Chapter 2[†]
Overview of Dispute Funding

I. Dispute Funding: An Introductory Overview

As international arbitration continues to grow in prominence and complexity, so do the attendant costs and, consequently, demands from users of the process to find innovative ways to finance their matters.[28] "Whether in favour or against, third-party funding of litigation and, more recently, arbitration, is an undeniable and important reality."[29] Anecdotal reports suggest that the global market for dispute funding – both litigation and arbitration – is currently estimated as exceeding US$ 10 billion and rapidly growing.[30]

The business of law is changing and dispute funding is very much an integral part of the future of the global arbitration and litigation markets. It is amidst this backdrop that an exploration of the interplay between dispute funding and international arbitration is not only increasingly timely, but of the utmost importance. The arbitration community must find a way to balance the increasing business need for innovative approaches to the financing of legal matters while protecting the integrity of the arbitral process and the ultimate enforceability of awards. The aim of this Chapter is to provide a general overview of dispute funding as it relates to international commercial and investment arbitration.

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† This Chapter was authored by James Blick and Erika Levin, with input from other Members of the Task Force.

28. See J. VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure,* International Arbitration Law Library, Volume 35 (Kluwer Law International 2016) pp. 1-2.

29. B. M. CREMADES, "Chapter 12. Concluding remarks", in B. M. CREMADES SANZ-PASTOR and A. DIMOLITSA, eds., *Third-Party Funding in International Arbitration* (ICC Dossier) (Kluwer 2013) p. 153.

30. See Financial Times, "Arbitration academics are living in the dark ages" (19 November 2017) available at <https://amp.ft.com/content/926355de-c941-11e7-ab18-7a9fb7d6163e> (last accessed 1 December 2017). See also Burford Capital's Quarterly Summer 2017 Overview, available at <http://www.burfordcapital.com/wp-content/uploads/2017/07/Burford-Quarterly-Summer-2017.pdf> (last accessed 28 December 2017). (As of Summer 2017, Burford Capital reports that it itself has "over $2 billion invested in and available to invest in the legal market"); CREMADES, "Chapter 12. Concluding remarks", p. 154. ("The New York City Bar Association estimated in 2011 that the aggregate amount of litigation financing outstanding exceeds US $1 billion. Fulbrook management estimated [in 2013] that there is a potential market for claimants in the United States needing financial support in the combined amount of US $8-10 billion.").

A. What is Dispute Funding?

In less than a decade, dispute funding has moved from the fringes of a handful of common law jurisdictions to centre stage in the global commercial litigation and arbitration market. Dispute funding first started in Australia and then migrated to the United Kingdom in the beginning of the twenty-first century. While Australia, the United Kingdom, and the United States are now known to have established and thriving legal dispute funding markets, the practice continues to emerge and grow in new jurisdictions around the world (e.g., Singapore, Hong Kong, China, Latin America, and Europe).[31]

In its simplest form, third-party funding involves an entity, with no prior interest in the legal dispute, providing financing to one of the parties (usually the claimant). Typically, this financing is offered on a 'non-recourse' basis, meaning that the funder has no recourse against the funded party if the case is unsuccessful. Under this model, the funder's recourse for repayment of the capital advanced and return on the capital invested is limited only to the claim proceeds recovered, if any.

1. Rising Demand for Funding

It has been suggested that the rapid expansion of this type of funding was fuelled by the economic downturn in 2008. Many corporations and investors experienced economic instability and were unable to proceed with meritorious claims due to reduced cash flow. At the same time, investors were seeking alternative capital outlets, where returns would not be correlated to traditional markets. It remains to be shown, however, whether there is any real as opposed to coincidental correlation between the 2008 crisis and the expansion of third-party funding in international arbitration.

In recent years, with the rising costs of international arbitrations[32] and the additional number of constraints being placed upon corporate legal budgets, it is not surprising

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31. See C. BAO, "Third Party Funding in Singapore and Hong Kong: The Next Chapter", 34 Journal of International Arbitration (2017, Issue 3) pp. 387-400; M. SECOMB, P. TAN and T. WINGFIELD, "Third Party funding for Arbitration: An Opportunity for Singapore to Lead the Way in Regulation", 16 Asian Dispute Review (2016, Issue 4) pp. 182-188; N. CASADO FILHO, *Arbitragem e Acesso á Justiça: O Novo Paradigma do Third Party Funding* (Saraiva 2017) pp. 1-272.
32. See VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure*, p. 8, fn. 1, citing CIArb Costs of International Arbitration Survey 2011, p. 13. ("Survey of 254 international commercial arbitrations conducted between 1991 and 2010 finding that claimants on average spend GPB 1,580,000 in total, while respondents spend GPB 1,413,000); UNCTAD, Investor–State Disputes, pp. 16-18 ('[c]ontrary to the expectations, it turns out that costs involved in investor–state arbitration have skyrocketed in recent years … costs for conducting arbitration procedures are extremely high') (emphasis original); OECD, Government Perspectives on Investor-State Dispute Settlement, p. 8 ('legal

that the demand for dispute funding has continued to increase. According to Professors Lisa Bench Nieuwveld and Victoria Shannon Sahani:

> "[The] four main forces driving the sharp increase in the demand … [are: (1)] increasing access to justice … [; (2)] companies seeking a means to pursue a meritorious claim while also maintaining enough cash flow to continue conducting business as usual … [; (3)] worldwide market turmoil and uncertainty … which has inspired ... investors to seek investments that are not directly tied to or affected by the volatile and unpredictable financial markets … [; and (4)] third-party funding as corporate finance, whereby corporate entities … enter into bespoke arrangements … as a means of raising capital for general operating expenses or expansion to meet new business goals."[33]

And:

> "The global economic slowdown has also inspired companies facing bankruptcy or insolvency to seek funding to pursue claims that may generate cash flow for their businesses or mitigate the risk of losing a 'bet-the-company' dispute."[34]

Additionally, and not surprisingly, the aforementioned economic situation has increased client pressures upon law firms to deliver innovative solutions, some of which require the use of funding directly by the law firms in conjunction with the offering of alternative fee arrangements, in order to attract legal work.[35]

Rising demand for third-party funding has led to a rather recent boom in supply. In the last few years, a multitude of new funders have entered the global dispute financing

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and arbitration costs for the parties in recent ISDS [investor-state dispute settlement] cases have averaged over USD 8 million')").

33. See L. BENCH NIEUWVELD and V. SHANNON SAHANI, *Third-Party Funding in International Arbitration*, 2nd edn. (Kluwer 2017), p. 11. See also, C. P. BOGART, "Third-Party Financing of International Arbitration", *The European Arbitration Review 2017* (GAR Special Report) (14 October 2016) available at <http://globalarbitrationreview.com/insight/the-european-arbitration-review-2017/1069316/third-party-financing-of-international-arbitration> (last accessed 28 December 2017) ("Litigation and arbitration, [particularly investor-state arbitration], are unduly expensive and frequently inefficient, and those deficiencies interfere with their ability to deliver justice.").
34. See BENCH NIEUWVELD and SHANNON SAHANI, *Third-Party Funding in International Arbitration*, p. 11.
35. See N. ROWLES-DAVIES, *Third Party Litigation Funding* (Oxford University Press 2014) p. 61 at para. 3.08 (Lawyers "are having to be innovative to survive …. The economic climate since the 'Great Recession' which began in around 2008 has caused many, even traditional institutional clients, to look for ways to reduce their legal fees, along with their business costs.")

market. Additionally, the larger, established players are continually raising significant levels of new capital. The growth of the industry shows no signs of slowing.

