THIRD PARTY FUNDING[1]

Clifford J. Hendel

ABSTRACT

En este artículo se aborda el concepto y la evolución del "*Third Party Funding*", o financiación de gastos de litigio por terceros, en particular, entidades financieras especializadas en el área. Analiza el génesis y la acogida actual de esta práctica y reflexiona sobre las consecuencias de su previsible mayor implantación en el mercado legal global y en particular en el mercado ibérico. El artículo describe el TPF como una muy interesante y poderosa herramienta que – a pesar de las cuestiones complejas que la rodea – está destinada a ser un "producto" o alternativa de gran utilidad para clientes en una amplia gama de controversias, especialmente en arbitrajes internacionales.

SUMMARY

I. INTRODUCTION

We lawyers are an odd lot: When we are busy, we focus exclusively and obsessively on our work and on our clients, bursting with the self-confidence and self-importance inspired by our excessive workload, which we deem to be unmistakable and objective proof of our unequalled professional merit. When we are not busy, we fritter away our time (secretly doubting that its hourly units are really as precious as we hold them out to be during our busy periods). Wallowing in the despair inspired by our decreased workload, we convince ourselves that this

[1] The author is indebted to a number of leaders of the TPF industry and of the profession for their assistance in providing him with most of the documentation on which this article is based. Thanks are particularly in order to Susan Dunn, co-founder of Harbour Litigation Funding Ltd, Christopher Bogart, Chief Executive of Burford Capital Limited, Prof. Doug Jones of Clayton Utz, Prof. Laurel Terry of Penn State Dickinson School of Law, John Gosling of Addleshaw Goddard and Peter Rees Q.C. of Royal Dutch Shell.

is unmistakable and compelling evidence of our extreme professional ineptitude. In both cases, our heads spend more time, ostrich-like, in the sand than they should.

A consequence of this perverse situation is that we are often blind to important changes in the world in which we and (especially) our clients live and work. Changes which in many cases could provide opportunities for our clients (and thus ourselves) to live and work better.

One such change is the rise of third-party funding of litigation[2] or TPF. TPF involves the funding of litigation by specialized legal funding companies who are neither parties to the dispute nor closely connected with it. TPF providers' sole interest in and connection with the dispute is the "mercenary" or capitalistic aim of making a profit. TPF providers are accordingly differentiable from others who may fund, to some extent, litigations in which they have an interest of another nature, including lawyers, unions, consumer organizations, insurers, legal aid groups, political or other interest groups. TPF is an intriguing and powerful innovation or "product"[3] which may be of material assistance to clients in a broad range of disputes, particularly in international arbitrations (carried out, as they are, with a significant, if not total degree of independence from the constraints of national judicial systems). Unfortunately, TPF has escaped the attention of the great majority of "head-in-the-sand" practitioners (including, but for a chance encounter at a recent conference, the author)[4].

In the expectation that the topic is similarly new to the vast majority of readers of this journal, this article aims to provide a basic understanding of the TPF concept and its possible consequences if - or more accurately, as - it is introduced into the Iberian legal/business market[5], with particular emphasis on the prospects for TPF in the area of international arbitration.

II. THIRD-PARTY FUNDING – AN ALTERNATIVE TO "THE GOOD OLD HOURLY RATE"[6]

TPF substantially increases the traditionally available options for financing the cost of litigation, these being:

[2] The term "litigation," except where specifically referring to court proceedings, is used in this article in the broad sense of contentious matters generally, thus including arbitration.
[3] The economic genesis and function of TPF bears similarities to all types of financial products and markets, from the swap (off-loading certain economic or financial risks, e.g., interest rate risks, to entities better able and more desirous of bearing them) to sale-and-leaseback transactions (up-loading speculative or residual-value risk of assets such as real estate or commercial aircraft from the operators who use them to provide their services to entities more interested and more able to shoulder such risks): all cases of Adam Smith-like capitalism in action. Not surprisingly, given the nature of the product, all or virtually all of the founders and principals of the leading TPF providers today are former (and very experienced) big-firm litigators, rightfully referred to in the September 2010 issue of The ABA Journal as comprising "a new class of lawyer-entrepreneurs."
[4] A principal of one of the leading TPF providers focussing its energies on the U.S. market was quoted in the June 8, 2010 issue of The New York Law Journal as saying "The industry's biggest enemy is unawareness, [a]nd most of the lawyers in the U.S. are unaware of it."
[5] The novelty of the product in the Iberian market should not be overstated, and perhaps should not be judged solely by its frequency of mention in the literature. While, as discussed below, the product has been principally developed and utilized to date in English-speaking jurisdictions, the author is aware that it has been used on at least one or two recent occasions in Spain, as well as having been touched upon in the recent literature. See, for example, Anne-Carole Cremades, *La Falta de Recursos Económicos Para Participar en Arbitraje*, 8 Spain Arbitration Review, 162-163 (2010), and other materials cited in Part VI of this article.
[6] The expression is used by Susan Dunn in "*Paying for Litigation – A "New" Option*"; Butterworth's Journal of International Banking and Financial Law, May 2007. The summary of available options for paying the costs of litigation set out in the text immediately below paraphrases the introductory portion of the Butterworth's article.

