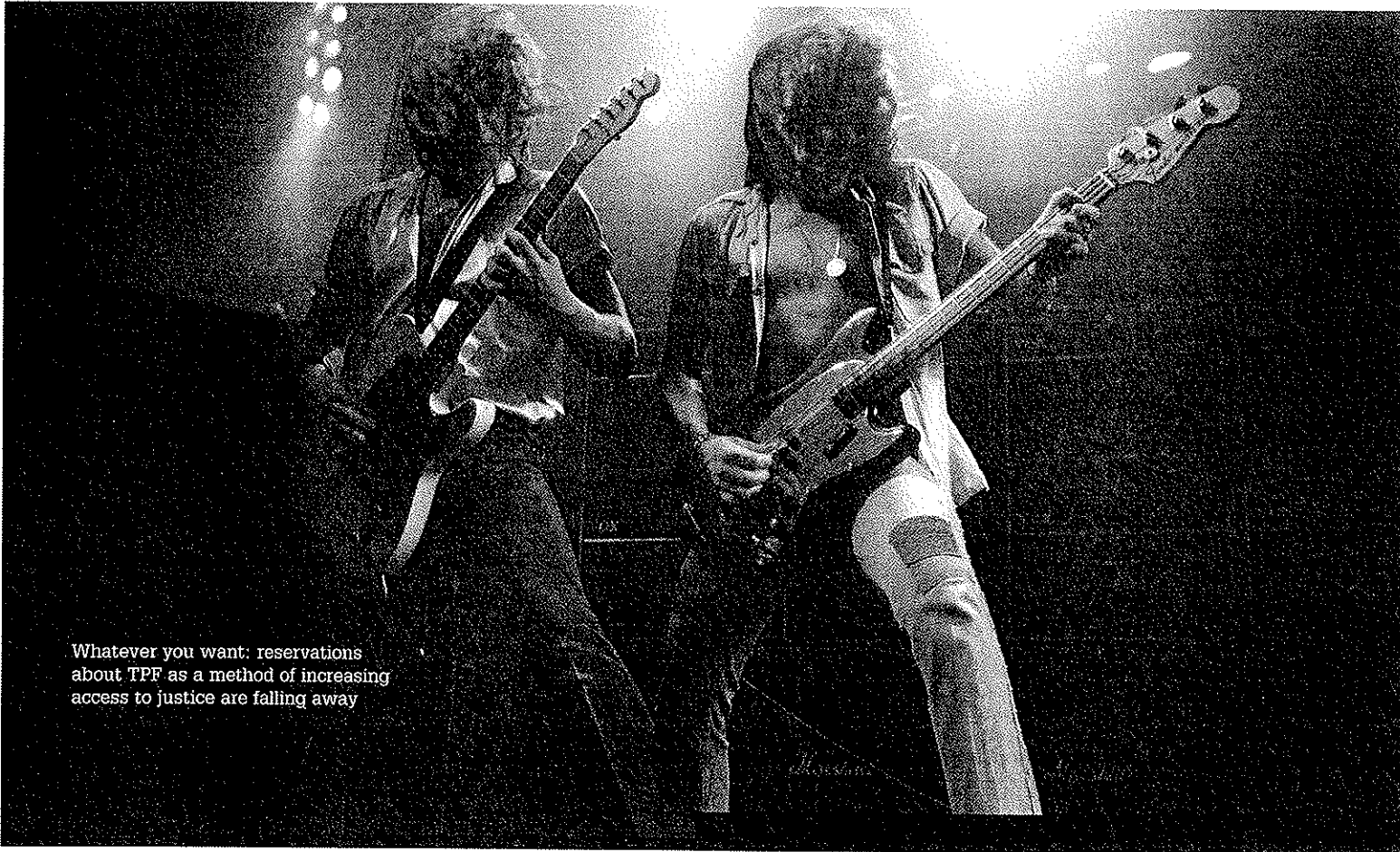


The third degree

Third-party funding has hit the headlines. Neil Rose looks at how this potentially huge market is shaping up



Whatever you want: reservations about TPF as a method of increasing access to justice are falling away

I just blinked my eyes and wondered what it's all about.' So says Nick Kanaar, solicitor to legendary rockers Francis Rossi and Rick Parfitt, recalling the moment he learned that the claimants on the other side of a royalties dispute had the benefit of third-party funding (TPF). It may be a reaction many more solicitors have in coming years as TPF takes off.

