

# A Guide to Litigation Finance



VALIDITY



## LITIGATION.

If you're in business, you will eventually face it. If you're a litigator, it is your business. Either way, you'll probably agree that litigation is expensive, time-consuming, and uncertain.

Litigation finance can help. Funding lets you manage the often unpredictable costs and risks of litigation.

At Validity, we want to walk side-by-side with you on the long, unpredictable road from filing a claim to resolution and recovery. We want to make a meaningful difference and level the playing field when it comes to accessing the legal system. We want to do that by being the most trusted, fair, and ethical funder out there.

We made this Guide in that spirit. Our goal is to cut through the fog and the jargon, and give you an insider's perspective on our industry. We want to help you understand litigation funding— and help you get funding, if you need it. Simply put, we want to give you the tools you need to win your case.

Let's get started.

## MEET SOPHIA

Sophia builds drones. Her company, Drone Out, designed and manufactures a drone that flies higher and farther than the competitors, and at a lower price too. Sophia's drones help firefighters fight fires, farmers grow crops, and photographers capture weddings.

**Sophia's years of hard work are finally paying off. But storms are brewing.**

Sophia buys state of the art camera lenses under a long-term supply contract, but her supplier abruptly breached its contract. "We have a new contract that needs to take priority over yours," the supplier tells Sophia, "so your company needs to take a back seat." Unable to procure this essential part, Drone Out has lost \$20 million in sales and counting.

It gets worse. Drone Out had a joint venture to produce a stylish new drone with an aerospace company. But once Drone Out shared its trade secrets and know-how, the aerospace company abruptly terminated the JV. Now it's producing its own drones using Drone Out's valuable intellectual property.

Sophia needs help. Drone Out has a valuable breach of contract claim against its supplier, and an essential trade secrets misappropriation claim against the aerospace company.

But Sophia is hesitant about directing capital away from growing her business and spending it on litigation. It will cost millions of dollars to bring her cases. The defendants, she's told, will bury her in discovery disputes and counterclaims. The litigation will tie up her finances for years.

What can Sophia do?



## ENTER LITIGATION FINANCE



Ever since the Wright Brothers took flight, there have been two main ways to finance litigation: pay your lawyer by the hour, or find a lawyer willing to work on a contingency.

That was inefficient. Even worse, it left companies like Sophia's locked outside the courthouse gates and at the mercy of better-financed counterparties.

If you or your lawyer didn't have the cash to bring the case, you were out of luck.

**Today, Sophia has a third option: litigation finance.**

A third party like Validity can help pay the fees and costs of Drone Out's contract and trade secrets disputes, in exchange for a share of the company's case proceeds. Before litigation finance came around, companies couldn't easily finance or monetize their legal claims.

Now, Drone Out can have its day in court while preserving its money to continue investing in growing the business.

## LEGAL CLAIMS ARE ASSETS

**At the heart of litigation finance is a simple idea: a meritorious legal claim against a solvent defendant is an asset with value.**

Litigants and lawyers can secure financing against the contingent value of that asset.

If Drone Out needs help to bring its contract and trade secret claims, the company can use the claims themselves to secure funding, hire the best lawyers, and win its cases.

And the company can do a lot more. It can monetize its claims today, getting working capital to develop a new product, expand into a new geography, or market its award-winning drone.

## FUNDING IS RISK SHARING

**Importantly, litigation finance is non-recourse.** The funder's return is backed by case proceeds.

If the cases fail, Drone Out owes the funder nothing.

**"We don't need litigation finance!" Zach, Drone Out's chief financial officer, tells Sophia. "Funding is for David against Goliath. We have millions in revenue. If we trim our R&D and hiring budgets a bit, we can find the money to pay for these cases."**



We usually think of litigation finance as supporting poor litigants who can't pursue their litigation without help from a funder.

But that's not all funding is about.

**Companies frequently use litigation finance even if they have enough cash in the bank to pay their lawyers by the hour.**

These companies recognize that litigation finance can be smart risk-sharing.

Money is finite. Every dollar that Drone Out spends on litigation can't be spent on research, product development, marketing, or hiring. Litigation finance lets companies invest their finite resources into their core competencies while still pursuing meritorious litigation.

**Put differently: savvy companies treat litigation finance as project finance for legal claims.**



CHOOSING  
THE RIGHT  
FUNDER

"If I want funding," Sophia wonders, "who should I call?" Not every funder invests in every kind of case. Sophia should make sure she approaches the right funder who can meet her needs.