ARAOZ & RUEDA

-paying the standard hourly rate of the lawyers involved, as well as all other costs (expert's fees, court (or arbitral)-costs, travel and related costs, etc) incurred in the matter[7]; and

-entering into, so long as permitted by applicable law and/or professional regulation and accepted by local practice, contingency or conditional fee arrangements[8], where a portion of the risk of the result is shifted to and borne by the lawyer[9].

It hardly needs stating that clients are more and more reluctant to agree to pay hourly rates without some manner of cap or collar to keep them within predictable budgetary parameters (any general counsel facing a potential contentious matter and not sharing these concerns is heartily encouraged to read no further and call the author without delay). Similarly, it hardly needs stating that lawyers, especially litigators, remain reluctant to agree to such caps or collars since the trajectory, longevity and demands of any matter, especially a contentious matter, are inherently unpredictable and the number of variables that could upset the most finely-crafted budgetary prediction render the exercise a mere "shot-in-the-dark."

Where permitted and accepted in the marketplace, contingency or conditional fee arrangements are partial solutions to the problem, at least in respect of legal fees. But such arrangements only go so far, and in any event do not address the other items of cost referred to above; e.g., the level of arbitrators' fees in an international arbitration, which on occasion can approach counsel's own fees. Very few lawyers are prepared to "finance" (more than on a rather limited basis) their clients' business or litigation needs: this is simply not our business and involves risks which we generally do not want (and, more importantly, do not need) to take.

Moreover, in some respects conditional and contingency fee arrangements can actually exacerbate the problem: for example, in current English practice (possibly to be changed as a result of the report referred to below), success fees in permitted conditional fee arrangements are payable by the losing party as part of costs, thus increasing the exposure faced by the litigant. "After the event" (or ATE) insurance premiums, contracted to cover an eventual cost award, are similarly absorbed by the loser in current English practice.

[7] As consumers, many of us tend to use a rule-of-thumb in our private lives with respect, say, to contractors remodelling or building our homes or offices which assumes (at least for budgeting and planning purposes) that the job will take twice as long and cost twice as much as initially-contemplated; oftentimes, even this 100% margin of prudence proves to be insufficient. Few litigators (or non-litigators, for that matter, although the point is particularly apt in the litigation context) will deny – at least in private – that a prudent client should probably apply a similar rule of thumb.

[8] In general terms, contingency or "pure" contingency fees are no win-no pay arrangements in which counsel receives, as a "success" fee, a contractually-agreed percentage of the damages awarded (or agreed in a settlement), i.e., if the matter is concluded favourably to the client, but receives nothing otherwise. A conditional fee typically is an arrangement where counsel offers a discount or "haircut" on hourly rates with the chance to recoup and multiply the discounted amount in the event of a favourable outcome. At the risk of over-generalizing, "pure" contingency fees are generally impermissible in the principal jurisdictions (other than the U.S.), but conditional fee arrangements are generally permitted. In the U.K., "pure" contingency fees are impermissible and a conditional fee arrangement is valid only if the fees ultimately charged, including the uplift, do not exceed twice the lawyer's benchmark or "rack" hourly rates.

[9] TPF is typically available to defendants/respondents as well as to plaintiffs/claimants, limiting and quantifying the risk of losing by, e.g., defendant's/respondent's agreeing to pay up-front to the funder a certain percentage of the amount claimed, in return for the funder indemnifying the defendant/respondent for all costs incurred and the ultimate amount of damages awarded or agreed. Nonetheless, as with contingency and conditional fee arrangements, TPF is much more commonly-seen on the plaintiff/claimant side, so for simplicity of exposition, this article will in general address the matter from their point of view.

ARAOZ & RUEDA

It is precisely here that TPF enters the scene, offering a product which provides a “third way” or option of satisfying a client’s litigation cost concerns: a TPF provider enters into an arrangement with the client (referred to in industry jargon as “the funded party”) pursuant to which the funder agrees to cover all the client’s costs of the case (including, in those jurisdictions – the very large majority other than the U.S. – in which costs follow the event and thus the winner’s costs tend to be absorbed at least in part by the loser). In return, the funder is entitled to a share of the upside calculated either as a percentage (typically 25-50%) of the effective proceeds of the litigation, or as a multiple of the funding provided, or the greater of the two as may be agreed.

