

SABC MEMBER LEGAL INSIGHTS

MITIGATING THE COSTS OF POTENTIAL DISPUTES IN AFRICA THROUGH THIRD-PARTY FUNDING

FEBRUARY/MARCH 2023

AUTHORS:



BERND EHLE
PARTNER

LALIVE



AUGUSTIN BARRIER
COUNSEL

LALIVE

LALIVE





THIRD-PARTY FUNDING

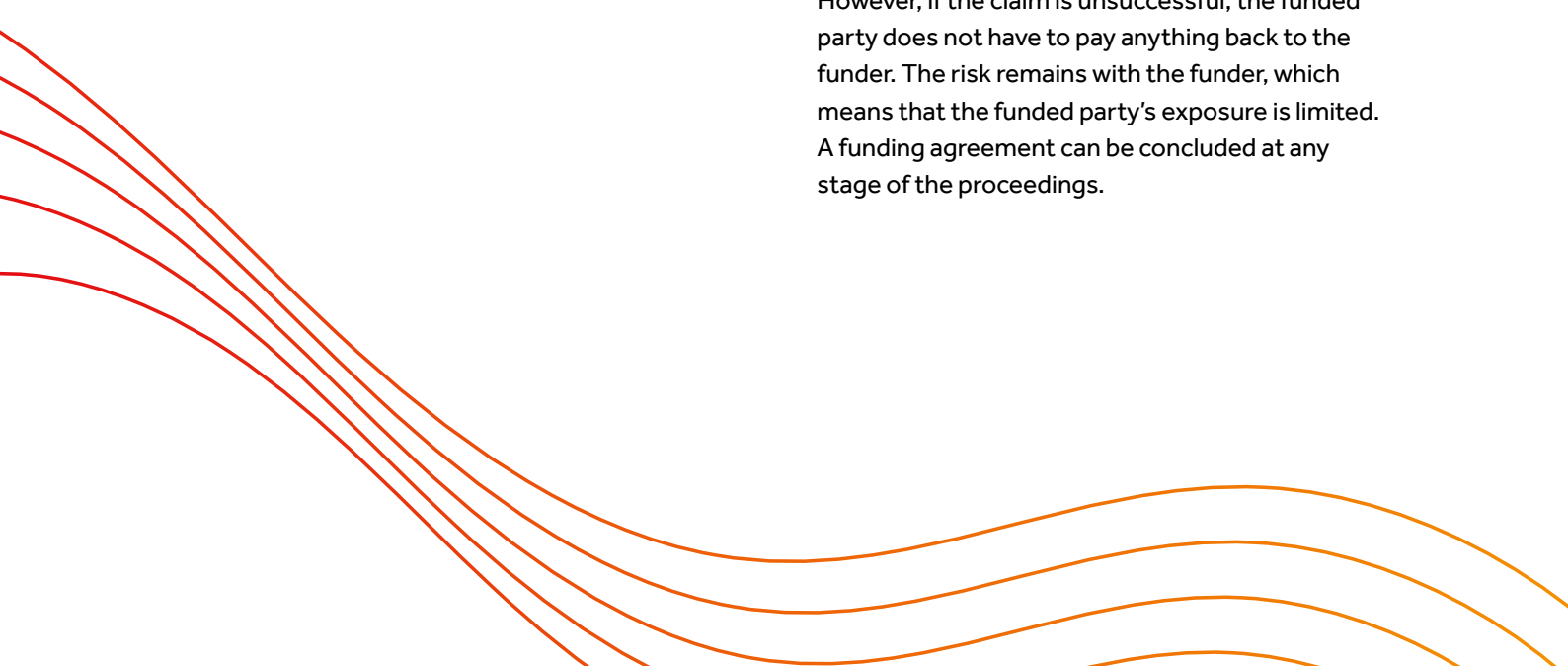
Disputes can be a source of significant uncertainty and costs. Accordingly, businesses try to avoid disputes as far as possible. There are however situations in which an amicable settlement is not possible and legal proceedings cannot be avoided. Such proceedings are usually bad news for a business as they cause disruption and divert legal costs from business operations or investments. These costs often remain blocked, at least until the end of the proceedings. In addition, the litigation risk associated with legal controversy is often compounded by enforcement risk.

Swiss companies often ignore the fact that these costs and risks can be transferred to a third party through litigation funding, in consideration for a premium depending on the outcome of the proceedings. Litigation funding has grown exponentially over the past decade, but the different regulations in each country and the variety of solutions available sometimes make this market difficult to navigate. This article aims to provide an insight into this mechanism and how it can be helpful to Swiss companies operating in Africa.

WHAT IS THIRD-PARTY FUNDING?

Litigation funding is at the crossroads between law, finance and commerce. It was originally intended to facilitate access to justice for companies with legitimate claims but without the ability or means to pursue them. Litigation funding has evolved significantly over the past decade, leading to the creation of numerous funds in different parts of the world.

Funders typically provide non-recourse financing to a litigant in exchange for a share of the proceeds from the subsequent judgment or settlement agreement. However, if the claim is unsuccessful, the funded party does not have to pay anything back to the funder. The risk remains with the funder, which means that the funded party's exposure is limited. A funding agreement can be concluded at any stage of the proceedings.



HOW TO SECURE THIRD-PARTY FINANCING OF A CLAIM?