**Take Validity.** We're a commercial litigation funder, which means we invest in business-to-business lawsuits. We'll usually advance \$2 million or more, and we specialize in U.S. commercial litigation and international arbitrations.

What counts as commercial litigation? It definitely includes Drone Out's contract and trade secret misappropriation claims. We also invest in breach of fiduciary duty, copyright, trademark, patent infringement, insurance recovery, and bankruptcy cases, among other commercial disputes.

Like other commercial funders, we'll also invest in commercial claims across the major domestic and international arbitral institutions, including the American Arbitration Association, the International Chamber of Commerce (ICC), the Singapore International Arbitration Centre (SIAC), and the International Centre for Settlement of Investment Disputes (ICSID).

Commercial litigation funders like Validity are different than consumer litigation funders, which invest in cases like personal injury, medical malpractice, and employment discrimination matters. A consumer litigation funder would not be the right fit for Sophia's contract and trade secret claims.

FUNDING  
PRODUCTS

Fees and  
Costs Funding

The bread and butter of funding: A funder pays some or all of the fees and costs of litigation, in exchange for a portion of case proceeds.

Claim  
Monetization

If you have a final judgment, funding can help finance asset enforcement efforts and also monetize part of that judgment today, mitigating collection and timing risk.

Portfolio  
Funding

Funding backed by a basket of cases. Often utilized to provide funding directly to law firms. Recipients of portfolio funding can use the money for general corporate or firm purposes.

Defense  
Funding

Funding to offload some of a company's defense litigation costs. Typically done as part of a portfolio, with the funder's return coming from other plaintiff cases in the portfolio and/or a success fee if the defendant avoids liability.

Appeals  
Funding

Monetize a favorable judgment that's on appeal, eliminating the risk of getting nothing if you're reversed on appeal. Can also be used to hire top-tier appellate counsel.

Bespoke  
Products

Validity and other funders are innovating new products every day. Give us a call to talk through some of the latest ideas.

## FUNDING FOR COMPANIES

"We need to pursue these cases, but we should be investing in R&D, not legal bills," Sophia decides. "But if we got funding for a single case, what would it look like?"



**Single-case funding is the most common litigation finance arrangement in the United States.** Here's what Drone Out's single-case funding might look like:

### THE INVESTMENT

The funder pays a portion of the attorneys' fees and costs (e.g., expert costs and filing fees) of litigation. The funder might also provide cash directly to Drone Out as "working capital."

### RISK SHARING

The funder will bear most—but not all—of the financial risk. At Validity, we usually fund attorneys' fees on a "50/50" model: We pay 50% of the lawyer's hourly rates, and the lawyer puts the balance at risk in exchange for a share of case proceeds. And we ask the client to bear some of the costs of litigation, like court filing fees if they are able to do so.

### RETURN STRUCTURE

The funder's return will vary. In one common structure, the funder receives the greater of a multiple on the original investment or a percentage of case proceeds, escalating over time.

**Clients should insist on fair terms. At Validity, we won't do a fees-and-costs deal if the client isn't expected to get upwards of 50% or more of case proceeds.**

### WATERFALL

The first dollars of case proceeds will likely reimburse the funder for its initial investment. Then the distribution of proceeds can vary. Typically, the funder and law firm will receive their return before the client recovers the rest of case proceeds.

## BENEFITS FOR COMPANIES

Zach remains skeptical.

"If we take funding and win the case, we'll have to give up a portion of case proceeds," he tells Sophia. "Why would we do that?"



**Funding isn't always the right move, but it often is. Here's why:**

### CASH IS KING

Funding helps claimholders like Drone Out get the money they need to pursue the litigation strategy they want, not the litigation strategy they can afford. With funding, Drone Out can hire the best litigators in the country.

### MITIGATE RISK

Litigation is uncertain. If Drone Out pays the entire cost of litigation out of pocket, it will bear all the risk of failure. With funding, it can trade in some upside to obtain serious downside protection.

### A TRUSTED PARTNER

At Validity, every case is vetted by a team of experienced litigators, and every investment approved by our investment committee, which includes two former judges. We share our insights with you, strengthening your case and providing an unbiased view of its merits.

### MONETIZING ASSETS

Instead of waiting years for a final resolution and bearing the risk alone, funding lets claimholders monetize part of their judgment today.