This “third way” actually increases the available options by much more than 50%, since the options are not mutually-exclusive. Instead, they can be “mixed and matched,” creating “a smorgasbord of funding options”[10] (in the words of Michael Napier, Q.C., former president the Law Society of England and Wales).

III. <u>AN ABBREVIATED HISTORY OF TPF AND AN EVEN-MORE ABBREVIATED SUMMARY GLOBAL SNAPSHOT OF THE ISSUE TODAY</u>

<u>A Page of History</u>

Legislation and case law in common law jurisdictions have traditionally prohibited –for public police reasons relating to the maintenance of credibility and integrity of the civil justice system –what would today be considered TPF by virtue of the doctrines of “maintenance” and “champetry”, terms which most common law students will likely have heard in their studies and recognize as some sort of outdated medieval tort or crime, but which very few will be able to define or explain with any degree of precision.

Essentially, “maintenance” involves the stirring-up of litigation by providing funding (or what corporation laws might refer to broadly as “financial assistance”) to assist a party to a dispute without the provider’s holding a corresponding and valid interest in its outcome. “Champetry” is the form of maintenance in which the funder is entitled to a share of the proceeds should the funded party prevail.

Over the course of recent decades, the statutory and case law prohibitions of maintenance and champerty have, however, been substantially relaxed in many jurisdictions and outright repealed in others as antiquated relics of a bygone era, reflecting antiquated societal conceptions of litigation. To a certain, perhaps very significant extent, the modern-day relaxation or repeal of these medieval prohibitions reflects an increasing awareness that litigation (i.e., ready access to the courts to defend legal interests and obtain redress for violations thereof) is – while not necessarily and universally “good” – at least not necessarily and universally “evil”.[11]

Today, the concepts of maintenance and champetry are generally of relevance in the TPF area only to limit the extent to which a non-interested party like the funder exercises control of

---

[10] In B. Rigby, “*Behind You All the Way*,” The In-House Lawyer, November 2008.

[11] A fascinating analytical view of the history of the genesis and evolution of common law rules involving investing in lawsuits and the assignment of claims is found in Prof. Anthony J. Sebok’s “*The Inauthentic Claim,”* (unpublished). The piece is a thorough de-bunking of the arguments typically used to restrict or prohibit TPF and the assignment of claims, arguments which the author views as based on an antiquated view that “all litigation is evil,” and in which he concludes, citing a 1936 observation by Max Radin in “*Maintenance by Champetry*”, 24 Cal. L. Rev. 48 (1936) that “There is no necessary and inevitable connection between improper litigation on the one hand and the acquisition by a third party of an interest in a litigated case on the other.”

ARAOZ & RUEDA

the conduct of the litigation. In England, champetry was de-criminalized in 1967. In many U.S. States and Australian territories, the prohibitions have similarly been repealed by statute or significantly relaxed by case law.

The result has been the development, in these countries in particular, of a market and an industry – first perhaps, a "cottage" industry but rapidly becoming something much more significant, solid and sophisticated – with a material number of players (including publicly-listed companies) offering litigation funding and even a number of entities acting as brokers between funders and parties in need of funding.[12]

The Apparent Global Trend Line Today

While not without certain criticism or hesitation, recent promulgations, recommendations, court decisions and legal scholarship in the following three jurisdictions have, in broad terms, and not without minimizing some of the differences in underlying legal rules and practices (such as those addressing contingency and conditional fees and those involving responsibility for costs) have been generally favorable to (or at least, not hostile or patently unfavorable to) TPF.

In England, the seminal document is a voluminous government-commissioned report entitled "Review of Civil Litigation Costs," finalized in December 2009 and released in January 2010 by Lord Justice Jackson (the "Report"). The Report devoted a full chapter to the issue of TPF[13].

The Report cites five reasons to support its view[14] that TPF is, in principle, beneficial and worthy of support. Due to the significance of the Report and the respect it is likely to be accorded beyond England, these reasons are set out in full as follows:

(i) *Third party funding provides an additional means of funding litigation and, for some parties, the only means of funding litigation. Thus third party funding promotes access to justice.*

(ii) *Although a successful claimant with third party funding foregoes a percentage of his damages, it is better for him to recover a substantial part of his damages than to recover nothing at all.*

(iii) *The use of third party funding (unlike the use of conditional fee agreements (CFA's) does not impose additional financial burdens upon opposing parties.*

(iv) *Third party funding will become even more important as a means of financing litigation if success fees under CFA's become irrecoverable [from the losing party, as L.J. Jackson advocates; author's note].-*

(v) *Third party funding tends to filter out unmeritorious cases, because funders will not take on the risk of such cases. This benefits opposing parties.*

---

[12] A partial list of TPF providers (most of which focusing their businesses only on this market) includes Juridica Capital Management Ltd., Burford Capital, Future Settlement Funding, Allianz Litigation Funding, Harbour Litigation Funding, Claims Funding International plc, Juris Capital, Arca Capital Partners, Omni Bridgway and even an arm of Credit Suisse Group; a leading litigation funding brokers is The Judge.

