



Litigation Finance

Appetite for litigation funding amongst claimants, and the capital available to satisfy that appetite, has never been greater. Combined with a widening liberalization of funding regimes across the globe, litigation funding is now a routine consideration for claimants with meritorious disputes in both domestic litigation and in international arbitration. It is therefore more important than ever for legal advisors to have the best understanding of litigation funding. At Silverback Universal, LLC, we see a number of common themes from the questions raised by those approaching litigation funding for the first time, be it claimant or legal advisor.

Those are:

- What benefits can non-recourse funding offer?
- What are the criteria for a case to be eligible for funding?
- What are the necessary diligence and transactional processes required to secure a funding commitment?

The aim of this guide is to shed some light on these common queries by:

- Providing an overview of litigation funding and its benefits to claimants.
- Identifying the fundamental criteria of a viable funding opportunity.
- Detailing the mechanics of the funder's underwriting process.

- Examining the principal sections of a standard litigation funding agreement.

Along the way, we will include some Industry Insights for claimants and their law firms to consider as they evaluate third-party funders to financially support their side of a commercial dispute

Overview of Litigation Funding

What is litigation funding?

Litigation funding involves a third-party financing some or all of the legal expenses of one or more legal disputes in exchange for a share of the proceeds recovered from the resolution of the dispute(s).

What makes litigation funding attractive to claimants?

These transactions are non-recourse, meaning that if there is no recovery made from the dispute, then there is no obligation to repay the funder its advances or to pay any return on its investment. It is the non-recourse nature of these arrangements that provides 'David' claimants with access to justice against 'Goliath' respondents. If these claimants had to bear the economic burden of enforcing their rights, they would simply not have their day in court against well-resourced respondents. Moreover, when Goliath realizes that David has a heavily capitalized funder supporting his cause, it often strengthens David's bargaining power, and can change the tone and content of settlement discussions dramatically.

Litigation funding is no longer merely a lifeline for those claimants for whom funding is a financial necessity. Non-recourse funding to pay the costs of dispute resolution also benefits those claimants who have ample resources, but simply do not have the risk appetite, or cash flow, to invest in long drawn-out litigation or arbitration.

Another benefit of litigation funding, which is often overlooked by claimants, is that it provides an additional assessment of the claims at no cost. A 'reality check' at a developmental stage of the dispute can greatly enhance the strategy of the case. Funders like Silverback Universal, LLC, which have a staff of legal experts who are deeply experienced in their areas of litigation specialism and who have likely

reviewed hundreds of cases of the specific claim type at issue, provide an extra layer of valuable diligence expertise.

Finally, for claimants that have yet to engage a law firm or may need to add local or specialized counsel, a well-established funder with a deep network of legal practitioners, such as Silverback Universal, LLC, can make introductions to a law firm best-suited to represent the claimant in the jurisdiction at issue.

Does the funder exercise any control over the litigation?

No. Reputable funders generally remain passive in disputes in which they have invested. The claimant retains complete control over all decision-making, as per the terms of their engagement with litigation counsel, and the funder should not interfere in any way with the relationship between the claimant and its lawyer. In some jurisdictions around the globe, litigation funding regimes may allow funders a greater level of involvement in the dispute. However, a reputable funder's role should be more one of adding additional expertise upon which the claimant and law firm can draw if and when required, rather than the funder having any form of control over the proceedings.

How is litigation funding different than other commercial financing?

A traditional bank loan is recourse, requiring the borrower to repay the principal and interest based on the term and maturity of the loan, regardless of the outcome of the dispute. Banking institutions do not have the litigation expertise to underwrite the merits of the claim or the competency of litigation counsel, so they usually require collateral and personal guarantees that would make the debt too risky and the litigation impractical for the claimant. Because funders see litigation rights as an asset to be monetized without additional collateral support, they can structure these transactions as non-recourse investments.

Does the funder advance the funds to the claimant or the law firm (In other words, who are the parties to the contractual arrangement)?

Certain funders, like Silverback Universal, LLC, offer non-recourse funding facilities for both claimants and law firms. A litigation funding

arrangement with a claimant usually supports the prosecution of connected causes of action, normally against one or more related respondents. In contrast, a law firm funding facility provides operational cash flow to cover the firm's overhead expenses and is supported only by the revenue to be generated from a portfolio of cases run by the firm on a contingency (or partial contingency) fee basis. Because a law firm portfolio facility allows the funder to diversify its risk across a range of cases, the pricing of the funder's return should be significantly lower than that of a claimant-side single case funding arrangement.

