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Third Party Litigation Funding: Investing in Arbitration by B.M. Cremades, Jr.

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THIRD PARTY LITIGATION FUNDING: INVESTING IN ARBITRATION

*Bernardo M. Cremades, Jr.*¹

1. INTRODUCTION

It is not uncommon that investors might consider the impact of pending litigation when deciding whether to buy the stock of a company on the open market. For example, think of a company engaged in a litigation proceeding whose outcome may materially influence the price of its stock. The question follows: *If investors in the stock market are permitted to invest indirectly in the results of litigation, why not invest directly in litigation itself?*

From the perspective of a company that is engaged in or is facing the prospect of a legal dispute with serious consequences for the future of the company, there may be a number of reasons that, if such company is a potential claimant with a meritorious action against a defendant, it may nevertheless choose to either settle the dispute for a discounted amount or even discontinue its efforts to obtain satisfaction. The reasons for this settlement or discontinuation could be, for instance, that: (i) the claimant lacks enough resources to pursue the claim; (ii) the allocation of immediate funds may result in the default of other obligations; or (iii) the potential claimant is bankrupt. Similarly, a company against whom a claim has been filed may face the same situation and, consequently, may see no other solution than to surrender to the pressure created by the claimant and thus enter into a one-sided settlement agreement even though it believes it has meritorious defenses to the claim.

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In such cases, the claimant or defendant may choose to seek funding assistance from others in order to enjoy proper representation in the proceeding. This can be achieved through different means, the most prominent being lawyer contingent fees or third party litigation funding. Without doubt, these funding tools are now being employed by parties in the international arena and, in particular, by parties in commercial and investment arbitration proceedings.²

2. THE CONCEPT

In essence, third party litigation funding is a modern twist on the classic contingency fee agreement, as it could be described as a contingent fee offered by non-lawyers. In third party funding, a funder covers the costs and expenses of the litigant in consideration of the assignment by the latter of a share in any future compensation. In addition to the fees and expenses of counsel, the funder may cover other costs or expenses agreed, such as arbitral institution fees, arbitrator's fees, costs of investigation, document production and review, hearing expenses, costs and expenses of witnesses and expert witness.³

If the funded litigant loses, the funder will lose the investment. However, if the claim is successful, either in litigation or settlement, the funder will receive a portion or percentage of the recovery. Traditional lenders may consider these types of loans too "high risk" because they do not have the ability to assess the outcome of the case, the maturity date is unknown, and there are no interim payments to collect on the cash advance. Thus, litigation finance companies assume risks that traditional lenders are unwilling to take because they stand to gain a substantial percentage of the litigant's recovery when the case is settled or is won. As with many other venture capital

² See J. Bédard, *Recession-Proof Arbitration of the Power of Constraint to Control Time and Costs*, 64-OCT DRJ 74 (1999); L. Atherton, *Third Party Funding in Arbitration: A Perspective from England*, K&L GATES NEWSSTAND: ARBITRATION WORLD, dated October 2009.

³ Note that Rule 1.8(e) of the ABA MODEL RULES OF PROFESSIONAL CONDUCT (2010) states that "[a] lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that: (1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and (2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client." However, some states like Texas have a somewhat more expanded rule which include other advances: "(1) a lawyer may advance or guarantee court costs, expenses of litigation or administrative proceedings, and reasonably necessary medical and living expenses, the repayment of which may be contingent on the outcome of the matter; and (2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client." Rule 1.08(d) of the TEXAS DISCIPLINARY RULES OF PROFESSIONAL CONDUCT, effective June 1, 2005.

businesses, some times investments will be lost, but the successful investments will result in considerable profits (offsetting losses in the unsuccessful investments, as well as providing beneficial margins).

3. ORIGINS, HISTORICAL PROHIBITIONS AND DEVELOPMENTS

Historically, the related doctrines of maintenance and champerty were developed to prevent third parties from offering assistance in the pursuit of legal claims. Maintenance is the “assistance in prosecuting or defending a lawsuit given to a litigant by someone who has no bona fide interest in the case”⁴ or “meddling in someone’s else litigation.”⁵ Champerty, which is an aggravated form of maintenance, is “an agreement between an officious intermeddler in a lawsuit and a litigant by which the intermeddler helps pursue the litigant’s claim as consideration for receiving part of any judgment proceeds.”⁶ Among laypersons, champerty can be known as “buying into someone else’s lawsuit.” Sometimes these doctrines may be coupled with “barratry,” which is “vexatious incitement to litigation, especially by soliciting potential legal clients.”⁷ Barratry is both a crime and a tort.⁸

⁴ B.A. Garner, BLACK’S LAW DICTIONARY (Thomson West, 2007), p. 973.

⁵ *Id.*

⁶ *Id.*, p. 246. In other words, “an agreement to divide litigation proceeds between the owner of the litigated claim and a party unrelated to the lawsuit who supports or helps enforce the claim.” *Id.* The U.S. Supreme Court defines these doctrines as follows: “[p]ut simply, maintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome.” *In re Primus*, 436 U.S. 412 (1978), pp. 424-425 (n. 15).

⁷ B.A. Garner, BLACK’S LAW DICTIONARY (Thomson West, 2007), p. 160. It has also been defined as “the offense of frequently exciting or stirring up suits and quarrels between others.” 14 AM. JUR. 2D CHAMPERTY, MAINTENANCE, ETC. § 16. See also *Vitaphone Corp. v. Hutchinson Amusement Co.*, 28 F. Supp. 526 (D. Mass. 1939); *Scott v. State*, 53 Ga. App. 61, 185 S.E. 131 (1936), *affirmed by* 184 Ga. 164, 190 S.E. 582 (1937); *Stewart v. Fourth Nat. Bank*, 141 Kan. 175, 39 P.2d 918 (1935).

⁸ 14 AM. JUR. 2D CHAMPERTY, MAINTENANCE, ETC. § 16, which provides that: “[f]or the purposes of civil barratry, a frivolous action exists when the proponent can present no rational argument based on the evidence or law in support of the claim. To fall to the level of frivolousness, there must be such a deficiency in fact or law that no reasonable person could expect a favorable judicial ruling.” Citing *Citibank (S.D.), N.A. v. Hauff*, 2003 SD 99, 668 N.W.2d 528 (S.D. 2003). “Malice for purposes of a civil barratry claim exists when the proceedings are instituted primarily for an improper purpose.” Citing *Pioneer Bank & Trust v. Reynick*, 2009 SD 3, 760 N.W.2d 139 (S.D. 2009). “Statutes defining barratry have also extended the definition of the offense to situations in which the offender institutes baseless litigation on his or her own behalf with a corrupt or malicious intent to vex and annoy.” Citing *People v. Budner*, 15 N.Y.2d 253, 258 N.Y.S.2d 73, 206 N.E.2d 171 (1965).

Although legal historians have traced the roots of champerty back to the Greek and Roman civilizations,⁹ the doctrines of maintenance and champerty (as we know them) arose in medieval England in response to the practice of, in return of an interest or share in the outcome of the litigation, assigning doubtful or fraudulent claims to persons of wealth and influence in the expectation that such individuals would enjoy greater success in prosecuting those claims at court.¹⁰ Another reason for its inception was that wealthy nobles would command their retainers to bring suits against the noble's enemies and the noble would control (and fund) those suits.¹¹ As a result, suits overwhelmed defendants.

The above reasons, together with the strong medieval Christian sentiments of forgiveness and turning the other cheek led people to believe that litigation was “an indication of a quarrelsome and un-Christian spirit.”¹² Detractors of the practices of maintenance and champerty were thus successful in convincing the courts and the crown to adopt laws against these practices. Accordingly, with the aim of protecting the legal system and the administration of justice, maintenance and champerty were made subject to criminal and tort liability (and, in turn, a rule of common law).¹³

The United States initially inherited these principles, but as early as 1937 Max Rodin wrote that contingency fee agreements by lawyers were a widespread accepted form of champerty:

When the practice first arose of offering a lawyer a share of the profit of litigation in lieu of his fee, it was clearly champerty – more precisely “maintenance by means of

⁹ 14 AM. JUR. 2D CHAMPERTY, MAINTENANCE, ETC. § 16; M. Radin, *Maintenance by Champerty*, 24 CAL. L. REV. 48 (1937), pp. 49-56. See also S.L. Martin, *The Wild West of Finance: Should it Be Tamed or Outlawed?*, HOFSTRA HORIZONS, Fall 2005, p. 20.

¹⁰ M. Radin, *Maintenance by Champerty*, 24 CAL. L. REV. 48 (1937), pp. 58-64. See also A. Hananel & D. Staubitz, *The Ethics of Loans in the Post-Rancman Era*, 17 GEO. J. LEGAL ETHICS 795 (2003-2004), p. 797; M. Steinitz, *Whose Claim is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268 (2011), p. 1287; W. R. Long, *Champerty and Contingent Fees Part III*, DRBILLLONG.COM, dated December 13, 2005.

¹¹ M. Radin, *Maintenance by Champerty*, 24 CAL. L. REV. 48 (1937), pp. 58-64. See also S.L. Martin, *Financing Plaintiffs' Lawsuits: An Increasingly Popular (and Legal) Business*, 33 U. MICH. J. L. REF. 57 (1999-2000), p. 83; A. Hananel & D. Staubitz, *The Ethics of Loans in the Post-Rancman Era*, 17 GEO. J. LEGAL ETHICS 795 (2003-2004), p. 797.

¹² M. Radin, *Maintenance by Champerty*, 24 CAL. L. REV. 48 (1937), p. 58.

¹³ *Id.*, pp. 64-67.

champerty,” *manutentia per campipartem* – because it would have been champerty, if anybody, lawyer or layman, had acquired such a share in the profits with or without consideration.¹⁴

However, since the American Bar Association granted approval of collection of contingency fees by attorneys in 1908, all U.S. states allow such fees to some extent, Maine being the last state to eliminate the prohibition on contingency fees in 1965.¹⁵ The United States Supreme Court confirmed the legality of the contingency fee agreement in *Stanton v. Embrey*:

Coming to the merits, the first objection of the plaintiffs in error is that the contract set up in declaration is one for a contingent compensation. Such a defense, in some jurisdictions would be a good one but the settled rule of law in this Court is the other way. Reported cases to that effect show that the proposition is one beyond legitimate controversy.¹⁶

On the other hand, third party funding is slowly developing in the United States, perhaps because contingency fees and other payment schemes were first permitted in the U.S. and have long dominated the field of U.S. litigation funding.¹⁷ In fact, in 2009, a

¹⁴ M. Radin, *Maintenance by Champerty*, 24 CAL. L. REV. 48 (1937), p. 69. See also S.L. Martin, *Financing Plaintiffs' Lawsuits: An Increasingly Popular (and Legal) Business*, 33 U. MICH. J. L. REF. 57 (1999-2000), p. 72 (“In the United States . . . the most notable exception [to the champerty prohibition] is the contingency fee system. A lawyer’s agreement to handle a case in exchange for a percentage of the damages recovered, if any, is clearly champertous. Nevertheless, all states recognize such agreements.”); P. Bond, *Making Champerty Work: An Invitation to State Action*, 150 PA. L. REV. 1297 (2002), p. 1303 (“Contingency fees for lawyers’ services are generally exempted from the champerty rule.”); A. Hananel & D. Staubitz, *The Ethics of Loans in the Post-Rancman Era*, 17 GEO. J. LEGAL ETHICS 795 (2003-2004), p. 811 (“[L]awyers who accept contingency fees are, in fact, champertors. An attorney accepting a contingency fee is really buying a share of a law suit and paying with legal services instead of cash.”); A.J. Sebok, *The Inauthentic Claim*, Benjamin N. Cardozo School of Law, Working Paper No. 298, dated April 2010, pp. 45, 71 (available at <http://ssrn.com>) (“Technically, of course, all fifty-one jurisdictions permit at least one form of maintenance: the contingency fee. . . . Furthermore, beginning with the adoption of a special exception for what I called lawyer maintenance (the contingency fee) in the early twentieth century.”). See also S.L. Martin, *The Wild West of Finance: Should it Be Tamed or Outlawed?*, HOFSTRA HORIZONS, Fall 2005, p. 20.