[13] Both the final report and the preliminary report (released for comment in May 2009) are available at www.judiciary.gov.uk/about_judiciary/cost-review/reports.htm.

[14] Footnote 95 of the final report indicates that the support for TPF expressed during the discussion period between the issuance of the preliminary and the final reports was general, but not unanimous, with for example the Young Barrister Committee taking the position that TPF should be prohibited in all circumstances on public policy grounds.

ARAOZ & RUEDA

Interestingly, in what Continental jurists may find a "typically British" approach to the issue, L.J. Jackson advocates that the "nascent" stage of TPF in England makes premature any formal, statutory regulation of the area. Instead, and until the institution is more widely used, he considers as necessary and appropriate a voluntary or self-regulatory code, to which litigation funders would subscribe.

In this regard, the Report reviewed and commented on the then-existing draft voluntary code that had been developed by the incipient U.K. Association of Litigation Funders. His principal comments were to "substantially tighten" the draft code's capital adequacy requirements so as to be better protect the client from financial problems of the funder, and to precisely define the circumstance under which a funder is entitled to withdraw or terminate funding arrangements. In light of his comments, the code was re-worked (although the funder's ability to "walk" out of the arrangement was not amended) and is expected to be published for general use in November 2010[15].

In short, the report, the code and the general ebullition in the English market are reflective of a "nascent" but confident industry with sufficiently firm roots planted in the relevant gardens to augur well for continued growth and market acceptance over the years to come.

In the US, perhaps the leading contribution to the discussion on TPF to date and the best indicator of the generally-favorable but pragmatic view prevailing in the U.S. is the 2010 paper prepared by Steven Garber for the think tank the RAND Corporation entitled "Alternative Litigation Financing in the United States: Issues, Knowns and Unknowns"[16].

Citing what he refers to as the "massive uncertainties" about recent and future effects of TPF on U.S. litigation, he echoes to a certain extent L.J. Jackson in counseling against broad regulation and what he refers to as "one-size-fits-all" policy prescriptions. He also expresses concern about uncritical acceptance of ethical arguments, and counsels wariness about the relevance of the evolution and effects of TPF in other countries on its evolution and effects in the U.S. In so doing, he stresses the importance of national institutional features and legal rules and their effect on the scope of; and prospects for, TPF in a particular jurisdiction. The U.K. and Australia reflect materially differing institutional features and legal rules compared to the U.S., he notes, including (as mentioned) the prohibition of counsel working under pure contingency arrangements, the existence of cost-sharing rules requiring or permitting the loser to pay the winner's legal costs (such costs including in current English practice, as noted above, both the "success" fee earned in a conditional fee arrangement and the cost of ATE insurance premiums), the absence (unlike in the U.S., where such are available in a broad range of cases) of punitive damages, or the relative inexistence of the jury in civil cases (whereas in the U.S., the jury remains the predominant fact-finder in civil litigation).

There are significant contrary views in the U.S.. Perhaps the leading "naysayer" is the U.S. Chamber of Commerce, as expressed in a paper published in 2009. Authored by three Skadden Arps attorneys and entitled "Selling Lawsuits, Buying Trouble", the paper reflects a far less measured, and far less sanguine, position on TPF than does the Rand paper. It begins as follows:

> *Third-party litigation financing is a growing phenomenon in the United States, and it has received much attention of late from both proponents and critics, including practicing lawyers, academics, jurists, and policy-makers. Although third-party funding is not*

[15] The final version is available at www.civil.justicecouncil.gov.uk/files/TPF_consultation_paper_(23.7.10).

[16] A product of the Rand Institute for Civil Justice Law, Finance and Capital Markets Program, the paper is available at www.Rand.org/icj/programs/law-finance/about/.

