

## **RDAI/IBLJ ROUNDTABLE 2012**

### **THIRD PARTY FUNDING IN INTERNATIONAL ARBITRATION IN EUROPE**

#### **PART 1: FUNDERS' PERSPECTIVES**

by Dr. Maxi Scherer<sup>1</sup> and Aren Goldsmith<sup>2</sup>

Third party funding has become one of the “hot topics” in international arbitration. More and more parties, whether in financial distress or not, explore the possibility of using funders to provide the necessary cash to pay for their lawsuit, allowing the funder to realize in return a percentage of the proceeds of the case (or multiple of costs financed), if successful. Third party funding thus shows similarities to certain forms of insurance contracts (where the insurer pays for the costs of the lawsuit, including, in certain cases, for the opposing party’s costs) and contingency fee arrangements (where the lawyer carries the costs of litigation in exchange for an interest in the proceeds of the case). The exact definition of third party funding, however, remains elusive and its legal and ethical implications in international arbitration, mostly unexplored.

This roundtable discussion aims at filling the gap, focussing in particular on the specificities of third party funding in international arbitration from a pan-European perspective. The project is organized in two stages. A first session with representatives from several of the most prominent funds active in the area of international arbitration addresses the actual practice and techniques of third party funding. This first session took place on January 27, 2012 and a summary report is published below. A second session will bring together a panel of leading arbitrators, arbitration practitioners and academics with the aim of considering the legal implications of third party funding in international arbitration, particularly from a civil law perspective. This second session will be held in the second quarter of 2012 and a report of the group’s findings published in one of the forthcoming volumes of the IBLJ.

#### **SUMMARY REPORT OF THE FIRST SESSION HELD ON JANUARY 27, 2012**

by Camille Fléchet<sup>3</sup>

This report summarises a roundtable discussion organised under the auspices of the International Business Law Journal and hosted by Cleary Gottlieb Steen & Hamilton LLP in Paris on January 27, 2012.<sup>4</sup> The roundtable was organized under the supervision of Professor Henry Lesguillons, Editor-in-Chief of the International Business Law Journal. The event was

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<sup>1</sup> *Avocat* at the Paris Bar, solicitor (England and Wales), Special Counsel at Wilmer Cutler Pickering and Dorr LLP London and Lecturer for International Arbitration and Energy at Queen Mary University, International School of Arbitration, London.

<sup>2</sup> *Avocat* at the Paris Bar, Member of the New York Bar, Senior Attorney at Cleary Gottlieb Steen & Hamilton LLP in Paris.

<sup>3</sup> *Avocat* at the Paris Bar, Associate in the International Arbitration and Litigation Group of Allen & Overy LLP in Paris.

<sup>4</sup> For the avoidance of doubt, no view or opinion described herein should be understood as representing the views or opinions of any of the participants named in this report or the firms or institutions with which they are associated.

put together, and the discussion was moderated, by members of the Journal's editorial board: Maxi Scherer and Aren Goldsmith.<sup>5</sup>

Representatives of litigation and arbitration funding entities who attended were Walter Remmerswaal, managing director of Omni Bridgeway; Selvyn Seidel, founder and chairman of Fulbrook Management and his colleague, Geneviève Labbé; Mick Smith, partner and co-founder of Calunius Capital; as well as Guy Lepage, Alain Grec and Paulina Touroude from La Française AM International Claims Collection.

In addition, several members of the legal panel that will participate during the second legal session participated in the industry discussion. In particular, participating practitioners and academics included: Professor Catherine Kessedjian of the University of Paris II, Panthéon-Assas; Sophie Nappert, an independent arbitrator with chambers at Three Verulam Buildings in London; and Yves Repiquet, a former Bâtonnier of the Paris Bar and now partner at Jeantet Associés.

The roundtable discussion was conducted using the Chatham House Rule; therefore, while the substance of the discussion is reported, comments have not been attributed to individual speakers.

### ***Background of Funding Entities in Attendance***

*Calunius Capital* – Established in January 2007, this London-based funder of litigation and arbitration has been authorised and regulated by the UK Financial Services Authority ("FSA") as an investment adviser since June 2007. Calunius is a founding member of the Association of Litigation Funders of England and Wales that established the Code of Conduct for Litigation Funders. Its team is made up of four partners with various backgrounds, including former investment bankers and litigators and one partner with extensive experience within Allianz Prozess Finanz, the former litigation funding subsidiary of the Allianz Group. Calunius funds commercial litigation and arbitration claims in both domestic and international contexts. It does not, however, provide funding for domestic court proceedings in the US.

*Fulbrook Management* – Launched in March 2011, its headquarters are located in New York and it has an active presence and offices in London. This fund was designed to invest in and advise on high-stakes litigation and arbitration, thereby providing classic funding services while proposing a range of related support services. Its business focuses on complex business disputes, including transnational commercial and investment arbitrations mainly in the UK and the US. It is in the process of expanding its business into continental Europe, in particular with respect to international arbitration. Prior to joining Fulbrook Management, Selvyn Seidel co-founded and was Chair of the Burford Group, the investment advisor to Burford Capital, a publicly-traded fund that is now the largest dedicated funder in the world. Prior to that, Mr. Seidel was a partner in the New York office of the international law firm Latham & Watkins LLP, chairing, at various times, the firm's international litigation and arbitration practice, its international practice in general, and its New York litigation practice.