2. *Why is Funding Sought and by Whom?*

The key participants in the dispute funding process are the claim holders, funders, lawyers and, potentially, funding brokers. Funding may be sought to cover legal fees, out-of-pocket costs (e.g., expert fees, arbitrator fees, arbitral institution fees, discovery-related fees, etc...), or costs associated with subsequent enforcement actions or appeals and may be structured around a single claim or a portfolio of claims. Dispute finance is also increasingly being used by claim holders for other purposes, such as for raising working capital for the claimant entity, discharging other financial liabilities, or financing other litigation (unrelated to the claim against which the financing is secured).

Historically, third-party funding was considered as being primarily a mechanism by which financially distressed claimants could obtain access to justice. However, much of the focus of the litigation finance market today is on the growing corporate utilization of funding by large, well-resourced entities. These entities may be looking for ways to manage risk, to reduce legal budgets, take the cost of pursuing arbitration off-balance sheet, or to pursue other business priorities instead of allocating resources to financing an arbitration matter.[36] Put simply, funding is not only for those that are impecunious. "The use of funding offers the client the ability to minimize risk, does not have any negative effect on their cash flow, and ensures payment of lawyers."[37]

a. Claimants

As noted above, the vast majority of recipients of third-party funding are claimants. At one end of the spectrum, there may be a party that has invested all of its resources into a failed project and funding provides this investor with the only mechanism by which the investor can seek redress from the parties that caused its losses.

Somewhere in the middle, exists a claimant who may be adequately capitalized, but nonetheless is a smaller entity than the corporation it wishes to pursue an action against. In his book, Nick Rowles-Davies provides an example that captures this scenario well.[38] The example involves a mid-size company that has been wronged by a

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36. See C. P. BOGART, "Third-Party Financing of International Arbitration" (Dispute funding "has developed quickly because it allows corporations to unlock the often substantial value they have tied up in unresolved claims, and it allows them to proceed with arbitrations while retaining control of their exposure to loss").
37. See ROWLES-DAVIES, *Third Party Litigation Funding*, p. 62.
38. See ROWLES-DAVIES, *Third Party Litigation Funding*, pp. 63-64 (highlighting a "real life practical example of a mid-sized company deciding whether to embark on a piece of litigation … [against] a much larger competitor.").

much larger competitor and is faced with the decision of whether to spend its capital on vindicating its rights (and unlocking a potential recovery) or allocating those resources to its core business operations.[39] Even if it does decide to self-fund the matter, it is likely that it will be outmatched in resources by its opponent. In the absence of external funding, the claimant would be in an untenable position. Funding allows the claimant to grow its business while pursuing the action in a manner that poses no cash flow burden or risk.[40]

At the other end of the spectrum, large corporations with strong balance sheets are increasingly employing dispute funding as a corporate finance tool that allows them to effectively manage their disputes without negatively impacting their balance sheets.[41] Dispute funding for corporate clients can take on a variety of forms including traditional capital outlay by funders as well as insurance/hedge offerings, which enable clients with good liquidity to mitigate litigation risk without paying substantial returns to a third-party funder.[42] As an alternative to tying up their own capital in litigation or arbitration, corporations can use dispute funding to pursue arbitrations that can help transition their in-house legal departments from cost centres to profit centres.

b. Law Firms

The role played by law firms in the third-party funding market is multi-faceted and evolving. In some instances, law firms, themselves, may be the users of dispute finance. For example, a law firm could seek the use of third-party funding as a way of supporting contingency fee opportunities, as discussed more fully below. In this context, the law firm would approach the funding market directly in order to seek financing options for its own fee risk exposure and enhance its ability to offer alternative billing offerings relative to its competitors.

In other instances, as discussed more fully below,[43] a law firm may effectively act as the provider of dispute finance, for example when offering to act on a contingency fee basis.

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39. *Ibid.*
40. *Ibid.,* at p. 63.
41. "Litigation can be financed – just like any other corporate expense. Yet most corporations still pay for legal costs out of pocket, and that has a profoundly negative financial impact: reducing operating profits, impacting publicly reported earnings, and thus valuation. Litigation finance removes this problem by shifting the cost and risk of pursuing high-value litigation off corporate balance sheets." Burford Capital, "Business Solutions", available at <http://www.burfordcapital.com/what-we-do/for-businesses/> (last accessed 14 August 2017).
42. R. STROM, "Litigation Finance, Sure. Litigation Insurance? UK Broker Seeks US Sales", The Am Law Daily, available at <http://www.americanlawyer.com/id=1202789743668/Litigation-Finance-Sure-Litigation-Insurance-UK-Broker-Seeks-US-Sales?slreturn=20170728074353> (last accessed 14 June 2017).
43. See Chapter 4, at p. 96.

Even where not directly a party to the funding agreement, the law firm's role is often pivotal in a claimant's decision as to whether it should explore the possibility of third-party funding and the approach taken if funding is sought. Although awareness of litigation finance is rising amongst corporate counsel,[44] most claimants rely heavily on their legal advisors for advice relating to third-party funding, the costs and practicalities involved, and which funder(s) or broker should be approached.

Funders therefore cultivate relationships with law firms in order to encourage future referrals. In some instances, even where a law firm is not a direct party to the eventual funding agreement, the firm may still be highly invested in the outcome of the approach to funders. It is not uncommon for a law firm acting for a financially distressed client to invest significant time on a speculative basis in preparing a case for presentation to funders, understanding that it will only be able to recoup that time investment if funding is successfully obtained.[45]

While the majority of opportunities presented to the funding market come via law firms, a growing awareness of third-party funding amongst clients has led to an increased percentage of claimants seeking funding directly, often prior to selecting a law firm (e.g., while still engaging in a law firm tender process).

c. Brokers and Other Intermediaries

As an alternative to approaching the funding market directly, some lawyers and claimants opt to use the services of a specialist third-party funding broker. The role of the broker is to advise on potential financing options, access a broader range of funders, and manage the process. With the ever-growing number of funds operating worldwide, as well as the range of alternative insurance structures available, brokers are regarded as playing an increasingly prominent role in the process of sourcing and structuring dispute finance arrangements. Support from funders can be either through traditional advice or new electronic platforms, which boast increased efficiency for parties.

A broker is usually paid either on an up-front basis, with the execution of the funding agreement, or on a contingent basis, which is correlated to the outcome of the funded case. Depending upon the arrangement, the broker's fees may be paid by the funder or by the claimant.

There are also different types of broker services. Some brokers function as an "introducers" who can introduce the claimant to a sub-set of the funding market. Other brokers function as sell-side brokers who can introduce the claimant to the whole or a sub-set of the funding market, but who acts in the interest of the funders, while still

44. See Burford Capital, "Business Solutions", at p. 15.
45. Given their potential self-interest in any funding arrangement, some legal systems require that lawyers advise clients to seek independent legal advice about the funding arrangement. This Report does not directly take up issues of national attorney regulation, but related Best Practices guidance can be found in Chapter 7, p. 191.

other brokers function as buy-side brokers, who can introduce the claimant to the whole or a sub-set of the funding market, and who represent the interest of the claimant.

In order to establish what type of broker they are dealing with, a party or its counsel should seek disclosure from the broker about how they are remunerated and whether they have access to the whole funding market or just a sub-set of it.