The Funder's Focus (the Fundamental Criteria)

We have made claimant-side funding arrangements the focus for this Guide, but we plan to offer a similar edition for law firm funding facilities in the future.

The funder will focus on six fundamental criteria when evaluating a claimant-side litigation funding opportunity:

1. Merits of the Claim

Funders will carefully review the strength of the claim and the evidentiary support, along with the anticipated defenses and counterclaims to predict the probability of the action being successful. The extent of the funder's review will depend largely on the case type, the status of the action, the complexities of the issues involved, the organization of the diligence materials and litigation counsel's ability to succinctly articulate its case.

Industry Insight:

Funders recognize that claimants and law firms will often focus, almost entirely, on the strengths of their case, but the best way to get funders comfortable with a claim, is for the claimant and counsel to also identify the weaker points. With well-organized materials and a defined litigation strategy that includes the anticipated defenses, the funder will be able to conduct its diligence efficiently and should make a decision on a proposal for commercial terms quickly.

2. Claimant

The funder will seek to understand the claimant's motivation for seeking funding, including if the

claimant lacks the required resources to bring the claims or desires to shift risk and/or free-up cash flow. The funder will also examine the claimant's prior litigation history to understand its mindset towards litigation.

Industry Insight:

Claimants and their counsel should keep in mind that the funder is not just analyzing the merits of the case but is evaluating the claimant as well. Whether the claimant is emotionally involved in the dispute will help the funder assess if the parties are likely to act rationally when considering a settlement offer

3. Claimant's Legal Representation

The reputation and experience level of the claimant's counsel is another threshold issue for a case to advance through the funder's initial screening. If the funder is not familiar with the litigation lawyers (and/or counsel) proposing to prosecute the case, the initial diligence will include a review of the legal team's experience with the claim type and their track record in similar actions. The funder will also need to review the firm's engagement agreement with the claimant to understand the economics of the arrangement and evaluate if the interests of the claimant and its law firm are appropriately aligned.

Industry Insight:

Again, proper alignment is critical to the viability of these funding structures, so the funder will need to ensure that any reliance placed on the legal team view of the case is sufficiently supported by the amount of risk that they assume for the value of their time.

4. Litigation Budget

Litigation funding provides a fixed commitment of capital to pay for fees and expenses associated with the litigation. The funder will review the proposed budget to understand both the types of expenses that are forecasted to be incurred as well as the expected timing of these outlays. Moreover, unless the funder has included a commitment extension for the facility, it will rely on either the claimant or the law firm to take responsibility for any budget overruns.

Industry Insight:

Funders that are self-financed (that is they do not require outside investment in funding of their cases), like Silverback Universal, LLC, tend to be more flexible and creative in structuring bespoke funding facilities to meet the needs of the claimant. Other funders backed by hedge fund investments and institutional capital are often more rigid and constrained in their ability to deviate from their standard structures.

5. Expected Damages

The size of a potential award will need to be sufficient to provide the funder with a return to match the investment risk and cover the cost of running the opportunity through the funder's rigorous diligence and transactional processes. No matter the size or efficiency of the funder, opportunity costs will necessarily be incurred, and the funder must be comfortable that if the case is successful, there is likely to be a recovery adequate enough to make for an economically rational investment.

Industry Insight:

Funders will often target a ratio of 10: 1 between: (a) a realistic recovery from a resolution of the dispute to (b) the amount of funding required. For instance, if a claim requires \$1 million in funding support, the expected damages should generally be in the range of \$10 million. However, funders that are more creative and nimble, may take a broader view by considering not just the size of the damages but also the likelihood and expected timing of a recovery along with the anticipated funding needs. Even if the expected damages are on the smaller side, these funders may work with the claimant to structure a facility that systematically balances the timing of expected outcomes with the size of the respective recovery.

6. Respondents and Recovery

Funders are fully aware that litigation is a two-party affair, with the respondent playing a critical role in how efficiently the litigation will proceed, and whether a

sizeable judgment or award will convert into a recovery for the claimant and the funder. The worst-case scenario for a funder (as well as the claimant and a legal team acting on a contingency fee basis alike), is to fund a litigation that proceeds through to

trial, ends in a successful verdict with an attractive judgement or award, but the recovery cannot be made because the respondent is insolvent or judgment-proof.