¹⁵ 17 A.M.R.S.A. § 516(2) (1983). See also A.J. Sebok, *The Inauthentic Claim*, Benjamin N. Cardozo School of Law, Working Paper No. 298, dated April 2010, p. 45 (n. 151) (available at <http://ssrn.com>); and M. R. Koval, *Living Expenses, Litigation Expenses, and Lending Money to Clients*, 7 GEO. J. LEGAL ETHICS 1117 (1994), pp. 1126-1127.

¹⁶ *Stanton v. Embrey*, 93 U.S. 548 (1877), p. 556, citing *Wylie v. Coxe*, 56 U.S. 415, 14 L. Ed. 753 (1853) and *Wright v. Tebbitts*, 91 U.S. 252, 23 L. Ed. 320 (1875).

¹⁷ T.V. Sankoorikal, M. Jonnalagadda & K. Van Hamersveld, *Third Party Financiers in Complex Litigation: Issues to Consider with Third Party Litigation Funding*, 840 PLI/LIT 351, August 1, 2010, p. 351. See also

publication guessed that not more than 30 cases a year were being funded by third parties.¹⁸ However, nowadays “third-party litigation funding has become a feature of the litigation landscape in the United States.”¹⁹ For example, in 2004, the American Legal Finance Association (ALFA) was formed by nine of the leading companies in the industry but today has grown to 20 members.²⁰

In the United States, the laws governing third party finance agreements appear to vary significantly from state to state. Nonetheless, we can identify three clear trends in the American legal system: (i) the doctrines of maintenance and champerty are not enforced (e.g., Massachusetts); (ii) whereas certain agreements are champertous, others are not (e.g., New York); or (iii) the doctrines of maintenance and champerty are enforceable to the fullest extent (e.g., the District of Columbia). At least 28 states allow maintenance to some extent.²¹ We will discuss hereunder Massachusetts, New York and the District of Columbia.

3.1. Massachusetts

Massachusetts initially enforced the common law prohibition against maintenance and champerty.²² The Supreme Court of Massachusetts eliminated the

N. Raymond, *More Attorneys Exploring Third-Party Litigation Funding*, LAW.COM, June 4, 2010, p. 1 (available at www.law.com).

¹⁸ M. Maleske, *Hedging Bets: Third-Party Litigation Funding Gains Steam in the U.S.*, INSIDE COUNSEL, dated December 1, 2009.

¹⁹ L.S. Schaner & T.G. Appleman, *The Rise Of 3rd-Party Litigation Funding*, LAW 360, dated January 21, 2011 (available at www.law360.com). Additionally, as mentioned above, a source estimated that there is a potential market of claimants in the United States needing financial support in the combined amount of US\$80 to US\$100 billion. Fulbrook Management LLC, *Investing in Commercial Claims, Nutshell Primer*, dated March 3, 2011, p. 22.

²⁰ ALFA's Website, "About ALFA" section (available at www.americanlegalfin.com).

²¹ In particular: Arizona, California, Colorado, Connecticut, Florida, Hawaii, Iowa, Kansas, Louisiana, Maine, Maryland, Massachusetts, Michigan, Missouri, Montana, New Hampshire, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, Tennessee, Texas, Washington, and West Virginia. See A.J. Sebok, *The Inauthentic Claim*, Benjamin N. Cardozo School of Law, Working Paper No. 298, dated April 2010, p. 45 (available at <http://ssrn.com>). A.J. Sebok adds that 16 of them explicitly permit maintenance for profit: Colorado, Connecticut, Florida, Iowa, Kansas, Maine, Maryland, Massachusetts, Montana, New Hampshire, North Carolina, Ohio, Oklahoma, Oregon, Washington, and West Virginia. *Id.*, p. 54 (n. 178). Finally, that author mentions that his survey is consistent with P. Bond, *Making Champerty Work: An Invitation to State Action*, 150 PA. L. REV. 1297 (2002).

²² S.L. Martin, *Financing Plaintiffs' Lawsuits: An Increasingly Popular (and Legal) Business*, 33 U. MICH. J. L. REF. 57 (1999-2000), p. 57.

doctrines of maintenance, champerty and barratry in *Saladini v. Righellis*.²³ The Court justified the end of the prohibition as follows:

We also no longer are persuaded that the champerty doctrine is 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. There are now other devices that more effectively accomplish these ends.²⁴

For the Court, the other devices that more effectively accomplish these ends were: (i) the rule governing contingent fees between attorneys and clients which is based on the principle that an attorney's fee must be reasonable; (ii) the public policy against the recovery of excessive fees; (iii) sanctions for misconduct; (iv) rules against the bringing of frivolous lawsuits; and (v) the doctrines of unconscionability, duress and good faith, which establish standards of fair dealing between opposing parties.²⁵

The Court concluded by mentioning that "if an agreement to finance a lawsuit is challenged, we will consider whether the fees charged are excessive or whether any recovery by a prevailing party is vitiated because of some impermissible overreaching by the financier."²⁶ In such case, the Court would be guided "by a rule of what is fair and reasonable, looking to all of the circumstances at the time the arrangement is made to determine whether the agreement should be set aside or modified."²⁷

3.2. New York

New York has reached a narrow reading of the definition of champerty in the landmark opinion of the New York Court of Appeals in *Merrill Lynch v. Love Funding*.²⁸ This case related to a challenge to the validity of the assignment of a claim in the context of purchasing distressed debt. In particular, the Court had to comment on the

²³ See *Saladini v. Righellis*, 687 N.E.2d 1224 (1997), p. 1226.

²⁴ *Id.*, p. 1227.

²⁵ *Id.*

²⁶ *Id.* In this regard, the Court pointed out that "Judges also retain their inherent power to disapprove an attorney's fee that is unreasonable." *Id.*

²⁷ *Id.*

²⁸ *Trust For the Certificate Holders of Merrill Lynch Mortg. Investors, Inc. v. Love Funding Corp.*, 918 N.E.2d 889 (2009).

scope of New York’s statute codifying the common law doctrines of maintenance and champerty in order to see whether such laws prohibit buyers or secondary holders of distressed debt from bringing claims related to the debt in question. In this vein, section 489(1) of the New York Judiciary Laws stipulates:

No person or co-partnership, engaged directly or indirectly in the business of collection and adjustment of claims, and no corporation or association, directly or indirectly, itself or by or through its officers, agents or employees, shall solicit, buy or take an assignment of . . . any claim or demand, with the intent and for the purpose of bringing an action or proceeding. . . .

Notwithstanding the above, there is a safe harbor provision for claims with an aggregate value of US\$500,000 or more.²⁹ The Court held that “a corporation or association that takes an assignment of a claim does not violate Judiciary Law § 489(1) if its purpose is to collect damages, by means of a lawsuit, for losses on a debt instrument in which it holds a preexisting proprietary interest.”³⁰ The Court summarized the conclusion as follows:

In short, the champerty statute does not apply when the purpose of an assignment is the collection of a legitimate claim. What the statute prohibits . . . “is the purchase of claims with the ‘intent and for the purpose of bringing an action’ that [the purchaser] may involve parties in costs and annoyance, where such claims would not be prosecuted if not stirred up . . . in [an] effort to secure costs.”³¹

Finally, the Court declared that “[i]n New York, however, the prohibition of champerty has always been ‘limited in scope and largely directed toward preventing attorneys from filing suit merely as a vehicle for obtaining costs’” and thus New York’s champerty law is intended “to prevent attorneys and solicitors from purchasing debts, or other things in action, for the purpose of obtaining costs from a prosecution thereof, and

²⁹ NEW YORK JUDICIARY LAWS, § 489(2).

³⁰ *Trust For the Certificate Holders of Merrill Lynch Mortg. Investors, Inc. v. Love Funding Corp.*, 918 N.E.2d 889 (2009), p. 890.

³¹ *Id.*, p. 895, citing *Wightman v. Catlin*, 113 App. Div. 24, 98 N.Y.S. 1071 (2d Dept. 1906).

was never intended to prevent the purchase for the honest purpose of protecting some other important right of the assignee.”³² Later decisions have followed this approach.³³

Addressing the development of third party funding, the New York City Bar Association has recently issued a Formal Opinion stating that litigation financing agreements are not unethical on their face:

Non-recourse litigation financing is on the rise, and provides to some claimants a valuable means for paying the costs of pursuing a legal claim, or even sustaining basic living expenses until a settlement or judgment is obtained. It is not unethical *per se* for a lawyer to advise on or be involved with such arrangements. However, they may raise various ethical issues for a lawyer, such as the potential waiver of privilege and interference in the lawsuit by a third party. A lawyer representing a client who is party, or considering becoming party, to a non-recourse funding arrangement should be aware of the potential ethical issues and should be prepared to address them as they arise.³⁴

3.3. District of Columbia

In a case decided by a federal court with limited effect in state courts, *Design for Business Interiors, Inc. v. Herson’s, Inc.*,³⁵ the U.S. District Court for the District of Columbia appeared to confuse the assignment of claims with champerty.³⁶ In this case, the Court had to decide whether the assignment of a contract for the future pursuit of litigation was champerty, prohibited in the District of Columbia. In particular, in this case, Commercial Office Environments, Inc. (hereinafter, **COE**) assigned to Design for Business Interiors, Inc. (hereinafter, **DBI**) five contracts with Herson’s, Inc.³⁷ DBI agreed to pay any monies received under these five contracts to COE, and the two

³² *Id.*, p. 894.

³³ See *U.S. Bank Nat’l Assoc. v. Crutch*, 2010 WL 2978172 (E.D.N.Y. July 26, 2010), at *3.

³⁴ New York City Bar Association, *Formal Opinion 2011-2: Third Party Litigation Financing*, dated June 2011. To render this opinion, the NYCBA analyzed Rules 1.2(d), 1.6(a), 1.7(a), 1.8(e), (f), 2.1, 2.2 and 5.4(c) of the N.Y. RULES OF PROFESSIONAL CONDUCT, effective April 1, 2009 (as amended May 4, 2010).

³⁵ *Design for Business Interiors, Inc. v. Herson’s, Inc.*, 659 F. Supp. 1103 (D.D.C. 1986).

³⁶ This is a very relevant case given the narrow approach taken by the Court and the importance of the District of Columbia in the field of arbitration.

³⁷ *Design for Business Interiors, Inc. v. Herson’s, Inc.*, 659 F. Supp. 1103 (D.D.C. 1986), p. 1107.

parties agreed to divide the costs of the litigation equally, including attorneys' fees.³⁸ The Court first acknowledged that "[t]he District of Columbia does not have a statute prohibiting champerty, but instead looks to the common law for its definition of this conduct."³⁹ For this purpose, the Court adopted a very broad definition of champerty:

Under the common law, champerty is defined as "a bargain to divide the proceeds of a litigation between the owner of the litigated claim and the party supporting or enforcing the litigation."⁴⁰

In the case at hand, the Court recognized that the assignment was not carried out "for legitimate business reasons."⁴¹ Instead, for the Court, "COE assigned the contracts to DBI with the understanding that DBI would give COE the proceeds obtained as a result of this suit."⁴² For the court, such arrangements were what the doctrine of champerty meant to ban:

Such an arrangement is precisely what the common law ban on champerty is designed to eliminate: "schemes to promote litigation for the benefit of the promoter rather than for the benefit of the litigant are regarded as contrary to public policy, and will not be enforced." 14 Williston § 1714 at 869. In exchange, DBI is receiving a 50% subsidy of the legal fees it incurs in asserting its own rights under the four contracts it acquired from COE. Such an arrangement falls within the ambit of the common law ban on champerty as enforced in the District of Columbia.⁴³

Thus, the Court concluded that a champertous contract is not enforceable in the District of Columbia.⁴⁴

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.*, citing 14 W. Jaeger, WILLISTON ON CONTRACTS § 1711 (3d ed. 1972), at 857.