Although arguably on the rise and valuable in navigating the expanding funding markets, some questions were raised in the public comment period, particularly from third-party funders, regarding the use of brokers. Some questioned the extent to which brokers may potentially increase costs or slow down the process of obtaining funding. Other comments suggested that there may in the future be questions about confidentiality and privilege with respect to information shared with brokers.

d. Respondents

While far from commonplace, financing for respondents is evolving and becoming more available. Apart from scenarios where a responding party may either via a counterclaim or a successful defence of the arbitration unlock a significant financial upside, funding for respondents is still relatively rare.[46] The funding of respondents poses challenges with respect to how to remunerate the funder for its provision of capital in the event of a successful defence, while avoiding any potential moral hazards created by the existence of the funding.

One possible option for respondents in situations where they can value their exposure may be to identify a realistic exit point, which, if met, will trigger a payment of some amount to their funders or law firms. Akin to a reverse or inverse contingency scenario, the respondent would pay the funder for some amalgamation of "the amount by which its liability has been reduced, comparing the amount originally claimed with the amount awarded".[47] Although this structure is occasionally referenced, in practice, it does not seem to be commonplace, with only a few such arrangements having been successfully negotiated between funders and respondents.

Of the few examples of respondent-side funding that exist, most involve situations where the funder has an independent financial or non-financial interest in the outcome. For example, in *RSM Production Corporation v. Grenada*, the respondent state was funded by a third party that apparently had a competing interest in the oil exploration rights that would have been awarded to the claimant if it prevailed.[48] In addition, cause-

46. In scenarios like this, a funder could agree to defend the respondent in exchange for a percentage of the proceeds and/or market share that are unlocked as a result of winning the case.
47. VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure*, pp. 48-49.
48. As one commentator describes:

based funding of a defendant has occurred, for example in *Philip Morris v. Uruguay*,[49] where the Tobacco Free Kids Foundation provided funding to Uruguay. Notably, the Uruguay case may not be an isolated example as the Bloomberg Philanthropies and The Bill and Melinda Gates Foundation have launched an "Anti-Tobacco Trade Litigation Fund" to support low- and middle-income countries.[50] It has also been suggested that, similar to what occurs in WTO proceedings, states might fund other responding states, either for political reasons or because they have an interest in the legal issues being decided by the tribunal.[51]

As noted in following sections, the defence of a claim could also potentially be included in a portfolio arrangement.

B. The Dispute Funding Process

1. Fundamentals

The nature, structure, and features of third-party funding arrangements can vary significantly from case to case, as can the process involved in putting the arrangement in place. The vast majority of cases presented to any given funder are rejected by the funder for one reason or another. There are few published statistics available, however

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"It appears from a separate decision in a subsequent case that such third party was a company called 'Global Petroleum'. See Rachel S Grynberg, Stephen M Grynberg, Miriam S Grynberg and RSM Production Corporation v Grenada, ICSID Case No ARB/10/6, Tribunal's Decision on Respondent's Application for Security for Costs (14 October 2010) para. 4.5. Global Petroleum had been awarded the oil exploration rights lost by RSM Production Corporation in Grenada and saw an interest in having the State prevail in the arbitration. See Investment Treaty News (8 April 2010)."

J. C. HONLET, "Recent decisions on third-party funding in investment arbitration", 30 ICSID Review (Fall 2015, Issue 3) pp. 699-712, at fn. 30, available at: <doi:10.1093/icsidreview/siv035> (last accessed 29 January 2018). See *Rachel S Grynberg, Stephen M Grynberg, Miriam. S Grynberg and RSM Production Corporation v. Grenada*, (ICSID Case No. ARB 10/6), Tribunal's Decision on Respondent's Application for Security for Costs (14 October 2010) para. 4.5.

49. *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, ICSID Case No. ARB/10/7).
50. See Bloomberg Philanthropies Press Release, "Bloomberg Philanthropies & The Bill & Melinda Gates Foundation Launch Anti-Tobacco Trade Litigation Fund" (18 March 2015) available at <https://www.bloomberg.org/press/releases/bloomberg-philanthropies-bill-melinda-gates-foundation-launch-anti-tobacco-trade-litigation-fund/> (last accessed 1 November 2017).
51. M. NAGELMUELLER, "Dispute Finance for Sovereigns in WTO Disputes – Access To Justice For Developing Countries", available at <http://worldtradelaw.typepad.com/ielpblog/2017/09/dispute-finance-for-sovereigns-in-wto-disputes-access-to-justice-for-developing-countries.html> (last accessed 12 January 2018).

anecdotal reports, as well as statements made by some funders, suggest rejection rates of 90 per cent or higher. This rate may change with the growing number of funders entering the market, coupled with lawyers and their clients' increasing familiarity with the basic requirements of most funders.

The decision about whether to fund a claim will be taken following detailed due diligence by the funder (often using external counsel, and potentially damages or technical experts), and approval by the funder's board or investment committee. Funders are primarily concerned with the case merits, the economics of the proposed investment (criteria listed below), and the enforceability of any award.

In order for a funder to seriously consider a potential opportunity, there must be an adequate demonstration of a solid claim with a healthy, recoverable margin between the anticipated damages recovery and the anticipated budget for legal fees and costs. The facts, the merits, the parties, and their representatives will all play a crucial role in this calculus. "In addition, the analysis will consider other factors such as: 1) value of the law suits; 2) amount to be advanced; 3) jurisdictional obstacles; 4) defenses; 5) nature and length of the proceeding (including whether arbitration or litigation; venue and applicable rules); 6) possibilities of settlement; 7) creditworthiness of client and the opposing party (particularly with a view to collection prospects); 8) visibility and location of the opposing party's assets; 8) counsel chosen and compensation structure (whether there is a contingency fee agreement in place) or 9) additional obligations of the party to be funded linked to the potential risk of recovery (such as previous funding agreements or any other alliance)."[52]

a. Economics

By far the most common reason for a potential opportunity to be turned down by a funder is not concerns over the legal merits of the case. Instead, when funders turn down a case it is more typically due to concerns that the quantum of the claim (or at least the realistic recovery or likely settlement value) will not be sufficient to justify the level of investment required to finance the arbitration budget.

Funders wish to ensure that the most likely outcome will leave the claim holder with more than a minority share of the recovery. This means ensuring that the combined funding costs (reimbursement of funder's capital and success fee, any contingent litigation insurance premium payable and any contingent fee payment to the legal team) is less than half of the total recovery.

While funders' approaches to this issue vary, many will include a fairly crude economics test in their investment criteria, requiring a minimum ratio between the funding request and a realistic claim value of 1:10. Notably, the 1:10 ratio does not assume a ten-fold return on investment. Instead, return on investment is estimated to be closer to four times the amount invested (including repayment of capital, which is referred to in the industry as a three-fold return (i.e., a return of amount invested, plus

52. B. M. CREMADES, "Chapter 12. Concluding remarks", p. 154.

three times that amount)). The 1:10 ratio instead means that if a funder invests US$ 1 and the claimant recovers US$ 10, the funder can recover its investment plus three-fold return, which will leave the claimant with 60 per cent of the proceeds.

Notably, while three-fold or four-fold return on investment is commonly discussed in the funding industry, even those rates of return are somewhat misleading. Not all cases will win. Consequently, for an investor investing in dispute funding, the actual return on investment is unlikely to be a three-fold return, but instead more likely in actual terms to be a double digit percentage.

It may be assumed that these numbers will leave a sufficient margin to allow for the claim holder to retain more than half of the claim proceeds, after deducting the cost of the funding arrangement. In this vein, most funders tend to be highly conservative when valuing claims and will concentrate on the realistic or likely "floor" value of the claim, as opposed to the maximum potential (but inherently more speculative) claim value.