### ACCOUNTING BENEFITS

When a company pays its lawyers, those fees are expenses, lowering a company's profitability. Litigation finance takes litigation costs off corporate balance sheets—something a CFO like Zach should appreciate. Funding can even turn the general counsel's office into a profit center by unlocking a potential source of revenue.

## HOW DOES IT WORK?

### NON-RECOURSE CAPITAL

There are many different shades and types of litigation finance. We encounter most of them in this Guide. But just about every litigation finance transaction shares a few attributes:

Litigation finance is secured by a legal claim—and only by a legal claim.

**If a funder backs Drone Out's contract claim, and Drone Out loses the case, the funder gets nothing. That's different than a recourse bank loan.**

### MULTI-PURPOSE FUNDING

Litigation finance is most commonly used to pay legal fees and expenses. But it can do a lot more. Funders frequently provide capital directly to companies or law firms that can be used for any legitimate business purpose, with the funder's return backed only by case proceeds.

**A lawyer could litigate Drone Out's case for a contingent fee, but the lawyer can't give Drone Out working capital, and it's often harder for law firms to pay the expenses of litigation.**

### THE CLAIMHOLDER REMAINS IN CHARGE

Drone Out will remain the real party in interest. The company and its lawyers will control litigation strategy and settlement decisions.

**If a funder demands settlement authority, Sophia should "just say no!"**

## LITIGATION FINANCE STEP-BY-STEP

Here's what Sophia can expect the funding process to look like:

- 1 CONTACT A LITIGATION FUNDER**  
Sophia signs an NDA with a commercial funder, and provides it with the factual and legal basis for Drone Out's claim.
- 2 SIGN A TERM SHEET**  
The funder should get back to Sophia within 14 days to reject the case or offer a non-binding term sheet.
- 3 PROVIDE DUE DILIGENCE**  
If Drone Out agrees to the terms, the funder will conduct due diligence into the company's likelihood of winning the case and collecting the judgment.
- 4 NEGOTIATE THE AGREEMENT**  
If the funder decides to invest, the parties will negotiate a litigation investment agreement.
- 5 LITIGATE THE FUNDED CASE**  
Counsel receives funding to litigate the case, and Sophia controls settlement decisions. Counsel updates the funder with important case developments.
- 6 DISTRIBUTE CASE PROCEEDS**  
If Drone Out wins its case, it will pay the funder a return owed under the investment agreement. If Drone Out loses, it owes the funder nothing.

## FUNDING FOR LAW FIRMS

Sophia calls her lawyer. “Single-case funding is great,” Chloe tells Sophia. “Or we could finance your case through my law firm portfolio funding arrangement.”



**Funding isn't just for claimholders. It's for law firms too.**

Law firms can obtain non-recourse funding backed by the firm's contingency fee matters. The portfolio will initially include some or all of the firm's ongoing matters—but it can grow over time, as the firm takes on new matters.

Here's what law firm portfolio funding looks like:

### THE INVESTMENT

Chloe's law firm will receive non-recourse capital from a funder based on the projected outcomes of all the cases in the portfolio.

### USE OF FUNDING

Chloe's firm can use the funding to offset the firm's contingent fee risk or for other general purposes. Some firms choose to use Validity's funding to launch new practice groups, build new offices, and hire new attorneys.

### BETTER RATES

Portfolios are less risky for funders because the funder's investment is “cross-collateralized” against multiple cases, not just one. At Validity, we believe that if we take lower risk, we should pass the benefit on to the law firm. So we offer lower returns that are often capped at a set amount.

## BENEFITS FOR LAW FIRMS

“I thought funding was only for claimholders,” Sophia tells Chloe. “Why did your law firm get portfolio funding?”



**There are many reasons why law firms tap into litigation funding:**

### SMOOTHING REVENUES

Contingency fee litigation can be highly profitable, but revenue streams are unpredictable. By converting a full contingency arrangement into a hybrid contingency, where a funder pays 50% of the firm's hourly rates, a law firm can secure a predictable revenue stream while still maintaining upside in its cases.

### RISK SHARING

Law firms that take cases on full or partial contingency are taking litigation risk alongside their clients. Working with a funder to monetize legal fees or subsidize contingency work provides an opportunity to share risk with a third-party.