Industry Insight:

There is a good chance that readers of this

Guide will have seen the movie, *The Rainmaker* and recall one of the final scenes where John Voigt, the respondent counsel, calls Matt Damon, the class action lawyer just days after the huge jury award, to revel in the respondent's bankruptcy filing. Unfortunately, judgments can force respondents into insolvency and make it unlikely that the claimant will recover. Other respondents recognize that collection is fraught with frustrations and challenges for claimants and will seek to settle for a reduced amount. Funders look for respondents who are individuals or businesses that are financially stable and likely to want to avoid collection activities and further costs.

The Mechanics of the Funder's Underwriting Process

Because a viable case for funding should satisfy each of these six fundamental criteria, funders will review hundreds of cases each year to identify a select number as suitable candidates for their investment capital. These opportunities are filtered through the funder's underwriting process at various phases.

A typical litigation funding transaction flows through an underwriting pipeline that includes five principal segments.

1. Opportunity Intake

The funder will have an initial discussion (on a non-confidential basis) with the claimant and/or the claimant's attorney to determine whether the matter is a potential fit with the funder's funding models. The principal focus here will be on size: the size of the expected funding budget and the size of the potential recovery.

Industry Insight:

The claimant and litigation counsel will be eager to prove to the funder the merits of their case, but

because their communications are not yet covered by the protection of confidentiality agreement, a reputable funder will caution the claimant to refrain from providing any sensitive non-public information at this early stage.

2. Confidential Discussion under Non-Disclosure Agreement

The funder should offer the claimant a mutual non-disclosure agreement intended to protect the confidentiality of their communications. This will allow for a more substantive exchange of information to enable the funder to better assess the opportunity and provide the claimant with proprietary information on the financing structures the funder can offer.

Industry Insight:

The funder should have a standard two-way confidentiality agreement that can be sent to the claimant or its lawyer within minutes after the initial contact is made. The confidentiality agreement is intended to maintain the confidentiality of, and, where possible, the privilege in the claimant materials and to seek to protect the funder communications with the legal team and the claimant from potential disclosure.

3. Preliminary Diligence

The funder will conduct an initial evaluation to determine if a funding proposal is viable. This preliminary review generally includes developing a basic understanding for the fundamental criteria in the Funder's Focus referred to above.

Industry Insight:

Some funders are better organized and have a well-developed process for conducting the preliminary diligence in an efficient manner. Funders should be able to provide a standard preliminary due diligence checklist, setting out the fundamental information the funder would need to offer commercial terms as soon as the NDA is fully executed. There is a lot of variation in the time it takes funders to complete their preliminary diligence and provide a proposal for commercial terms. Claimants and lawyers should ask the funder the expected timeframe to evaluate if funding proposal can be made, bearing in mind that claimants and litigation counsel are responsible for providing thorough responses to the funder due

diligence questions. Silverback Universal, LLC is typically able to conduct its preliminary due diligence and make a decision on a proposal for commercial terms within 3 to 5 days from receipt of the preliminary due diligence information.

4. Term Sheet

The funder and the claimant will agree on the indicative commercial terms of the funding arrangement in a Term Sheet. It is standard for the funder to include a provision in the Term Sheet which affords it with a period of exclusivity to review the case in more detail and put a definitive funding agreement in place. The Term Sheet will ultimately be converted into the Litigation Funding Agreement which will include the agreed-upon commercial terms as well as other contractual provisions for a transaction of similar nature.

Industry Insight:

The breadth of the Term Sheet varies by funder, but claimants should look to have all of the material portions of the arrangement covered. It is also in the funder's best interest to confirm that there is a meeting of the minds to prevent the opportunity costs associated with expending precious due diligence and transactional resources, if the parties are not ultimately able to agree on the commercial terms.

5. Final Phase: Two Parallel Tracks

Final Due Diligence

Once the Term Sheet is signed, the funder should send the claimant and lawyers a fuller due diligence questionnaire, with the exclusivity period (generally 30 days) triggered from the funder's receipt of substantive responses to each of the funder's questions and requests. The funder's legal, technical and financial experts will review the case and relevant documents in more detail and conduct follow-up calls or meetings with the claimant and/or its lawyers to address questions and fill in missing pieces. As the review progresses, the funder is regularly re-evaluating the litigation risk, recognizing that the longer the case remains in the pipeline, the greater the opportunity cost of its diligence resources if a funding commitment is not made. This requires the funder to continually consider if the opportunity is one that should be allowed to

continue its journey down the funnel or be filtered out along the way.