⁴¹ *Id.*, p. 1108.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*, citing *Marshall v. Bickel*, 445 A.2d 606 (D.C. 1982), p. 609. Interestingly, the court pointed out that among the reasons for this policy was to prevent the abusive use of federal courts: "If federal court jurisdiction could be created by assignments of this kind, which are easy to arrange and involve few disadvantages to the assignor, then a vast amount of ordinary contract and tort litigation could be channeled into the federal courts at the will of one of the parties." *Id.*, p. 1109.

4. DIFFERENTIATION FROM OTHER FUNDING METHODS

Although sometimes related to or connected with other funding devices, third party funding should be distinguished from the financing devices discussed hereunder.

4.1. Assignment of Claims

When a party assigns a cause of action, such party loses control to the fullest extent over the disposition of the cause of action, including the power to settle (and for what amount), as well as the power to manage or direct the litigation strategy (*i.e.*, selection and compensation of attorneys, evidence to be used, selection of witnesses, etc.).⁴⁵ In other words, whereas in the assignment of lawsuits the litigant sells the lawsuit itself, in third party funding the litigant merely sells the possible “fruits” of the lawsuit. Of course, it is sometimes difficult to draw a clear line between third party funding and assignment of claims.⁴⁶

The most obvious examples of assignment of claims are: (i) assignment of contractual rights to third parties; (ii) factoring agreements or sale of distressed debt; and (iii) *qui tam* actions.⁴⁷

4.2. After The Event Legal Expenses Insurance (a.k.a. “ATE Insurance”)

Legal expenses insurance provides coverage against the potential costs of legal actions. ATE insurance is a particular type of legal expenses insurance that is taken out after an event, such as an accident, to cover the anticipated costs of the defense or pursuit of litigation related to the event. ATE insurance is usually purchased by people or companies who did not have “before-the-event” legal expenses insurance. If the

⁴⁵ A.J. Sebok, *The Inauthentic Claim*, Benjamin N. Cardozo School of Law, Working Paper No. 298, dated April 2010, p. 56 (available at <http://ssrn.com>).

⁴⁶ For Anthony Sebok, “[o]nce the maintainer [*i.e.*, the funder] assumes full control of the lawsuit, she is really an assignee and the contract that brought her control of the lawsuit is properly a contract in assignment, not maintenance.” A.J. Sebok, *The Inauthentic Claim*, Benjamin N. Cardozo School of Law, Working Paper No. 298, dated April 2010, p. 56 (available at <http://ssrn.com>). Generally, the assignability of the following powers to an assignee may be problematic: (i) power to decide on whether to sue or not or to abandon the case; (ii) power to select the attorney; (iii) power to accept or refuse a settlement (and to decide the amount thereof); (iv) power to determine the theory of the case or the litigation strategy; (v) power to make a decision on the selection of witnesses (whether expert or fact witnesses); or (vi) power to decide on whether to present some piece of evidence or not. Nevertheless, a third party funder may retain the power to indirectly decide on those issues by simply directing the funds and the allocation thereof.

⁴⁷ For discussion on these types of assignments, see M. Steinitz, *Whose Claim is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268 (2011), pp. 1296-1299.

purchaser of such insurance loses in the litigation relating to the event, the insurer pays all costs, both related to defending or commencing a lawsuit. If the purchaser succeeds in the lawsuit, he/she is obligated to pay the insurer the agreed-upon premium. The payment of the premium is thus generally deferred until the conclusion of the case and is only payable on success (and, in most cases, the premium is self-insured).

4.3. Contingent Fee Agreement

A contingent fee agreement is, as noted above, funding by the attorney hired for bringing about the claim.⁴⁸ The litigant will enter into a contingent fee representation agreement pursuant to which the attorney will represent the client for free or for a discounted price in return for a percentage of the compensation obtained by the client. In case no compensation is obtained, the attorney or law firm will not be paid. In the U.S., the litigant will normally still bear the other costs of the proceeding and will be responsible for the award of any costs or fees to the adversary.⁴⁹

As described by Professor Maya Steinitz in a recent article, the “key difference [with third party funding] is that funders are not providing a service for a fee but rather are investing in an asset.”⁵⁰

5. THE THIRD PARTY FUNDING INDUSTRY

Modern third party litigation funding began in Australia in the late 1980s or early 1990s,⁵¹ and currently is spreading into Austria, Germany, Switzerland, the United Kingdom and the United States.⁵² The New York City Bar Association estimated in 2011 that the aggregate amount of litigation financing outstanding exceeds US\$1

⁴⁸ In addition to the United States, as of 2004, contingency fee agreements with attorneys were lawful in Australia, Brazil, Canada, Dominican Republic, France, Greece, Ireland, Japan, New Zealand and the United Kingdom. See H. Kritzer, RISKS, REPUTATIONS, AND REWARDS: CONTINGENCY FEE LEGAL PRACTICE IN THE UNITED STATES (Stanford University, 2004), pp. 258-259.

⁴⁹ See n. 3, *supra*.

⁵⁰ M. Steinitz, *Whose Claim is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268 (2011), pp. 1293-1294.

⁵¹ J. Beisner, J. Miller and G. Rubin, *Selling Lawsuits, Buying Trouble: Third-Party Litigation Funding in the United States*, U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, dated October 2009, p. 9; C. Barksdale, *All That Glitters Isn't Gold: Analyzing the Costs and Benefits of Litigation Finance*, 26 REV. LITIG. 707 (2007), p. 708; M. Steinitz, *Whose Claim is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268 (2011), p. 1279.

⁵² M. Maleske, *Hedging Bets: Third-Party Litigation Funding Gains Steam in the U.S.*, INSIDE COUNSEL, dated December 1, 2009.

billion.⁵³ Another source estimated that there is a potential market of claimants in the United States needing financial support in the combined amount of US\$80 to US\$100 billion.⁵⁴

The largest third party funders operating in the U.S.,⁵⁵ which also operate in other countries, are Juridica Capital Management (hereinafter, **Juridica**), Burford Capital Limited (hereinafter, **Burford**) and IMF Ltd. (hereinafter, **IMF**).⁵⁶ Juridica and Burford obtained capital by means of initial public offerings (*i.e.*, IPOs) on the London Stock Exchange.⁵⁷ Although the industry began with loans to personal injury plaintiffs, this appears not to be the situation any longer.⁵⁸ Juridica, for example, focuses exclusively on business-to-business related claim investments and it does not invest in personal injury, product liability, mass tort, or class action claims.⁵⁹ On the other hand, Selwyn Seidel, founder of Burford, said that the latter would not be opposed to funding class actions, and added that “[c]lass actions are not a sin.”⁶⁰ Banks, such as Credit Suisse (Litigation Strategies Group)⁶¹ or Citigroup (Counsel Financial),⁶² and insurance

⁵³ New York City Bar Association, *Formal Opinion 2011-2: Third Party Litigation Financing*, dated June 2011, *citing* B. Appelbaum, *Investors Put Money on Lawsuits to Get Payouts*, N.Y. TIMES, dated November 14, 2010.

⁵⁴ Fulbrook Management LLC, *Investing in Commercial Claims, Nutshell Primer*, dated March 3, 2011, p. 22.

⁵⁵ For a detailed discussion on the different types of investment funds, refer to *id.*, pp. 20-21.

⁵⁶ IMF was incorporated in Australia and the U.S. is not its primary market. See www.imf.com.au.

⁵⁷ R. Lloyd, *The New, New Thing*, THE AMERICAN LAWYER, dated May 17, 2010 (*available at* www.law.com). Juridica raised US\$180 million and Burford US\$130 million. *Id.* Today, Burford and Juridica have, respectively, a capital of about US\$305 million and US\$210 million. See Fulbrook Management LLC, *Investing in Commercial Claims, Nutshell Primer*, dated March 3, 2011, p. 21.

⁵⁸ M. Steinitz, *Whose Claim is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268 (2011), p. 1277.

⁵⁹ Juridica’s website, “About Juridica” section (*available at* www.juridicainvestments.com). In addition, Juridica “eschews suits that address novel legal issues or have a good chance of being reversed on appeal.” R. Lloyd, *The New, New Thing*, THE AMERICAN LAWYER, dated May 17, 2010 (*available at* www.law.com).

⁶⁰ N. Raymond, *More Attorneys Exploring Third-Party Litigation Funding*, N.Y. LAW JOURNAL, dated June 4, 2010 (*available at* www.law.com). It was recently discovered that Burford had invested US\$15 million in a class action in Ecuador. See *Chevron Corporation v. Steven Donzinger et al.*, S.D.N.Y., 11-CV-0691, Complaint filed on February 1, 2011; *Chevron Corporation v. Steven Donzinger et al.*, S.D.N.Y., 11-CV-0691, Order on Plaintiff’s Motion for Temporary Restraining Order dated February 8, 2011; and *Chevron Corporation v. Steven Donzinger et al.*, S.D.N.Y., 11-CV-0691, Opinion dated March 7, 2011.

⁶¹ J.D. Glater, *Investing in Lawsuits, for a Share of the Awards*, N.Y. TIMES, dated June 2, 2009.

⁶² B. Appelbaum, *Investors Put Money on Lawsuits to Get Payouts*, N.Y. TIMES, dated November 14,

companies, such as Allianz,⁶³ are also launching divisions to invest in disputes.⁶⁴ In addition, some traditional financial companies like General Electric Capital Corporation have sometimes invested in litigation.⁶⁵

Most of Juridica's and Burford's investments (about 60 percent) are referred to them by large law firms and concern both litigation and arbitration.⁶⁶ Generally, Juridica or Burford will invest between US\$3 million and US\$10 million in a US\$25-100 million lawsuit⁶⁷ in exchange for an agreed-upon percentage of the recovery, which is usually two-and-a-half to four times its up-front investment or 10 to 45 percent of the damages awarded.⁶⁸

Andrew Longstreth cites the following example to illustrate the potential windfall profits of third party funders:⁶⁹ in 2009, Gray Development Group reached out to Burford for funding and the latter agreed to advance US\$5 million in exchange for 33 percent of any settlement and 40 percent of any judgment. In June 2010, a jury awarded Gray Development a US\$110 million verdict, resulting in a recovery for Burford in the amount of approximately US\$44 million – or, in other words, a return of approximately 880 percent on its investment.

2010.

⁶³ M. Herman, *Fear of third party litigation funding is groundless*, TIMES ONLINE, dated October 25, 2007.

⁶⁴ See also M. Maleske, *Hedging Bets: Third-Party Litigation Funding Gains Steam in the U.S.*, INSIDE COUNSEL, dated December 1, 2009; M. Steinitz, *Whose Claim is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268 (2011), p. 1277. See also generally M. Kantor, *Third-Party Funding in International Arbitration: An Essay About New Developments*, ICSID REVIEW – FOREIGN INVESTMENT LAW JOURNAL, Volume 24, Number 1, Spring 2009; J. Lyon, *Revolution in Progress: Third-Party Funding of American Litigation*, 58 UCLA L. REV. 571 (2010), p. 573.