*La Française AM International Claims Collection* – Established in Paris in early 2009 as a service provider dedicated to the resolution of international litigation or arbitration for La

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<sup>5</sup> Lorenzo Melchionda, also of Cleary Gottlieb Steen & Hamilton LLP, participated as a special advisor on questions in international investment law. Messrs. Goldsmith and Melchionda are the authors of an article regarding third party funding and international arbitration published in the Journal as part of its investigation of the subject. See A. Goldsmith and L. Melchionda, "Third Party Funding In International Arbitration: Everything You Ever Wanted To Know (But Were Afraid To Ask)", *International Business Law Journal*, No. 1 – 2012 (Part II published in No. 2-2012).

Française IC Fund, a Specialized Investment Fund based in Luxembourg. The fund is regulated by the *Commission de Surveillance du Secteur Financier* in Luxembourg ("CSSF") and is open to institutional investors. La Française AM International Claims Collection is a 100% subsidiary of the asset management group La Française AM, regulated by the French *Autorité des Marchés Financiers* ("AMF"). La Française AM is an 80% subsidiary of Crédit Mutuel, which is regulated by the French Banking Commission.

La Française IC Fund provides funding for international arbitration proceedings at all stages and accessorially purchases discounted international debts by allocating funds supplied *inter alia* by Crédit Mutuel. Guy Lepage, Chief Executive Officer, has more than 30 years of experience in this field and most of the members of his team have a legal background, some of them having been admitted to the Paris bar.

*Omni Bridgeway* – Established in The Hague in 1986, Omni Bridgeway was one of the first professional third party litigation and arbitration funders in the world. It concentrates on the recovery of defaulted debts and claims globally while also providing both risk capital finance and management services for the prosecution of claims through litigation or commercial and treaty arbitration. Prior to joining Omni Bridgeway, Walter Remmerswaal practiced litigation and trade and insolvency law with the law firm Loeff Claeyns Verbeke.

When explaining the rationale for locating their offices in the cities they had chosen, the participants cited, beyond personal reasons, the importance of finding a leading litigation and/or arbitration centre, a major financial centre, and/or a jurisdiction that is favourable to third party funding. Funders were divided in their perceptions as to which of London, Paris, New York or the Hague represented the world's leading jurisdiction for international disputes.

### ***Defining Third Party Funding***

The roundtable did not produce a consensus among the funders present regarding the definition of third party funding. Several definitions were proposed, a majority of which relied on a broad definition, encompassing different types of financing.

One such definition described third party funding from an economic perspective as "every possible contract where the pay-out under that contract is linked to the proceeds of litigation" – a definition that the participant stated could allow the litigation to be considered an "asset" and all related contracts as "derivatives". This definition thereby covers lawyers' contingency fee arrangements and insurance contracts, even though they are held by different stakeholders and regulated by different entities.

For a second funding provider, "there is no such thing as third party funding" as funding of claims exists in many forms, including contingency fee arrangements or insurance contracts (despite the various distinctions that can be highlighted). Even with more traditional core notions of third party funding, the dynamics of the process are quite different where the claim is funded from its outset versus cases where the mere enforcement of an award is funded. Likewise, large differences exist depending on whether the third party funding advances the claim of a consumer or the claim of a large corporate entity. In addition, the distinction between a funder and a subrogated insurer can be either non-existent – in terms of practical implications – or quite significant – when looking at a commercial definition. Consequently, it is almost impossible to find a one-size-fits-all definition of third party funding. Rather, it remains for the community to "label" the practices that are to be considered third party funding.

A third funding provider also relied on a broad definition, categorising third party funding as "any financial solution offered to a party regarding the funding of proceedings in a given case". Viewed in this way, third party funders do not differ from after-the-event (ATE) insurers, except in terms of financial implications. This funder nevertheless considers contingency fee arrangements to be a distinct business in particular because, in cases of such fee arrangements, the client does not have specific knowledge of the amount corresponding to the legal services that were provided during the litigation or arbitration, whereas third party funding allows the client to have such information. In particular, under this funder's business model, once it has committed to funding a party's litigation expenses, the committed amount is put aside and reserved for that sole purpose.

Another funder defined the concept more narrowly, relying on the following elements to distinguish third party funding from other related practices: (1) Third party funding requires the investment of "third party capital", which differentiates third party funding from contingency fee arrangements in which lawyers invest their professional services instead of capital. Moreover, the funder can offer funding *and* a choice in counsel to the client, while contingency fee arrangements by definition lock in the choice of counsel. (2) Third party funders typically supply funding to sophisticated commercial corporate entities, which do not need the same types of protection as a consumer. (3) They are dedicated to funding claims and, where applicable, to providing additional services to manage the claim, which differentiates them from one-off funding that could be provided by a hedge fund. (4) The type of return further differentiates third party funders and insurance companies since the return to the funder is usually either a percentage of the recovery (or benchmarked using such percentages) or a multiple of the capital invested (or whichever is higher).