> *Due diligence process*

Given the risk that third-party funders assume, securing financing for a claim can be a lengthy process. It usually begins with an informal funding request. If the funder is interested, the applicant must submit a more formal application that includes a description of the claim and its prospect of success. The parties typically also enter into a non-disclosure agreement.

Then begins the first phase of the due diligence process, in which the applicant must usually submit a so-called funding memorandum setting out the factual background, legal arguments and scope of its claim, and provides a set of key supporting documents.

Based on the analysis of this memorandum, the funder may make a preliminary financing offer or propose a funding term sheet. Based on this preliminary agreement, the funder undertakes a second, more thorough due diligence phase, during which it has access to all relevant documentation. The funder may also seek the assistance of external legal advisors and quantitative or technical experts to assess the claim from a legal and economic perspective.

The funder then decides whether to invest in the claim. In the event of a positive decision, the parties negotiate and sign a litigation funding agreement.



> *The funding agreement*

The funding agreement governs the relationship between the funder and the funded party. Outside counsel is not a party to the funding agreement, which often indicates that the funded party retains full control of the claim. Accordingly, the funded party agrees to have its legal counsel report to the funder on a regular basis, and the agreement specifies the manner in which the invested amount will be disbursed by the funder based on an agreed budget.

The funding agreement also sets out the funder's success fee, which may vary depending on the funder or the case. It may consist of a fixed portion of the amount recovered, a multiple of the invested amount, a percentage of the recovered amount, or a combination of several mechanisms.

Once the agreement is concluded, the funders usually do not intervene in the proceedings.

WHAT ARE THE CHALLENGES OF THIRD-PARTY FUNDING?

> *Due diligence process*

Funders review a large number of claims each year and fund only a fraction of them. The due diligence process is therefore designed to exclude applications in case of uncertainty rather than to force investigations. Accordingly, if the documentation received, including the funding memorandum, does not meet the funder's expectations for presentation, they may reject the application.

It is therefore advisable for the applicant to seek the assistance of outside counsel in preparing the funding memorandum.

Whenever possible, the law firm retained should have experience in dealing with third-party funders and in drafting funding memoranda. Such law firms also have good contacts with multiple funders and can thus submit the claim to several funders simultaneously. They also know whether or not certain funders are more willing to finance certain types of disputes.

Finally, the costs associated with hiring outside counsel for the due diligence phase are not necessarily a problem, as funders are often prepared to fund at least a portion of those costs down the road when the funding agreement is signed.

> *General challenges*

Funders are reluctant to finance disputes that do not involve monetary compensation, such as requests for declaratory relief or defence against a claim without a counterclaim. There are of course exceptions, but the lack of a financial interest often limits access to external funding.

Similarly, external funding of a dispute can make it difficult to reach a settlement on non-monetary terms. In the absence of recovery, typical funder compensation mechanisms do not work. Therefore, it is critical that the funding agreement include a specific mechanism for when the case settles early, including on non-monetary terms.



Another important consideration is the extent of risk transferred to the funder. For example, most funders do not assume the risk of having to bear the costs imposed by the arbitral tribunal against the funded party if the case is not successful. They sometimes require the funded party to take out special insurance for this eventuality, known as After-the-event (ATE) insurance.

> *Challenges specific to Africa*

Funders are often reluctant to finance state court litigation in African countries because they consider those as too risky for a number of reasons, including the lack of judicial independence, the quality of decisions, and the lack of speed. As a result, third-party funders almost exclusively finance arbitration proceedings.

Experience has shown that even in arbitration, claims are generally judged by a more rigorous standard when they are related to Africa. Notably, most funders consider that it is more difficult to enforce arbitration awards in African jurisdictions. It is therefore necessary to identify the potential risks and address them directly in the funding memorandum. For example, applicants can gather evidence of the opposing party's ability to pay or suggest enforcement strategies.



Another way to mitigate the risk is the increasingly common practice of funders to finance portfolios of claims rather than individual claims by bundling claims with different levels of risk to limit the overall exposure. For example, a funder may accept to finance a mix of Swiss intellectual property litigation and arbitration claims related to Africa.

Finally, the funding memorandum should address whether third-party funding is regulated or even prohibited at the seat of the arbitration or in the country of enforcement. The fact that the case

was funded may be considered by local courts as a public policy violation and lead to the setting aside of the award.

In Namibia, Uganda and Zimbabwe, for example, third-party funding is expressly prohibited. It is also prohibited in Nigeria, although it is soon to be permitted by law. In most other African countries, with the exception of South Africa, where it is permitted, third-party funding is not regulated, so a country-specific analysis is required to determine whether third-party funding is permissible.



CONCLUSIONS

- Although it is more difficult to obtain funding for legal proceedings in Africa because of perceived additional risk, Swiss companies should consider third-party funding to mitigate the risk of their disputes in Africa.
- The assistance of outside counsel with experience in dealing with third-party funders is essential to present a sound and convincing funding memorandum that addresses all the relevant aspects and potential risks of the case.
- Bundling claims into a portfolio is a useful tool to mitigate risk and build a real partnership with a funder.
- A well-negotiated funding agreement transforms the dispute from a cause of stranded costs and uncertain reward into an income-generating asset with an immediate impact on a company's balance sheet.