. See Steinitz, *supra* note 5, at 509; see also Bernard S. Black & Ronald J. Gilson, *Venture Capital and the Structure of Capital Markets: Banks Versus Stock Markets*, 47 J. FIN. ECON. 243, 252-53, 258-59 (1998).

to negotiate or accept a settlement that the Plaintiff believes is not in its best interest shall violate this covenant. Notwithstanding the previous sentence, the Funder's mere exercise of its right to terminate without cause, including the Funder's refusal to invest Committed Capital at a Milestone Event, shall not constitute breach of this covenant.

Comment: This provision would also protect the Plaintiff from the Funder's conflicts of interest, and the Funder may be more willing to accept it than the fiduciary duty provision. A parallel duty need not be imposed on the Plaintiff for three reasons. First, the Plaintiff is already under several specific duties that cover the kinds of bad faith actions a Funder should be concerned about, such as failure to disclose material information or impairing the Claim. Second, the Plaintiff is motivated to act in good faith to increase the chances that the Funder will continue to invest in the Claim at Milestone Events. Third, the Plaintiff is subject to the implied duty of good faith and fair dealing.

Corporate Finance Version Comment: *The good faith version should be the default for Subsection 3.2.1.*

4.0 Common Interest and Confidentiality

4.1 **Common Interest:** The Plaintiff and the Funder agree they share a common legal interest and, to the degree necessary to further their common legal interest, agree to share Common Interest Material in accordance with the provisions of Subsections 2.2.4.2 and 3.1.3. The Plaintiff and the Funder agree the material would not be shared if the common legal interest did not exist.

4.2 **Non-Disclosure Generally:** During the term of this Agreement and for [X] years following its termination, the recipient of Confidential Information shall not disclose, use, or make available, directly or indirectly, any Confidential Information to anyone, except as needed to perform its obligations under this Agreement or as the disclosing party otherwise authorizes in writing. When disclosing, using, or making Confidential Information available in connection with the performance of its obligations under this Agreement or as permitted by the disclosing party, recipient shall enter into an agreement with such secondary recipients to preserve the confidentiality of the Confidential Information on terms no less restrictive than as set forth in this Agreement. The recipient agrees that neither the execution of this Agreement nor the provision of Confidential Information thereto enables the recipient to use the Confidential Information for any purpose or in any way other than as specified in this Agreement.

Comment: If a subset of information has been defined as "Proprietary Information," a term should be added describing how that information should be handled.

4.3 **Potentially Enforceable Disclosure Requests:** If a party receives a potentially enforceable request for the production of Confidential Information, including without limitation a subpoena or other official process, that party will promptly notify the other party in writing, unless such

notice is prohibited by law. If allowed, such notice shall be given before complying with the request and shall include a copy of the request.

If the request is of the recipient of Confidential Information, and notice to the disclosing party is prohibited by law, the recipient must make a good faith effort to contest the disclosure, if appropriate. The recipient shall also make a good faith effort to obtain an agreement protecting the confidentiality of the Confidential Information prior to disclosing it.

If a party elects to contest the request, no party shall make any disclosure until a final, non-appealable or non-stayed order has been entered compelling such disclosure. The contesting party shall pay its own expenses and control its contest, *provided that*, if the recipient contests a request when forbidden by law to give the disclosing party notice of the disclosure request, the disclosing party shall reimburse the recipient's reasonable expenses promptly after being notified of them.

5.0 Funding Terms

5.1 Committed Capital: Subject to the terms and conditions of this Agreement, the Funder[s] commit[s] [\\$] to finance the conduct of the Claim through to the Conclusion of the Claim [as specified in Exhibit [X]].

Comment: This Exhibit is different than the one contemplated by the definition of Committed Capital. This Exhibit is to show how much capital is invested at each milestone; the other schedule, used only if sufficient multiple funders are participating, lists each funder and how much total capital they are committing.