⁶⁵ General Electric Capital Corporation invested US\$5.8 million for a US\$10 million contingency share in a US\$151 million judgment against Chase Manhattan Bank. See S.L. Martin, *Financing Plaintiffs' Lawsuits: An Increasingly Popular (and Legal) Business*, 33 U. MICH. J. L. REF. 57 (1999-2000), p. 81; B. Rubenstein, *Company Sells Shares in Jury Award as Appeal Hedge*, CORP. LEGAL TIMES, December 1998, p. 32.

⁶⁶ R. Lloyd, *The New, New Thing*, THE AMERICAN LAWYER, dated May 17, 2010 (available at www.law.com). See also A. Hananel & D. Staubitz, *The Ethics of Loans in the Post-Rancman Era*, 17 GEO. J. LEGAL ETHICS 795 (2003-2004), p. 799.

⁶⁷ See Juridica's and Burford's websites: www.juridicainvestments.com and www.burfordcapital.com.

⁶⁸ L. Atherton, *Third Party Funding in Arbitration: A Perspective from England*, KL GATES LLP NEWSTAND, dated October 2009 (available at www.klgates.com).

⁶⁹ A. Longstreth, *Litigation Finance Firm Backs Big Winner in Arizona Dispute*, THE AMERICAN LAWYER, dated July 30, 2010 (available at www.law.com).

Before committing the funds, third party funders will customarily undertake a due diligence analysis of the claim during which the funder will also decide what share or fee is acceptable.⁷⁰ To this end, the funder will perform a thorough analysis of the facts and merits, including the nature of the damages and clearness of liability of the opposing party. In addition, the analysis may include other factors such as:⁷¹ (i) value of the lawsuit; (ii) amount to be advanced; (iii) jurisdictional obstacles; (iv) defenses; (v) nature and length of proceeding (including whether arbitration or litigation, venue and rules applicable); (vi) possibilities of settlement; (vii) creditworthiness of client and opposing party (particularly, collection prospects); (viii) counsel chosen and compensation structure (whether there is a contingency fee agreement in place); or (ix) additional obligations of the party to be funded linked to the potential recovery (like previous funding agreements or any other liens).⁷² The typical due diligence period to analyze the profitability of the potential investment ranges from 30 to 60 days.⁷³ Juridica explains the process as follows:

Juridica Capital Management's evaluation and due diligence processes seek to remove as much risk as possible from the investment process through solid analysis of business, economic and legal risk factors to identify claims that can be

⁷⁰ Fulbrook Management LLC, a fund incorporated by Selvyn Seidel (who is also one of the founders of Burford), maintains that "for each 10 to 12 Claims that seek funding, only about one ends up with funding." Fulbrook Management LLC, *Investing in Commercial Claims, Nutshell Primer*, dated March 3, 2011, p. 15. As of May 2010, a source estimated that Juridica reviewed around 400 claims and only invested in 23. See R. Lloyd, *The New, New Thing*, THE AMERICAN LAWYER, dated May 17, 2010 (available at www.law.com).

⁷¹ Fulbrook Management LLC explains this as follows: "There are almost countless factors that play into the due diligence timing, including the stage of the dispute, how much has been already collected through discovery or otherwise, the thoroughness and capability and reliability of the attorneys and Claimant, the nature of the case (Antitrust? Patent? Securities Fraud? Breach of contract? Fraud? Claims against Sovereigns? Environmental? International? And so forth), the judges or arbitrators or mediators who may already be involved, the time zones, the languages used, the translations of documents available, reconciling differing laws and/or public policy, hiring and using specialized experts that may be needed). The matrix and checklists used by respected Funders are sophisticated. The integration of many people and many disciplines into the process is itself time consuming." Fulbrook Management LLC, *Investing in Commercial Claims, Nutshell Primer*, dated March 3, 2011, p. 16.

⁷² See Fulbrook Management LLC, *Investing in Commercial Claims, Nutshell Primer*, dated March 3, 2011, pp. 15-19; E. Libby, *Whose Lawsuit is it?: Ethics Opinions Express Mixed Attitudes About Litigation Funding Arrangements*, A.B.A. JOURNAL, May 2003, p. 36; and C. Barksdale, *All That Glitters Isn't Gold: Analyzing the Costs and Benefits of Litigation Finance*, 26 REV. LITIG. 707 (2007), pp. 710-711.

⁷³ See Juridica's and Burford's websites: www.juridicainvestments.com and www.burfordcapital.com. However, there would be certain cases that should be "put on a fast track" for review. See Fulbrook Management LLC, *Investing in Commercial Claims, Nutshell Primer*, dated March 3, 2011, p. 17.

monetised for fair value in a timely and efficient manner. The underwriting process focuses not only on legal merits, damages and collection risk, but also on the entire business context of the claim. Ultimately, Juridica seeks to invest in claims that are likely to be resolved through settlement in a reasonable time frame.⁷⁴

For its part, Burford describes the process as:

Having identified potential opportunities, the Investment Adviser will follow a rigorous process designed to rapidly screen out unsuitable cases. This initial screening process, which will be carried out by the Investment Adviser and suitably qualified legal professionals selected by the Principals, considers a number of factors including, but not limited to: the strength of the claim and its likelihood of success; the potential value of a claim both following adjudication and for settlement purposes; enforceability of an ultimate award; financial condition of the defendant; the likely cost of litigating the claim; regulatory and ethical risks, if any, in the relevant jurisdiction; timing to get through trial and final judgment; and timing and likelihood of settlement.⁷⁵

As the amount of money and the number of players in the field has grown, the sophistication of their practices has likewise increased. The creative use of such tools to assist parties in meeting their cost needs to fund sophisticated disputes continues to expand.

6. STRUCTURES FOR DEFENDANTS

By this time, the reader may be thinking that third party funding is applicable only when the financed party is the plaintiff in the litigation or arbitration proceeding. However, there are a number of ways that contingent fees and third party funding mechanisms may be applied to finance defendants.

6.1. Counter-Claims

The first and most obvious situation where a defendant may seek outside financing is when he or she also files a counter-claim. In such case, everything discussed thus far would be applicable. Additionally, in theory, we may find the rare

⁷⁴ Juridica's website, "Investment Policy" section (*available at www.juridicacapital.com*).

⁷⁵ Burford Capital Limited, PLACING OF 80,000,000 ORDINARY SHARES AT A PRICE OF 100 PENCE PER ORDINARY SHARE AND ADMISSION TO TRADING ON AIM, p. 22 (no date is provided).

situation in which both sides have entered into financing agreements with litigation financiers and, therefore, whichever party succeeds either in litigation or settlement will be the only one who should have to pay the fee to his/her corresponding funder.

When financing a claim in which there is also a counter-claim by the opposing party, or when financing a counter-claim itself, the third party funder has to take into consideration that the recovery that his/her borrower may receive would possibly be offset (to some extent) by the other party's recovery. As an example, think of party "A," to whom it has been awarded US\$100, on one side, and party "B," to whom it has been awarded US\$50, on the other side. In this example, the effective recovery of party "A" will be US\$50 (*i.e.*, US\$100 minus US\$50).

6.2. Donations or Free Financial Assistance

The second situation would be when a defendant receives financial assistance from a foundation or any other disinterested third party without expectation by the latter of any kind of recovery whatsoever. In other words, the defendant receives donations, grants, or any other kind of financial aid, which is for the defendant to keep regardless of the outcome of the proceeding. Of course, the third party offering financial assistance in these situations may demand certain assurances or guarantees that the funds will be used to pay certain or all costs arising from the proceeding (and not for other purposes).⁷⁶

We have recently seen this situation in the context of ICSID⁷⁷ arbitration. Indeed, on February 19, 2010, FTR Holding, S.A., Phillip Morris Products, S.A. and Abal Hermanos, S.A. (hereinafter, jointly referred to as **Phillip Morris**) filed a request for arbitration against the Oriental Republic of Uruguay under the Switzerland-Uruguay BIT.⁷⁸ The claims arose from a package of measures enacted previously by the Uruguayan Government with the aim of reducing tobacco consumption in that country.⁷⁹

⁷⁶ The funder may ask, for instance, that the funds be used to pay legal counsel only. Conversely, the funder may allow that the funds be used to pay any other costs agreed.

⁷⁷ International Centre for Settlement of Investment Disputes (hereinafter, **ICSID**).

⁷⁸ Agreement between the Swiss Confederation and the Oriental Republic of Uruguay on the Reciprocal Promotion and Protection of Investments, signed on October 7, 1988, in force since April 22, 1991.

⁷⁹ *FTR Holding S.A. (Switzerland), Philip Morris Products S.A. (Switzerland) and Abal Hermanos S.A. (Uruguay) v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Request for Arbitration dated

According to Phillip Morris, the measures had a negative effect on their business in Uruguay for a number of reasons.⁸⁰

At some point there was debate over the possibility of Uruguay surrendering by relaxing the measures. However, fortunately for Uruguay (and unfortunately for Phillip Morris), on October 8, 2010, counsel for Uruguay⁸¹ issued a press release confirming that the Campaign for Tobacco-Free Kids, a U.S.-based research and advocacy organization funded by the Bloomberg Foundation,⁸² had agreed to help finance Uruguay's defense.⁸³ Later, the president of this NGO, Matthew Myers, confirmed that his organization had agreed to pay US\$200,000 to cover the first stage of the case.⁸⁴

The financial help to Uruguay by the Campaign for Tobacco-Free Kids came along with a broader pledge by Michael Bloomberg himself to Uruguay whereby Bloomberg Philanthropies, through its partner organizations, "will assist Uruguayan government officials by providing legal research and expertise, launching public education mass media campaigns, and galvanizing world support and public opinion."⁸⁵

February 19, 2010, ¶ 2.

⁸⁰ For Phillip Morris, the measures: (i) resulted in a decrease in sales, notably because its local subsidiary was forced to discontinue a number of its product varieties; (ii) caused a deprivation of intellectual property rights and undermined the goodwill of trademarks (with a consequential reduction in the value of its local subsidiary); and (iii) altogether resulted in substantial losses. See *FTR Holding S.A. (Switzerland), Philip Morris Products S.A. (Switzerland) and Abal Hermanos S.A. (Uruguay) v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Request for Arbitration dated February 19, 2010, ¶¶ 6, 43-50.

⁸¹ Foley Hoag LLP.

⁸² Prior to the initiation of the arbitration by Phillip Morris, Uruguay had received over US\$510,000 in grants from the Bloomberg Initiative To Reduce Tobacco Use Grants Program to implement legislation against tobacco. See Bloomberg Initiative To Reduce Tobacco Use Grants Program's website (search for Uruguay), available at www.tobaccocontrolgrants.org. In 2008, Michael Bloomberg and Bill Gates, in a joint effort to combat global tobacco consumption, announced a combined investment of US\$500 million to help governments in developing countries implementing proven policies and increase funding for tobacco control. See Bloomberg Philanthropies and Bill & Melinda Gates Foundation joint press release, *Michael Bloomberg and Bill Gates Join to Combat Global Tobacco Epidemic*, dated July 23, 2008.

⁸³ Foley Hoag LLP, *Government of Uruguay Taps Foley Hoag for Representation in International Arbitration Brought by Philip Morris to Overturn Country's Tobacco Regulations*, dated October 8, 2010 (available at www.foleyhoag.com).

⁸⁴ S. Perry, *Uruguay Won't Cave in on Tobacco Laws*, GLOBAL ARBITRATION REVIEW, dated October 7, 2010 (available at www.globalarbitrationreview.com).

⁸⁵ Bloomberg Philanthropies, *Bloomberg Philanthropies Pledges Assistance to President José Mujica as the Tobacco Industry Targets Uruguay's Gold Standard Anti-Tobacco Laws*, dated November 10, 2010 (available at www.mikebloomberg.com).