This funder further distinguished between a "classic funding" definition and an "evolving definition" of third party funding. The "classic" definition stems from the first category of customers for litigation or arbitration funding – financially distressed claimants requiring support to litigate ongoing disputes. However, the definition has evolved as to encompass claimants who have the financial resources to fund their own claims as well as defendants who have weak claims brought against them.

Finally, two of the representatives of third party funders emphasised the diversity amongst the entities in their industry. For example, differences may arise depending on whether the funder is regulated by a financial authority. Likewise, differing areas of expertise or focus make them unique "like a snowflake" according to one funder in attendance: some specialize in enforcement of judgments, ICSID claims, or international commercial arbitration, while others prefer to concentrate on patent claims, companies in financial distress or claims against energy companies. The same funder, however, noted that in spite of this diversity, the industry only has about ten "serious dedicated funders" globally.

*Third Party Funding as an Industry* – Given the variety of opinions regarding the nature and definition of third party funding, participants queried whether it is possible to refer to third party funding as one "industry". One funder raised the idea that third party funding could be seen as somewhere between an industry and a "cottage industry" in light of the clear emergence of a practice notwithstanding the great diversity of funders spread throughout the world, dealing with different contracts and different rules. Another funder explained that third party funding as an industry is relatively new in Europe, by some accounts existing for fewer than 10 years, which may explain some of the differences in approaches. In this respect, the participant added that differences in funders are unsurprising considering that the demand for such services varies greatly depending on the jurisdiction and clients involved.

*Hands-on and Hands-off Approaches* – While some funders do not get involved in the management of cases and see themselves as mere passive investors in the client's case, others will provide additional services, including helping in the management of the case, providing resources, and lobbying.

This led one of the funders to divide third party funding entities into two groups: the ones that have a "hands-off" approach and the ones that have a "hands-on" approach, observing that the two types of funders face different considerations when funding. As the issue of control of the case by third party funders was raised in this context, this funder added that this is a spurious issue: a hands-on approach means that the financing entity offers support for the case and not that it has control over it, as the decisions remain to be taken by the client and its counsel. However, according to this funding provider, there would be nothing wrong with funders having the possibility to exercise some form of control: an entity who invests in the client itself to become a controlling shareholder would "own" and hence control the client's claims despite that it will often know little about these claims, whereas at least the third party funders have an intimate understanding of the claim and how best to pursue it. Another funder explained having an interest in monitoring the case, which does not imply a concrete influence, but rather may translate into an interest in adding litigation support.

In addition, even if sensitivities related to the extent of permissible control arose out of the common law concepts of champerty and maintenance, issues related to control may also exist in civil law jurisdictions via the concepts of public policy or ethical standards. One funder added that they have used both German law funding agreements as well as English law agreements, and that either way the ethical questions across different countries remain the same: is there an abusive behaviour by the funder, e.g. tampering with witnesses, or is the bargain excessive?

### ***Funding Defendants and Respondents***

The participants were divided over the question of whether third party funding for defendants is viable, although no one in attendance reported having already funded such cases. One individual questioned whether funding defendants would ever develop on the basis that hedging the risk of defence requires significant amounts of funds.

Others, however, were of the view that while defendant funding may not exist for now in their practice, there is a clear demand for it. One fund in particular had received a number of solicitations by defendants, including two sovereigns recently asking for funding for a defence. This funder concluded that it is merely a matter of a few years before such a practice develops. The funder further explained that this development is likely not only to relate to funding the fees of the legal proceedings for defendants but also to funding their possible

liability in a given case, leading the funder to consider offering a package to a defendant together with an insurance company. A second funder confirmed this trend, further observing that one kind of defendant funding already exists in some form in investment arbitration: in many cases, the actual beneficiary of an expropriation is a private group that, as a matter of fact, assumes the costs of the proceedings on behalf of the state as well as the payment of damages if the state is found liable.

### *The Nature of Invested Capital*

As one funder explained, the capital invested by third party funders can have various origins. A funder can have a "pot of gold" – as is the case for some prominent funders – or it can have capital on call, which implies working with a network of investors. One funder also referred to a new development in Canada where the Canadian mining company Crystallex is issuing securities on the stock market linked to the proceeds of what it hopes will be an ICSID arbitration victory against Venezuela. None of the attendees at this roundtable reported having used such a mechanism; as one funder explained, this is a new phenomenon for which it could be difficult to find investors.

*Available Capital for Individual Funders* – The participants described available capital amounts that varied across different funding companies. One funder reported to have a capital of about USD 65m, of which less than 20% has been allocated to active legal disputes. Another funder reported an available capital of about USD 63m, coming primarily from a few large North American pension funds. For both of them, once the money is budgeted for a given case, it is ring-fenced for future use.

