Litigation funding – the highs and lows

Is litigation finance just fool’s gold? And will Brexit create more uncertainty? Jason Yardley, partner at law firm Jenner & Block, talks to Alt Credit

Investors will be aware that the litigation funding industry is having something of a moment. Funders are now larger and more specialised, and are exploring new destinations for their capital.

Litigation funding is now well-established in the US, Europe and Australia, and is rapidly expanding in Hong Kong, Singapore and elsewhere.

Capital is flooding to the sector. In December 2018, Burford announced that it had secured $667m from an unnamed sovereign wealth fund, taking its capital resources to $1.6bn. More recently, Therium announced it has built a $1.07bn war chest, again with contributions from a sovereign fund. Harbour has raised over £750m of capital commitments. Funders report significant interest in IP disputes, follow-on competition actions and investor-state arbitrations.

The industry is increasingly visible to investors. Litigation Capital Management and insolvency-specialist Manolete Partners both floated on AIM last year, and Burford now has one of the largest market capitalisations on the junior market.

Several other investment firms, such as Fortress, have also moved into litigation funding.

The growth of this industry, however, has not all been plain sailing. Juridica, another funder, floated in 2007 but delisted and entered voluntary liquidation in December 2018, following some unsuccessful investments.

Calunius announced in December 2018 that it would not invest in new cases and had no plans to launch another fund. Others have lost out trying to navigate a legal landscape with which they may be unfamiliar.

What, therefore, are some of the common issues and pitfalls that a would-be litigation funder should be aware of?

Champery and maintenance

Historically, English law refused to recognise agreements under which a dispute was funded or “maintained” by a third party.

Champery and maintenance were both unlawful, the principle being that an external financial interest could damage the way a dispute was conducted, encouraging parties to inflate the value of the claim or even to manipulate evidence.

While the law has moved on and litigation funding in itself is no longer automatically champerous in many jurisdictions, would-be funders must still act cautiously lest their funding agreement – and consequently their right to claim a return – be declared unlawful as a matter of public policy.

Whether or not a funding agreement is lawful depends on a number of factors.

Generally, the extent to which a funder has control over the litigation will affect how the funding agreement is viewed. However the action is funded, the funded party should maintain control over the conduct of the litigation.

It should have complete access to the documents and information underpinning the matter and should be able to instruct its legal counsel on how to conduct the case.

The lawyers should act for and take instructions from the funded party, not the funder.

While funders will usually want access to relevant documentation (see further below) and may offer their opinion on conduct or strategy, they cannot control the litigation; funders should remain more or less passive stakeholders.

Funders should also leave an appropriate proportion of any potential economic benefit for the funded party. Courts are likely to take a dim view of funding arrangements whereby the funders will receive the vast majority of damages in the event of a successful judgment.

Funders looking for greater control over a case may, in certain circumstances, be able to acquire the economic right to a claim from the claimant, thereby removing the original party from the equation.

In JEB Recoveries v Binstock, for example, the High Court refused to strike out a claim as champerous where it had been assigned to an SPV incorporated to pursue the assigned claim and others like it.

This route may be most appropriate for insolvent companies (where insolvency practitioners are empowered to sell company assets, including causes of action), or for enforcement proceedings, where a party has received an award or judgment but has not yet enforced it.

Confidentiality and legal privilege

A party seeking funding will need to provide a funder with confidential and legally privileged information at various stages of the proceedings.

Initially, the party seeking funding will provide information to allow the funder to carry out its diligence. The party may need to send information to several different funders before securing finance.

After any funding has been agreed, the funder(s) will need to be updated with further privileged information as the matter progresses.

A major concern, therefore, is that providing confidential and privileged information to funders should not result in a waiver of privilege, meaning that such information could be subject to a disclosure application from the opposing party. Protecting privilege and confidentiality is therefore an important concern for both funder and funded party.

Unless diligence can be carried out without sharing confidential or privileged information (unlikely), the parties should ensure that a robust confidentiality or non-disclosure agreement is in place, prior to entering into a comprehensive funding agreement.

Such agreements should prohibit onwards disclosure and impose provisions for the return and/or destruction of the information at the end of its use, and may assert the relevant privilege over the documents. Parties should also consider any relevant data protection requirements in their jurisdiction(s).
Adverse costs

If the funded party loses the case, the funded amount is usually irrecoverable. However, the funder may also be ordered to pay additional sums in respect of the winning side’s legal fees.

In England, the case of Arkin v Borchard established the principle that a funder’s liability for adverse costs would be limited to the amount of funding it had provided (the “Arkin cap”). Subsequent cases have chipped away at that principle, however.

In Excalibur v Keystone, the High Court decided to include within the cap sums provided by the funders as security for the defendants’ costs, in addition to the sums paid towards the claimant’s legal fees.

This case involved a number of funders providing capital on different terms, at different times and under different agreements. The funders had cumulatively provided £14.25m in respect of the claimant’s costs and a further £17.5m by way of security for the defendant’s costs.

The judge described the case as a “resounding, indeed catastrophic defeat” for the claimants, criticising their aggressive conduct (which had increased the overall level of costs) and the quality of evidence at trial and ordering costs on an indemnity basis (the higher level).

On appeal, the funders argued that the High Court was wrong to order the funders to pay indemnity costs, since their conduct was separate to that of the funded party.

The Court of Appeal held that there was no principled basis on which a funder could distance itself from the conduct of those it had elected to fund. Funders should keep in mind, therefore, who they fund and how that party may conduct the litigation, as well as the legal merits of the underlying action.

More recently, in Bailey v GlaxoSmithKline, the court ordered a funder to provide security of £1.75m for the defendant’s costs, notwithstanding the funder had only committed £1.25m to the claimant, thereby exceeding the Arkin cap. The judge suggested it would be incorrect to assume that the Arkin cap would automatically apply and ordered security accordingly.

Investor-state arbitration, Achmea and Brexit

While making predictions around Brexit is fraught with difficulty, the UK’s possible departure from the EU may offer at least one benefit to funders in the field of investor-state arbitration under intra-EU bilateral investment treaties (BITs) and the Energy Charter Treaty (ECT).

In Slovak Republic v Achmea, the Court of Justice of the European Union (CJEU) upheld the position of the European Commission (EC) that arbitration provisions in intra-EU BITs contravene EU law and are therefore invalid as, the Court held, disputes involving questions of EU law can only be finally determined by the CJEU and not by an investor-state arbitration tribunal.

Since the Achmea decision, the EC has asserted forcefully that the same logic applies to the arbitration provisions of the ECT, insofar as they relate to intra-EU disputes. A number of tribunals have concluded that neither the Achmea decision nor the EC’s declarations impact on their jurisdiction and have proceeded to issue awards but, nevertheless, member-state courts will come under pressure from the EU not to enforce such awards.

Brexit may provide an opportunity for parties hoping to enforce BIT or ECT arbitration awards in the UK. At the time of writing, the mechanics of the UK’s exit from the EU are still (highly) uncertain.

If the UK were to leave without a deal, it would no longer be bound by EU law.

UK courts are generally supportive of arbitration, and Brexit, depending on its terms, could provide an opportunity for them to reject Achmea’s applicability to BIT and ECT claims involving UK parties.

Counterintuitively therefore, Brexit may lead to greater certainty in the field of BIT and ECT arbitrations and create renewed interest for third party funders in this exciting sector.