5.2 Purchase of Litigation Proceed Rights: Subject to the limitations of Sections 6 and 7 and Subsections 5.4, 5.5, 5.6, and 5.7, at each Closing the Funder shall purchase Litigation Proceed Rights by depositing its Investment in the Litigation Account, such Investment being the Funder's committed capital amount specified on Exhibit [X] less any Accelerated Investments previously made from that committed capital. The Funder may invest more than such amount only with the prior written agreement of the Plaintiff.

Corporate Finance Version Comment: All internal references are accurate for the access to justice version, however, the corporate finance version will need conforming changes throughout to reflect the deletions and the related renumbering.

5.3 Sale of Litigation Proceed Rights: Subject to the terms and conditions of this Agreement, at each Closing the Plaintiff shall sell to the Funder the number of Litigation Proceed Rights the Funder is due based on the applicable purchase price and the total amount of capital the Funder deposits in the Litigation Account at such Closing. At each Closing, the Funder shall receive Litigation Proceed Right Certificates evincing its purchases.

5.3.1 The Initial Closing: At the Initial Closing the Plaintiff will sell [10] Litigation Proceed Rights. The Litigation Proceed Right Purchase Price for the Initial Closing is [\\$] per Litigation Proceed Right.

Comment: The number of shares indicated is arbitrary. Parties should negotiate an appropriate number keeping in mind the considerations discussed above.

5.3.2 **The Discovery Closing:** At the Discovery Closing the Plaintiff will sell [20] Litigation Proceed Rights to the Funder. The Litigation Proceed Right Purchase Price for the Discovery Closing is [\$] per Litigation Proceed Right. Subject to the limitation imposed by Subsection 5.7, if the Plaintiff chooses, in its sole discretion, it may sell more than [20] Litigation Proceed Rights at the Discovery Closing.

Comment: The number of shares indicated is arbitrary. If accelerated investments occur, this number will be reduced accordingly. The Model Contract assumes a different Risk Discount Factor will be used to set the price, reflecting the information revealed to date. If additional milestones are negotiated, they will need their own closings.

5.4 **Accelerated Investment:** If an Acceleration Event occurs, Litigation Counsel shall so certify to the Funder. Within [30] days of receiving such certification, the Funder shall purchase [a pro-rata share of] [5] Litigation Proceed Rights at the Litigation Proceed Right Purchase Price used at the Closing immediately prior by depositing the Funder's total purchase price into the Litigation Account. This Accelerated Investment shall not represent a new capital commitment; instead it is the acceleration of a portion of the capital intended for investment at the next Closing. The number of Litigation Proceed Rights sold at an Acceleration Closing shall reduce the number of Litigation Proceed Rights offered for sale at the [Discovery Closing/at the next Milestone Event Closing] by a like amount.

Comment: The bracketed language regarding next Milestone Event Closing reflects the idea that additional such closings may be negotiated.

Corporate Finance Version Comment: *This provision should be deleted as corporate finance plaintiffs do not need the bargaining power protection provided by Accelerated Investments.*

[5.5 **Supplemental Investment:** If a Supplemental Investment Event occurs, Litigation Counsel shall so certify to the Funder. Within [30] days of receiving such certification, the Funder shall purchase [a pro-rata share of] [5] Litigation Proceed Rights at [the Litigation Proceed Right Purchase Price used at the Closing immediately prior/at a price [10%] less than the price used at the Closing immediately prior] by depositing the Funder's Supplemental Investment into the Litigation Account.]

Comment: This provision is optional, as the parties may not wish to allocate this risk ahead of time. If used, the number of rights indicated is arbitrary; parties should negotiate the number. Funders will likely want a premium for being forced to make a supplemental investment; the language suggests one way it could be paid.

Corporate Finance Version Comment: *This provision should be deleted as corporate finance plaintiffs do not need the bargaining power protection provided by Supplemental Investments.*

5.6 Re-pricing Litigation Proceed Rights:

5.6.1 Invoking Right to Re-price: Within [7] days of receiving certification from Litigation Counsel that a Re-pricing Milestone has occurred, [the/a majority of] Funder(s) may trigger a Re-pricing Event by serving notice on the other part(y/ies).