Mr Kanaar, a consultant at London firm Collyer Bristow, is acting for Handle Artists Management and Messrs Rossi and Parfitt in defending a claim by Alan Lancaster and John Coghlan – original members of Status Quo in the 1960s – that they are entitled to royalties made on contracts made 40 years ago that became due from the 1980s. A judge at Central London County Court recently found in favour of the claimants, although there is an appeal.

Tastier still could be the detailed assessment, where Mr Kanaar hopes to learn more about the funding arrangement. He makes it clear that he does not like TPF. 'We regarded legal aid as blackmail, and this is more blackmail with a nasty thing behind it – someone's making a profit,' he says.

Predictably, the claimant's solicitor, Simon Jacobs of London firm Seddons, is a great fan of TPF. He was not surprised by the furor that erupted when he informed the defendants about the funding – 'because they didn't understand it'. But, he reckons, 'it's here to stay and will only get bigger'. As well as helping get some cases off the ground that otherwise would not (although the Status Quo case was already under

way), he says it encourages potential claimants to spend a relatively small amount of money to investigate whether they have a case. TPF also helps refocus clients who may lose interest once protected by a 'no win, no fee' deal. 'In agreeing to funding, the client has to understand what it'll cost him,' he explains.

A QUESTION OF TIMING

Funding in the Status Quo case was provided by AllianzProzessFinanz, the German funder which last month opened in London. Christian Stürwald, who heads the office, says he has been investing in UK cases for the past two years from Germany, and that time proved the demand. 'We've come here at the right moment both politically and commercially,' he says. Allianz obtained independent advice and then approached the Ministry of Justice – both said that TPF, done properly, would be welcomed from an access-to-justice perspective. Well-known litigation funding specialist Bob Gordon, who advised Allianz on setting up, says the contingency element has the advantage of simplicity for clients.

It is clear that reservations about TPF as a method of increasing access to justice are falling away – the Civil Justice Council's (CJC) costs forum earlier this year saw broad support for controlled TPF. Speaking to *Litigation Funding* in April, the Master of the Rolls, Sir Anthony Clarke, said that last year's *Fostif* decision – in which Australia's highest court backed TPF – pointed the way. 'I don't see why the principle of third-party funding, subject to reasonable controls

should not be accepted here,' he said. 'As long as [it is] willing to be transparent, one can see a public interest in supporting the funder.'

And so, in its report on the future funding of litigation that followed the forum, the CJC recommended to the government that properly regulated TPF should be recognised as an acceptable option for mainstream litigation. It said rules of court should be developed to ensure effective controls. As a result, the CJC will next month hold a summit to discuss how regulation could be achieved. Chief executive Robert Musgrove explains: 'It only takes the wrong case by the wrong funder with the wrong lawyer to have a very serious impact upon the market's development. So we're looking at a form of industry-agreed common standards to allow the market to emerge.'

There is broad support for regulation. Solicitor Rocco Pirozzolo, legal expenses underwriter at QBE Insurance, considers it 'vital' – ultimately so the client knows the money is there, but for their lawyers too. 'If the solicitors haven't done their due diligence – which is critical when you're talking about this kind of money – then the client is going to be looking to the solicitors' professional indemnity policy,' he says. 'That's not exactly what solicitors thought they were signing up to.'

But not all are so sure. Sam Eastwood is the partner at City firm Norton Rose handling Stone & Rolls' TPF-backed \$140 million (£70 million) negligence claim against accountants Moore Stephens, which catapulted TPF into the headlines in early

2007. He says: 'I am not convinced regulation is necessary – a well-advised client should be able to secure contractual protection if presented with a range of alternative funders. Regulation of some sort, however, in my view is very likely and I would expect it to focus on ensuring a direct lawyer-client relationship in funded actions, increasing transparency, disclosure requirements and ensuring the independence of lawyers from litigation funders.'

HISTORIC HURDLES

Other potential hurdles are the ancient legal principles of champerty and maintenance, which prohibit a party with no legitimate concern in a case from supporting and profiting from it without just cause or excuse. These have already been eroded, especially with the decision in *Arkin v Borchard Lines* [2005] EWCA Civ 655, but caution persists. Accountants Smith & Williamson (S&W) have entered the litigation funding world with one eye firmly on champerty and maintenance, and constructed a model that ensures they are not an issue.

The primary class of case for S&W is insolvency, because if one of its insolvency practitioners is appointed as liquidator or administrator of a company which has a good cause of action, the funding is technically not that of a third party. For non-insolvency cases, Stephen Cork, S&W's head of restructuring and recovery, puts forward the intriguing possibility that a trading company with a claim could assign it to a wholly owned subsidiary, which it then places into voluntary liquidation. He says S&W will consider pure TPF, but 'it's not as strong as our approach'.