Industry Insight:

As formal diligence begins to unfold, the funder should be transparent with the claimant and litigation counsel on its developing view of the case. Funders like Silverback Universal, LLC, which invest in the resources to conduct their diligence internally, do not incur the time needed to have outside counsel clear conflicts, review the diligence materials and prepare multiple drafts of an opinion. Funders which operate in this way can often provide substantive feedback to the claimant much more quickly than funders relying upon outside advice, often within the first week of the diligence period. If the preliminary assessment finds a high level of risk for a threshold issue that will be decided early in the litigation, the funder may offer an initial funding commitment needed to progress the case to the pivotal point where the threshold issue will be resolved. If the claimant's case is able to clear that hurdle, it will trigger the availability of the additional funding commitment so the case can proceed fully funded through to trial as initially planned.

Litigation Funding Agreement

As the funder's due diligence progresses positively, the funder should begin preparing a draft of the Litigation Funding Agreement which establishes the framework of the funding relationship. A standard Litigation Funding Agreement will condition funding on the successful completion of the funder's detailed due diligence process. Some funders engage outside counsel to draft and negotiate the Litigation Funding Agreement which can cause significant delay and make negotiation more difficult, time-consuming and frustrating for the claimant and litigation counsel. Funders like Silverback Universal, LLC, which have invested in the internal resources needed to handle the transactional work 'in-house' are much more efficient and easier to work with to get a deal closed. Details of the types of provisions to look out for in the Litigation Funding Agreement are included in the discussion below.

Industry Insight:

Claimants should seriously consider engaging transactional counsel to review and negotiate the Litigation Funding Agreement on their behalf. The disputes lawyers acting on the case may be perfectly

capable of advising the claimant on the terms and provisions of the Litigation Funding Agreement but, because they are a benefactor of the proposed funding, there could be a potential conflict of interest.

Examining a Standard Litigation

Funding Agreement

After all of the funder's discussions with the claimant and its legal team, each of the terms and conditions of the arrangement are set out in the Litigation Funding Agreement. Funders who can provide their counterparties with a draft of the Litigation Funding Agreement early in the process will generally reach the finish-line first, as the review and negotiation of the Litigation Funding Agreement can be the most time-consuming phase of the funding process.

The following is intended to provide an overview of the principal sections of a typical Litigation Funding Agreement along with some Industry Insights for claimants and their lawyers to consider. The below does not include all of the provisions that may be found in the Litigation Funding Agreement, and by no means does it represent an exhaustive list of the items worthy of careful consideration.

1. Definitions and General Terms

Any capitalized term that is used in the Litigation Funding Agreement should be included in this section along with its defined meaning. Claimants need to be mindful that many words that have a certain common usage in everyday language will have quite a different meaning in the Litigation Funding Agreement.

Industry Insight:

The definitions should not be overlooked. Some are generic and unsurprising, but many of these defined terms will include the fine details and intricacies of the arrangement. Items such as the success fee, the collateral and the breadth of mass revenue and revenue events are often spelled out in lengthy definitions in this section, requiring special attention from the claimant and its transactional lawyers.

2. Funding Process Mechanics

This section includes the process for how funding requests are made by the claimant or its lawyers as well as the funder's obligations to make advances. Based on their diligence, funders may need to stage the funding for different phases of the litigation or have a portion of the committed amount hinge on the resolution of a threshold issue in the action. This is another example where funders, like Silverback Universal, LLC, which deploy their own capital, can be more flexible in their approach to structuring the funding mechanics.

Industry Insight:

If the claimant has questions about whether the funder will be capable of meeting its funding commitment, the claimant should ask thunderworm assurances regarding its capital adequacy.

3. Representations and Warranties

The Funding Agreement will contain representations and warranties to be made on behalf of the claimant as well as the funder. These representations and warranties are statements of present or past facts which are relevant to the transaction. The representations and warranties required from the claimant will vary depending on whether the claimant is a natural person or a corporate entity as well as on the nature of the proceedings that are being funded. The purpose is to drive disclosure by the claimant and to allocate the risk of a misunderstanding of fact to the party in the best position to assume the risk.

Industry Insight:

The claimant needs to review each of its representations and warranties carefully to confirm that it is providing the funder with accurate statements. The Litigation Funding Agreement should offer a schedule to include items that need to be carved-out of the representations. For instance, in order to make a representation that there are no liens on a patent, a claimant may need to exclude existing lienholders, even if they will be subordinated to the funder. In the event that there is a material misrepresentation made by the claimant in the Litigation Funding Agreement, the funder could have recourse through a breach of contract claim for the sustained damages. This is an instance where the claimant may have a level of financial responsibility to the funder even though the advances are strictly non-recourse.

