CASE NOTES ON THIRD-PARTY FUNDING

Although third-party funding in international arbitrations is in its infancy, legislative change and existing case law are waking third parties up to the market's possibilities. Here is a snapshot of seven jurisdictions

AUSTRALIA

Largely because of the private nature of arbitration, there has been little judicial consideration of the issue of third-party funding of arbitration in Australia.

The one court decision that has considered the question was *Minister for Transport for Western Australia v Civcon Pty Ltd*, a case dealing with the Western Australian Commercial Arbitration Act. In that case, Master Sanderson made no distinction between the principles governing third-party funding of arbitration and the principles that would apply to third-party funding of litigation. Indeed, the Master referred to a party "seeking litigation funding to enable it to pursue the arbitration".

There may be sound reasons why third-party funding for arbitration and litigation should not be governed by identical legal principles, especially the fact that one process is essentially private, while the other uses public institutions. Although the matter remains largely untested for practical purposes, however, it is reasonable to expect that Australian courts will treat funding of arbitration in substantially the same manner as funding of litigation.

Assuming that third-party funding of arbitration is likely to be treated in much the same way as litigation funding, it is worth noting that the position on litigation funding, though far more widely recognised, is itself not entirely settled. A judge of the New South Wales Supreme Court has noted, in a judgment delivered late in 2007, that the view allowing and supporting litigation funding does "not yet command universal acceptance".

That said, litigation funding is common in Australia and the practice is generally accepted by the courts. The torts of maintenance and champerty have been abolished in a number of individual Australian jurisdictions, including New South Wales. Judgments have been made that are favourable to litigation funding, including one from Australia's highest appellate court – though the comments were made in obiter. Other courts have supported the idea, based in part on the principle that this type of funding offers access to justice that might otherwise remain closed.

One particular aspect of litigation funding in Australia worth noting, and which may become increasingly relevant to arbitration, is the tendency to permit the practice subject to some form of court control. Arbitration must be distinguished by the absence of such direct court control. Whether this might prompt separate discussion and perhaps a reining in of arbitration funding, however, remains to be seen.

Partners Max Bonnell and Peter Megens of Mallesons Stephen Jaques in Melbourne.

ENGLAND AND WALES

English law has traditionally restricted the funding of litigation or arbitration by third parties whether that funding is provided by specialist third-party financiers or by lawyers through a no win, no fee arrangement. That position, however, is changing. The recent emergence of a number of specialist third-party funding providers in the London market, some specifically targeting international arbitration, and calls by the Civil Justice Council and the Office of Fair Trading to permit contingency fees in some circumstances have placed traditional restrictions in the spotlight.

Funding by specialists

Although recent case law suggests that prohibitions based on principles of champerty and maintenance are being relaxed, the scope of that relaxation remains unclear.

In *Arkin v Borchard Lines*, the appeal court accepted that in some cases (here, a competition law claim) third-party funding may increase access to justice. The court also held that a "pure" funder would not normally be liable for costs under fee-shifting principles.

In *Arkin*, however, the appeal court expressly preserved its discretion to declare third-party funding arrangements contrary to public policy and to award costs against a third-party funder. The boundaries of the *Arkin* doctrine remain unclear, and it is uncertain whether the considerations that might make third-party funding permissible in competition claims apply, for example, in an investor-state arbitration – where there is an arguable public interest in enforcing treaty rights – or, indeed, in an international commercial arbitration.

Funding by lawyers

Section 58 of the Courts and Legal Services Act 1990 now permits conditional fee arrangements, (where lawyers recover nothing if unsuccessful, but up to double their actual fees and costs if successful) in some circumstances.

English law still imposes particularly stringent prohibitions on contingency fee arrangements (where the lawyer receives a share of any judgment or award).

In *Bevan Asford v Geoff Yeandle*, Sir Richard Scott VC expressly held that the prohibition on contingency fees extended to arbitrations, and dismissed earlier suggestions from Steyn LJ in *Giles v Thompson* that, because arbitration was a consensual process, the same public policy considerations might not apply.