ARAOZ & RUEDA

> *widespread, it is playing an increasingly visible –and potentially harmful- role in U.S. litigation. If such funding becomes more prevalent, it will pose substantial risks of litigation abuse. This is particularly true in the context of class or mass actions, which are already very vulnerable to abuses.*
>
> *The root problem with third-party litigation financing is that it introduces a stranger to the attorney-client relationship whose sole interest is a financial one. The stranger wants to protect its investment, and its interest lies in maximizing its return on that investment, not in vindicating a plaintiff's rights. Put simply: the stranger's motive is to pursue investment that will generate returns whether or not the claims underlying those returns lack merit. The stranger, like a law firm, is a repeat player in the lawsuit-financing game. But unlike a law firm, the stranger does not have a privileged, fiduciary relationship with the plaintiff. Eventually, then, the stranger's presence will require a relaxation of the rules governing attorney professional responsibility, compensation, and the attorney-client privilege to accommodate these new realities. This relaxation threatens to chip away at- and eventually eradicate- critical safeguards against lawsuit abuse.*

Not surprisingly, the Chamber of Commerce article concludes by advocating the outright prohibition of TPF in the US, or "at the very least," its ban in the context of aggregate or class litigation (where its attractiveness is perhaps most obvious).

The contrast between – on the one hand – the generally-favorable, albeit qualified and pragmatic, view of the Rand think tank paper, which appears on the basis of the materials that the author has been able to access, to be shared in general terms with the majority of those American scholars and observers as well as of bar associations and leaders who have taken positions on the matter, and – on the other – the contrarian views expressed in the Chamber of Commerce paper can be usefully viewed under the (over-simplified but not for that reason essentially inaccurate) prism which splits the U.S. legal profession into two hostile camps, the "plaintiff's (or "trial lawyers`) bar" and the "defense bar" (comprising corporates and their counsel). Paralleling to some extent certain residual dichotomies concerning the views on the current relevance and applicability of maintenance and champerty, these two schools can be characterized as diverging on the question of the fault-lines of access to justice (favored by the "plaintiff's bar") and avoiding frivolous litigation of the "defense bar." Another, simpler explanation for the divergence in views is that the Chamber of Commerce focuses its criticism of TPF on class actions, a particularly-troublesome (and particularly American) matter, whereas the Rand paper is broader in scope. A still simpler explanation (without going so far as to name political party inclinations) would be to associate the former school of thought to left-leaning liberal lawyers and the latter to right-leaning conservative lawyers.

In any event, all indications are that despite the views of the Chamber of Commerce, TPF is here to stay in the U.S. Inevitably, given both the huge size and the specific nature of the US litigation market – with its high stakes, higher costs and (as mentioned above) its class actions, punitive damages and jury trials for civil matters – the US is viewed as the "mother lode" or "El Dorado" of the industry, where literally billions of dollars are at stake on a systemic basis, creating appetizing possibilities for packaging and marketing attractive litigation claim-based investment portfolios.

In Australia, TPF has a longer history than in England or the U.S. and is generally considered to have a particularly relaxed approach to the issue, with clear and solid judicial support for the concept on grounds of increasing or facilitating access to justice. A recent and somewhat controversial High Court case held that even a funding arrangement in which the funders both initiated and controlled the litigation was not invalid on public policy grounds. Australia stakes its claim to be the most TPF-favorable jurisdiction on the globe, and certainly of the three

ARAOZ & RUEDA

referred to in this article (in England and generally in the U.S., where the lawyer owes a dual duty – both to client and to the Court – allowing the funder to take control of a claim would almost certainly run afoul of the prevailing rules, whether cast in terms of champetry, ethical rules, or otherwise).

IV. TPF IN PRACTICE

As is understandable in any relatively new, small and essentially unregulated market, and despite the growing amount of interest generated by the topic (and by the funders themselves, which is equally understandable), relatively few facts and figures are available as to the extent to which, and the types, sizes and general nature of the matters in which, TPF has been and is being used.

Nonetheless, ample useful information as to the actual mechanics or operations of TPF is available on the web pages of most of the significant players in the industry. Set out in the footnote below is the text of two sections of Harbour Litigation Funding's webpage (available at www.harbour/litigationfunding.com) captioned "*How Does The Funding Work?*" and *"What Do We Look For In A Case?"*[17]

Of particular interest are the criteria established for the "vetting" of a case under consideration for possible funding (or, to call a spade a spade, "investment"), being: (i) enforceability, in terms of capacity of the defendant/respondent to pay an eventual judgment/award and the