4. Covenants

The covenants are the claimant's 'promises' to the funder to take future actions (or refrain from taking future actions) that could impact the success of the litigation or the funder's rights to its share in the recovery. For instance, when seeking funding for a patent infringement matter, the claimant will promise to continue ownership of the patents, maintain the patents in good standing, refrain from encumbering the patents and take those actions reasonably necessary to pursue a recovery from the respondent. A failure on the part of the claimant to perform any of these obligations would constitute a breach of the Litigation Funding Agreement and could give the funder a right to compensation for damages.

Industry Insight:

It is essential that the claimant understands its performance obligations because, like with the representations and warranties, a breach by the claimant of one or more of the covenants could create financial responsibility through a breach of contract claim, regardless of the non-recourse nature of the transaction. The claimant should work closely with its transactional counsel to ensure a full understanding of its obligations under the Litigation Funding Agreement.

5. Distribution Provisions

The Litigation Funding Agreement will set forth "the waterfall" for how a recovery is to be divided between the claimant, the lawyers (if applicable), any insurer providing cover for adverse costs (again if applicable) and the funder, as well as the timing and priority of how these payments will be made. It is usually the case that distributions will first be made to the funder to return the amount of contributions advanced under the facility; provided, however, that if the claimant or lawyers are also advancing funds alongside the funder, then the distributions may be made pro rata until all parties who have made advances are fully reimbursed. The next step in the waterfall of payments will often include a minimum level of return to the funder with the remaining proceeds being divided among the claimant, the legal team and funder according to an agreed formula.

Industry Insight:

The distributions to be made upon a recovery are generally spelled out carefully in the Term Sheet which the provisions of the Litigation Funding Agreement should simply mirror. Claimants should, however, pay careful attention to the defined terms used in the distribution provisions and refer back to the Definition section of the Litigation Funding Agreement to confirm that they accurately reflect their understanding of the financial arrangement.

6. Termination Events

The Litigation Funding Agreement will include a section that provides the claimant and the funder with rights to terminate the agreement in certain situations. Since the funder should usually remain a passive investor with no control over the litigation, the termination provisions may offer the funder the only option to 'manage' its investment. These termination rights are typically triggered upon a material adverse development in the litigation such as the termination or resignation of counsel. In many cases, the funder will still be entitled to the return of its contributions and the payment of its success fee in the agreed waterfall upon recovery irrespective of the funder terminating the funding commitment.

Industry Insight:

The funder's termination rights may be the most important section of the Litigation Funding Agreement because if broadly drafted, they can allow the funder to stop funding at a crucial juncture of the litigation.:

- Reasonably ceases to be satisfied about the merits of the dispute.
- Reasonably believes that the dispute is no longer commercially viable; or
- Reasonably believes that there has been a material breach of the Litigation Funding Agreement by the funded party.

Some funders, like Silverback Universal, LLC, upon terminating the Litigation Funding Agreement will (in certain limited circumstances) offer a claimant an option to pay off the funder contributions with an interest rate-based return in exchange for the funder foregoing its interest in any future recovery.

7. Miscellaneous Provisions

The Litigation Funding Agreement will also include a miscellaneous section of "boilerplate" provisions that are not the substantive focus of the parties. However, claimants have to be careful not to overlook these details which could have very important legal implications for the manner in which the Litigation Funding Agreement is construed and how the parties would settle a dispute over its interpretation.

Industry Insight:

In particular, claimants should carefully consider both the governing law provision which sets out the law which will govern the parties' rights under the Litigation Funding Agreement, and the dispute resolution mechanism which provides how a disagreement between the parties is to be handled.

Final Thoughts

It is evident that the high costs and uncertainty of litigation are fueling an emerging market for litigation funding across the globe. From a cost-benefit analysis, it generally makes sense for a claimant to submit its case to a litigation funder for review. Funders do not charge an application fee to evaluate a funding opportunity so there is no out-of-pocket cost and, as detailed above, there can be many material benefits to both the claimant and its lawyers. Hopefully this Guide will help claimants and their lawyers to assess if their case is likely to meet the funder's eligibility criteria and to understand, and prepare for, the underwriting and transactional processes involved in obtaining a funder's support.

In closing, our final Industry Insight: It is definitely the case that all funders are not created equal... so claimants and their lawyers must also conduct careful due diligence on funders. Our hope is that this Guide will assist lawyers with advising clients on choosing the funding partner best suited to support their commercial dispute. If questions remain unanswered or if you would like to discuss any aspect of litigation funding, please do not hesitate to get in contact.

For further information, visit

www.silverbackuniversal.com

or email info@silverbackuniversal.com directly.

Disclaimer: This publication is offered with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought.