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Third party litigation funding

England has traditionally adopted a strict approach to third-party litigation funding, so that it was only available in very few circumstances. Some recent decisions by the legislature and judiciary, driven largely by access to justice concerns, have liberalised the English legal system's approach and attracted a developing market for litigation funding in the UK.

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Impact on UK D&O and professional negligence claims

The rise of third party litigation funding alone will not be enough to have a significant impact on the number of claims being brought against directors, officers and other professionals in the UK. However, the timing of its arrival, in the economic context of the credit crisis and anticipated recession in the US, coupled with the increased duties of directors and availability of derivative actions under the Companies Act 2006, may mean that third party litigation funding will be a significant driver that will spark an increase in the volatility of the claims environment in the UK.

Historical context

Until recently, the long-established law on maintenance and champerty has acted to thwart third party litigation funding in England. Under English law, a person is guilty of maintenance if he supports litigation in which he has no legitimate concern without just cause or excuse. Champerty is where maintenance is provided in return for a share of the spoils of litigation. It used to be the case that criminal and tortious liability attached to agreements that were champertous. This position was reversed by the Criminal Law Act 1967, but it remains the case that such agreements are unlawful and unenforceable as a matter of public policy.

The public policy objection has historically been to deter 'trafficking in litigation' and the development of collective actions. The courts have recognised that what constitutes maintenance or champerty is a fluid concept that can change over time. What was objectionable in the Victorian ages is not necessarily objectionable in the 21st Century. This makes it difficult to conclude on the champertous nature of a particular funding arrangement. Recent authorities focus upon the importance of approaching the issue on a case-by-case basis.

Recent developments

In recent years, there has been a spate of developments that suggest that the English legislature and judicial system are adopting a more liberal approach to third-party litigation funding.

Conditional Fee Agreements (CFAs)

The recent developments can be traced to a legislative change in 1995, which allowed lawyers to work for clients under CFAs, such as 'no win, no fee'. In a 'no win, no fee' arrangement, a solicitor will only be paid if the claim is successful. The solicitor, if successful, will also be entitled to an additional success fee, which is calculated as a percentage of their fees (the maximum permitted by law is currently 100%). Both the basic fee and the success fee are normally paid in whole or part by the losing party. If the litigant loses, they will not have to pay the solicitor's fees, but they will still have to pay the expenses and the other side's solicitors' fees and expenses.

Insurance policies, known as 'after the event' insurance, are available to protect litigants against this risk. Under these policies, the insurer will usually reimburse the litigant for any expenses and will pay an opponent solicitors' fees and expenses if they lose.

In contrast, under the US contingency fee regime, a solicitor receives a proportion of the damages recovered in favour of his client, as opposed to a percentage of his fees. The introduction of CFAs into English law did not go as far as the US contingency fee regime; however, it was big step towards relaxing the strict approach to allowing a third party to benefit from the successful outcome of a claim.

Judicial liberalisation

The courts, albeit in a piecemeal fashion, have gradually become more relaxed about maintenance and champerty.

The courts have given strong indications that lawful, or justifiable, maintenance is no longer against public policy. The signs are very clear to the effect that the courts will refrain from ordering a stay of any action on the ground that it is being unlawfully maintained. What shall constitute unlawful maintenance of a kind that would attract the concerns of the courts seems now to be "*wanton and officious intermeddling with the disputes of others in which the [maintainer] has no interest whatever*".

The key question the court will ask itself is whether the arrangement in question has "*a tendency to corrupt public justice*". When the courts are deciding this issue, they are looking for arrangements that may give rise to the temptation to "*inflame damages, suppress evidence, to suborn witnesses or otherwise undermine the ends of justice*".

The most prominent liberalisation came in the Al Fayed libel litigation, where the Court of Appeal rejected an attempt by Mohamed Al Fayed to make Neil Hamilton's financial backers liable for the costs of his unsuccessful libel claim. The judge ruled that only very rarely would it be just and reasonable to make such an order. What is striking from this judgment is that access to justice prevailed over the statutory rights of Mr Al Fayed to recover his costs. The courts justified this volte-face on the basis that if litigation funders were to be made responsible for such costs, funding would be withdrawn in the future and access to justice would suffer.