Funders will also carefully scrutinize the arbitration budget (assuming that the financing is being provided primarily or solely for this purpose). A light or overly optimistic budget may be a cause for concern. While the funding commitment will be limited to a fixed or staged sum, a case which exceeds the budget where there is no pre-agreed mechanism in place to deal with the overrun can be problematic for all parties, potentially necessitating renegotiation of the funding agreement mid-way through the case. Funders increasingly will address this issue upfront, potentially requesting a fee cap or an overrun agreement from the claimant's legal team in order to secure budget certainty.

Ultimately, the most desirable cases are those that have a very high (realistic) claim value as well as a high ratio between the arbitration budget and the quantum of the claim.

b. Return Structures

A dispute funder providing "non-recourse" litigation finance will generally expect to make a multiple return on the capital invested. This reflects both the high-risk nature of the investment as well as the Internal Rate of Return ("IRR") expectations of those that invest in litigation funds. From the claimant's perspective, the funder's return (or success fee) may be structured in a number of different ways. It may be structured as a multiple of the capital invested or as a percentage of the "claim proceeds" (the amount recovered by way of damages or settlement). Some arrangements will involve a combination of these, for example the greater of 3x the capital invested or 35 per cent of the claimant's recovery. By way of illustration, this was the structure and pricing of the funder's return in the *Norscott v. Essar* case,[53] in which the arbitrator accepted

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53. (ICC Case No. 15790/VRO), Award (17 December 2015) Sir Philip Otton sitting as a sole arbitrator in an arbitration subject to the International Chamber of Commerce (ICC) rules made an unusual award requiring that the Respondent be liable for the cost of the claimant's funding arrangement, in addition to the damages awarded. Essar applied to the English Court

evidence that the cost of the funding was reasonable in the circumstances of the specific case in question.

It is also common for the funding agreement to link the funder's return to the duration of the case (or to the amount of capital that has been drawn down), meaning that the funder's return is lower if the case settles early, but rises throughout the proceedings. Such a structure will facilitate early settlement for the claimant, while ensuring that the return to the funder is more proportionate to the actual capital risk taken if the case settles early.

While many funders target broadly similar returns, the differences from a claimant's perspective between different funding offers on a specific matter can be huge, especially where the claim value is high. Fully understanding the commercial terms of any funding arrangement requires, at a minimum, some basic financial modelling in order to calculate the amount that the funder will be entitled to in a range of theoretical settlement outcomes at different stages of the case with different levels of capital deployed. With the growing number of funders competing for business and the ever-increasing diversity and complexity of funding agreements, claimants are well advised to obtain and compare (either directly or with the advice of brokers or independent counsel) multiple funding offers before entering into a funding agreement.

c. Waterfall Agreement

Closely related to the funder's return structure is what is often referred to as the "waterfall agreement" or "priority agreement". This agreement can either be included within the funding agreement or be a separate document, and will usually require execution by all "stakeholders" (i.e., those entitled to a share or contingent payment from any recovery, typically including the claim holder, the funder, the law firm and any insurer providing coverage for fees, costs or an adverse costs award). The waterfall agreement will set out how the claim proceeds are to be divided between the stakeholders. The terms of this agreement can be as important as the return structure when considering the cost of a potential financing arrangement.

d. Risk Alignment

Risk alignment (or "skin in the game" as it is more colloquially referred to) is an important consideration to many funders when considering a potential opportunity. Some funders have a strict requirement that the law firm should assume some element of risk in relation to its fee budget, either by offering a partial contingency fee and/or fee cap or overrun agreement. Even for those funders that do not require this element as a matter of course, a law firm's (and/or client's) willingness to share in the risk and

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to have the award set aside under s. 68(1) of the Act on the ground of serious irregularity, but was unsuccessful in its application.

reward is usually regarded as a positive feature when assessing a potential funding opportunity.

e. Control

The extent to which the funder will assert control over the arbitration and the claimant's decision-making process (e.g., whether, when and at what level to settle the claim) is often a concern expressed by claimants, lawyers, and regulators. In some common law jurisdictions, it can also be an important issue in assessing the legality of the financing arrangement where doctrines of maintenance and champerty still exist.

In reality, the vast majority of third-party funding arrangements are structured carefully to ensure that the funder does not have control over the case or the claimant. In many jurisdictions, this is essential in order to avoid or minimize the risk of a challenge to the lawfulness of the funding agreement. Even in civil law jurisdictions that permit the sale or assignment of claims, many funders still adopt this common law model, although there are also many examples of funds in such jurisdictions seeking to purchase and aggregate (and thus take over control of) claims. This approach is prevalent, for example, in cartel damages claims in jurisdictions such as Germany and the Netherlands, but less common in international arbitration.

However, even where the funding arrangement does not seek excessive control, there are nevertheless certain safeguards built in to protect the funder's investment. A third-party funding arrangement is not an unconditional agreement to fund the case to conclusion. Provision of ongoing funding will be subject to the merits of the case and compliance with the terms of the funding arrangement. Breach of the agreement or a fundamental change in the likelihood of success may entitle the funder to terminate the agreement (and, in some instances of serious breach, may allow the funder to seek recourse for the amount invested). While this does not amount to direct control, if the claimant is financially reliant upon the funder in order to pursue the claim to conclusion, the possibility of the withdrawal of funding may still amount to powerful indirect control.

Related to the issue of control is the question of how actively the funder wishes to monitor its investment. This varies from funder to funder, but it should be assumed that at a minimum, the funder will require reports about the progress of the case, the right to monitor fees and/or approve expenditures, notification of any significant developments (e.g., settlement offers or new information that changes the case outlook) and direct access to the claimant's legal team. In some instances, the funder may play a highly active role, attending client meetings and/or hearings, being copied on correspondence, and providing input on strategic issues. Some clients regard this active involvement by the funder as a 'value added' in terms of budget management and legal, strategic, or technical expertise, beyond the mere provision of capital.

f. Confidentiality/Privilege

Securing funding necessarily requires the sharing of confidential, privileged and, on occasion, highly sensitive information with prospective funders. Ensuring the protection of that confidential information and that any existing privilege is not lost are important issues that claim holders and their advisors must consider before seeking funding.

Anyone navigating the process must balance the disclosure of information required for assessment/due diligence and minimizing the risk of waiving privilege. Certain basic steps, such as entering into non-disclosure agreements before sharing any information and limiting the information shared early on, are fairly standard practice. The concerns and protocols for protecting confidential and privileged information necessarily vary depending on the jurisdiction or jurisdictions involved. In some national jurisdictions, the law is fairly well-established, whereas in others it is still evolving (although generally in the direction of accepting that parties should be able to share information with funders without waiving privilege).[54]

Issues of privilege are particularly complex in international arbitration. Tribunals often use conflict-of-laws analysis to determine which national law applies to the determination of whether a privilege exists. Some international standards are also developing, for example to resolve when different potentially applicable national rules point to opposite outcomes or to determine when waiver has occurred. The Task Force's Principles on confidentiality and privilege are set forth in Chapter 5, and Chapter 6 also includes some guidance on best practices.

g. Conflicts of Interest

The third-party funding market necessarily has to grapple with the issue of conflicts of interest (whether actual, potential or perceived) that arise as a result of the funder's participation in a particular case. The issue of arbitrator conflicts of interest is addressed in Chapter 4, and so will not be discussed at length here.