The following questions about the boundaries and practical consequences of this prohibition remain unresolved:

- Should the same public policy prohibition apply in an English-sited arbitration involving a non-English party where the contingency fee arrangement would be valid in the jurisdiction of one or more of the parties?
- Does the *Arkin* approach to awarding costs apply in such circumstances?
- Can the prevailing party seek to recover their costs from lawyers providing funding under a contingency-fee arrangement?
- If the contingency-fee arrangement is considered invalid, what are the consequences of the invalidity in allocating costs?

As the use of third-party funding grows, and in light of calls for a more liberal approach to such funding and contingency fees, there will inevitably be further debate and developments with regard to the scope and effect of such arrangements on international arbitrations sited in England or governed by English law.

Partner Steven Finizio and counsel Duncan Speller of Wilmer Cutler Pickering Hale and Dorr LLP in London.

FRANCE

Third-party funding of an international arbitration has received limited attention in France, where it is expressly addressed neither by French legislation nor the bar rules. In the only reported case on the issue, though, the validity of funding agreements has been indirectly confirmed by a French court.

French law only expressly provides for third-party funding through insurance coverage. The 'Legal Expense Insurance Transaction' – article L 127-1 of the French Insurance Code – covers the insured party's legal fees and court costs in the event of disputes falling within the scope of the insurance policy. The insurance company has no entitlement to any damages that may be awarded to the insured party.

This insurance is to be distinguished from funding arrangements (such as those typically encountered in Anglo-Saxon countries), which are entered into in view of a specific dispute and pursuant to which the third party will receive a portion of any awarded damages. Given these differences, it cannot be assumed that "speculative" third-party financing is permissible.

SA Veolia Propreté (formerly SA Onyx) v Foris AG

French courts were asked to enforce an agreement for the funding by a German private fund, Foris, of an international arbitration brought by an Australian party in The Hague against a French company, Veolia Propreté. The funding arrangement extended to any costs of Veolia Propreté that the Australian party could be ordered to bear. The Australian party was unsuccessful and ordered to bear the entire costs of the proceedings.

Veolia Propreté subsequently initiated an action against Foris before a French court to recover its costs as a third-party beneficiary to the funding agreement. The lower court enforced the funding agreement, although this decision was subsequently quashed on appeal for lack of jurisdiction.

The Versailles appeal court did not accordingly address the validity of funding agreements under French law, noting that such agreements are "sui generis and unknown in the European Union except in countries having a Germanic legal culture".

Although the lower court decision indirectly acknowledged the validity of third-party funding agreements, only limited reliance can be placed on this one decision.

Ethics

No ethical rule directly forbids French lawyers from acting in actions funded by third parties. Article 11.3 of the French National Bar Regulation provides that "the lawyer can receive payment of his fees only from his client or someone granted power of attorney by the latter". The same article also prohibits pure contingency-fee arrangements.

As long as these two rules are complied with, it seems that nothing prevents a French lawyer from representing a party whose litigation is funded by a third party. These rules apply only to French lawyers and not to foreign legal representatives participating in an international arbitration with its seat in France.

In sum, there is no legislation in effect in France or other grounds to question the validity of third-party funding arrangements. Should third-party funding become more common (as appears to be likely), debate is bound to arise as to whether such funding should be regulated or even forbidden on public policy grounds. The authors do not foresee, however, any risk of the validity of third-party arrangements in international arbitrations being seriously called into question.

Partner Philip Dunham and associate Samantha Nataf of Dechert LLP in Paris.

HONG KONG

Hong Kong courts have established numerous exceptions to maintenance and champerty rules. Two grounds for exclusion might be called the "common interest" and the "access to justice" categories.

In 2007, the Hong Kong Court of Final Appeal considered the principles of maintenance and champerty in *Unruh v Seeberger & Anor.* Eco Swiss China Time Limited was participating in arbitration proceedings in the Netherlands. Pending the result of the arbitration, the company's owner, Siegfried Unruh entered into a memorandum of agreement with Hans-Joerg Seeberger, in which he agreed inter alia:

- to transfer his shareholding in Eco Swiss to a company wholly owned by Seeberger; and
- to use his best endeavours to assist in the arbitration.