5.6.2 Purpose of Re-pricing: Subject to the limitation in Subsection 5.7, the parties agree that the purpose of re-pricing pursuant to this Subsection 5.6 is to preserve the Expected Value of the Funder [’s/s’] Litigation Proceed Rights and not to renegotiate it.

5.6.3 Mechanism of Re-pricing: Subject to the limitation imposed by Subsection 5.7, the Plaintiff shall immediately transfer additional Litigation Proceed Rights to the Funder until the total number of Litigation Proceed Rights owned by the Funder has the Expected Value, and the Plaintiff shall document this transfer by promptly delivering additional Litigation Proceed Right Certificates, *provided that*, if the Re-pricing Milestone is a proposed settlement, such transfers shall occur simultaneously with the consummation of the settlement. If the settlement is not consummated and the Claim continues, the number of Litigation Proceed Rights owned by the Funder shall not change.

Comment: The purpose of re-pricing is to preserve the underlying economic bargain. A different type of re-pricing could be time-triggered, again with the goal of preserving the underlying economic bargain.

5.7 Minimum Plaintiff Proceeds: Under no circumstances shall the Plaintiff sell more than [50] Litigation Proceed Rights, nor shall the issuance of additional Litigation Proceed Rights pursuant to Subsection 5.6.3(a) result in the Plaintiff receiving less than [50%] of the Proceeds.

Comment: The percentage should be negotiated to avoid claims of unconscionability, based on legal precedent.

5.8 No Commitment for Additional Financing: The Plaintiff acknowledges and agrees that [no Funder has/the Funder has not] made any representation, undertaking, commitment, or agreement to provide or assist the Plaintiff in obtaining any financing, investment, or other assistance, other than the investments as set forth herein. In addition, the Plaintiff acknowledges and agrees that (i) no statements, whether written or oral, made by [any/the] Funder or its Representatives on or after the date of this Agreement shall create an obligation, commitment, or agreement to provide or assist the Plaintiff in obtaining any financing or investment; (ii) the Plaintiff shall not rely on any such statement by [any/the] Funder or its representatives; and (iii) an obligation, commitment, or agreement to provide or assist the Plaintiff in obtaining any financing or investment may only be created by a written agreement, signed by [such/the] Funder and the Plaintiff, setting forth the terms and conditions of such financing or investment and stating that the parties intend for such writing to be a binding obligation or agreement.

5.9 New Funder Participation: The Plaintiff can invite other potential funders to participate in any Closing at its sole discretion, provided that existing the Funder[s] [is/are] allowed to continue participating according to the capital commitment [it/they] had already made. The Funder[s] can invite additional potential funders to participate in Closings, but the Plaintiff, in its sole discretion, must approve both the new funder's participation and the size of its investment before the potential funder can participate. For the avoidance of doubt, no Litigation Proceed Rights shall be sold to any person unless such person joins this Agreement.

6.0 Funder Right to Terminate Investment Without Cause

6.1 Termination at Milestones:

Within [7] days after receiving certification from Litigation Counsel that a Milestone Event has occurred, the Funder may give notice to the Plaintiff of its intention to terminate investing under this Agreement. If the Funder gives such notice it shall not participate in any Closing related to the Milestone Event unless its notice fails to become effective. For such notice to become effective, within [90] days of giving notice the Funder must deliver an executed amendment to this Agreement in the form of Exhibit [X]. Such amendment provides that (i) the Funder shall retain the Litigation Proceed Rights it previously purchased except that such rights will no longer be subject to re-pricing pursuant to Subsection 5.6, and (ii) certain other provisions of this Agreement remain in effect. If the executed amendment is not timely sent to the Plaintiff, the Funder's investment termination notice is void as if never given and the Funder must immediately make the Investment that was due at the Closing related to the Milestone Event.

Comment: The Funder "pays" for exiting early without providing Plaintiff with replacement funding by losing its ability to mitigate its downside risk.