A related issue is how the claimant's legal team can mitigate or manage potential conflicts of interest arising between its duties to the claimant and its relationship with the funder. While the majority of funded cases proceed smoothly with an aligned interest between the funder and claimant (and legal team), there is always the potential for an issue to arise. For example, under some funding structures, the funder is entitled to a multiple of the capital invested as a priority over the claimant. Under such an arrangement, there is a theoretical possibility that the funder could receive a healthy return (for example, repayment of its investment plus a return of 3x the invested capital), but the claimant receives nothing. Such a structure (while not uncommon) can clearly give rise to tensions when it comes to considering an offer of settlement proposed by the respondent that would produce that kind of result under the funding

54. See *Viamedia, Inc. v. Comcast Corp.* (30 June 2017), [2017] WL 2834535.

agreement. Similarly, issues such as budget overrun, a change in legal representation during the proceedings, or a deterioration in the merits of the case can create situations where the interests of the claimant diverge from those of the funder.

Most of these issues are addressed fairly and effectively through a well-written funding agreement. The most common structure of a third-party funding arrangement is one that clearly demarcates the duties the law firm owes to the claimant and those (if any) owed to the funder. The claimant and the funder enter into an arrangement under which the funder provides the claimant with capital in order to finance the legal fees and costs associated with the arbitration. Under this structure, the claimant's lawyer advises and owes duties only to the claimant (the funder typically having taken separate advice from its own external counsel).

In reality, however, the relationships between funders and law firms are often more complex. It may be for example that the client entered into the funding arrangement as a result of the law firm's introduction to or relationship with the funder. It may even be that the law firm relies upon the funder for financing across a portfolio of matters, which can make it more difficult to avoid or manage perceived conflicts of interest where a disagreement arises between the funder and one of the funded clients in the portfolio.

Many of these issues can be managed through adherence to industry-based best practices (see Chapter 7, below) and careful drafting of the funding agreement. Many of these issues are also subject to national or local ethical rules. In addition, some clients use and law firms recommend the services of independent brokers (or independent law firms) in order to maintain distance from the funder selection process and mitigate any perceived conflict issues.

2. The Process for Obtaining Funding

a. The Approach

The dispute funding market is changing rapidly, with a continued influx of new capital providers, greater competition amongst funders, and an increasing availability of alternative insurance-based structures. Since most clients are not repeat users of dispute funding, it may be increasingly important to rely upon a specialist broker or lawyer with expertise in this area for advice and guidance and to manage the process throughout.

Regardless of whether an independent lawyer or broker is used, any party considering third-party funding for a claim will be well-advised to simultaneously approach multiple prospective funders. This increases the chances of securing funding (as noted above, individual funds reject the vast majority of opportunities presented to them), while creating a competitive process to enable the terms of any funding offer received to be weighed up in the context of any competing offers available.

Once a decision has been made to approach prospective funds with a particular matter, success in securing funding will often depend on careful funder selection based

upon the case profile and specifics, and taking into account each funder's investment criteria, as well as the types of structure and commercial terms sought.

Case presentation is also important. As noted above, funders' investment decisions will be based upon a range of factors. A well-prepared and comprehensive case presentation covering the items listed at section B(ii) above will enable prospective funders to form a preliminary view on the case and move quickly to a decision on whether or not to offer terms.

b. Case Assessment

Each funder's approach and decision-making process is different, as is the speed with which each can move from initial case presentation to execution of a funding agreement. The most common approach is a two-stage process. The first stage involves an initial (usually internal) evaluation of the opportunity by the funder. This evaluation will include an assessment of the items discussed above, such as the case merits, amount of the funding request, claim value, legal landscape, enforcement, etc.[55] If satisfied that the case meets the funder's investment criteria, the funder will make an offer (usually in the form of a term sheet or conditional funding agreement). The offer will usually be subject to the funder completing a second more detailed due diligence process, often using external counsel. Given the time and expense incurred during the second phase, many funders request a period of exclusivity in order to complete this process.

The requirement for exclusivity is not universal, but it is a relatively common practice amongst funders. While it should generally be accepted as a legitimate requirement by a funder about to embark upon an intensive and potentially costly due diligence process, it should also be approached with caution by claimants. Agreeing to a lengthy exclusivity period in a time-sensitive case can be highly damaging if the funding agreement is not executed at the end of the process.

Some funders also employ a third level of review, which requires submission of the claim and the proposed funding terms to an investment committee for a final decision.

55. See M. SMITH, "Chapter 2: Mechanics of Third-Party Funding Agreements: A Funder's Perspective" in L. BENCH NIEUWVELD and V. SHANNON SAHANI, *Third-Party Funding in International Arbitration*, 2nd edn. (Kluwer 2017), pp. 34-38, for a discussion of the valuation of a claim from a funder's perspective, including an overview of a matrix approach employed by Calunius Capital.

c. The Funding Agreement[56]

The funding agreement sets forth the terms upon which the funding is provided to the claimant, including the extent of funding commitment, return structure, rights and obligations of the parties and termination rights.

For purposes of providing an overview, the sample Therium funding agreement contained within Nick Rowles-Davies' book is useful, as is his explanation and those of other authors.[57] However, each funder's standard funding agreement is different and most funding agreements eventually executed by a claimant are individually negotiated and therefore depart from the funder's standard form to some extent. As such, it is beyond the scope of this Chapter to attempt to comment in detail upon the commonalities and differences between various agreements.

However, there are some provisions that are worthy of particular consideration. For example, the circumstances in which the funder may suspend or terminate the funding or potentially seek recourse against the claimant for the amount invested are especially important. The Association of Litigation Funders of England and Wales ("ALF") Code of Conduct envisages the following grounds for the funder seeking termination of the funding agreement (the last of which potentially entitling the funder to recourse for the capital invested to that point):

> "11.2.1 reasonably ceases to be satisfied about the merits of the dispute;
> 11.2.2 reasonably believes that the dispute is no longer commercially viable; or
> 11.2.3 reasonably believes that there has been a material breach of the LFA by the Funded Party."[58]

While on the face of it, these are reasonable grounds for the withdrawal of funding, the manner in which the merits and commercial viability of the claim are to be judged and by whom are significant.

The ALF Code of Conduct requires that any dispute about settlement or termination should be resolved by independent counsel. A dispute resolution clause along these lines is a common feature in many funding agreements (including agreements with funders who are not members of the ALF) to enable a funder to exercise reasonable

56. For a more thorough discussion, please see VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure*, pp. 11-72; SMITH, "Chapter 2: Mechanics of Third-Party Funding Agreements: A Funder's Perspective", pp. 19-38; and ROWLES-DAVIES, *Third Party Litigation Funding*, pp. 120-125, 221-247 (Appendix 1, which provides a copy of a sample Therium Litigation Funding Agreement).
57. *Ibid.* See also M. STEINITZ and A. C. FIELD, "A Model Litigation Funding Contract", 99 Iowa Law Review (2014) p. 711.
58. Code of Conduct for Litigation Funders (November 2016), available at <http://associationoflitigationfunders.com/code-of-conduct/> (last accessed 30 August 2017).

termination rights, while protecting the client from a unilateral and unreasonable decision by the funder to cease funding.

It should also be noted that in addition to the funding agreement, various ancillary agreements may also be entered into as a part of formalizing the overall funding arrangement, such as the so-called waterfall or priorities agreement,[59] a retention or engagement agreement with the law firm, and/or related insurance policies. As noted above, the waterfall agreement is a particularly important document (or section within the funding agreement). It can also be one of the more challenging items to negotiate, given that multiple parties, potentially with competing interests, need to agree to the framework.

II. Other Dispute Funding Models

Although third-party funding has only relatively recently emerged as a distinct industry, it should be viewed in context as one of a number of the alternative ways of financing arbitrations. This Section provides some examples of the other models that exist.