6.3. Simple Reverse Contingency Fee

Although more difficult to apply, it is sometimes possible to offer contingent fees to assist defendants in funding the costs of defending litigation or arbitration. The simple reverse contingency fee⁸⁶ is one way to calculate a third party funder's fee contingent on the amount that the defendant (*i.e.*, the borrower) saves in relation to the exposure presented by the dispute. In order to calculate the simple reverse contingency fee, one calculates the amount saved by the defendant, which is the result of subtracting the amount finally awarded from the amount originally claimed. Thereafter, the amount saved may be multiplied by an agreed-upon fee percentage, which may range from 5% to 40% (depending on the amount litigated). The result of this calculation will be the funder's (or the attorney's) recovery. In other words, we should apply the following formula in order to determine the amount of the third party funder's fee:

$$y = (x - z) * r$$

Saved Amount Constant Fee Percentage

Where:

- “y” is the amount due to the lender (*i.e.*, the funder's fee or recovery).
- “x” is the amount originally claimed by the plaintiff.
- “z” is the amount finally awarded to the plaintiff.
- “r” is the agreed-upon fee percentage to be applied to the amount saved by the defendant.

Hypothetically, party “A,” or plaintiff, claims US\$1,000 (*i.e.*, the “x” in the formula) against party “B,” or defendant. Party B, who has limited resources to properly defend himself, agrees with a third party funder (or contingent fee lawyer) that the latter will

⁸⁶ In the context of attorney-client contingency fee, in 1993 the American Bar Association stated in an Ethics Opinion that there was no ethical prohibition against charging a client a fee based on a percentage of the money the client would save if the lawyer was successful. See American Bar Association Formal Ethics Opinion 93-373, dated April 1993. The District of Columbia Bar has followed this view in Ethics Opinion 347, dated March 2009.

cover all costs and expenses of the proceeding. In exchange, B will give to the funder a percentage of any amount saved (*i.e.*, the “y” in the formula). As mentioned above, the amount saved is the result of subtracting the amount finally awarded to the plaintiff (*i.e.*, the “z” in the formula) from the amount originally claimed by the plaintiff (*i.e.*, the “x” in the formula). Thereafter, the amount saved (*i.e.*, “x” minus “z” in the formula) is multiplied by a constant fee percentage (*i.e.*, the “r” in the formula).

Having said that, in our example further imagine that: (i) the funder advanced US\$40 to cover all legal costs; (ii) B and the funder agreed to a contingent fee equal to 15% of any amount saved; and (iii) the arbitration tribunal awarded plaintiff US\$300 at the end of the proceeding. Plugging all factors into the formula:

$$y = (1,000 - 300) * 0.15$$

The result will be that the defendant will have to pay to the funder a fee in the amount of US\$105. The funder’s profit will thus be US\$65, which is the result from subtracting the amount advanced (*i.e.*, US\$40) from the funder’s final fee (*i.e.*, US\$105). Accordingly, the defendant’s total expenses at the end of the proceeding will be the compensation due to the plaintiff (*i.e.*, US\$300) plus the funder’s fee (*i.e.*, US\$105), resulting in a total amount of US\$405 – which altogether remains lower than the amount originally claimed against him.

The defendant and the funder may agree beforehand that the above-described fee calculation would apply only if the defendant’s savings fall beyond an agreed threshold or benchmark. In this regard, in the example above, B and the funder may have agreed, for instance, that: (i) if B’s savings were US\$500 or less, the funder will receive no fee; and (ii) only if B’s savings were US\$501 or more, the formula will apply. The problem would be how to arrive at such threshold or benchmark, but a similar case where an award was rendered (or a settlement was reached) may be very illustrative for these purposes. Additionally, they could have agreed that if B’s savings were between US\$400 and US\$500, the funder will only be entitled to recover the amount advanced (*i.e.*, US\$40) – without the application of the formula.

The defendant and the third party funder could also agree that the former should return, in addition, the cash advance. In such case, we will simply add another factor

equivalent to the cash advance (*i.e.*, “a” in the formula below) to the fee calculation formula:

$$y = a + [(x - z) * r]$$

In the example discussed, as the amount advanced by the funder was US\$40, the new compensation will be calculated as follows:

$$y = 40 + [(1,000 - 300) * 0.15]$$

As a result, the funder’s fee would now be US\$145.

Finally, it would be worthwhile mentioning that this fee structure may pose a problem when the damages are not liquidated, as the defendant would have to calculate the true value of the claim against him/her.⁸⁷ Indeed, in such situation, the defendant may be required to hire counsel and/or an expert to assess the true value of the dispute, with the consequent additional expense, in order to use such figure in the above-described formula (instead of the amount originally claimed by plaintiff). On the other hand, this problem will not arise in cases where the amount at issue is a liquidated amount (*e.g.*, claims related to a bond). In the latter cases, the true value of the claim will likely be equal to the amount originally claimed against defendant. Note that these issues will also arise in the context of the compound reverse contingency fee described in the next section.

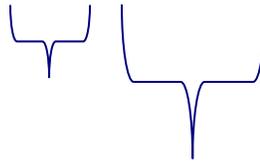
6.4. Compound Reverse Contingency Fee

The compound reverse contingency fee is somewhat more complex than the simple reverse contingency fee described in the preceding section. In the compound reverse contingency fee, the fee percentage applied to the amount saved by the defendant increases proportionally with the amount saved.

The fee calculation formula may be expressed in mathematical terms as follows:

⁸⁷ In particular, think of a situation in which a plaintiff claims an exorbitant amount completely unsupported by the facts or law.

$$y = (x - z) * \left[\frac{(x - z) * k}{x} \right]$$



Saved Amount

Variable Fee Percentage

Where:

- “y” is the amount due to the lender (*i.e.*, the funder’s fee or recovery).
- “x” is the amount originally claimed by the plaintiff.
- “z” is the amount finally awarded to the plaintiff.
- “k” is a limiting factor in order to restrict the fee percentage to a certain percentage (typically, this factor will range from 5% to 40%).

As opposed to the simple reverse contingency fee, here there is no “r” or constant fee percentage. Instead, the percentage increases along with the saved amount (up to a certain limit).

If we use similar parameters to the example discussed in the preceding section, we will have: (i) the funder advanced US\$40 to cover all legal costs; (ii) plaintiff claims US\$1,000 (*i.e.*, the “x” in the formula); (iii) the arbitration tribunal awarded plaintiff US\$300 at the end of the proceeding (*i.e.*, the “z” in the formula); and (iv) the fee percentage is limited to 30% of any saved amount (*i.e.*, the “k” in the formula) – as noted, there is no constant fee percentage in this case. Plugging the numbers into the formula:

$$y = (1,000 - 300) * \left[\frac{(1,000 - 300) * 0.30}{1,000} \right]$$

More simply:

$$y = (700) * [0.21]$$

In other words, with an amount saved equivalent to US\$700, we will apply a 21% fee rate.⁸⁸ This will result in a fee due to the funder in the amount of US\$147. Since we mentioned that the funder had advanced US\$40 to cover all legal cost and expenses, the funder's profits will thus be US\$107 (which results from subtracting US\$40 from US\$147). Furthermore, in this example, the defendant's total expenses at the end of the proceeding will be the compensation due to the plaintiff (*i.e.*, US\$300) plus the funder's fee (US\$147), resulting in a total amount of US\$447 – which altogether remains lower than the amount originally claimed against him.

Finally, the defendant and the funder may agree beforehand that the above-described fee calculation would apply only if the defendant's savings fall beyond an agreed threshold or benchmark. In this regard, in the example above, the defendant and the funder may have agreed, for instance, that: (i) if B's savings were US\$500 or less, the funder will receive no fee; and (ii) only if B's savings were US\$501 or more, the formula will apply. The problem would be how to arrive at such threshold or benchmark, but a similar case where an award was rendered (or a settlement was reached) may undeniably be very illustrative for these purposes. Additionally, they could have agreed that if the defendant's savings were between US\$400 and US\$500, the funder will only be entitled to recover the amount advanced (*i.e.*, US\$40) – without the application of the formula.

6.5. Sale of Risk

Although the “sale of risk” in litigation finance is highly theoretical, it nevertheless constitutes an original way for a defendant to finance a dispute. In essence, the sale of risk could be described as an expansion of the *After The Event Legal Expenses Insurance* to include, in the event the litigation or arbitration is lost, the potential amount awarded to the plaintiff.⁸⁹

The reason an investor might want to purchase risk is to obtain an uncertain opportunity of making money. The potential for profit arises from the differential between the price paid to the litigant and the potential payout (the difference is called

⁸⁸ Recall that this variable percentage fee will be higher or lower depending on the amount saved.

⁸⁹ See section 4.2 *supra* on After The Event Legal Expenses Insurance.

“risk premium”). As mentioned, transferring the risk to a third party is not much different from insurance, which has been commonly accepted in all legal systems for centuries. Additionally, derivatives are a rather newer form of transferring risk. There are few doubts about the usefulness or legality of derivatives, though their contribution to the global financial crash of 2008 has given rise to far greater regulation.

In the context of litigation financing, these principles may be applied without difficulty. This would be easier to understand with an example. Imagine that party “A,” or plaintiff, claims US\$1,000 against party “B,” or defendant. Party B is sure that no tribunal would award party A more than US\$200, but does not want to (or cannot) engage in an arbitration or litigation proceeding. Therefore, party B may assign his or her claim to party “C,” a litigation financier, and pay C US\$200. In exchange for the payment, C will relieve B from any liability and will undertake to litigate the claim on B’s behalf and to pay to A any amount awarded (or settled) at the end of the proceeding. C will either make profit or incur loss depending on the outcome of the proceeding:

- If the tribunal ultimately awards an amount lower than US\$200, C will profit from the spread. For instance, if the tribunal awards to A US\$100, C will make a profit of US\$100 (*i.e.*, US\$200 minus US\$100).
- On the other hand, if the tribunal ultimately awards an amount higher than US\$200, C will incur in a loss equivalent to the difference between the two amounts. For instance, if the tribunal awards to A US\$300, C will incur in a loss of US\$100 (*i.e.*, US\$200 minus US\$300).

In any case, the purchaser of such risk (*i.e.*, “C”) must be certain that the seller (*i.e.*, “B”) fully cooperates and provides all documents, especially those of confidential nature, during the proceeding (and any appeals). To this end, the funder may: (i) contractually demand from the defendant a covenant to fully cooperate throughout the entire proceeding (including any appeals); (ii) contractually demand certain documents⁹⁰; (iii) demand some kind of security – such as mortgages, pledges, liens, etc. – in order to recover the investment in case the defendant does not cooperate, or misrepresents or hides any fact or piece of evidence; or (iv) enter into an agreement with the defendant whereby the latter will maintain a certain portion of the liability (and

⁹⁰ In this regard, it would be very helpful for the third party funder to carry out a thorough due diligence analysis in order to know beforehand what documents are of critical importance.

thus encourage his/her participation). However, every case will be different and thus the options may vary from one case to another.

Finally, the purchaser of risk may lower his or her risk by, in turn, entering into reinsurance-type agreements with other financiers. In such case, of course, both the risk undertaken and the expectation of profits would be more distributed, as a greater number of individuals or entities will have an interest in the outcome of the underlying proceeding.

7. APPLICATION TO INVESTMENT ARBITRATION

A recent high-profile dispute reveals some of the unique risks involved in the third party financing of international investment arbitration disputes. *S&T Oil Equipment and Machinery Ltd. v. Romania*⁹¹ provides an example of a case in which an investor sought financing from a third party funder to pursue its claim within the framework of the ICSID Convention.⁹² There are many other instances of a party seeking outside financing in the context of investment arbitration,⁹³ but this case is illustrative of many of the concerns that have been expressed by some commentators.