Essentially, the position of the English courts seems to be that funding of litigation is generally to be permitted if intended to assist in a genuine claim. Sir Anthony Clarke, the Master of the Rolls, recently confirmed the judiciary's approach by saying "*I don't know why the principle of third-party funding, subject to reasonable controls, should not be accepted here, as long as [it is] willing to be transparent, one can see a public interest in supporting the funder.*"

Professional litigation funders

With the increased judicial liberalisation in this area, we are now seeing an emergence of professional litigation funders entering the EU and UK litigation markets, whose very business is to profit from investing in litigation.

Who else is funding litigation?

In July 2007, **Calunius Capital** were the first **broker** of third-party litigation funding to gain approval from the Financial Services Authority (FSA) to act as a specialised adviser and intermediary in litigation and general dispute risk. Since Calunius entered the litigation funding market, there has been a wave of new entrants.

Two former shipping lawyers have set up **Global Arbitration & Litigation Services (GALS)**. GALS' focus is primarily on arbitrations, which in the opinion of joint founder Nina Hall, has become the favoured method of international dispute resolution. The brokers have sourced funding for six international arbitrations so far. GALS works on high value cross-border disputes, where funds are looking to put in around $3-5m.

Meanwhile, **MKM Longboat**, the UK hedge fund, has decided to diversify by hiring Susan Dunn, the former managing director of IMLF, to set up **Harbour Litigation Funding** in order to explore litigation-based investments. MKM Longboat is the first hedge fund to have hired a dedicated fund manager with a specific pool of money (£100m) to invest in UK and European legal disputes. The emergence of Harbour into the market is a strong indicator that much of the thrust for third party litigation funding in the UK will emerge from the capital markets.

The accountants, **Smith & Williamson** has also set up a litigation fund, and **Allianz**, Europe's largest insurer, recently announced it is coming to London to set up a third-party litigation fund.

In January 2008, third-party litigation funding jumped into the mainstream of financial investments with the first admission to AIM of a specialist litigation fund. **Juridica Investments**, founded by two US lawyers, will invest in claims of more than £1m, mainly focusing on US-based litigation and international arbitrations.

Litigation funding - good or bad?

Since litigation in the UK is expensive, and success can by no means be guaranteed no matter how strong your case is, surrendering a slice of the potential upside in return for

Case study: IM litigation funding (IMLF)

One pioneer in this area is Toby Duthie, the founder-director of Forensic Risk Alliance, a forensic accounting and investigations business. Duthie became familiar with the US litigation system while assisting European companies responding to US-based litigation. Duthie recognised that there were many differences between the US and the various EU legal systems. For example, unlike in the UK, the application of contingency fees to plaintiff actions is permissible in the US (see above). Another crucial difference is that currently in the UK the losing party has to pay the entire cost of the litigation while, in the US, each party bears its own costs.

Duthie saw a gap in the market and recognised that, particularly in the insolvency area, there was a need for funding in order to allow insolvency practitioners to meet the costs of pursuing claims on behalf of their creditors, eg banks, shareholders and tax authorities. Therefore, he set up Insolvency Management (now IMLF) with a group of lawyers experienced in insolvency work. So far they have funded in excess of 50 cases, mostly insolvency-related and in the UK, but they are now dealing with non-insolvency matters, hence the change in name, and have twice funded claims in other countries.

They invest anything from £50k upwards, often co-funding with others to spread the risk as well as increasing access to capital. The amount of the investment is proportionate to the expected legal costs. IMLF will only take on a case if there is a 70% chance of success based on a view of the merits of pursuing such action. They have funded 49 cases in total, out of 400-plus that have been put forward. Only two have been lost: one in which IMLF claims that the wrong solicitors were acting and the other was an Italian arbitration. If IMLF win a case, they ask for reimbursement of their costs, plus 25% to 50% of the litigation proceeds after costs.

some downside protection is extremely attractive for claimants. However, sceptics of litigation funding base their objections on two specific arguments:

First, many detractors say that there is something repugnant or unethical about a third party that has no involvement in a legal dispute being allowed to profit from it. The English legal system costs the taxpayer a large amount each year and sceptics consider it inappropriate that it be used to generate profit as opposed to compensating parties who have actually suffered loss.

Second, that the availability of third-party litigation funding removes the element of fear of losing a case, and so encourages claimants to bring groundless lawsuits. If an unsuccessful litigant no longer has a duty to pay, opponents say, they have nothing to lose and the courts will be overrun with baseless claims. In fact, Mick Smith of Calunius has recently been quoted in the Law Society Gazette as saying "*the perception that you need strong merits is wrong - there's a price for everything*".