[17] **How does the funding work?** The time it takes to complete our review process and decide whether to fund your case depends upon the amount of additional due diligence we need to in order to complete our evaluation of your claim. **Step 1** A summary of the case comprising the 4 elements of what we look for in a case is provided by the advisor (not the Claimant) running the matter. We will review that summary and request additional information if the case has passed that initial hurdle. **Step 2** If the case is of interest after a review of any additional information requested, we will arrange to meet with the Claimant and their advisor and enquire more extensively into the background to the claim, its merits, value, timeline and likely costs to trial. **Step 3** In the event the case remains of interest, we will complete a background check on the Claimant and then submit the case for formal approval for funding. **Step 4** In the event the claim is approved, a funding agreement will be entered into with the Claimant which sets out the extent of, and the terms of, the funding. The amount charged for funding will be a factor of the amount of funding required, the value of the claim and when the matter is likely to conclude. Standard funding terms are the greater of a percentage of the proceeds of the action or a multiple of the amount of funding provided at the time the matter concludes. The Claimant will engage its advisors in the usual way, ideally, but not necessarily on at least a partial Conditional Fee Agreement (typically at 50-70% of the advisor's hourly rate with the applicable uplift on success). For funded cases, all bills that have been agreed to be funded, are paid on a monthly basis, throughout the life of the case. **Ongoing monitoring** As the claim proceeds, the advisor provides Harbour with a monthly report on the progress of the case. If successfully concluded, whether by way of settlement or judgment at trial, the proceeds are paid to the Claimant and Harbour in accordance with the terms of the funding agreement. If the matter is unsuccessful, all agreed costs are borne by Harbour.
What do we look for in a case? We look for 4 key elements in a claim. All 4 of these must be satisfied if we are to consider the matter for funding. The demand for our funding is always very high and therefore we must decide which cases best satisfy our criteria, which are: **Creditworthy Defendant:** Does the defendant have the ability to satisfy the claim – what is its asset position and where are those assets located?. **Good Legal Merits:** What are the legal merits of the claim? Merits mean not only a strong case on liability but a clear comprehensible basis for the value of the claim. In addition we will want to know how long it is likely to take for the matter to come to trial or final hearing. The more developed a case is, the better. Written advice on these issues from your legal representative is desirable as it will expedite our evaluation process. **Proportionate Costs:** How much will the claim cost to run? This includes all own side legal and experts' costs and estimated adverse costs through to trial or final hearing. An estimate provided by the legal advisor will be required in order to consider a case for funding. While we do not insist that your advisor works on a conditional fee basis, we will look at a case more favourably if the advisors are prepared to take some risk on their fees because it helps to demonstrate their confidence in the merits of your case. **Experienced Legal Team:** Is the advisor running the claim someone with demonstrable experience in the area of law to which the claim relates? We only fund cases where the representative has such experience.

ARAOZ & RUEDA

location and nature of its assets in the event that it fails to pay voluntarily; (ii) merits, in terms of liability but also of value – typically certain minimum thresholds are required before a funder will dedicate the resources necessary to evaluate a claim for possible funding – and the expected time frame for concluding the case, i.e., realizing the value; (iii) expected costs, including adverse costs to the extent that cost-shifting may be involved; and (iv) the experience and capacity of the legal team running the case.

The "due diligence" on the merits of the case is of course essential, and typically involves confidential review by a panel of independent experts so as to filter out cases that are not likely to prevail. In this regard, it is noteworthy (and of course no coincidence) that not only are the founders or principals of most of the leading TPF providers actually seasoned-litigators and often former partners of blue chip law firms, but they have retained eminent counsel to sit on their boards or advisory/evaluation committees. This would seem to kill two birds with one stone, i.e., use top legal talent to most effectively separate the wheat from the chaff in the cases considered for funding, and – arguably – to co-opt leading lights in the profession so as to strengthen the perception of, and case for, TPF in general.

As should be immediately apparent to counsel, the things that the funder looks for as set out herein – save of course the final consideration, as to which counsel has no doubt – are precisely what we lawyers look at (or should look at) when we take on a contentious matter, particularly when we consider downside protection for the client by means of a conditional or similar fee arrangement involving an hourly rate discount compensated by an uplift in the event of a favorable result.

Anecdotal evidence suggests that funders tend to accept only about 10 percent of the cases presented to them, and logic suggests that the cases presented are generally viewed by the presenter (typically counsel) as of above-average merit. A funder's acceptance of a case comes only after its own rigorous, expensive (reportedly involving expenses of some $ 100,000) and time-consuming (reportedly involving a 2-3 month due diligence) vetting process. This process is presumably more strict and "independent" than the similar process effected by counsel, who on the one hand may have pre-existing relations or familiarity with the dispute or with the client generally so as to "color" his evaluation and who in general simply cannot afford to accept only one case of ten that come through the door. A favorable funding decision is thus a shot-in-the-arm for the funded party and its counsel (whose confidence would not be boosted if an "all-star cast" of evaluators viewed your case so solid as to be willing to "buy into" it?) and a very strong message to the other party as to the limited merits of its case. From this perspective, the vetting process would indeed seem, as TPF defenders assert, to "level the playing field" and achieve the socially salutary effect of helping to bring meritorious cases to justice while filtering out meritless cases.