According to Juridica's 2008 Annual Report, it had US\$3.5 million invested in an ICSID arbitration as of April 29, 2009.⁹⁴ In the same 2008 Annual Report, Juridica advised that another claim against a sovereign had settled in March 2009.⁹⁵ It seems likely that the \$3.5 million investment referenced in the 2008 Annual Report was related to the *S&T Oil v. Romania* arbitration. In 2011, the dispute erupted into nasty litigation

⁹¹ *S&T Oil Equipment and Machinery Ltd. v. Romania*, ICSID Case No. ARB/07/13.

⁹² Convention On The Settlement Of Investment Disputes Between States And Nationals Of Other States, International Centre For Settlement Of Investment Disputes, signed in Washington, D.C. on March 18, 1965 and entered into force on October 14, 1966 (hereinafter, the **ICSID Convention**).

⁹³ Examples of other cases in which outside financing was involved include: *FTR Holding S.A. (Switzerland), Philip Morris Products S.A. (Switzerland) and Abal Hermanos S.A. (Uruguay) v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7; *Ioannis Kardassopoulos v. The Republic of Georgia*, ICSID Case No. ARB/05/18; *Bernardus Henricus Funnekotter and others v. Republic of Zimbabwe*, ICSID Case No. ARB/05/6; *Gustav F. W. Hamester GmbH & Co KG v. Republic of Ghana*, ICSID Case No. ARB/07/24; *Chevron Corporation and Texaco Petroleum Corporation v. Republic of Ecuador*, UNCITRAL, PCA Case No. 2009-23; and *Siag and Vecchi v. Egypt*, ICSID Case No ARB/05/15.

⁹⁴ Juridica Investments Ltd. Annual Report and Accounts 2008, p. 4 (*available at www.juridicainvestments.com*).

⁹⁵ *Id.* Juridica "received a return of \$4.3 million made on 7 July 2008 yielding an internal rate of return of 71%." *Id.*

and the following facts were alleged by S&T in a Racketeer Influenced by Corrupt Organizations (RICO) Act complaint and supporting motion for preliminary relief filed by S&T in the U.S. District Court for the Southern District of Texas.

Valerian Simirica, an Illinois based individual, and his fully owned company S&T Oil Equipment & Machinery Ltd. (hereinafter, jointly referred to as **S&T Oil**), entered into certain business relationships with the Government of Romania, but those business relationships ended in litigation.⁹⁶ Thereafter, S&T Oil entered into a contingent fee agreement in which their lawyers⁹⁷ were to bring a claim for alleged violations of the bilateral investment treaty between Romania and the United States.⁹⁸

On July 16, 2007, ICSID registered a request for arbitration dated May 30, 2007, submitted by S&T Oil against Romania.⁹⁹ The claim related to an alleged expropriation of an ammonia production enterprise.¹⁰⁰ However, within a year of filing the arbitration under ICSID, S&T Oil's lawyers allegedly informed their clients that, unless they located an outside funding source, they would resign.¹⁰¹

On May 28, 2008, S&T Oil and Juridica entered into an "investment agreement" whereby Juridica agreed to fund part of the legal fees and costs of the ICSID arbitration (hereinafter, the **Investment Agreement**).¹⁰² In exchange, S&T Oil assigned to Juridica

⁹⁶ *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Complaint dated February 14, 2011, ¶ 18.

⁹⁷ King & Spalding LLP. See *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Memorandum and Order dated April 25, 2011, p. 2.

⁹⁸ Treaty Between the Government of the United States of America and the Government of Romania Concerning the Reciprocal Encouragement and Protection of Investment, signed on May 28, 1992 and entered into force on January 15, 1994. See also *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Complaint dated February 14, 2011, ¶¶ 18-19.

⁹⁹ *S&T Oil Equipment and Machinery Ltd. v. Romania*, ICSID Case No. ARB/07/13, Order to Discontinue Proceedings dated July 2, 2010, ¶ 1.

¹⁰⁰ S. Perry, *ICSID Claimant Sues Third-Party Funder*, GLOBAL ARBITRATION REVIEW, dated March 18, 2011 (available at www.globalarbitrationreview.com).

¹⁰¹ *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Complaint dated February 14, 2011, ¶ 22.

¹⁰² *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Memorandum and Order dated March 10, 2011, pp. 1-2; *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Complaint dated February 14, 2011, ¶ 25; *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Memorandum and Order dated April 25, 2011, pp. 1-2, 11-12. The Investment Agreement is not publicly available (though some portions thereof are quoted throughout the court documents). See *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Order

a percentage of any proceeds from the Romanian Arbitration and granted Juridica a security interest in all “collateral,” which included, *inter alia*, S&T Oil’s rights in a Romanian joint stock company.¹⁰³ Juridica required, as a condition precedent, a number of amendments to the representation agreement that S&T Oil had previously entered into with its lawyers, who would continue as counsel in the ICSID arbitration.¹⁰⁴ In addition, pursuant to the Investment Agreement, Juridica was allegedly provided access to all confidential information, including attorney-client privilege and work product documents, allegedly protected by the “common interest exception.”¹⁰⁵

Thereafter, the parties filed, respectively, the memorial, counter-memorial, reply memorial and rejoinder.¹⁰⁶ On June 24, 2009, the ICSID tribunal requested an advance payment of US\$300,000 (US\$150,000 per party) under ICSID Administrative and Financial Regulations¹⁰⁷ to meet the costs to be incurred in the proceedings in the next three to six months, including the costs related to the hearing on the merits.¹⁰⁸ Allegedly, one month before the September 2009 hearing, the lawyers notified S&T Oil

dated February 17, 2011 (granting Juridica’s motion to seal, *inter alia*, the Investment Agreement).

¹⁰³ *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Memorandum and Order dated April 25, 2011, pp. 12-13. Furthermore, S&T Oil also assigned to Juridica a percentage of any proceeds from a case that S&T Oil had filed in the national courts of Romania. *Id.* The Investment Agreement did, however, note that S&T Oil intended to withdraw that case from the Romanian courts to the extent permissible by Romanian law. *Id.*

¹⁰⁴ *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Memorandum and Order dated March 10, 2011, p. 2; *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Complaint dated February 14, 2011, ¶ 26. Those amendments included: (i) transformation of the representation agreement into non-contingent hourly fee; and (ii) the lawyers were reimbursed 50% of their “normal” fees allegedly incurred at closing and 100% of their costs previously paid associated with the Romanian arbitration (the lawyers were further paid 50% of their ongoing fees and 100% of the costs associated with the Romanian Arbitration). *Id.*

¹⁰⁵ *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Complaint dated February 14, 2011, ¶ 29. S&T Oil sustained that, after entering into the Investment Agreement with Juridica, the lawyers began seeking legal advice or counsel from Juridica. *Id.*, ¶ 30. S&T Oil also sustained that, pursuant to Juridica’s monitoring, the lawyers were required to place all information regarding the strategy, public profile, factual or legal developments of the Romanian arbitration on a Juridica’s affiliate internal website. *Id.*

¹⁰⁶ *S&T Oil Equipment and Machinery Ltd. v. Romania*, ICSID Case No. ARB/07/13, Order to Discontinue Proceedings dated July 2, 2010, ¶¶ 8-9, 13, 18.

¹⁰⁷ ICSID Administrative and Financial Regulations, adopted by the Administrative Council of the Centre pursuant to Article 6(1)(a) of the ICSID Convention.

¹⁰⁸ *S&T Oil Equipment and Machinery Ltd. v. Romania*, ICSID Case No. ARB/07/13, Order to Discontinue Proceedings dated July 2, 2010, ¶ 16.

that they refused to proceed with their representation in the ICSID claims because they “failed to provide . . . a critical piece of evidence.”¹⁰⁹ Counsel for S&T Oil asked for postponement of the hearing because the latter was unable to meet the required advance payment and its own costs necessary for the preparation and the attendance of the hearing.¹¹⁰ On September 17, 2009, ICSID informed the parties of the default of the claimant, and invited either party to make the outstanding advance payment of US\$150,000.¹¹¹ On November 4, 2009, as payment was still pending, the tribunal stayed the proceedings.¹¹² On November 10, 2009, Juridica sent a purported rescission letter to S&T Oil, refusing to further finance the Romanian arbitration (and demanding that they return all monies funded to the lawyers).¹¹³ On November 16, 2009, the lawyers withdrew as counsel.¹¹⁴ On July 2, 2010, the proceedings were effectively discontinued because payment from claimant remained outstanding since July 24, 2009.¹¹⁵

In accordance with the Investment Agreement,¹¹⁶ on December 22, 2010, Juridica filed an arbitration claim with the London Court of International Arbitration (hereinafter, **LCIA**) against S&T Oil seeking actual and punitive damages, as well as interest and attorneys’ fees.¹¹⁷ The *situs* of the LCIA arbitration was Guernsey, United Kingdom.¹¹⁸ The dispute in the LCIA arbitration has been described as follows:

¹⁰⁹ *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Complaint dated February 14, 2011, ¶¶ 32-33

¹¹⁰ *S&T Oil Equipment and Machinery Ltd. v. Romania*, ICSID Case No. ARB/07/13, Order to Discontinue Proceedings dated July 2, 2010, ¶ 20.

¹¹¹ *Id.*, ¶ 21.

¹¹² *Id.*, ¶¶ 22-23.

¹¹³ *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Complaint dated February 14, 2011, ¶ 37

¹¹⁴ *S&T Oil Equipment and Machinery Ltd. v. Romania*, ICSID Case No. ARB/07/13, Order to Discontinue Proceedings dated July 2, 2010, ¶ 24.

¹¹⁵ *Id.*, ¶¶ 27, 32.

¹¹⁶ *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Memorandum and Order dated April 25, 2011, p. 2.

¹¹⁷ *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Memorandum and Order dated March 10, 2011, pp. 2-3. *See also S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Complaint dated February 14, 2011, ¶¶ 46, 89.

¹¹⁸ *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-

The dispute in the Guernsey arbitration at issue here is whether [S&T Oil] failed to disclose material facts to [Juridica] in connection with [Juridica]'s funding [S&T Oil] attorneys' fees in the Romanian Arbitration. Thus, the details of that international arbitration are in issue.¹¹⁹

On February 14, 2011, S&T Oil filed a complaint alleging violation of the Racketeer Influenced by Corrupt Organizations (RICO) Act in the U.S. District Court for the Southern District of Texas against Juridica Investments and two affiliates.¹²⁰ S&T Oil alleged that the "claims for relief [were] brought . . . in connection with a scheme devised by defendants to defraud plaintiffs and to procure secret profits from plaintiffs by failing to fully disclose interests in transactions with plaintiffs."¹²¹

S&T Oil alleged that, when entering into the Investment Agreement, Juridica omitted material facts, including that:¹²² (i) the Investment Agreement violated the attorney-client privilege; (ii) the representation agreement that Juridica required S&T Oil to execute was unconscionable and illegal; (iii) S&T Oil was not advised that they needed the advice of an independent legal counsel before entering into the Investment Agreement; (iv) Juridica intended to use S&T Oil's attorney-client and privilege information against the latter (mainly in the LCIA proceedings); and (v) the LCIA is conflicted with regard to an arbitration in which Juridica is a party. S&T Oil sought, *inter alia*, the following relief: (i) actual, punitive and treble damages, including costs of investigation and litigation, interest and attorney fees; and (ii) temporary and permanent injunctive relief to halt the LCIA arbitration.¹²³

On March 10, 2011, the U.S. District Court for the Southern District of Texas rendered an order, which is currently being appealed,¹²⁴ denying S&T Oil's application

0542, Memorandum and Order dated April 25, 2011, p. 3.

¹¹⁹ *Id.*, p. 13.

¹²⁰ *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Complaint dated February 14, 2011.

¹²¹ *Id.*, ¶ 1.

¹²² *Id.*, ¶ 11.

¹²³ *Id.*, ¶¶ 1-2, 93.