A more detailed examination of how the litigation funding market in London works, reveals that professional funders are only seeking to invest in commercial rather than personal disputes. A distinction should be made between a commercial entity managing its litigation risk by hedging its exposure, and a litigation funder reaping profit from the pain and suffering of an individual. The former is by no means unethical. As for the 'baseless claims' argument, it is precisely because these businesses are managed according to profit-making principles that fears of a propagation of baseless claims are misguided. Litigation funders, like IMLF, will scrutinise claims with extreme diligence. If anything, litigation funding may have the opposite effect of encouraging an atmosphere of closer scrutiny across the litigation spectrum and ultimately reduce the number of spurious or vexatious lawsuits.

Third party costs orders

In the past decade, there has been a marked shift towards the argument that a non-party who funds unsuccessful litigation, from which it stood to gain if its succeeded, should pay the successful party's costs whether or not that support constituted maintenance.

The most recent and important guide to the position regarding professional funders is *Arkin v Borchard Lines Ltd*. In making a third party costs order against a funder, limited to the sum provided by way of litigation support, the Court of Appeal emphasised the importance of the principle that anyone who causes a party to defend themselves in litigation and incur substantial costs should, in principle, be responsible for paying them. This was decided in the context of professional funders, therefore, the financial backers like those who stood behind Mr Hamilton will remain subject to the *Hamilton v Al Fayed* approach. There the access to justice policy shall prevail; however, in the context of professional funders, there is

also a need to ensure they are not deterred against offering valuable litigation support by the threat of becoming liable for all costs of an unsuccessful litigation. Therefore, the Court of Appeal adopted a compromise that only champertous professional funders, defined as persons who control the litigation, should be liable for all the costs. Non-champertous funders should be able to limit their liability to the sum provided for litigation support, £1.3m in this case. An exception to this rule is likely to emerge in relation to security for costs orders, discussed below.

The relationship between professional funding and CFAs

To hedge against the implications of losing in litigation, many professional funding arrangements see the lawyer working under CFAs. The CFAs are not usually 'no win no fee', but are based on discounted rates. For example, IMLF pays the solicitor 60% of their standard hourly rate. The remaining 40% becomes payable upon successful conclusion of the litigation, together with an agreed success fee. If the case is unsuccessful, the solicitor will nonetheless receive 60% of their standard rate. After-the-event insurance is also used to transfer some of a professional funder's exposure.

Regulation of litigation funding

Building on the access to justice attitude of the legislature and judiciary, the Civil Justice Council (CJC) published a report in 2007 that welcomed litigation funding as long as it was regulated properly.

The CJC recently held a 'summit' meeting on 8 February to canvass views upon what form regulation of the litigation funding industry should take. The majority of those in attendance - including senior litigators, regulators, funders and brokers - have indicated that a consensus is emerging for greater transparency in the litigation funding market as opposed to restrictive regulation.

The key proposal emerging from the summit is a change to the current rules on security for costs. An application for security for costs will usually be made by a defendant who is confident of successfully defending a claim, but may fear that the claimant will not and/or cannot pay any costs awarded against it. To safeguard against this risk, in certain circumstances a defendant can apply to the court early in the proceedings for an order that the claimant provide security for costs (usually a payment into court) as a condition to proceeding with the claim. The proposal is to make it possible to require third-party funders to put in money at the start of a dispute to cover adverse costs. Should the proposal be adopted, this would further dilute the 'baseless claims' argument, and further deter funders from backing weak claims.

Conclusion

Third party litigation funding has been quick to develop in the past decade. The English courts have adopted a more pragmatic approach to litigation, and indeed access to justice. With the demise of legal aid, the acceptance of professional funding of claims was an inevitable model for the English courts to embrace. No longer is the concept of an organisation benefiting from another's litigation an abomination.

The development of litigation funding, in the current climate of economic downturn, may be the catalyst for a change to the European claims culture that has been benign compared to the US.

How far the English courts are willing to go to promote access to justice remains to be seen. The 'loser pays costs' approach under English law also has a tendency to frustrate access to justice. Does this mean that this established principle of English law will also fall to be reassessed? It appears that the English legal system has no immediate plans to deviate from its access to justice path, and the natural progression may inevitably lead to a convergence towards the US position, where each party bears its own costs.

Directors' Liability and Indemnification: A Global Guide

Edward Smerdon is consulting editor of *Globe Business Publishing*'s new D&O book.

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