One funder reported working with a limited network of investors that have USD 450m to 500m available to invest. The approach here is only to fund cases where there is a match between the investor's interests and the claim, which allows this fund to operate as a one-off investment or on a mini-portfolio basis with each investor. The managers of this fund are also considering setting-up a proprietary fund of approximately USD 150m, in addition to its current financing format.

A further investor explained that the source of the company's capital is private investments, with each of the partners having invested themselves, combined with a stand-by facility with additional investors to call in if necessary. The internal rule for this funder is to keep a three-year capacity to run off its portfolio.

*Breakdown of Allocated Capital Between Litigation and Arbitration* – The allocation of capital across different types of proceedings also varies amongst the funds represented at the roundtable, although participants shared a clear interest in international arbitration. One funder reported a 50/50 split between court litigation and international arbitration, which includes arbitration under various institutions, such as the ICC, and various seats of arbitration, such as Paris, London, and Switzerland, as well as both investment and commercial arbitration. On the litigation side, 20% of all funded cases are before the English courts with the remaining 30% in German and Northern European courts not including France.

By contrast, a second funder indicated that 90% of its activity is funding international arbitrations and that the remaining 10% is funding domestic cases, mainly domestic arbitration proceedings. This funder specified that its activity is not limited to a specific region of the world. A third funder reported that 60% of its allocated resources are devoted to

funding litigation cases in courts with the remaining 40% allocated to arbitration cases. Another funder stated that while it has a roughly even split between international arbitration and court litigation, 95% of the cases it funds involve cross-border elements. Of those cross-border cases, 70% of the cases are located in the US or the UK.

In response to queries regarding whether there is something in particular that makes international arbitration attractive for third party funding versus domestic litigation (or rather if it is just a question of demand), one of the funders emphasised the intellectual flexibility that comes with the multicultural and multijurisdictional approach of arbitrators and arbitration practitioners, which makes it easier for them to work with the relatively new challenges of third party funding, including questions of capital adequacy, security of interests and matters of banking law. Another funder noted that other advantages can include the prospect of resolving a major dispute more quickly and more inexpensively than in litigation, working with awards that are more likely to be enforceable by treaty than in litigation, and working within a dispute umbrella that might allow for more flexibility than in court proceedings, since the matter will be governed for the most part by contract.

### ***Investment Guidelines for Funding***

The funders discussed and weighed a variety of possible criteria for deciding whether to fund a claim.

*Jurisdiction Where the Claim is to be Prosecuted* – All funders present agreed that they would be uncomfortable operating in some domestic courts or arbitral seats that are clearly unsuitable. These include corrupt jurisdictions and, for some of the funders, the US, where discovery issues may arise. Other jurisdictions may be avoided if it is determined that they are inhospitable to third party funding. One funder reported that acceptable or recommended jurisdictions include common law jurisdictions (other than the US), and northern Europe along with Germany and the Netherlands. On the contrary, another funder's focus includes the US as well as the UK, the Commonwealth countries and various countries in continental Europe, including France, Spain, Germany and the Netherlands.

*Size of Claim and Projected Legal Costs* – All of the participants agreed that important criteria include the size of the claim as well as the projected amount of legal costs. One of the funders finances cases where the expected legal costs are, at a minimum, USD 1m and where the claim is, at a minimum, valued at around USD 6 or 8m, with no upper limit. Another funder only seeks claims that are projected to return above USD 25m with an investment of costs and fees that ranges, in the best case, between USD 1m to 10m. Most of the claims funded by this funder are for damages in an amount reaching in the hundreds of millions of USD with some being in the billions of USD. A third funder described targeting cases where the claim is for between USD 5m and an upper limit of USD 1 billion. A further funder explained that it concentrates on claims of USD 1m or more, although it does not exclude taking on a case of a lower amount, for example where the case is particularly strong on the merits.

*Probability of Success* – Whereas all of the funders systematically and carefully look at the claim at stake and the probability of success for such a claim, their approaches differ. For two of them, a probability of success of 70% or higher is desirable. Another described not requiring such a figure but nevertheless typically avoiding cases where the likelihood of success is about 50%, unless there are mitigating factors. A mitigating factor could be where

there is a weaker position on a headline jurisdictional issue, which lowers the global chances of success, but a very strong case on the merits.

*Projected Calendar for Prosecution of the Claim* – For a majority of the funders, the projected calendar is of the essence. One of the funders' portfolio aims to ensure that the averaging amount of time spent on a given case is limited to 2.5 years. This funder further explained that 40% of their cases are expected to produce returns within a year.

*Obstacles to Enforcement of any Successful Awards* – All funders present cited the enforceability of the award as a central criterion to fund an international arbitration case. Globally speaking, the question is whether the jurisdiction where the award will probably be enforced is likely to accept such enforcement, and the funders would rule out cases that raise risks in this respect. One funder considers ICSID arbitration to be advantageous in terms of limiting any such risk. More particularly, a funder specified that it would avoid certain defendants, including Argentina and Russia (both as sovereigns and regarding corporate entities from those states), as well as Sub-Saharan Africa.