¹²⁴ See *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Plaintiff's Notice of Appeal dated May 24, 2011.

for a temporary restraining order against the LCIA proceeding.¹²⁵ For the court, “[a] party seeking a temporary restraining order or other injunction pursuant to Rule 65 of the Federal Rules of Civil Procedure has the burden to demonstrate each of four elements: (1) a substantial likelihood of success on the merits; (2) a substantial threat of irreparable injury if the injunction is denied; (3) that the threatened injury outweighs any prejudice the injunction might cause the defendant; and (4) that the injunction will not disserve the public interest.”¹²⁶ The court’s reasoning for denying the application can be summarized as follows:

- *Substantial likelihood of success on the merits*: The court generally found that the applicants did not demonstrate a substantial likelihood of success on the merits of their claims. In particular, the court reasoned that applicants had failed to demonstrate that the arbitration clause contained in the Investment Agreement with Juridica was: (i) unenforceable under the New York Convention;¹²⁷ (ii) procured by fraud; and (iii) substantively and procedurally unconscionable.¹²⁸ The Judge remarked that “[n]one of these arguments is persuasive on the present record.”¹²⁹
- *Substantial threat of irreparable injury*: The irreparable harm argued was that they were “simply without the financial means to defend themselves in

¹²⁵ *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Memorandum and Order dated March 10, 2011, p. 1.

¹²⁶ *Id.*, p. 4, citing *Janvey v. Alguire*, 628 F.3d 164 (5th Cir. 2010), p. 174; and *Affiliated Prof'l Home Health Care Agency v. Shalala*, 164 F.3d 282 (5th Cir. 1999), p. 285.

¹²⁷ The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, adopted on June 10, 1958, and implemented by the U.S. Congress through 9 U.S.C. §§ 201-208.

¹²⁸ The court expressed the following test of unconscionability: “The test for substantive unconscionability is whether, given the parties’ general commercial background and the commercial needs of the particular trade or case, the clause involved is so one-sided that it is unconscionable under the circumstances existing when the parties made the contract.” *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Memorandum and Order dated March 10, 2011, p. 11, citing *In re Palm Harbor Homes, Inc.*, 195 S.W.3d 672 (Tex. 2006), p. 678. Furthermore, the court mentioned that “[u]nconscionability principles are applied to prevent unfair surprise or oppression.” *Id.*, citing *In re Palm Harbor Homes, Inc.*, 195 S.W.3d 672 (Tex. 2006), p. 679.

¹²⁹ *Id.*, p. 5. A few things are worth an additional word. First, the Judge found, *inter alia*, that despite the fact that some of Juridica’s top officials resided in New York, it remains a Guernsey-based corporation and thus fulfills the requirement of non-United States entity for purposes of 9 U.S.C. § 202. *Id.*, pp. 5, 8. Second, the court rejected the fraud argument on the grounds that, as opposed to what S&T Oil argued, none of the non-executive members of Juridica’s Board of Directors were simultaneously members of LCIA’s Board of Directors (which, in turn, is responsible for appointing arbitrators to various cases). *Id.*, pp. 9-10. Third, as regards unconscionability, the court was not persuaded by the applicant’s arguments because: (i) they did not demonstrate that the expenses of arbitration before the LCIA in Guernsey are significantly greater than federal litigation in Texas; (ii) Juridica had no officers in LCIA’s Board of Directors; and (iii) they did not present evidence demonstrating that arbitration in Guernsey would cause “grave inconvenience or unfairness.” *Id.*, pp. 11-14.

the costly LCIA arbitration.”¹³⁰ However, the court noted that “the expense of an arbitration does not constitute irreparable harm.”¹³¹

- *Balance of hardships*: The court noted that the applicants failed to demonstrate “that any harm they may suffer from denial of the [injunctive relief] outweighs the prejudice to [Juridica] caused if the court were to grant the requested [injunctive relief].”¹³² Conversely, “[e]njoining the arbitration harms [Juridica] by preventing it from exercising the bargained for arbitration rights under the Investment Agreement.”¹³³
- *Public interest*: The court pointed out that the applicants’ request should also be denied because “[t]here is a ‘liberal federal policy favoring arbitration agreements’” and “injunctions staying arbitrations are viewed with disfavor.”¹³⁴

Finally, on April 25, 2011, the District Court granted Juridica’s motion to dismiss in favor of arbitration and thus dismissed the case,¹³⁵ but this order is currently being appealed by S&T Oil.¹³⁶ For the District Court, all requirements set forth in *Freudensprung v. Offshore Tech. Servs., Inc.*¹³⁷ were present in the case at bar and the court was thus obliged to compel arbitration.¹³⁸ Furthermore, as to S&T Oil’s arguments that that the arbitration clause contained in the Investment Agreement was not enforceable because it was procured by fraud and was substantively and procedurally

¹³⁰ *Id.*, p. 15.

¹³¹ *Id.*, citing *City of Meridian v. Algernon Blair, Inc.*, 721 F.2d 525 (5th Cir. 1983), p. 529; *Siag v. King & Spalding LLP*, No. H-10-367, 2010 WL 2671580 (S.D. Tex. June 30, 2010), at *2; *Encompass Power Servs., Inc. v. Eng’g & Constr. Co.*, No. H-05-2759, 2005 WL 3234369 (S.D. Tex. Nov. 29, 2005), at *2.

¹³² *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Memorandum and Order dated March 10, 2011, p. 16.

¹³³ *Id.*

¹³⁴ *Id.*, pp. 17-18, citing *City of Meridian v. Algernon Blair, Inc.*, 721 F.2d 525 (5th Cir. 1983), p. 529; and *Siag v. King & Spalding LLP*, No. H-10-367, 2010 WL 2671580, (S.D. Tex. June 30, 2010), at *2.

¹³⁵ *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Final Order dated April 25, 2011. See also *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Memorandum and Order dated April 25, 2011, p. 15.

¹³⁶ See *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Plaintiff’s Notice of Appeal dated May 24, 2011.

¹³⁷ *Freudensprung v. Offshore Tech. Servs., Inc.*, 379 F.3d 327 (5th Cir. 2004).

¹³⁸ *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Memorandum and Order dated April 25, 2011, pp. 5-6, 10-11, 14. These requirements are: “[A] court should compel arbitration if (1) there is a written agreement to arbitrate the matter; (2) the agreement provides for arbitration in a Convention signatory nation; (3) the agreement arises out of a commercial legal relationship; and (4) a party to the agreement is not an American citizen.” *Freudensprung v. Offshore Tech. Servs., Inc.*, 379 F.3d 327 (5th Cir. 2004), p. 339.

unconscionable, the District Court expressed that these same arguments were rejected in the Court's order dated March 10, 2011 denying the temporary restraining order application.¹³⁹

In sum, this case presents some of the risks facing all parties to international investment arbitration when third party funding is involved given the current lack of regulation of the litigation and arbitration finance industry. On the one hand, S&T Oil now faces a complex arbitration proceeding to avoid having to return the amounts advanced by Juridica. On the other hand, as a result of the discontinuance of the arbitration proceeding because S&T Oil lacked enough funds to continue its efforts, Romania may find itself in a situation where it cannot recover the litigation costs from the previously well-funded claimant. The same situation may have happened even if a final award was rendered, as it is likely that the funder would have refused to pay the adverse party's costs in case of losing the case but the absence of third party funding may have caused earlier dismissal and thereby reduced Romania's expenses.

At least one ICSID tribunal has declined to extend to the third party funder of the losing party the responsibility to pay the arbitration costs and legal expenses. In *Ioannis Kardassopoulos and Ron Fuchs v. Republic of Georgia*,¹⁴⁰ Georgia alleged, *inter alia*, "that the Claimants' legal costs [were] excessive and because the Claimants' costs ha[d] been borne in part by a third party investor it [was] questionable whether such costs [were] properly recoverable."¹⁴¹ The tribunal did not agree with Georgia. More precisely, the tribunal found "no principle why any such third party financing arrangement should be taken into consideration in determining the amount of recovery by the Claimants of their costs."¹⁴² Furthermore, the tribunal pointed out that the relevant BITs to the arbitration proceeding provided in their respective dispute

¹³⁹ *S&T Oil Equipment & Machinery Ltd. et al. v. Juridica Investments Ltd. et al.*, Civil Action No. H-11-0542, Memorandum and Order dated April 25, 2011, p. 14. The Court added that "[p]laintiffs ha[d] not presented any additional legal or factual argument that would alter the Court's analysis." *Id.* Therefore, for the same reasons stated in the Court's order dated March 10, 2011, it found that the applicants did not demonstrate that the arbitration provision was secured by fraud, or that it was substantively or procedurally unconscionable.

¹⁴⁰ *Ioannis Kardassopoulos and Ron Fuchs v. Republic of Georgia*, ICSID Cases Nos. ARB/05/18 and ARB/07/15, Award dated March 3, 2010.

¹⁴¹ *Id.*, ¶ 686.

¹⁴² *Id.*, ¶ 691.

settlement provisions that, while not directly applicable to the issue at hand, a “Contracting Party shall not raise as an objection at any stage of the proceedings the fact that the investor has received compensation or an indemnity under an insurance contract in respect of all or part of the damages incurred.”¹⁴³ The tribunal thus concluded that it was “difficult to see why in this case a third party financing arrangement should be treated any differently than an insurance contract for the purpose of awarding the Claimants full recovery.”¹⁴⁴

On the other hand, outside the investor-state arbitration context, some local courts in the United States¹⁴⁵ and in England¹⁴⁶ have chosen to extend to third party funders responsibility to pay for the successful adverse party’s litigation costs.

8. CONTROVERSY

It has become clear that litigants, legal professionals and financiers do not remain indifferent to third party funding. Proponents, on one side, and detractors, on the other, claim that it has different implications and consequences. Following are some of those views.

8.1. Proponents

The proponents of third party litigation and arbitration funding claim that it has concrete benefits. The most notable benefit urged is that it provides access to justice

¹⁴³ *Id.*

¹⁴⁴ *Id.*

¹⁴⁵ See, e.g., *Abu-Ghazaleh v. Chaul*, 36 So. 3d 691 (Fla. Dist. Ct. App. 2009). In this case, the District Court of Appeal of Florida for the Third District reversed the trial court’s decision to find that a litigation lender was a “party” to the suit for purposes of the state’s attorneys’ fees statutes and, therefore, liable for the victorious defendant’s fees and costs. Interestingly, the Court noted that the funder: (i) had the right to approve counsel; (ii) paid the costs of the litigation; (iii) had the power to veto when, whether, and how the suit was filed; (iv) paid the medical expenses of one of the plaintiff’s witnesses; (v) had the sole authority to approve any settlement agreement; and (vi) were to receive a percentage of any sum awarded to the plaintiffs. The court concluded that the funders “‘had such control . . . as to be entitled to direct the course of the proceedings’ and [were] part[ies] to the suit.” *Id.*, p. 694.

¹⁴⁶ See, e.g., *McFarlane v. E.E. Caledonia Ltd. (No. 2)*, [1995] 1 W.L.R. 366 (a claims consultant company maintained an unsuccessful action for a claimant and was ordered by the court to pay all the successful defendant’s costs); *Dymocks Franchise Systems (NSW) Pty Ltd v. Todd (Costs)*, 2004] 1 W.L.R. 2807 (the court found that costs will generally not be awarded against “pure funders” but, if the third party funder substantially controls or, at any rate, stands to benefit from the proceedings, justice would ordinarily require that the latter pay the successful party’s costs if the proceedings fail); *Arkin v. Borchard Lines Ltd (Costs Order)*, [2005] 1 W.L.R. 3055 (the court ordered that the third party funder pay the successful adverse party’s costs to the extent of the amount funded).

for litigants who would otherwise have no way of vindicating their rights.¹⁴⁷ More precisely, according to the proponents of this device, third party funding allows claimants with meritorious claims – but limited financial resources – to pursue their rights and, conversely, may also permit defendants with sound defenses to avoid surrendering to a better-financed plaintiff's pressure to enter into an early (one-sided) settlement agreement. In other words, third party funding levels the playing field on which disputes are resolved and insures more equal access to justice.