In return for these obligations, Unruh was entitled to receive a percentage of the monetary compensation Eco Swiss would receive in the arbitration as a special bonus.

Before the first arbitration was resolved, a second arbitration began. Unruh assisted with both of the arbitrations, which ultimately settled for US$42 million, but received no special bonus.

Unruh brought a claim against Seeberger for payment of the bonus, which the trial judge and the Court of Appeal upheld. Seeberger appealed again, alleging among other things that the memorandum was a champertous agreement and contrary to public policy.

The Court of Final Appeal unanimously rejected and dismissed Seeberger's arguments, confirming that the memorandum was not a champertous contract because Unruh had a sufficient genuine commercial interest in the outcome of the arbitration proceedings.

The Court of Final Appeal decision

The common law rules making maintenance and champerty criminal offences and torts and grounds of public policy for invalidating tainted contracts remain part of Hong Kong law. However, the continued retention by Hong Kong of criminal and tortious liability for maintenance and champerty may not be justified and this question merits serious legislative attention.

Unruh had a genuine commercial interest in the outcome of the arbitration. His unique positioning and participation as a witness in the arbitration was not artificial, nor was it likely to pose a risk to the integrity of the arbitral process.

It is inappropriate for Hong Kong to impose its current public policy against maintenance and champerty on mature commercial parties that have chosen to arbitrate in a jurisdiction which does not recognise those concepts.

The question of whether maintenance and champerty apply to agreements concerning arbitrations taking place in Hong Kong was left open.

Partners Paul Starr, David Bateson and Galit Alon of Mallesons Stephen Jaques in Hong Kong.

SINGAPORE

Compared with the surge of third-party funding of litigation and arbitration in Australia and Europe, Singapore has been relatively subdued. There are no publicised examples of third-party funding in arbitration in Singapore, and those in litigation are few. What is of interest is how the evolution of third-party funding around the world is likely to affect Singapore.

Third-party funding's failure to take off here so far is because the torts of champerty and maintenance still apply. This regulatory regime is under review – but for the time being, champertous contracts offend public policy and are unenforceable.

The doctrine of champerty applies to arbitration proceedings as well as litigation, as recently held by the appeal court in *Otech*

Pakistan Pvt Ltd v Clough Engineering Ltd. Public policy considerations of purity of justice and the interests of vulnerable litigants continue to shape the courts' attitude when they face cases where one party agrees to help another bring a claim in exchange for a share of whatever is recovered.

As in England and Wales, contingency-fee arrangements are prohibited in Singapore. Lawyers are forbidden from entering into negotiations with a client for either an interest in the subject matter of litigation or remuneration proportionate to the amount recovered by the client in the proceedings (section 107 of the Legal Profession Act).

That said, the doors are not closed to third-party funding in litigation and arbitration. In 2006, a committee headed by V K Rajah, Judge of Appeal at the Supreme Court of Singapore, was appointed to undertake a comprehensive review of the country's legal services. In a recent report, the committee recommended introducing a suitable model for class actions, and conditional fee arrangements – where lawyers are paid more than their usual fees in cases with successful outcomes, as in England and Wales. These recommendations are now before the Ministry of Law for further study.

Change may therefore be in store. Even the courts acknowledge that, where the third-party funder has a genuine commercial interest in enforcing proceedings, funding may not be champertous. In *Lim Lie Hoa and another v Ong Jane Rebecca,* the appeal court held that since the third-party funder "had an interest in financing the litigation in the hope that the respondent would recover funds from the estate to enable her to discharge her liabilities", the arrangement made between the third-party funder and the respondent was not champertous. It is, however, too early to speculate on the extent to which existing prohibitions will be modified.

Alvin Yeo SC and Swee Yen Koh of WongPartnership LLP in Singapore.

SWITZERLAND

Third-party funding of arbitrations is a relatively novel concept in Switzerland. There are few arbitration or litigation finance providers based in the country. That said, foreign companies – in the UK, the Netherlands, Germany and the US, for example – have shown they are prepared to fund claimants based in Switzerland or participating in arbitrations seated in Switzerland (see below).