*Other Criteria* – One participant added the importance of chemistry with the client and with the group of lawyers working on the case. He especially emphasised the need to be able to work as a team with the client and its counsel, as good communication and cooperation were essential to avoiding or resolving any possible future disagreements. Another funder mentioned that adherence to ethical standards represents the first criterion to consider, noting that this is of particular importance to northern European investors. Finally, one participant added that a foreign applicable law that is less well-understood or with which it is more challenging to develop familiarity, may not necessarily be a criterion to rule out a case, provided the jurisdiction concerned is a favourable one.

### ***Standard Pricing Structure***

Pricing structures vary amongst the funders. One funder structures its return via a combination of a percentage of the damages granted, which will be generally above 20% and may reach 40% where the case is perceived as risky or runs for a long time, and cost multiple, which can be as low as two and as high as four. The general idea for this funder is, at a minimum, to triple the value of the investment. It was further explained that this pricing structure is likely to be considered too expensive for large corporations, with the exception of a subsidiary with a constrained litigation budget litigating in a jurisdiction where it does not have experience.

A second funder determines return via different approaches, including percentage, capital, Internal Rate of Return ("IRR") and several combinations of these. It hence uses rather complex formulations. Globally, this funder's goal is to have a return on the average of four to one. This funder added that very little data on what funders earns is available but that most private equity firms would consider a 20% or 25% return a good return.

A third funder emphasised the fact that the pricing structure will be determined on a case-by-case basis depending on the circumstances as well as on the team working on the case. The return will be calculated via a percentage of damages, normally operating in the range of 20% to 40%, or cost multiple, which ordinarily runs from two to four, or a combination of these.

Another funder agreed that the return is decided on a case-by-case basis. For this funder, this is accomplished using an internally-developed methodology. The pricing structure will

combine a percentage of the recoveries and IRR. The percentage of damages will generally decrease depending on the amount obtained, being as low as 10% and as high as 40%.

Two funders suggested that there should be a cap on percentages of damages, which would be 45% for one of them and around 50% for the other (whereas this 50% cap would not apply in insolvency cases). One justified this cap based on the need for ethical standards and on the fact that it would mean dealing with a client who would be barely invested in its own case. Another funder calculates a hard cap in terms of size and not in terms of percentage, specifying that there can be no generalities and that this cap can only be determined on a case-by-case basis. The remaining funder was of the view that if a major corporate entity is willing to pay a return of 90% of the damages recovered, there is, from a commercial point of view, no evident reason to not accept this deal. According to the funder, so long as there is no asymmetry in sophistication and other ethical standards are observed, the parties should in principle be free to decide on issues of remuneration.

### ***Due Diligence***

All of the funding providers rely on careful due diligence before agreeing to fund a case. However, the funders have different approaches to the questions of whether to request an exclusivity agreement and how the due diligence process itself should be funded.

*The Due Diligence Process* – One funder explained that due diligence requires extensive information and material provided by the client and its lawyers: They are requested to provide an initial package of information so as to allow for a quick grasp on the type of claim brought and for the identification of key elements, such as the parties, costs of bringing the claim, the theory for damages and the likely recovery. This review may take seven to ten days, after which period the funder will revert to the client with its view on the financial terms and a "conditional litigation funding agreement", i.e. a funding agreement subject to due diligence as a precondition. This funding agreement grants exclusivity for a limited period of time, which may be of four to six weeks and up to eight weeks in complicated early stage cases. The funder will then have recourse to due diligence questionnaires and will, depending on the stage of the case, incorporate two rounds of questioning. If the case is very developed, for example at the post trial stage, there is less need for extensive due diligence. This funder may conduct the due diligence purely internally but will rely on external advice if the case raises new or technical issues of law, such as difficult treaty or intellectual property law issues.

Another funder works via a two-step process. The first step is an internal assessment, which may take around five days to conduct to see if it falls within the basic criteria for funding. The second step is a more extensive due diligence process that requires an outside counsel and that may take up to one or two months. In this second stage, the claimant's lawyers could provide some help in assessing the case, although such involvement is not always necessary.

A third funder has an in-house team dedicated to due diligence questions, which can be combined with external consultation where necessary. It may take up to two or three weeks for this funder to give the client an initial idea as to whether it may fund the case, after which negotiations will start, subject to further due diligence.

For another funder, due diligence includes reviewing analyses provided by the client's counsel, which the funder will combine with additional external legal advice. Most of the due

diligence process is dealt with internally. In addition to internal lawyers, the funder's team includes one engineer specialised in tracing invisible internet information.