A. Insurance

Insurance is one of the oldest alternative sources of funding for disputes.[60] Liability insurance generally involves funding the "legal representation in any action to defend against liability or recover damages, or to pay any award, order, or judgment against the insured, or both".[61]

There are also specialized forms of legal expenses insurance, sometimes referred to as "before-the-event" (BTE) and "after-the-event" (ATE) insurance. Both forms of insurance are specifically intended to cover the insured's liability for legal fees and costs incurred in relation to litigation or arbitration. Depending on the structure, coverage may be provided for the insured's own legal fees and costs and/or the

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59. See VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure*, p. 34 (The priorities "agreement involves all relevant stakeholders in the claim and stipulates who will receive what in case of successful recovery."); SMITH, "Chapter 2: Mechanics of Third-Party Funding Agreements: A Funder's Perspective", at pp. 24-25 (describing and providing an example of a typical priority of payments structure).

60. J. CLANCHY, "Navigating the Waters of Third Party Funding in Arbitration", 82 The International Journal of Arbitration, Mediation and Dispute Management (2016, No. 3) pp. 222-232.

61. See BENCH NIEUWVELD and SHANNON SAHANI, *Third-Party Funding in International Arbitration*, p. 4.

insured's potential liability for the opponent's legal fees and costs if the claim is unsuccessful.[62]

BTE is taken out to cover the risk of possible future litigation arising. It is sometimes sold as an add-on to other kinds of insurance and is usually limited in the types of dispute covered and the level of coverage provided. It will provide funding for bringing a claim falling within the scope of cover, paying lawyers', arbitrators' and experts' fees during the course of the arbitration. It may also cover an insured's liability for a costs award in its opponent's favour.

A BTE insurer is remunerated through premiums paid in advance (usually annually). It has no interest in the proceeds of an arbitral award, other than (for arbitrations in which cost shifting is ordered) avoiding cover for an adverse costs award and potentially receiving reimbursement of the amount funded. When an insured dispute arises, the BTE insurer therefore has an interest in seeking to minimize its loss by controlling the conduct of the claim as closely as it can. Depending upon the policy terms, this may include requiring the policyholder to utilize the insurer's choice of legal representative.

ATE insurance (increasingly known as litigation/arbitration insurance) is taken out after a legal dispute has arisen and covers the risk that the insured party will be unsuccessful in the litigation/arbitration. The industry flourished in the UK in the early 2000's and was historically aimed primarily at insuring against the risk of fee shifting (liability for adverse costs), although most policies also covered the claimant's own 'disbursements', such as expert fees, barrister fees, court fees etc., on the basis that the law firm would be engaged on a conditional fee basis.

Today, the litigation/arbitration insurance industry is mature and well-established, albeit still niche and highly specialized. Coverage may be provided for the insured's attorney's fees and out of pocket costs as an alternative or complementary option to third-party funding. In addition, in forums and jurisdictions where fee shifting applies, insurance generally remains the most cost-effective way for parties to hedge the adverse costs risk and provide security for costs where necessary. The UK is still one of the largest markets, but the industry is growing rapidly, especially in North America and Asia, but also across Europe. Many insurers are now experienced in underwriting large, complex international arbitrations (both commercial and investor/state). The term "ATE insurance" may be regarded as too narrow when describing the broader global litigation /arbitration insurance market. Whilst it is true that some of the structures, premium pricing, underwriting criteria and policy wordings have their origins in the UK ATE insurance market, the market has evolved significantly in scope

62. BRISTOWS, "Guide to Litigation Costs Funding and Insurance", available at <http://www.zorinlegal.com/fileadmin/user_upload/docs/Litigation_funding_insurance_guide.pdf> (last accessed 31 October 2011); Raconteur Media, "Raconteur on Legal Efficiency", The Times (Supplement) (25 March 2010) available at <http://np.netpublicator.com/netpublication/n89269938> (last accessed 28 August 2017).

and sophistication and indeed many of the present day market participants would not regard themselves as writing ATE insurance.

Litigation/arbitration (including ATE) insurance premiums can be structured in a number of ways. A common model, which is unique to this type of insurance, is a "contingent premium" model, by which the insured only pays the insurer a premium if and when they are successful in the claim (in which case the premium is usually paid out of the settlement or damages award obtained, in a similar manner to a third-party funder's return, although usually much lower in amount).

As the ATE/litigation/arbitration insurance market expands internationally, it is increasingly competing directly with (as well as in some instances supporting and complementing) the third-party funding market. In practical terms, a claimant considering third-party funding as an option may also, in parallel, consider using insurance to cover its legal fees and/or out-of-pocket costs (both historic and future) in exchange for which it will only pay the insurer a premium if it wins the case and collects damages or a monetary settlement. In this form, litigation/arbitration insurance is structurally very similar to third-party funding. The only material differences are that the insurer does not provide day-to-day financing, but instead will pay out on an indemnity basis if the case is unsuccessful. The other important difference is that insurance premiums are typically much lower than the typical return sought by a third-party funder.

B. Loans, Corporate Financing, Equity-based and Inter-Corporate Funding

Arbitrations may also be funded through traditional loans, corporate finance, equity-based investments, or some hybrid. For example, a parent company may make a loan to a subsidiary to enable it to pursue a claim, or the shareholders, creditors or beneficial owners of an entity may provide financial support for the pursuit of a claim which will in turn provide a financial benefit which will flow back to them.

Some types of funding are effectively a form of private equity.[63] There have been some examples of third-party funders taking an equity position in the claimant entity and, as such, gaining control over its investment through traditional corporate governance (i.e., membership on the Board of Directors).

Corporate financing specifically to fund a party's costs in a dispute can raise some of the same issues as third-party funding. Those issues, however, have traditionally been resolved through traditional corporate governance mechanisms and existing rules that govern corporate relationships. For example, the potential for conflicts of interest between an arbitrator and a party extends not only to the party itself, but also to

63. Examples include in *Churchill Mining PLC and Planet Mining Pty Ltd v. Republic Indonesia*, (ICSID Case No. ARB/12/14 and 12/40 (not public) Award (6 December 2016)), and *Crystallex International Corporation v. Bolivarian Republic of Venezuela,* (ICSID Case No. ARB(AF)/11/2) Award (4 April 2016).

affiliates of and entities that have a "controlling influence" on that party.[64] An extended discussion of arbitrator conflicts of interest analysis with respect to such arrangements is provided in Chapter 4.[65]

C. Attorneys as Funders

Attorneys may effectively act as funders when engaged to act on a full or partial contingency fee basis.[66] In either instance, the attorney bears some or all of the cost of the arbitration and assumes the risk of loss. A common structure involves the client financing the out of pocket costs and expenses (either from its own resources or with external financing) with the law firm forgoing payment of some or all its fees in exchange for a share of any award or settlement obtained. However, in some instances, the law firm may also agree to cover the out of pocket expenses, including tribunal fees, in exchange for a larger contingency fee.

This type of arrangement (especially where the law firm pays the out of pocket costs) is conceptually and structurally similar to third-party funding in many ways. It may also produce comparable economics from the claim holder's perspective – the law firm's share of the proceeds for taking a case on full contingency, including covering the out of pocket costs, may reasonably be expected to be similar to the share required by a funder for financing the case in full. Where, as is not uncommon, the law firm and a third-party funder share in the risk / reward (e.g., by the firm forgoing payment of fees with the funder covering the expenses), each party should expect a share of the proceeds which is commensurate with the relative risk taken by each.

Although there are a number of law firms that have amassed significant "war chests" to support contingent fee work, many of the more conservative law firms are not able to assume significant fee risks on large claims. Such firms have historically been more likely to turn to third-party funders. However, developments in the availability of insurance options to enable law firms to hedge fee risk,[67] as well as the rise in law firm portfolio financing is enabling historically conservative firms to take on more contingent fee work, while mitigating fee risk and cash flow concerns.