6.2 Termination at Any Time: At any time, the Funder may give notice to the Plaintiff of its intention to terminate its investment in the Claim. To make its notice effective, within [90] days the Funder must return a fully executed Amendment in the form of Exhibit [X] and return all of its Litigation Proceed Right Certificates. The Amendment shall reflect that the Funder (i) no longer owns any Litigation Proceed Rights, and (ii) certain other provisions of this Agreement remain in force.

Comment: If Accelerated and Supplemental Investments are not part of the contract, this provision is not necessary. This provision allows a Funder to avoid Accelerated or Supplemental Investments, but it is designed to provide a strong disincentive to discontinue funding in between milestones without lining up a replacement investor.

Corporate Finance Version Comment: *Accelerated and Supplemental Investments are not part of the corporate finance deal, as such plaintiffs do not need their bargaining power protection. Thus, Subsection 6.2 should be deleted.*

6.3 Termination at Any Time with Replacement Funding: At any time the Funder has the right to propose exiting the Agreement by assigning its

rights and obligations to a Qualified Replacement Funder. Such assignment requires (i) the Plaintiff's consent, which shall not be unreasonably withheld; and (ii) the Qualified Replacement Funder's joinder to this Agreement. The ownership of the exiting Funder's Litigation Proceed Rights will be retained by the exiting Funder or transferred to the Qualified Replacement Funder pursuant to their agreement.

Comment: This provision, like Subsection 6.2, is only necessary if Accelerated and Supplemental Investments are used.

Corporate Finance Version Comment: *Accelerated and Supplemental Investments are not part of the corporate finance deal, as such plaintiffs do not need their bargaining power protection. Thus, Subsection 6.3 should be deleted.*

7.0 Termination for Cause

Either party may terminate this Agreement for cause if the other party commits a material breach as defined in this Section, with the consequences as specified in this Section. After such termination, Section 4.0 and Subsection 2.2.4.2 relating to confidentiality and privilege, Subsection 2.2.3.2 relating to conflicts of interest, Subsection 2.2.5.2 relating to securitization of litigation proceed rights, and Section 9 shall remain in force. If the termination is pursuant to Subsection 7.1, then Subsection 5.6 relating to re-pricing litigation proceed rights shall also remain in effect.

7.1 Material Breach by the Plaintiff:

7.1.1 Material Provisions: The provisions of this contract relating to complete and accurate disclosure of material information about the Claim; to cooperation in conducting the Claim and of non-impairment of the Claim; and to the potential award and any proceeds thereof. These provisions are the very essence of this agreement and any breach by the Plaintiff of those provisions is presumptively material. For the avoidance of doubt, the material provisions are: Subsections 2.1.2 and 3.1.3 (relating to disclosures), Subsection 2.1.4 (no impairment), and Subsection 3.1.2 (cooperation). The presumption of materiality can be rebutted by the Plaintiff by showing that such breach did not reduce the potential value of the Funder's Litigation Proceed Rights by more than [10%] compared to the Expected Value of those Litigation Proceed Rights.

7.1.1.1 Notwithstanding Subsection 7.1.1, failure to disclose material information about the claim that supports the claim, strengthens the claim, or otherwise cannot reasonably be believed to have influenced the Funder to avoid investing or re-investing in the claim had it been disclosed when required is not a material breach of the disclosure provisions.

Comment: The purpose of defining presumptively material provisions is to facilitate dispute resolution by making material breach relatively easy to prove; the purpose of making it rebuttable is to prevent the Funder from abusing the provision by claiming a technical breach that has little or no impact.

7.1.2 Material Breach of Other Provisions: The breach by the Plaintiff of any other provision is material if it, by itself, reduces the potential value of

the Funder's Litigation Proceed Rights by more than [33%], compared to the Expected Value of those Litigation Proceed Rights.

Comment: The bracketed number is arbitrary and should be negotiated. This is just one way of defining material breach. Whatever is adopted should be a significant bar as the crucial provisions are dealt with in Subsection 7.1.1.