The potential size and the special financial characteristics of the TPF market make it of great interest to investors.

As to size, the figures are staggering: according to public filings made in 2008 by two of the leading publicly-traded litigation funders, annual litigation revenues for the largest 200 U.S. law firms alone approached $30 billion in that year, while overall US litigation spending approached $80 billion[18]. As stated by a co-founder of a San Francisco-based litigation funder, "litigation is a multibillion dollar industry for which there is almost no private capital…

[18] *"Third-Party Investors Offer New Funding Sources for Major Commercial Lawsuits,"* BNA Daily Report for Executives, March 5, 2010.

ARAOZ & RUEDA

[which is] unique and odd. Most major industries in the US, from manufacturing to high-end services, have a lot of private and/or public investment dollars in them"[19].

As to the nature of the investment and its particular appeal to investors, large-scale litigation – viewed as a financial investment or product, through the eyes of a hedge fund manager or investment banker and not the eyes of a lawyer, in a process said to "bring the discipline of the capital markets to the legal market"[20] – is an asset class of potentially enormous size and with certain uniquely-attractive qualities (wholly untied to interest rates, employment levels, the stock market or any other inherently unstable, purely economic or economic policy matter) which, properly structured and managed ("sliced and diced", in the pejorative expression applied to sophisticated mortgage-related investments to which the principal responsibility for the recent global economic crisis has been ascribed) can be the basis for a fund to offer a novel and attractive product to its investors.

V. TPF AND INTERNATIONAL ARBITRATION

TPF funders may be particularly interested in the potential of international commercial arbitrations as attractive investments, and parties in such disputes may be particularly interested in the opportunities for cost-hedging provided by TPF.

While very little appears to have been written specifically on this issue, it is hard to find fault with the observation of Susan Dunn that "In terms of external funding, there is not much difference between litigation and arbitration"[21]. A short multi-jurisdictional overview published in 2008 by the on-line Global Arbitration Review and entitled "Case Notes on Third Party Funding" reflects a general consensus that there was insufficient practice and precedent with TPF generally and TPF in the arbitration context in particular to permit clear predictions as to the future of TRP in the arbitration context. The participating authors then proceeded to venture predictions, which were frequently inconsistent.

By way of example, the authors of the Australian overview observed that it would be reasonable in their view "to expect that the Australian courts will treat funding of arbitrations in substantially the same manner as funding of litigation[22]." The authors of the French overview, on the other hand, after noting the risk that litigation funding could in certain circumstances become subject to prohibition in France on public policy grounds, observed that they did not "foresee, however, any risk of the validity of third-party arrangements in international arbitrations being seriously called into question[23].

A concise and incisive approach to the issue by Prof. Doug Jones in a 2008 presentation to a leading London-based solicitors firm[24] identifies a number of convincing reasons suggesting that arbitration will be a fertile field for TPF activity. These include:

- the large sums often at stake in arbitrations; the relative speed of resolution of arbitrations; and relative certainty of the calendar for decision;

[19] B. Rose, *"Law: The Investment"*, ABA Journal, September 2010, quoting Mike Guthrie of Corax Capital Partners.
[20] Id.
[21] "Class of its Own", CDR (Commercial Dispute Resolution), Q.4, 2010, Issue 2, p.14.
[22] 3 GAR 1, 2008
[23] Id.
[24] Prof. Doug Jones, "*Third-Party Funding of Arbitration,"* presented at S. J. Berwin's forum on Hot Topics in International Arbitration" held on September 22, 2008.

ARAOZ & RUEDA

- the increased certainty (or at least, decreased uncertainty) of decisions due to the arbitrators' presumed experience, both generally and in the area of the dispute in particular;

- the existence of the New York Convention as providing a much more fluid and reliable system for international enforcement of arbitral awards as compared to the less attractive and less effective available means of international enforcement of judicial decisions;

- the possibility (uncertain as of this date in the jurisdictions under review) that to the extent that the restrictions or prohibitions on maintenance and champetry discussed above continue to have material bearing on the issue of TPF, that they may be nonetheless be considered to have little or no bearing on arbitral disputes due to the inapplicability of the public policy/protection of the national system of civil justice basis for the prohibitions in the court litigation context in the consensual private world of arbitration; and

- the fact that any disputes between the funder and the funded party would not typically be arbitrable and thus would not interfere with or delay the arbitration as they might a litigation with more "global" jurisdiction over the parties and the process than in an arbitration.