*Exclusivity Agreements* – The funders' practices regarding exclusivity agreements during the due diligence process also differ. As mentioned above, one funder systematically has recourse to an exclusivity agreement, for a period of four to six or even eight weeks once the preliminary review of the case is completed. Another funder takes a similar approach, requesting an exclusivity agreement once a preliminary review has been finalised and before significant cost and time has been devoted to a case. This funder, however, specified that the absence of an exclusivity agreement might not be a concern as long as there is good dialogue with the client and its lawyers. For the two remaining funders, an exclusivity agreement is not required. One does not require an exclusivity agreement at the due diligence stage because it trusts in the virtue of fair competition and the other will only request an exclusivity agreement in certain circumstances while the principle remains that none is required.

*Who Pays for the Due Diligence Process* – Some funders in attendance indicated that they will pay for the due diligence, since, as one of them explained, the claimant is quite often in financial distress. For another funder, the model is that either the claimant will cover the costs of the due diligence or the claimant's lawyers will advance the costs, in which case the funder will cover the costs retroactively in the event that it decides to fund the case. For another funder, whether they will cover the costs will depend on the circumstances, i.e. they will not pay for an information memorandum but normally agree to cover the costs of due diligence if they already have a clear information memorandum and they would like to obtain further advice on specific items or a second opinion in general.

#### ***Liability for Adverse Costs and Security for Costs***

Funders' approaches to liability for adverse costs vary. One participant does not accept liability for costs on principle, as it already suffers a great loss when the client's claim is unsuccessful. For another funder, this will depend on the contract and the pricing structure used. Whether the funder assumes the responsibility for paying the opposing party's costs also depends on the jurisdiction involved: in the US, for example, there is no liability for adverse costs whereas in the UK, the funder is liable for adverse costs. As one funder added, it would agree to pay adverse costs in some jurisdictions, such as Germany, where it perceives costs as relatively controlled.

As to the possibility of recourse to ATE insurance, there was a consensus among participants that it is too expensive in relation to the possible return for funders so that it is not provided as part of the funding package. However, where the ATE insurance cost is recoverable under the applicable law, one funder indicated that it may consider using such insurance and another stated that it could conceivably contract with an insurer to cover the risk via a bond.

Regarding security for costs, a majority of the attending funders considered it to be part of the funder's commitment and it is, as such, provided for in the funding agreement. As another funder explained, security for costs may depend on whether the client is asking for it. The question was also raised of whether this would automatically lead to the disclosure of the funding agreement's existence (an important issue which is further developed below).

### ***The Client's Legal Team***

*The Choice of Counsel* – All of the funders stated that the choice of counsel is an important one. In practice, none of them would agree to fund a case where they do not agree with the choice of legal counsel selected by the party seeking funding. As explained by one funder, funding could be refused for this sole reason even where all remaining criteria to select a case are satisfied.

Funders will also take the opportunity to recommend counsel to the party seeking funding. According to one funder, where the counsel chosen is not satisfactory, suggesting a co-counsel could be a prerequisite for the funding of the case, even though this is a rare scenario. In this respect, another funder also drew a distinction between cases where the client is open to counsel suggestions, in which case they will be happy to provide suggestions, and cases to which they are referred by the counsel already appointed, where the dynamic is necessarily different.

In assessing whether counsel can be deemed satisfactory or not, one funder explained that this can be a purely instinctive decision, and added that credible counsel are more or less self-evident. It was also explained that where the funding relates to an international arbitration case or award enforcement proceedings, appointed counsel will be required to have experience in these areas of law. Another funder stressed that rather than settling for a "satisfactory" legal team, it would insist on having top-tier counsel as a condition for funding. In addition, this funder would potentially refuse funding if one of the appointed arbitrators was not satisfactory or if the claimant was looking at appointing an arbitrator who was not acceptable.

*Instructing or Monitoring Counsel* – There was a consensus among third party funders that they would monitor the legal team but not directly instruct them. For all funders, this monitoring is performed on a monthly basis and requires, at a minimum, reviewing the invoices issued by counsel. One funder explained that it would always make use of monthly monitoring clauses in the funding agreement.

*Counsel's Budget* – All the funders present stated that they require the setting of a budget at the outset of the funding agreement and require counsel to work within its budget. This has been reported as a key issue in the funding of claims, although in practice there are differences in how flexible funders are with respect to counsel exceeding a budget. Some funders emphasised the importance of having a hard cap, in particular where the money is set aside once the budget is established. The necessity of a hard cap approach was explained as a recent phenomenon as well as being particularly important in international arbitration cases.

For one of the funders, except in cases where there is a "material change of circumstances" – which is subject to specific provisions in the funding agreement – if the legal team exceeds its budget, it will not be paid for the extra work provided. On the other hand, this funder also reported that in a recent case, where the lawyer was significantly under budget, this was taken to reveal a deficiency in case management, as the counsel in charge of the case was not putting a sufficient amount of work into the case. Another funder indicated that it would accept roughly a 10% to 15% margin for developments that could not be reasonably expected at the time of the execution of the contract.

*Alternative Fee Arrangements* – The funders present agreed that alternative fee arrangements with counsel, such as contingency fee arrangements, are not necessary but are welcomed. For

one funder, this is true only to a certain limit, i.e. the funder seeks to avoid the lawyer becoming a co-funder because it has taken too large a part in the funding of the case. Earlier in the discussions, however, another funder had expressed the contrary view that when negotiating a funding contract where there is a contingency fee arrangement in place with the acting counsel, this counsel needs to be treated as a co-investor.