7.1.3 Notice of Material Breach by the Plaintiff: If the Funder believes the Plaintiff has materially breached this contract it shall promptly serve notice on the Plaintiff. If the breach can be cured the Plaintiff then has [30] days to do so. Breaches of the following provisions cannot be cured: the failure to disclose material information not covered by Subsection 7.1.1.1 or attorney-client privilege at the time of contract execution and the failure to disclose existing claim impairment at contract execution.

7.1.4 Consequences of Material Breach by the Plaintiff: If the Plaintiff commits an incurable material breach under Subsection 7.1.1 or Subsection 7.1.2 or fails to timely cure material breach as defined therein, the Funder is entitled to an immediate refund of all of its Investment remaining in the Litigation Account and is entitled to keep its Litigation Proceed Rights. The Funder shall have no further obligations under this Agreement other than the provisions that explicitly survive the termination of this Agreement. This provision shall not limit the Funder's other remedies at law or equity.

7.1.4.1 If the existence of a material breach is disputed by the Plaintiff the Disputed Refund provisions of the escrow agreement governing the Litigation Account shall apply.

Comment: The purpose of this provision is to make the Funder as whole as possible by providing the refund and to deter the Plaintiff from committing material breaches because the result is the total loss of its funding. However, Subsection 7.1.4.1 prevents the Funder from threatening to destabilize the Plaintiff, or from actually destabilizing the Plaintiff, by demanding a refund based on a breach that does not justify it. The precise mechanism for handling a "disputed refund" belongs in the Litigation Account escrow agreement, as it will have to be instructions to the escrow agent on what it is supposed to do. As a result, we are not proposing substantively what that mechanism should look like.

[Alternate:

7.1.4 Consequences of Material Breach by the Plaintiff: If the Plaintiff commits an incurable material breach under Subsection 7.1.1 or Subsection 7.1.2 or fails to timely cure material breach as defined therein, the Funder may seek damages from said breach at law or equity.]

Corporate Finance Version Comment: We propose that for corporate finance plaintiffs, Alternate Subsection 7.1.4 become the default and vice-versa.

7.2 Material Breach by the Funder:

7.2.1 Material Provisions: The Funder recognizes that its representations regarding its ability to honor its capital commitments, its commitments to protect Plaintiff's privileged information [and Proprietary Information], and its assumption of [a fiduciary duty/duty of good faith and

fair dealing] are of the essence of this Agreement. For the avoidance of doubt, these are the material provisions: Subsection 2.2.1 (funds), Subsection 2.2.4 and Section 4.1 (privilege and common interest), [and] Subsection 3.2.1 ([fiduciary duty/good faith]) [, and Section 4.3 (Proprietary Information)]. A material breach of Subsection 2.2.1 occurs if the Funder is unable to invest Committed Capital when required. A material breach of Subsection 2.2.4 or Subsection 4.1 occurs if the disclosure could result in waiver of the privilege if any other party to the litigation learned of the disclosure, regardless of how the other party to the litigation learned of the disclosure. A material breach of Subsection 4.1 has occurred if a judge, arbiter, or other third-party dispute resolution mechanism so rules. [A material breach of Subsection 4.3 Proprietary Information occurs if the breach results, by any method, in the Proprietary Information being received by any person or entity that could use it to its commercial advantage or to commercially disadvantage the Plaintiff.]

7.2.2 Material Breach of Other Provisions: The breach by the Funder of any other provision is material if it, by itself, reduces the potential value of the Award or Proceeds by more than [10%] as measured against the Initial Claim Value.

7.2.3 Notice of Material Breach by the Funder: If the Plaintiff believes the Funder has materially breached this Agreement, the Plaintiff shall promptly serve notice on the Funder. If the breach can be cured by the Funder, then it has [30] days to do so.

7.2.4 Consequences of Material Breach by Funder: If the Funder commits an incurable breach under Subsection 7.2.1 or Subsection 7.2.2 or fails to timely cure a material breach as defined therein, the Funder's Litigation Proceed Rights are canceled and the Funder must promptly return its Litigation Proceed Right Certificates. This provision shall not limit any other remedies the Plaintiff may have in law or equity.