No legal obstacles prevent third-party funding of arbitration in Switzerland. A draft law, proposed by resolution of the Cantonal Council of Zurich in 2003 and which, inter alia, prohibited the financing of litigation by any third party, was challenged before the Swiss courts. In a pivotal decision rendered on 10 December 2004, the Federal Supreme Court in Lausanne ruled that the relevant provision of the draft law prohibiting third-party funding should be set aside, on the basis that it would restrict freedom of commerce in a way that was disproportionate to its intended purpose. The court's decision renders Switzerland a favourable jurisdiction for third-party funding when compared with jurisdictions where the tort of champerty presents legal obstacles.

There has been at least one specific instance of third-party funding in Switzerland. A large French company acquired 100 per cent of a software company in Switzerland. The final instalment of the purchase price was payable three years after the takeover, provided the acquired company hit certain profit thresholds. When these were not reached, the purchaser refused to pay the final instalment of the purchase price. The sellers argued that the purchaser had made those thresholds unattainable by allegedly taking its acquisition into the computer hardware industry, as well as requiring it to continue developing software. The dispute has been referred to ICC arbitration proceedings in Zurich, for which third-party funding has been provided by a German finance provider.

There appears to be another large dispute in Switzerland in which funding is being arranged. Few details of the case are available, although it is known that a Swiss law firm has been instructed by the claimant and is assisting with the attainment of third-party funding.

The conditions for obtaining third-party funding in Switzerland vary from one provider to another, but generally include the following:

- a claim for damages exceeding a certain amount, ranging from 300,000 to 800,000 Swiss francs (€190,000 to €500,000) depending on the provider;
- a very good prospect of success; and
- enforceability of the eventual award against the defendant.

Associate Noradèle Radjai of LALIVE in Geneva.

UNITED STATES

Third-party funding of litigation or arbitration varies from state to state in the US. Some states retain common law doctrines or statutes, such as maintenance and champerty, prohibiting disinterested persons from investing in lawsuits. Others have renounced them.

A sample of state jurisprudence reflects the divergent approaches. The highest courts of several states have explicitly rejected champerty and maintenance doctrines. The 1997 Massachusetts Supreme Court decision in *Saladini v Righellis* is typical. In ruling that the doctrines of maintenance and champerty "no longer shall be recognised in Massachusetts", the court reasoned that:

> *The champerty doctrine is [no longer] needed to protect against the evils once feared: speculation in lawsuits, the bringing of frivolous lawsuits, or financial overreaching by a party of superior bargaining position.*

The court explained that new tools such as fee regulations, sanctions rules and the doctrines of unconscionability, duress and good faith provide sufficient safeguards to protect against the "evils" the common law doctrines were originally intended to address. The Supreme Court of South Carolina adopted the *Saladini* analysis in *Osprey v Cabana Limited Partnership* in 2000.

In contrast, the Ohio Supreme Court ruled in *Rancman v Interim Settlement Funding Corporation* in 2003 that a funding company's advance to a litigant in return for a percentage of the recovery was void under principles of champerty and maintenance, regardless of whether the advances were considered loans or investments. According to the court, "a lawsuit is not an investment vehicle" and "[a]n intermeddler is not permitted to gorge upon the fruits of litigation".

Lying in the middle of these extremes are state courts that have limited – but not abolished – the common law doctrines. In the 1996 *Kraft v Mason* case, for example, a Florida appellate court held that an arrangement in which the litigant obtained third-party funding in exchange for relinquishing set percentages of the ultimate recovery was not prohibited by champerty because the financier had neither instigated the litigation nor set the terms of the loan.

On the wider stage, there are reputedly several high-profile investment treaty cases managed by US and UK law firms in which the claimants are receiving third-party financing for arbitration expenses or engaging in other alternative fee arrangements with third-party financiers (or arbitration counsel) that enable claimants to proceed with their arbitration claims while delaying payment until the issuance of any resulting arbitration award.

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