### ***Access to Legal Analysis Prepared by Counsel***

A consensus appeared to exist amongst funders that receiving written legal analysis of client's counsel is not required when evaluating the chances of success of a given claim. Some funders actively avoid receiving written analysis due to the risk of it becoming discoverable in certain jurisdictions. As one funder explained, the incentive is more to gather as many factual elements as possible, which may have to be disclosed under the relevant statutes in any event. Funders agreed that this particular question relates to privilege or professional secrecy issues that may vary depending on the jurisdiction involved, noting that the US is one of the most challenging jurisdictions in this respect.

In this context, for one funder, counsel are welcome to provide legal opinions only where the jurisdiction of the dispute offers protection against disclosure orders. Another funder explained that in extreme cases, it would consider building a data room to be able to take its own notes, but that it has never had to use this process. It is worth noting that the discovery mechanism as known in the US was the reason for this particular funder refusing to operate in the US. To protect against disclosure requests, confidentiality agreements or non-disclosure agreements are included in some of the funding contracts, with a governing law that is favourable in that respect.

One funder also contended that the rules should be different in international arbitration cases, since the parties' agreement forms the key element in an arbitration case. Consequently, the parties' agreement as to confidentiality should prevail. For another funder, it is for the arbitral institutions to deal with the question of the disclosure of confidential information.

### ***Disagreements Over Fundamental Strategic Decisions***

Funding agreement typically include provisions regarding potential disagreements between the funder and the funded client. Funders appeared to agree that the use of a third party as a referee is usually a suitable solution provided for in the funding agreement – although there are differences on who this third party may be. Whereas a majority of funders present agreed on the idea of an English QC (or equivalent) as a potential third party referee, one of the funders hesitated to fully endorse this solution, explaining for example that in cases of disagreements on the wisdom of settlement, there may be extrinsic factors that should be taken into account, such as a client facing immediate financial difficulties where a settlement is driven by the need for cash flow. Another funder explained that the referee can only be a true neutral third party, which excludes recourse to the client's counsel. This third party referee should be selected based on a consensus but could also be agreed upon beforehand by creating a list of a few mutually acceptable individuals.

Most funders appear to agree that deciding on whether to enter into a settlement and or whether to waive certain rights remains the client's decision. On the contrary, for another funder, where the objection to settling the matter is important, the funding contract may provide that the counsel's opinion will prevail. This requires making sure that the client's counsel is located in a country where professional liability exists as an enforceable concept.

One participant indicated that where a disagreement persists despite discussions with the client, mediation, arbitration or referring the issue to the client's counsel for advice could all be envisaged.

Moreover, as some of the funders stressed, a key to resolving differences in opinion as to settling or withdrawing a claim is first and foremost having good communication with the client. In this respect, one funder explained that hardly any contractual clause can be of much help in the case of conflicts if there is a lack of effective communication with the client.

### ***Disclosure of Funding Agreement***

The disclosure of the existence of the funding agreement is considered by the funders to be a central issue in third party funding. As a general matter, funders require that their involvement not be revealed, unless the client is compelled to do so under applicable legal disclosure obligation or unless particular circumstances justify disclosure, such as a possible conflict of interest between an arbitrator hearing the dispute and the funder. The funders use confidentiality agreements to guard against the disclosure of funding arrangements. Nevertheless, voluntary disclosure is not categorically excluded.

For one participant, any regulation of this issue should be dealt with by the arbitration institutions, with the understanding that non-disclosure as a rule should not be penalized, except in particular circumstances, e.g., where the funder interferes in the proceedings. The issue may hence be different where the funder is the lawyer itself.

For this funder, if arbitration institutions take the lead and amend their rules so as to require the disclosure of funding agreements, it would not be averse to such disclosure provided that two preconditions are met: (i) the disclosure requirement applies to all parties involved, whether in presence of a sovereign and whether the funding is operated via an insurer or the lawyer itself; and (ii) the arbitral institution guarantees that this will not affect the arbitration proceedings. In essence, there must be some form of guarantee that the case will not be treated differently because a third party funder is involved.

Another funder called for the "demystification of third party funding", in particular in light of how, firstly, for about a century, insurers were in a similar position as funders without being subject to the same disclosure considerations – even though in most cases insurers were taking the lead on the management of the case, including appointing the legal counsel etc. Secondly, funders play an important role to limit the number of frivolous cases, in that when refusing to fund a given case, this often leads to the claimant abandoning the pursuit of its claim.

Another participant observed that disclosure issues may be different at the various stages of an arbitration and distinguished between two phases: prior to bringing the claim and once the arbitration has started. First, prior to bringing a claim, the parties' agreement is key, the rule being that the existence of the funding agreement shall not be disclosed unless the funder agrees to such disclosure. In some instances, disclosure of the existence of the funding agreement might be beneficial for the funded party. For example, the claimant may want to disclose the existence of the third party funder in settlement discussions, as this may be an asset to bring additional pressure on the defendants to show that it has the financial means to pursue the claim. In such a case, the funder often consents to such a disclosure.