In addition to traditional contingency fee arrangements, other alternative fee arrangements may divide the risk between clients and attorneys. Examples include a reduced hourly rate, or capped fees, but with a "success fee" added as a bonus if the claimant wins, as well as fee collars, staged fee caps, etc. Such arrangements will often

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64. See IBA Guidelines on Conflicts of Interest in International Arbitration, Guidelines 4.4.2-4.4.4.
65. See Chapter 4.
66. See generally BENCH NIEUWVELD and SHANNON SAHANI, *Third-Party Funding in International Arbitration*, pp. 4-5, for a discussion of how contingency fee arrangements may act as financing.
67. Solicitors Journal, "'Game-changer' for UK litigators with launch of first DBA insurance" (24 May 2017) available at <https://www.solicitorsjournal.com/news/201705/'game-changer'-uk-litigators-launch-first-dba-insurance> (last accessed 28 August 2017).

bear much less resemblance to third-party funding and may in practice represent only a small departure, in risk/reward terms, from the law firm's normal hourly rate model. However, such a fee agreement is still highly relevant to the third-party funding structure. For example, a fee cap which ensures that there is no risk of budget overrun will be a positive feature from the perspective of potential funders and may in some instances be preferable to a discounted hourly rate.

With pro bono lawyering, the attorney may absorb all or most of the cost of representing a client, who is usually indigent or otherwise unable to pay, without any guarantee or reasonable expectation of reimbursement or profit. To date, pro bono representation has been relatively rare in international arbitration, but certain NGOs are active as *amici* and it is plausible they could end up providing representation for certain claims that implicate causes they support. Although it has some similar markers and may raise some similar issues, pro bono representation is not usually treated as a type of "financing" because no money changes hands. But as Bench Nieuwveld and Shannon Sahani point out, "the practical effect of the attorney representing the client without requiring payment could certainly be viewed as a form of 'financing', because the financial burden of legal representation has been shifted from the client to the attorney".[68]

III. Current Trends and Evolution of Funding Models

The rising global prominence of dispute funding has led to some jurisdictional liberalization and a re-analysis of the status of champerty and maintenance in a number of jurisdictions,[69] with some notable exceptions, such as Ireland, where the Supreme Court recently held that third-party funding was unlawful on the ground of champerty.[70]

In its modern incarnation, dispute funding has the ability to transform a legal claim into a financial asset, which can potentially be monetized or used as collateral in order to secure finance. At present, dispute funding is moving more into the realm of corporate finance, with increasingly diverse and sophisticated options becoming available.

At the same time, the global third-party funding market is growing exponentially, both in terms of the number of funds operating, and in terms of the amount of capital available. However, when it comes to individual dispute funding, many funders have

68. See BENCH NIEUWVELD and SHANNON SAHANI, *Third-Party Funding in International Arbitration,* pp. 4-5.
69. For example, *Arkin v. Borchard Lines Ltd and others* [2005] EWCA Civ 655; see also Hong Kong Legislative Council's 2017 amendments to the Arbitration Ordinance (Cap. 609), Part 10A (ss. 98E-98W) abolishing the doctrines of champerty and maintenance for arbitration.
70. *Persona Digital Telephony Ltd & ors v. The Minister for Public Enterprise & ors* [2017] IESC 27.

similar appetites and underwriting criteria, meaning that in some jurisdictions, the market is become increasingly crowded, forcing funders to compete more aggressively for opportunities and explore alternative ways of deploying capital. What follows are some examples of the ways in which the market is evolving.

A. Portfolio Funding

Portfolio funding is gaining prominence as an alternative to financing on a case-by-case basis and is an approach that many funders now actively promote. A portfolio arrangement can be structured in many ways, but there are two major types of arrangements: (1) finance structured around a law firm, or department within a law firm, where the claim holders may be various clients of the firm; or (2) finance structured around a corporate claim holder or other entity, which is likely to be involved in multiple legal disputes over a relatively short period of time.

Structuring finance around multiple claims under either model usually involves some form of cross-collateralization, meaning that the funder's return is dependent upon the overall net financial performance of the portfolio as opposed to the outcome of each particular claim. This type of structure may enable the entity (e.g., the law firm or corporate client) to secure third-party funding more quickly, on pre-arranged terms, and, depending on the structure, the ability to benefit from the overall success of the portfolio. Additionally, there may also be economic benefits to this approach – if the funder's risk is spread across multiple claims, this should in turn dictate a lower cost of capital for the funded party (although this does not always materialize in practice).

From a corporate claim holder's perspective, portfolio financing offer some interesting options, such as the possible inclusion of some types of cases within the portfolio that would not ordinarily be capable of being funded on an individual basis (e.g., defence or non-monetary cases). This is possible because the funder's return is collateralized by the claimant cases within the portfolio. Such a model may also enable the corporate claimant to monetize the portfolio, drawing capital secured against the dispute portfolio to utilize not just for financing legal expenditure but for other business purposes and/or to declare as profits.

A law firm portfolio may be structurally similar, where the finance is provided to support a law firm's contingency fee portfolio, with the funder's return pegged to the law firm's success. Again, such a model potentially allows for the law firm to draw capital more flexibly than a single case funding scenario, as well as enabling, for example, fee overruns on one case to be offset by another case that is operating below budget. Under the above model, the funder may have no direct contractual relationship with the law firm's clients, as the portfolio funding agreement is only between the law firm and the funder.

An alternative variety of law firm portfolio (which may exist alongside the structure described above) is one where the law firm's clients enter into individual funding agreements with the funder, but the terms of those agreements and/or the process for putting finance in place is dictated by the law firm's wider arrangement with the

funder. Such arrangements are arguably not portfolio arrangements as defined above, as it is unlikely that cross-collateralization would be possible amongst the funded cases. (It would be surprising for one claimant to agree that some portion of its claim proceeds should go to offset losses suffered by another unrelated client of the firm.) Such arrangements can still offer clear benefits to the law firm, if for example the funder offers an expedited due diligence process, pre-agreed funding terms, etc. However, such arrangements do create potential conflict of interest issues, which law firms need to navigate carefully.

B. Going Beyond Financing Legal Cost

Another developing area with respect to the litigation finance market is the increasing willingness of funders to consider (and in some instances, actively pursue) opportunities where the funder's capital is to be used for a purpose other than solely financing legal fees and costs. For instance, funders are providing working capital to the claimant entity during the life of the proceedings, providing financing to enable the claimant to discharge pre-existing liabilities or simply providing an advance on the damages to the claimant. Such structures are substantially similar to "traditional" third-party funding, in that the funder commits to provide a certain amount of capital with the funder's return tied to the success of litigation or arbitration. Using this model, a claim holder can use the claim as an asset in order to raise capital for a variety of potential purposes.

In the early life of the market, this structure was viewed by many funders as unattractive. Where offered, it was usually only relatively modest in sum and incidental to a larger funding provision for legal costs. However, as the market has become more competitive, funders are increasingly seeking to differentiate themselves and offer alternative applications for their capital, including in some instances inviting prospective clients to consider third-party funding not only as a means of financing their litigation but simply as a way of raising capital on a non-recourse or limited recourse basis.

That said, the practical availability of such arrangements should not be overstated. Whether a deal is capable of being structured in practice depends upon a large number of factors. The dynamics of such arrangements may be unattractive. For example, if the majority or entirety of the funder's committed capital is to be drawn on day one, this may be a significant departure from the traditional litigation finance economics, where the funder expects its funding commitment to be gradually drawn down during the life of the proceedings. This may entail a greater cost of capital to the funder and therefore less favourable funding terms.