As this enumeration makes clear, there are a large number of factors – above and beyond the fact that arbitration is a paying exercise and experienced arbitrators and large arbitrations generate a high level of arbitrators' fees which a court litigation of course would not share – inducing young and growing TPF providers to give particular interest to arbitration opportunities.

The somewhat "virtual" or geographically "non-localized" nature of international arbitration raises certain questions of a practical/regulatory nature which may present special conundrums with respect to TPF. Imagine, for example, an arbitration sited in England (where pure contingency fees are banned) involving one or more parties from Spain (where such are permitted): (can/should the panel award such fees in a costs order? Would such an order have any bearing on an English court annulment action? On a Spanish or other court enforcement action? Or should we just put our heads back in the sand on these sticky points and hope for the best?

VI. TPF IN IBERIA

If little has been written about the question of TPF in the context of international arbitration, less still has been written about its use or potential use in Iberia.

While one observer has perhaps overstated the case by indicating that "commercial third party funding [is]… unknown in Spain"[25] and anecdotal but unreported evidence suggests that TPF has in fact been used on occasion by Spanish corporates, it is clear that the market is extremely thin and the literature extremely limited at present. As noted by a leading international firm in a pan-European survey on the issue, the absence of punitive damages and the presence of public funding for consumer actions may have had and continue to have the effect of limiting the incentive for and scope of TPF funding in Spain[26]. But as the Freshfields survey itself concludes, it cannot be discounted that this situation may change in the light of the increased funding options becoming available… across the rest of Europe"[27].

[25] Prof. Pablo Gutiérrez de Cabiedos Hidalgo, "*Group Litigation in Spain*" (unpublished).
[26] Freshfields Bruckhaus Deringer, "*Class Actions and Third Party Funding of Litigation – An Analysis Across Europe,"* June 2007.
[27] Id.

ARAOZ & RUEDA

Recently, long-standing Spanish prohibitions of "pure" contingency fees were stricken; surprisingly, not by the courts, but by the competition law authorities, who ruled that the prohibition was an impermissible restraint on the freedom of parties and counsel to negotiate fee arrangements with absolute liberty, and thus were in violation of the competition laws[28]. In so doing, certain extremely vague and frankly anachronistic provisions of Spain's "*Estatuto General De La Abogacía Española*" as developed in the "*Código Deontológico de la Abogacía Española*" were overridden, including provisions which required that counsel receive, apart from a contingent amount, at least "some amount sufficient to cover at a minimum the costs of the provision of service [and] constituting adequate, just and dignified compensation therefor"[29].

This relaxation could signal a flexibility and "*laissez faire, laissez passer*" approach to litigation / arbitration funding in Spain; time will tell.

As far as Portugal is concerned, a search of the literature has disclosed only the following mentions in recent market overviews. The first, regarding the permissibility of third party funding in the area of competition law, states that "There is no provision regarding such matter… [but]… it is forbidden for lawyers to share their fees with third parties that did not cooperate in advising the client"[30]. The second, responding to the same question stated in general terms, states that "Parties are free to commence proceeding using third-party funding, based on contractual arrangements. However, the third-party investor is not a party in the proceedings and, therefore, can have no intervention in the same and the allocation of winnings is subject to contractual agreement[31]."

VII. <u>CONCLUSION</u>

TPF is here to stay.

While it may not yet have made its presence felt strongly in Iberian litigation, and may be slow or limited in so doing, due to specific characteristics of such litigation, every consideration of logic suggests that in this area as in so many others, the Iberian legal market, to twist a marketing phrase used for decades in Spain is <u>not</u> really that different from others, just a little slow in picking up on, adapting and implementing practices employed with success in other jurisdictions.

Will TPF become an attractive and frequently-used option in Iberian-related international arbitrations? Place your bets… but only after taking your head out of the sand.

****

ARAOZ & RUEDA

[28] Resolution of the *Tribunal de Defensa de la Competencia* of September 26, 2002, affirmed by the Third Chamber of Spain's Supreme Court in a ruling of November 4, 2008.
[29] Art. 16, *Código Deontológico de la Abogacía (2002)*, reflecting article 44.3 of the *Estatuto General de la Abogacía Española.* See generally "*El Final de la Prohibición del Pacto de Quota Litis", J.R. Rodríguez Carbajo, Diario La Ley, No. 7117, Sección Doctrina, 18 Feb 2009.*
[30] Alves Pereira, Teixeira de Sousa & Asociados, in Getting the Deal Through – Dispute Resolution, Law Business Research (2009).
[31] Sérvulo & Asociados, in The International Comparative Legal Guide to Competition Litigation 2009, Global Legal Group (2009).