

An introduction to third-party funding

By Fred Vroom, director. **La Française**

In the absence of a universally-recognized definition of 'third-party funding', the term generally means the provision of finance by a person (corporate or individual) – known as the third-party funder (TPF) – to a party (most often the claimant) to litigation in return for a share of any proceeds obtained through settlement or award/judgment. The TPF will have no prior interest in the litigation, and the financing enables the claimant to pay, in whole or in part, its expenses incurred by way of legal, expert, arbitrator and arbitral institution's fees.



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ABOUT THE AUTHORS

Fred VROOM is a Director of La Française International Claims Collection (ICC) based in Paris, which he joined in mid-2015 to co-manage its expanding activities in third-party funding, following more than 30 years practice in law as an English solicitor and *avocat* in international commerce, finance and trade, and litigation, both in private practice and in banking.

What is 'third-party funding'?

The activity of third-party financing is contractual, not statutory. In most countries where the activity exists, it is not currently subject to statutory regulation. Under French law, for example, a funding contract is probably categorized as being *sui generis*, or composite.

The activity in its modern conception can probably be traced to Australia in class action suits in the 1990s, before becoming an alternative means of litigation financing in the United States (though not in all its states) and in England. Continental Europe followed soon thereafter (in particular, Germany and Switzerland) such that the activity has become increasingly widespread in both common law and civil law countries since 2010. France stands somewhat apart in that third-party funding remains rare in domestic judicial proceedings with respect to commercial disputes – this can probably be explained by the absence of effective judicial sanction against a dilatory party (making it difficult to estimate the duration of the proceedings), the absence of the doctrine of precedent (resulting in legal uncer-

tainty), and the relative ease with which the losing party can appeal to a higher court (adding to the unsanctioned delays already incurred).

Recent surveys by international management consultants and law firms indicate that third-party funding of litigation is rapidly gaining acceptance, probably due to greater awareness and seasoned legal practitioners becoming comfortable with it. This in turn is prompting calls from certain governmental representatives, bar associations and academics for the activity to become regulated – a discussion of that subject is beyond the scope of this presentation. What is certain is that with the increasing number of third-party funders, potential clients stand to benefit from the increasing competition among TPFs.

Third-party funding has developed enormously since the 1990s: most TPF users today do so not by reason of necessity but rather by a deliberate policy of the management to optimize the company's financial resources by prioritizing its use to the company's core business which, with the exception of law firms, is seldom litigation.

In fact, in the context of third-party funding, use of the words 'financing' and 'financiers' is somewhat of a misnomer, since those words tend to denote a lending activity, which is not what most third-party funds engage in – there is no repayment nor interest accrual, and the disbursements made by the funder are without recourse to the client/claimant – indeed, they are without recourse to anybody or anything except possibly to security provided by the client for securing its obligations towards the funder. If the litigation does not lead to an effective recovery, the funder is not remunerated. The activity is thus not one of lending (which is a regulated activity in most Anglo-Saxon and Continental jurisdictions).

What advantages does third-party funding bring to participants in litigation?

Access to non-recourse funding increases the willingness of a potential claimant to seek redress against a wrongdoer in circumstances wherein, without such access, the potential claimant would have felt that the cost of losing would outweigh the benefits of winning. Yet this does not mean that third-party funding fosters the bringing of frivolous claims – rare indeed is the funder willing to back any but the

KEY POINTS

- TPFs provide an alternative means for financing the legal, experts and other expenses of a claimant involved in, or contemplating, international legal proceedings.
- An experienced TPF provides its client with a 'second opinion' of the merits of its case, its likely *quantum*, tactical recommendations, and enforcement management.
- Historically providers of finance to the meritorious though impecunious, TPFs have become an alternative source of finance for perfectly solvent claimants, who benefit by optimizing their treasury resources at no risk or cost.

strongest case, since it is putting its – or its investors' – money at stake. In fact, finding suitable cases is a TPF's greatest challenge: to identify one, it will have reviewed tens of others, if not more.

A TPF does not only provide the financial means for a client/claimant (potential or actual) to pursue its remedies against an alleged wrongdoer: a TPF with an existing track-record (and/or with a management/staff comprised of experienced litigation professionals) also provides the client with the benefit of the funder's experience in similar cases, for example by making recommendations as to an eventual settlement or enforcement strategy. A TPF will be careful not to infringe the exclusive right of lawyers in relevant jurisdictions to the giving of legal advice.

Furthermore, a client/claimant can rest assured that in agreeing to fund, the TPF will be convinced – through its rigorous

assessment of the underlying strengths and weaknesses of the claim, the procedural hurdles, and the availability of evidence, including witnesses – that the case has an excellent chance of being won, and the losses/damages sought will be obtained in a sufficient amount and recoverable in enforcement proceedings against a recalcitrant losing defendant/debtor. Conversely, if the TPF is uncomfortable with the merits of the case or its assessment of the quantum likely to be obtained by the winning claimant, and/or the availability of assets of the defendant/debtor against which the award/judgement could be enforced, the client/claimant will in any event have received a second opinion – and a prudent one – from experienced litigation practitioners – usually free of charge.

Thus, this alternative means for financing litigation can be seen to bring advantages to the participants in litigation:

1. to the client/claimant who has been financially weakened by the alleged wrongdoing of the defendant: by providing the financial means to obtain redress at little or no cost
2. to the client/claimant who seeks an alternative source of finance: by optimizing its cash resources and offloading risk
3. to the client/claimant's legal advisors: by addressing the reluctance of potential clients to initiate and pursue litigation, and by assuring the payment of their budgeted fees and expenses.

What are the best practices to avoid pitfalls?

Given the pure contractual relationship which exists between the TPF and its client, it is essential for the contract bringing them together to deal with at least the following issues:

- (i) full disclosure: the client must undertake to disclose all the facts and circumstances reasonably necessary for the TPF to be able to assess the merits of the claim and the assessment of losses/damages
- (ii) lawyer/client/TPF confidentiality issues
- (iii) avoidance of actual or potential conflicts of interest between the TPF, client, lawyers and/or arbitrators
- (iv) the identification of what precisely the TPF is to fund (lawyers, experts, arbitrators and arbitral institution fees, adverse cost order, security for costs and any miscellaneous other costs) and the budget for each item ♦