Additionally, there is the problem of the case itself. If the claim holder wishes to use the claim to raise capital, it is likely that they may also require financing for legal costs. In such a case, the overall funding commitment will be materially larger than it would have been if the funding was limited solely to the arbitration budget, therefore requiring a much larger claim value in order for the arrangement to work. Funders will

be wary of a deal that puts too much cash into the client's pocket upfront or too heavily erodes the client's expected net recovery, because of the risk that the client may lose interest in the outcome of the case and not commit itself fully to maximizing the chances of success.

C. Equity Financing

As noted above, under the traditional model of dispute funding, the funding commitment, the expected level of return, and the terms of the investment are set out within and governed by contract (e.g., the funding agreement and/or a waterfall or priority agreement that sets out the distribution of any recovery). However, if the claim holder is a special purpose vehicle ("SPV") or entity with no other material assets other than the claim in question, the third-party funder may be able to structure its investment and return by purchasing equity in the claimant entity. Under this model, the funder's return is derived from distributable profits generated from the success of the arbitration, as opposed to a contractual return. Such a structure may offer a number of potential benefits. It may, for example, enable the funder to take greater or total control over the litigation without running afoul of champerty restrictions. For example, it has been expressly recognized by the Irish Supreme Court that structuring investment in this way would not be deemed to be champertous, whereas third-party funding would be.[71]

Furthermore, owning a stake in the claim holder may enable the funder to be brought within the circle of privilege, allowing the funder access to all privileged information without concerns about a potential discovery application for information shared with the funder.

D. Assignment/Sale of Claims

There are many situations where the outright sale of the claim may be preferable for both the claim holder and the funder to the 'traditional' third-party funding model. A claim holder may view lengthy arbitration (or litigation) proceedings as a costly and time-consuming nuisance and would prefer to transfer the rights to another party in exchange for an immediate payment of cents on the dollar. From the funder's perspective, having total, unfettered control of the claim (including, in particular, control of settlement decisions) may be highly desirable.

In common law jurisdictions, the outright sale or assignment of claims may not be permitted. In jurisdictions where champerty still exists, funders may be prohibited from taking control of another party's litigation in this way. The traditional definition of third-party funding in common law jurisdictions will therefore typically describe the

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71. *Persona Digital Telephony Ltd & ors v. The Minister for Public Enterprise & ors* [2017] IESC 27.

arrangement as an investment in the claim holder's litigation in exchange for a financial interest in the outcome,[72] as opposed to an outright sale.

However, as noted above, in some civil law jurisdictions, funders may adopt a model where the claim is simply purchased outright and pursued by the purchaser, possibly aggregated to other similar claims in order to produce costs savings. The market for the purchase and aggregation of cartel damages claims in Germany and the Netherlands is a good example of this approach. To date, there are few examples of international arbitration claims being arrogated in this way.

In the UK, the exemption for liquidators allows the assignment of claims to other parties. This option has led to a rise in the practice of funders offering to buy claims arising in insolvency rather than fund the claims directly. The structure may involve an upfront purchase price (allowing an immediate distribution to creditors), a deferred structure where the funder pays a share of any amounts recovered to the insolvent estate, or a combined part upfront, part deferred payment structure.

E. Enforcement Financing

By definition, the non-recourse litigation financing model requires the funder to accept both what may be described as "dispute risk" (i.e., the risk of an adverse ruling or award) and enforcement or collection risk. In other words, in order to see a return on invested capital, the funded party must not only win the case, but must also successfully enforce the award.

Traditionally, many third-party funders have been more comfortable assessing litigation risk than enforcement risk, which is perhaps a reflection of the fact that most third-party funders are managed by former lawyers. In the early stages of the market's development, it was common for funders to simply turn down cases where enforcement was likely to be challenging due to the lack of identifiable, locatable assets. However, as the market has developed, funders have recognized that many of the largest and potentially most lucrative disputes might require an acceptance of material enforcement risk.

Today, many funders have in-house asset-tracing and enforcement capability, and may seek to differentiate themselves on that basis. Similarly, there are a number of funders that originally started out as award enforcement or debt recovery agencies, but have gradually embraced opportunities to get involved and finance contested claims at earlier stages in the arbitration process and now finance contested claims. Some such funders may now be known generally as third-party funders, even though their businesses may pre-date the modern third-party funding industry. Others may not describe themselves as third-party funders, but nevertheless offer similar structures.

In practice, enforcement financing may be expressly or implicitly built into an agreement to fund an arbitration claim on the basis that the funder will not see a return until the award is successfully enforced. Funders will also often consider enforcement-

72. See ALF Code of Conduct for Litigation Funders (November 2016).

only opportunities, where an award has already been obtained and the claimant seeks financial support and/or expertise to secure collection. Enforcement financing is therefore a necessary component of third-party funding and something which most funders today provide, albeit with different risk appetites and levels of expertise.

F. Assignment/Sale of Awards

Related to the purchase of claims (discussed above) is the market for the purchase/assignment of awards and judgments. This practice is permitted in most jurisdictions and pre-dates modern concepts of third-party funding. Many of the funds that operate in this space would not consider themselves to be third-party funders, however many third-party funders will also consider such opportunities. Like claims sales, the sale of awards can be structured in a number of different ways, from a simple upfront purchase price to a payment which is in whole or in part based upon the amount collected.

IV. Conclusion

In the last decade, the global dispute finance industry has grown beyond all recognition and continues to expand, both in terms of the number of funders operating and in terms of the amount of capital raised and deployed. This market growth has gone hand-in-hand with rising awareness amongst the legal community. There are few arbitration attorneys that are not at least aware of the basic premise of third-party funding, and there is an ever-growing proportion that have first-hand experience of the market.

Much of the focus of the larger dispute funders today is on encouraging greater corporate use of such forms of finance. While historically third-party funding was considered an option of last resort for financially distressed claimants, funders are today increasingly encouraging corporate entities with strong balance sheets to use dispute finance as an alternative to tying up their own capital in litigation or arbitration. The idea and advantages of off-balance sheet litigation and turning in-house legal departments into profit centres are well-established.

While the market is becoming more diverse, the larger funders have tended to follow a relatively similar pattern. They commonly seek primarily to invest in a relatively small volume of very large commercial disputes and portfolios. The amount of capital committed to each investment tends to be in the millions of dollars, the claim values in the tens or hundreds of millions (or more), and the funders are expecting to make a multiple return on the capital invested in successful cases.

Investing in this profile of cases with the levels of financial risk involved tends to necessitate both high rejection rates and detailed due diligence. While many funders advertise speed of execution by comparison to their competitors, the reality is securing funding can be a lengthy and complex process. More streamlined options for financing

smaller to medium-sized claims are still limited in many jurisdictions, although this is an area which is gradually attracting interest from the dispute finance market and is expected to continue to develop in the next few years.

The growing number of funders has already produced and should continue to yield positive developments for prospective users of dispute funding, requiring funders to compete on speed and cost of capital in order to win business and meet target capital deployment levels.

Third-party funding must also be seen in the context of the wider arbitration finance and risk management market. As noted above, law firms may play an increasingly prominent role in this regard. Currently, some historically conservative firms are using external finance and insurance to support development of contingency fee portfolios. As more innovative financing solutions become available to law firms, potentially with lower capital costs than traditional third-party funding, law firms and funders may also start to compete for opportunities.

In addition, the dispute risk insurance market is developing rapidly, growing in prominence and expanding into new markets and jurisdictions. These insurance options are now being presented by lawyers and brokers alongside third-party funding as part of a broader discussion about the potential options available to finance or de-risk arbitration.