7.2.4.1 If the Funder disputes the existence of a material breach, the Disputed Rights provisions of the Escrow Agreement governing the Proceeds Account shall apply.

[Alternate:

7.2.4 Consequences of Material Breach by Funder: If the Funder commits an incurable breach under Subsection 7.2.1 or Subsection 7.2.2 or fails to timely cure a material breach as defined therein, the Plaintiff may seek damages at law or other remedy in equity.]

Corporate Finance Version Comment: We propose that for corporate finance plaintiffs, Alternate Subsection 7.2.4 become the default and vice-versa.

8.0 Security Interest

8.1 Proceeds Account: The Plaintiff hereby irrevocably instructs, and, if further instructions are needed, will instruct, Litigation Counsel to receive any Proceeds that the Plaintiff becomes entitled to on behalf of the Plaintiff, and to immediately deposit all such Proceeds in the Proceeds Account.

8.2 Security Interest in the Proceeds Account: To secure its obligation to the Funder represented by the Litigation Proceed Rights owned by the Funder, the Plaintiff hereby grants the Funder a security interest in the Proceeds Account and any and all property therein, whether such property is in the account now or is after-acquired. Such security interest shall terminate at the earlier of the Plaintiff paying the Funder the full value of the Funder's Litigation Proceed Rights or the Conclusion of the Claim, if, at the Conclusion of the Claim, the Plaintiff is not entitled to receive any Proceeds from any Defendant.

8.3 No Other Security Interests: The Plaintiff shall not grant a security interest in the Proceeds Account [or the Claim] to anyone other than the Funder without the Funder's prior written consent.

9.0 Miscellaneous

9.1 Governing Law: This agreement shall be governed by New York law.

9.2 Forum Selection: Each of the parties hereto hereby irrevocably and unconditionally consents to submit to the exclusive jurisdiction of the courts of the State of New York and of the United States of America located in the City of New York for any actions, suits, or proceedings arising out of or relating to this Agreement and the transactions contemplated hereby, and agrees not to commence any action, suit, or proceeding relating thereto except in such courts. Each of the parties hereto irrevocably and unconditionally waives any objection to the laying of venue of any action, suit, or proceeding arising out of or relating to this Agreement and the transactions contemplated hereby in the courts of the State of New York and of the United States of America located in the City of New York, and hereby further irrevocably and unconditionally waives and agrees not to plead or claim in any such court that any such action, suit, or proceeding brought in such court has been brought in an inconvenient forum.

CONCLUSION

In the foregoing, we have identified the core challenges of negotiating funding arrangements that are fair, economically sound, and in the public interest—promoting access to justice without corrupting the civil justice process. We have provided model provisions, many of which, on their own, contribute new, practical thinking on how to address the challenges presented by third-party funding. And, we have explained the interaction between the various provisions.

In the course of so doing, we have identified additional issues that are implicated by litigation funding and that parties to most commercial litigation funding are likely to encounter in their contract negotiations but are beyond the scope of this Article. These include: the securities regulatory implication of different deal structures; the question of how tax

optimization, for both funder and plaintiff, may affect deal structures;¹⁵⁰ how deal structure impacts funders' claim if plaintiff goes bankrupt and the proceeds are part of the bankruptcy estate; how provisions should change if the claim is a tort or other personal claim; and how the closely related retainer agreement between attorney and client should be structured. Last but not least, there is a need in creating conceptual frameworks for altogether different funding structures, given that funding scenarios vary widely based on such variables as the business model of the funder, the type of claim, the type of plaintiff (or even defendant), the jurisdiction that governs the contract, and more.¹⁵¹

We call on other scholars to join us in this exciting new field of litigation finance contracting.

150. Cf. Ronald J. Gilson & David M. Schizer, *Understanding Venture Capital Structure: A Tax Explanation for Convertible Preferred Stock*, 116 HARV. L. REV. 874 (2003).

151. For a taxonomy of funding scenarios, see generally Steinitz, *supra* note 18. For an example of how deal structures can vary widely based on the type of claim, see Balganesch, *supra* note 20 (suggesting four different finance structures for copyright claims).