Insolvency was also the way into the market for the UK pioneer of TPF, IM Litigation Funding (formerly Insolvency Management). The name change reflects the growth of IM's business over the last five years into a wide range of commercial cases, including the Stone & Rolls case, which it is backing with two other funders. Legal director Peter Horrocks, one-time head of corporate recovery and insolvency at

City firm Lovells, says it has funded 49 cases in total, out of 400-plus that have been put forward. Only two have been lost: one in which he reckons the wrong solicitors were handling the matter, while the other was an Italian arbitration – 'which I don't recommend to anyone'.

Until recently, the public face of IM – and indeed the whole argument for TPF – was Susan Dunn, but she made waves last month by jumping ship to set up Harbour Litigation Funding, reportedly backed by \$100 million from Jersey-based hedge fund MKM Longboat. However, just three weeks into her new venture, Ms Dunn who will effectively be a fund manager – feels unable to discuss it.

Nonetheless, the Harbour launch is further evidence that much of the impetus for TPF seems to be coming from the capital markets, and with that has come the emergence this year of brokers, specifically Global Arbitration Litigation Services and Calunius Capital. Calunius offers 'dispute risk hedging', which Mick Smith, a former Freshfields lawyer and one of Calunius's founders, describes as 'extracting risk from claimants and defendants, and placing it in an appropriate financially modelled way'. He says the 'Holy Grail' for a hedge fund is access to 'uncorrelated risks', explaining: 'The beauty of buying individual legal risks is that, even if you have a blow-up and get nothing, the fund manager knows that it won't contaminate anything else.'

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BROKER IN THE PACK

Calunius looks at two types of transaction: litigation funding of commercial disputes, where a claimant cannot extract value from an asset (that is, a claim) without high-quality legal advice; and where a company has a contingent or deferred liability of a legal nature that it wants to get off its balance sheet ahead of, for example, a sale or flotation ('outcome hedging'). Calunius considers the claim in terms of its merits, quantum, recoverability and volatility, and produces a matrix of potential outcomes and their probabilities, which is used to calculate the expected return of any transactional structure based on that dispute.

For Global, the focus is more on arbitration, which joint founder Nina Hall, formerly of Herbert Smith, says has become the favoured method of international dispute resolution. She got into this field three years ago when working for a Dutch sovereign debt recovery company. Ms Hall says hedge funds have been dabbling in TPF for about 20 years, but have recently become far more interested, in part because of Ms Dunn's success. Global works on high-value cross-border disputes, where funds are looking to put in maybe \$30-50 million.

'A new fund seems to appear on the market every two weeks at the moment,' she says. 'The appetite from hedge funds is growing and the need for sensible financial products and funding arrangements to meet the demands of the parties involved – funder, claimant and lawyer – is paramount. We apply our expertise not only to the selection of cases but also to their good management, and broker deals that focus on the

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need for all the players to be working effectively together or there is no sensible investment.'

Ms Hall says one reason brokers are needed is that 'the players in the market all have different parameters', and that is clear simply from looking at the different financial starting points. Allianz, for example, will look at cases valued from £100,000, a figure most others seem to think too low (given that any case of substance that goes to court is likely to cost at least £50,000); Mr Stürwald acknowledges it is 'a very low threshold', but while a case has to make sense commercially – and in fact he anticipates that most will need at least £1 million – 'we do take the access to justice element quite seriously'. For S&W, the claim is likely to be worth in excess of £250,000. IM Litigation Funding has a minimum of £350,000. Commercial Litigation Funding Ltd, set up by the ubiquitous Brian Raincock of Litigation Protection, is not keen on anything much below £1 million, while the likes of Calunius and Global are potentially looking at far more. Susan Dunn's venture is a minimum £3 million. A \$2 billion hedge fund is not going to be interested in putting in less than £5-10 million, Mr Smith reckons.

Clearly, for any funder, there needs to be something tangible which it can realise at the end, which to a degree limits the kinds of cases for which TPF can be used, but it is not necessarily just damages – it could be, for example, non-cash items such as preferred equity or share options. Allianz's funding has been used in Germany for disputes ranging from divorce and inheritance to professional fees recovery and public liability claims. Mr Gordon says it could be a non-financial remedy, such as return of a licence, from which money could then be generated.

