Unlocking potential

Steven Friel looks at developments in third-party funding

Singapore has approved third-party funding in arbitration

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By now, in spring 2017, we can all agree that third party litigation and arbitration finance is firmly established globally and recognised as an accepted and valuable tool for facilitating litigation risk sharing and providing better access to justice.

Recent, and very welcome, developments in the world of international arbitration are further evidence of litigation funding's move into the global legal mainstream. In recent months, Singapore has passed legislation to permit third party funding in arbitration, with Hong Kong likely to follow suit shortly. Each of these jurisdictions believes that it would be at a significant competitive disadvantage in the international dispute resolution market if it did not. Indeed, arbitral bodies – including the ICC's International Court of Arbitration – have clearly signalled that third-party funding is a positive force in dispute resolution. These unambiguous endorsements have been applauded by the entire funding community.

The litigation and arbitration finance market has matured, and begun to expand its investor base beyond its historical reliance on high-net-worth individuals and one or two funds. Today, banks and hedge funds are far more willing to invest in litigation than previously. Many now regard litigation funding as a relatively low-risk asset class, given its potentially impressive, non-correlated headline returns. The growing willingness of additional sources of finance to enter the market is, in turn, enabling the litigation funding market to expand.

Given that litigation funding allows both firms and their clients to effectively manage and mitigate risk, there is now growing evidence that at least some managing partners, corporate chief financial officers and general counsel 'get it'. Law firms benefit from the finance, which enables them to take on more contingency fee work. In the corporate sector, litigation funding allows businesses to run claims that they otherwise would not, because they lack either the legal budget or the risk appetite.

For corporates, litigation funding also has an advantage over self-financing from an accounting perspective. Under standard accounting rules, any additional legal expense will be clearly recognised, while the proceeds of any successful claims may well be treated as 'exceptional items'. Litigation funding can remove significant costs from the balance sheet while delivering a steady stream of risk-free returns, explaining why it is increasingly viewed as corporate finance for law.

Litigation funding clearly has much to offer the legal and corporate sector. But we should not lose sight of the important role that litigation funding plays in improving access to justice, ensuring that claimants who may not otherwise have the resources for litigation are able to pursue their case. Litigation and arbitration should not just be the preserve of the wealthy and well-resourced. In fact, litigation and arbitration funding is particularly pertinent in 'David versus Goliath' cases where a smaller claimant takes on a bigger, more powerful defendant. Thanks to litigation finance, all claimants who have valid claims with strong merits are now able to bring their claims to court, irrespective of their size or status.

ALIGNING RISK, BACKING WINNERS

While there is increasing understanding and acceptance of the benefits of litigation funding, there are still many who do not understand when it is appropriate and the benefits it can bring for both firms and their clients. The industry still has a job to do educating key stakeholders.

Arguably one of the biggest myths about litigation funding is that it encourages unmeritorious claims. This is completely wrong, and misunderstands the entire business model of the industry – litigation funders would go bust if they did so to any great extent.

In fact, funders perform a great deal of due diligence before any decision to fund is taken. Credible funders will only back cases – or increasingly portfolios of cases – with strong legal merits. Just as importantly, the litigation funder's due diligence also extends beyond the legal merits of the case to also include the likelihood of the successful recovery of damages, should the claim succeed. This due diligence includes an evaluation of whether the defendant can pay, and whether any judgement is likely to be enforceable.

Litigation funders will always look more favourably on cases where the law firm has some 'skin in the game', and is shouldering some of the risk itself. For example, if the law firm is operating on a contingent or conditional fee basis, the risk is aligned between the claimant, the claimant's lawyers and the funder. In this scenario, all parties are taking some risk, confident that they will benefit from the fruits of any success.

An often overlooked benefit of working with a litigation funder is that the mere involvement of the funder can often encourage the speedy resolution of the dispute. Faced with a well-resourced claimant, backed by a litigation or arbitration funder who has dispassionately assessed the merits of the case and has committed a significant amount of capital on a non-recourse basis, many defendants will read the writing on the wall and agree to settle.

WHERE ARBITRATION LEADS, LITIGATION FOLLOWS

Thankfully, the effect of medieval principles of champerty and maintenance – which precluded litigation and arbitration finance – has been significantly limited in many jurisdictions. In many legal markets, this liberalisation process begins with arbitration, but is then followed by litigation at a later date. For example, in the debate leading up to the decision by the Singaporean parliament to liberalise the rule regarding third party funding of arbitration cases, it was argued that the country appeared to be at risk of losing its status as a leading centre of dispute resolution if the reform did not take place. In this debate, it was also made clear that permitting arbitration funding was likely to be the first step along the road to permitting full litigation funding.

The *Essar v Norscot* [2016] EWHC 2361 (Comm) case of last year has the potential to make a major impact on arbitration and litigation funding. This was a case where Woodsford Litigation Funding backed the successful claimant. The dispute, between two companies operating in the oil and gas industry, was first heard by a sole arbitrator under the ICC Rules of Arbitration. Sir Philip Otton found in Norscot's favour, not only on the merits of the case but also in relation to Norscot's decision to rely on litigation funding. In reaching his decision, the arbitrator concluded that Essar's conduct had been so unreasonable that it effectively forced Norscot to seek third party funding. For that reason, the arbitrator decided that Essar should pay Norscot's funding costs, including the success fee payable to Woodsford. This decision was later upheld by the Commercial Court, who rejected Essar's claim that the award in Norscot's favour should be set aside.

This case is a game changer. As a result of this decision, claimants in international arbitration can now use litigation finance not just to support the funding of their claim but also for tactical reasons. In *Essar v Norscot* the defendant was, in effect, punished for bad behaviour by being forced to pay the claimant's litigation costs.

English courts and tribunals in particular have a long history of using cost sanctions as a way of influencing litigant behaviour. *Essar v Norscot* shows the rest of the world that arbitrators should be using cost sanctions as a way of influencing the behaviour of both defendants and claimants. As a result of *Essar v Norscot*, lawyers and claimants around the world are now considering how to use litigation funding for the tactical reasons that the court effectively endorsed.

FURTHER DRIVERS OF LITIGATION FINANCE

Regulatory reform and judicial endorsement are helping to make litigation funding a viable option in many countries around the world. However, there are also two further – market led – reasons why the use of litigation finance is increasing. The first area of growth is in relation to portfolio funding, whereby funders provide finance for a number of disputes at once. Typical recipients of portfolio funding include large multinational organisations who are involved in multiple similar high-value disputes, and law firms that take on a significant amount of contingency fee business.

The second market-driven driver of change is the growing appetite of litigation funders to support smaller claims. In the past litigation funders focused on claims valued at around £50m to £100m. Now, litigation finance is increasingly supporting claims worth between £5m to £50m, particularly as organisations realise that there are financial options that make the pursuit of claims much more attractive.

All of these factors make it likely that new entrants will continue to be attracted to the litigation funding sector. It will become vitally important for claimants, lawyers and financiers to ask the vital fundamental questions about any proposed funding partner. Do they have a track record of financing successful claims? Do they have the appropriate legal expertise? Do they have access to sufficient capital to see disputes through to their conclusion?

Arbitration and litigation funding has proved itself as a robust business model that creates value for funders, law firms and their clients. There are opportunities for corporate claimants to offset risk effectively and bring claims that they may not otherwise have been able or willing to bring, while lawyers can offer their clients innovative funding options that enable them to win more business and take on more contingent fee work. There are clear opportunities for financiers and investors. However, the hedge funds, banks and high-net-worth individuals that are increasingly looking for opportunities to deploy their capital into litigation funding, need to choose their partners carefully.

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