Second, once the proceedings are in place, the decision may be in the hands of the tribunal either because of conflicts issues or because the tribunal wants disclosure of the real player behind the claimant. Funders therefore have to anticipate their possible exposure in arbitral proceedings even where the funding agreement provides for a confidentiality clause. Such disclosure ultimately may be justified in certain circumstances. For this funder, the real issues then becomes how to monitor this disclosure and how much information to disclose. For instance, should only the existence of the funding agreement be disclosed or some of its actual terms? Also, to whom should the disclosure be made, the arbitral tribunal in camera or all parties involved in the arbitration proceedings?

This funder also drew a clear distinction between arbitration and litigation cases, arguing that regarding the former category, the parties' agreement governs the issue of disclosure and should only be disregarded in cases of possible conflicts of interest between one of the arbitrators and the funder. In this context, another funder expressed being very mindful of potential conflicts, in particular when dealing with arbitration boutique firms in which a lawyer may act as counsel in a funded claim that represents a significant percentage of his or her firm's revenues, while also acting as an arbitrator in a dispute in which one of the parties is financed by the same funder.

Based on these comments, the point was raised that there appeared to exist a baseline preference for non-disclosure of funding arrangements coupled with a suspicion that disclosure could adversely influence a tribunal. One funder referred to the recent *Fuchs and Kardassopoulos v Georgia*<sup>6</sup> case as an example to show that disclosure may lead to what the funder perceived as frivolous defences that raise the cost of the proceedings. According to this funder, arbitrators may not be in a position to guarantee that the existence of a third party funder in a case would not, in fact, change the nature of the case.

### ***Terms of Funding Agreement***

*Termination for Material Breach* – All of the funders include clauses relating to the termination of the funding relationship in their contract. A majority of them emphasised that termination clauses are included to protect them where there is no full and honest cooperation by the client. Another funder explained that termination is envisaged also in cases of material changes in circumstances. Two funders reported including penalty clauses in funding agreements in order to determine in advance the amount due by the client in case of a breach of one of its obligations under the funding agreement. For another funder, the remedies will be those set out by the governing law. Finally, one funder stated that a key question remains as to how to terminate the funding agreement while providing for sufficient protection for the funder itself and for the client (e.g. the client's ability to pursue the claim).

*Governing Law and Dispute Resolution Mechanism* – Funders do not always submit their funding agreements to the same applicable law, and it may well differ from the seat of the arbitration proceedings. Three participants listed the law where their offices are located as a possible choice of law. While some funders consider UK law or US law, in particular New York law, to be possible choices, another funder made it clear that it would always prefer to avoid choosing these as applicable laws to steer clear of champerty and maintenance issues.

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<sup>6</sup> In *Fuchs and Kardassopoulos v Georgia* the claimant's claim was funded by Allianz Litigation Funding, whose existence was disclosed to the arbitral tribunal. The defendant argued that it should not be liable for the claimant's costs on the basis that those legal fees had allegedly been met by an undisclosed third party. The tribunal ultimately held that the existence of a funder did not affect the recoverability of costs from the losing defendant and ordered the defendant to pay the claimant's legal costs for an amount of USD 8m.

All of the participants spoke favourably of using German law, even where, as one explained, the proceedings are taking place in a common law jurisdiction. For two of the funders, German law is seen as protective of funding agreements in particular against challenges based on the champerty principle. One other funder added that Germany has also developed what the funder believed to be an extensive collection of case law on third party funding over the years, which makes its legal regime more predictable.

In terms of dispute resolution mechanisms, one of the funders described using arbitration clauses, always specifying the place of arbitration, and expressed being disinclined to use mediation clauses. Another funder either provides for dispute resolution clauses in favour of the courts of the place where it has offices or an arbitration clause.

### ***Repeat Business***

The last issue raised during the course of the roundtable related to whether funders rely on repeat business. For two of the funders, cases mainly arrive via referrals from law firms with which they have ongoing relationships, while another bases its business on a combination of law firm referrals and relying on a wide client base that consists of various multinational companies. This participant specified that it relies less on repeat business, as one client is unlikely to be a candidate for funding on a regular basis. Regarding law firm referrals, one funder explained that it has established key relationships with a few law firms, permitting it to have a fair amount of repeat business with a certain guarantee of quality. On the contrary, another funder reported having relationships with about 200 law firms and specified that these law firms provide for 80% of the funding requests it receives.

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This roundtable allowed for the gathering of fact-specific information from funders on subjects that are rarely expressed openly. Particularly striking was the diversity in the views and policies expressed by the funders' in attendance, revealing a variety of types of third party funding businesses amongst the participants. The discussions between funders and other participants also raised certain underlying legal and ethical issues, which will be the subject of the next roundtable organised by the International Business Law Journal in the second quarter of 2012.