### GROWTH CAPITAL

Law firms, like other businesses, need capital to grow: to hire new lawyers, build new offices, expand into new regions, and develop new subject matter expertise. Unfortunately, the recourse financing options typically offered by financial institutions are often unattractive to law firms. Portfolio litigation finance provides a law firm with non-recourse capital that can be used to grow. The only collateral are the firm's cases—which means if the cases don't succeed, the lawyers won't lose their practice.

### WIDER SWATH OF FUNDED CASES

Cases that aren't a good fit for single-case funding might qualify for portfolio funding. For example, Drone Out's trade secret claim is strong on the merits, but the damages are on the smaller side for a single-case investment. Yet the case could work as part of a portfolio.

## ETHICAL FUNDING

"Is funding ethical?" Sophia asks Chloe. "And what about disclosure—could funding put my case at risk?"



Litigation funding is perfectly consistent with—and indeed promotes—a lawyer's ethical obligations. Parties should always consult with a lawyer, but funding is legal in most places, and courts generally deny efforts at disclosure.

Here's a framework for thinking about the ethics of funding:

### GATING QUESTIONS

**Is litigation finance legal in your jurisdiction?**

### CHAMPERTY

Champerty is an ancient doctrine designed to prevent medieval English nobles from stirring up frivolous litigation against each other. In modern America, it's not an issue in most states. Many state courts have either abolished champerty or don't apply it to modern commercial funding agreements.

### FEE SHARING

Legal ethics rule 5.4 prohibits "fee sharing" between lawyers and non-lawyers. Single-case investments between a funder and claimholder don't implicate the rule. And the prevailing view among practitioners is that law firm funding doesn't conflict with the fee sharing rule. For a strong endorsement of this position, see the New York City Bar Association's February 2020 working group report on litigation finance.

### USURY

Most courts hold that usury laws don't apply to "non-recourse" litigation finance transactions, where the funder's return is contingent on success in the case. Many states also entirely exempt higher-dollar transactions from their usury laws.

## PROCESS QUESTIONS

### DISCLOSURE DURING DISCOVERY

**How should lawyers and claimholders interact with funders, courts, and defendants?**

Defendants sometimes seek disclosure of funding agreements and communications during discovery. Most courts hold that such documents should not be disclosed, for two reasons. First, the documents are irrelevant to the case and thus not discoverable. Second, even if relevant, they are protected from disclosure under the work product doctrine or attorney-client privilege.

### MANDATORY DISCLOSURE

Separately, some anti-funding groups are pushing for mandatory disclosure of funding at the outset of litigation. Check your local rules, but for the most part mandatory disclosure isn't required.

### NON-DISCLOSURE AGREEMENT

To maximize protections against disclosure, it's best practice to execute an NDA with a funder before disclosing confidential information.

### CONFIDENTIAL INFORMATION

Legal ethics rules generally require client consent before a lawyer shares confidential information with another party, including a funder. So lawyers should obtain client consent as required by the rules.

**If the ethics rules are meant to promote clients' interests, and clients benefit from funding, then litigation finance promotes rather than undermines the ethics rules.**

## FUNDERS SHOULD ADD VALUE

Sophia is intrigued by funding, but she can't figure out who these funders are. "Are they lawyers or finance professionals?" Sophia asks. "Should I expect them to help with my case?"

Funders shouldn't exercise control over litigation. Your lawyers, not your funder, should litigate your case.

But the best funders add value by developing expertise in helping craft successful case strategies. They can also provide additional checks on whether you've got winning arguments.

Some claimholders just want capital, and that's OK with us. But a funder can also serve as a long-term trusted advisor, and help you think through your company's approach to litigation.

**At Validity, we are seasoned litigators with an average of more than 18 years of litigation experience. We've tried cases at some of the nation's top firms, and clerked for federal courts ranging from district court to the U.S. Supreme Court.**

Let us know how we can help.







## VALIDITY

Validity is a leading commercial litigation finance company dedicated to fair funding practices that build trust. Validity's mission is to make a meaningful difference in our clients' experience of the legal system. We invest in commercial, patent, bankruptcy, and breach of contract litigation, as well as international arbitration. With decades of combined experience in funding, our team of trial-tested attorneys has invested over \$370 million since 2018 across more than 70 matters and portfolios. Our management team has an over 85% success rate. Clients and law firms count on Validity for reliable capital, strategic help, and risk minimization. Our focus is fairness, innovation and clarity. **For more, visit [www.validityfinance.com](http://www.validityfinance.com)**

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accountability, transparency,  
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