This is very much a bespoke market, but some of the models are nonetheless clear on how the return works. Allianz has a starting point of 30% of the first £350,000 recovered, and 20% on anything above that. IM relates its take to when monies are recovered, ranging from 25% for up to six months from the letter of intent, to 50% for over 18 months. S&W ranges anywhere between 15% and 45%. In general, a funder will be looking for at least three or four times the sum invested.

GETTING THE LEGALS RIGHT

It is clearly vital to the funders and brokers to have the right lawyers in place. Mr Horrocks calls it 'the most important issue in any case'. If need be, they will tell a potential client to change solicitor if they want funding. Part of the reason is that, as TPF takes off in the UK, it is unlikely that the courts will permit the funder to have much active control over the litigation, in contrast to Germany and Australia (in *Fostif*, the funder actively procured claimants for a class action and then ran it). Mr Horrocks admits: 'It would be nice to have a greater say in the manner in which certain steps are taken in a case.'

However, Mick Smith observes: 'Put crudely, [control] is not the bag of a hedge fund. It wants a contractual reassurance that the litigation will be dealt with properly and offers will be considered sensibly.' Brian Raincock talks about having 'stabilised relationships' with a small number of expert solicitors. Those who are already in the field, such as Simon Jacobs, could be well placed. 'I'd like to market it more,' he says.

Steve Philippssohn, a well-known fraud specialist, is the kind of solicitor likely to benefit. His London firm, PCB Litigation, is a small niche practice doing big cases which aim to recover a lot of money. 'We're seeing more demand for this kind of [TPF] arrangement,' he says. 'The people we're dealing with are sufficiently experienced, and we're sufficiently experienced, to come to an arrangement at the outset

and then they let us get on with it.'

What the control question often comes down to is deciding on a settlement offer. Mr Stürwald says he has had 'to take a step back' in the UK. 'It makes other things more important, such as knowing the people you're dealing with – for example, a client who will make a business decision [about a settlement] rather than wanting their day in court.' The reality, of course, is that much of this will have been discussed in advance anyway and, if worst comes to the worst, the funder has the ultimate, if blunt, weapon of withdrawing funding. It is also a matter of time. When TPF began in Australia, similar restraints were imposed, but these have been relaxed as confidence has grown.

By focusing purely on international matters, Ms Hall is less constrained by this problem. In fact, she says: 'You should take the issue of control with a big pinch of salt. Anyone who's writing a cheque is interested in how it's being spent.' Her model is to set up deals almost as a joint venture between the claimant and funder, with an outside claims manager – usually another law firm – in place to resolve any 'emergency deadlock situations' between them.

SHARED RISK

The risk transfer does not stop outside the solicitor's door, however. Many TPF deals are likely to see the lawyers working under conditional fee agreements – maybe not 'no win, no fee', but at least discounted fees, if for no other reason than to limit the funder's exposure (rates generally could be squeezed, in fact). There is also the question of after-the-event (ATE) insurance as a way of transferring some of the funder's risk – Allianz's funding, for example, may sometimes simply be used to pay an ATE premium. Mr Raincock's model has ATE integrated into it, which means no more 'crazy' deferred premiums.

Well-known litigation funding specialist Claire Edwards sees TPF and ATE as two complementary elements of the fight to contain costs when litigating. 'It's about understanding the shape of the litigation and structuring your funding,' she says. If you had £1 million in funding and an ATE premium of £1 million, you would not spend it all on the premium because then there would be nothing left for disbursement – you may, for example, look to defer some of the premium. Mr Jacobs argues that court-led capping of defendants' costs will also be crucial.

Unsurprisingly, those involved in the TPF market are talking it up, aided by a sudden spurt of press interest. Mr Smith speculates that there could be as much as \$1 billion of funding waiting in the wings, and *Litigation Funding* is aware of one well-known name poised to join the fray early next year. But it appears that, for all the hype, only a small number of cases have actually been funded.

Sam Eastwood says his experience of TPF has been 'wholly positive' and the response of clients 'very encouraging'. And while Mick Smith says 'the perception that you need strong merits is wrong – there's a price for everything', some are sceptical about the impact TPF might make. Group action specialist David Greene of London firm Edwin Coe says: 'I think we are getting a bit over-excited about TPF... What funders are really looking for is a high-value claim with a high chance of success without complications. It's quite a narrow class.'

But for Sam Eastwood, things have changed very quickly. 'Securing [TPF] back in 2006 was extremely difficult. The market was very undeveloped. The position has now changed beyond all recognition. Today there is risk capital readily available from a number of sources and the challenge is for legal practitioners to understand and take advantage of the significant opportunities presented by third-party funding.'