Furthermore, the proponents of litigation and arbitration financing argue that third party funding may actually have a positive impact on settlements, as financially stronger parties who would otherwise have tried to take advantage of their financial strength would be more amenable to engaging in settlement negotiations with the weaker (but funded) party at an earlier stage of the dispute.¹⁴⁸ They add that litigation financiers will often structure the compensation scheme as to favor an early settlement – *i.e.*, they will charge a smaller amount if the case is settled at an earlier stage.

Finally, proponents stress that third party funding will provide to the litigant an early and independent evaluation of the claim, as a funder will carry out a due diligence analysis at an early stage in order to assess the possibilities of success.¹⁴⁹ In other words, a third party funder will provide an assessment on the potential success or failure of the claim and, should the funder consider the possibility of success unlikely, the litigant may consider this as an indication that he/she should discontinue the dispute. Sophisticated third party funders argue that they may apply risk assessment devices or analysis methods not generally available to law firms or to the parties themselves.

¹⁴⁷ Fulbrook Management LLC, *Investing in Commercial Claims, Nutshell Primer*, dated March 3, 2011, p. 29; L.S. Schaner & T.G. Appleman, *The Rise Of 3rd-Party Litigation Funding*, LAW 360, dated January 21, 2011 (available at www.law360.com); M. Steinitz, *Whose Claim is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268 (2011), p. 1326.

¹⁴⁸ See J. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367 (2009); J. Molot, *A Market Approach to Litigation Accuracy*, presented at the 10th Annual Legal Reform Summit, U.S. Chamber Institute for Legal Reform, October 28, 2009; M. Steinitz, *Whose Claim is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268 (2011), p. 1313.

¹⁴⁹ L. Atherton, *Third Party Funding in Arbitration: A Perspective from England*, K&L GATES NEWSSTAND: ARBITRATION WORLD, October 2009.

As a corollary of the above, proponents argue that unfounded or unmeritorious claims will not obtain financing, as third party funders will certainly carry out a detailed due diligence analysis before undertaking to finance a dispute and thus will never undertake a “silly risk.”¹⁵⁰ The Court of Appeals of Texas expressly discussed this precise issue in *Anglo-Dutch Petroleum v. Haskell*:

Presumably, prior to making an investment pursuant to a similarly structured agreement, an investor would consider the merits of the suit and make a calculated risk assessment on the probability of a return on its investment. An investor would be unlikely to invest funds in a frivolous lawsuit, when its only chance of recovery is contingent upon the success of the lawsuit.¹⁵¹

8.2. Detractors

For detractors of third party funding, the root problem is that it introduces a stranger to the attorney-client relationship whose sole interest is a financial one.¹⁵² They argue that this results, in turn, in a number of negative consequences.

First, they claim that litigation financing encourages frivolous and abusive litigation.¹⁵³ In this regard, they say that, as opposed to contingency fee agreements, third party funders are lacking the same incentives as contingency fee lawyers: (i) the ethical duty to advise clients when potential claims would be frivolous; and (ii) when lawyers are working on contingency, they obviously would rather spend their finite time

¹⁵⁰ As of May 2010, a source estimated that Juridica reviewed around 400 claims and only invested in 23. See R. Lloyd, *The New, New Thing*, THE AMERICAN LAWYER, dated May 17, 2010 (available at www.law.com). See also J. Lyon, *Revolution in Progress: Third-Party Funding of American Litigation*, 58 UCLA L. REV. 571 (2010), p. 591.

¹⁵¹ *Anglo-Dutch Petroleum v. Haskell*, 193 S.W.3d 87 (Tex. 2006), p. 105. The Court also noted that “the manner in which the agreements were structured may actually have encouraged settlement.” *Id.* See also S.L. Martin, *The Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed*, 10 FORD. J. CORP. & FIN. L. 55 (2004), p. 77 (“No one is going to invest in a frivolous lawsuit because any money thus invested will be lost”).

¹⁵² J. Beisner, J. Miller and G. Rubin, *Selling Lawsuits, Buying Trouble: Third-Party Litigation Funding in the United States*, U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, dated October 2009, p. 1. Interestingly, the law firm where the lawyers that wrote this report were working at the time (*i.e.*, *Skadden, Arps, Slate, Meagher & Flom LLP*) was “reportedly using third-party funding in an arbitration case.” A. Jones, *Third-Party Litigation Funding Stepping up in U.K.*, WSJ LAW BLOG, dated March 20, 2008; see also C. Ruckin and S. Lind, *External Funding Booms as Litigators Plot Upturn*, LAW.COM, dated March 20, 2008.

¹⁵³ J. Beisner, J. Miller and G. Rubin, *Selling Lawsuits, Buying Trouble: Third-Party Litigation Funding in the United States*, U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, dated October 2009, pp. 5-6; M. Herman, *Fear of third party litigation funding is groundless*, TIMES ONLINE, dated October 25, 2007.

on cases that are likely to be successful, as opposed to cases with a low probability of success. Additionally, opponents of third party funding argue that if the potential recovery is sufficiently large, the lawsuit will be an attractive investment, even if the likelihood of actually achieving that recovery is small.¹⁵⁴

Second, they argue that third party funding has a negative impact on settlements. In this regard, detractors say that a claimant will not settle for any amount offered by the defendant that is less than the aggregate of the principal amount advanced by the funder and the current interest accrued.¹⁵⁵ In other words, they say that litigation funding raises the floor on negotiations to create an artificial inflation of the numbers.¹⁵⁶

Third, detractors argue that litigation financing raises a number of ethical concerns because litigation financing arrangements undercut the claimant's control over his or her own claim, as investors inherently desire to protect their investment and will thus seek to exert control over strategic decisions in the lawsuit.¹⁵⁷ In particular, they claim that third party funding: (i) places the power to make strategic decisions about the case in the hands of the funder, whose duties are to its investors, instead of in the hands of the attorney, whose duties are to the client; (ii) creates conflicts of interest for the plaintiff's attorney, particularly with the attorney's duty of loyalty owed to the client; and (iii) raises confidentiality concerns insofar as they require litigants to disclose

¹⁵⁴ J. Beisner, J. Miller and G. Rubin, *Selling Lawsuits, Buying Trouble: Third-Party Litigation Funding in the United States*, U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, dated October 2009, pp. 5-6. This Institute provides in this regard an analogy with the junk-bond market. *Id.*, p. 6.

¹⁵⁵ Note that some funders apply a monthly interest rate payable only if the claim is successful either in settlement or litigation.

¹⁵⁶ *Id.*, p. 4. See also M. Rodak, *It's About Time: A Systems Thinking Analysis of the Litigation Finance Industry and its Effect on Settlement*, 155 U. PA. L. REV. 503 (2006-2007), p. 522 ("This artificially inflated minimum acceptable offer and the nonrecourse character of the arrangement will lead the rational plaintiff to reject otherwise reasonable settlement offers, since, if she loses at trial, she will owe nothing. In this way, litigation finance gives plaintiffs disincentives to settle and instead encourages disputes to progress to trial"). For further details and rationale, see discussion in *Rancman v. Interim Settlement Funding Corp.*, 789 N.E.2d 217 (Oh. 2003) and J. Lyon, *Revolution in Progress: Third-Party Funding of American Litigation*, 58 UCLA L. REV. 571 (2010), pp. 595-597.

¹⁵⁷ See J. Beisner, J. Miller and G. Rubin, *Selling Lawsuits, Buying Trouble: Third-Party Litigation Funding in the United States*, U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, dated October 2009, pp. 7-8. To support this view, the Institute cites, *inter alia*, the statement of an officer of an accounting and financial consulting firm, who said that clients may have to relinquish some decision-making authority to the funder and that "the client's interests may diverge from the funder in that other business reasons may suggest that they might settle a claim for less than the funder has targeted." *Id.*, citing A. Urda, *Legal Funding Gains Steam But Doubts Linger*, LAW360, dated August 27, 2008 ([available at www.law360.com](http://www.law360.com)).

privileged information to the financier, who arguably does not enjoy attorney-client privilege.

Confidentiality and privilege are particularly relevant because, before committing any funds, third party funders will customarily undertake a due diligence analysis of the claim in order to decide whether to invest and to estimate what share or fee is acceptable.¹⁵⁸ Confidentiality and privilege are of paramount importance in the United States, but they are less important in the context of international arbitration, where the common law privileges do not usually apply (or at least they are not given the importance as in local litigation or arbitration in common law fora).¹⁵⁹

The American legal system is deeply committed to protecting the relationship between an attorney and its clients, which intrinsically includes confidentiality and privilege.¹⁶⁰ Attorney-client privilege “is the oldest of the privileges for confidential communications known to the common law.”¹⁶¹ Its purpose is “to encourage full and frank communications between attorneys and their clients,” and it exists to protect “not only the giving of professional advice to those who can act on it but also the giving of information to the lawyer to enable him to give sound and informed advice.”¹⁶² Therefore, the question remains whether these communications with the third party

¹⁵⁸ See Section 5, *supra*.

¹⁵⁹ However, sometimes international arbitrations between foreign parties may be subject to litigation in the United States where one of the parties requests documents from the third party funder of the opposing party. In this regard, take into consideration 28 U.S.C. § 1782 (“The district court of the district in which a person resides or is found may order him to give his testimony or statement or to produce a document or other thing for use in a proceeding in a foreign or international tribunal, including criminal investigations conducted before formal accusation. . . . A person may not be compelled to give his testimony or statement or to produce a document or other thing in violation of any legally applicable privilege.”). See, e.g., *In re Application of Chevron Corp.*, 10-MC-28, 2010 WL 5173279 (E.D. Pa. Dec. 20, 2010) *rev’d sub nom. In re Chevron Corp.*, 650 F.3d 276 (3d Cir. 2011).

¹⁶⁰ J.W. Amberg, *Saving the Attorney-Client Privilege*, Los Angeles County Bar Association, COUNTY BAR UPDATE, Vol. 25, No. 6, dated June/July 2005. See also L. Cole, *Revoking Our Privileges: Federal Law Enforcement’s Multi-Front Assault on the Attorney-Client Privilege (And Why it is Misguided)*, 48 VILL. L. REV. 469 (2003); D.R. Richmond, *The Attorney-Client Privilege and Associated Confidentiality Concerns in the Post-Enron Era*, 110 PENN ST. L. REV. 381 (2005). These principles are contained in Rule 1.6 of the ABA MODEL RULES OF PROFESSIONAL CONDUCT (2010) and Canon 4 of the MODEL CODE OF PROFESSIONAL RESPONSIBILITY (1983) (which some states still follow).

¹⁶¹ *Upjohn Co. v. U.S.*, 449 U.S. 383 (1981), p. 389.

¹⁶² *Id.*, pp. 389-391. See also L. Cole, *Revoking Our Privileges: Federal Law Enforcement’s Multi-Front Assault on the Attorney-Client Privilege (And Why it is Misguided)*, 48 VILL. L. REV. 469 (2003), pp. 489-491.

funder remain protected under the “common-interest privilege,” which protects communications when two or more clients simultaneously consult with an attorney on matters of common interest.¹⁶³ The common-interest privilege is based upon the principle that “persons who share a common interest in litigation should be able to communicate with their respective attorneys and with each other to more effectively prosecute or defend their claims.”¹⁶⁴

However, for the common-interest privilege to apply, the clients must share an identical, or nearly identical, legal interest as opposed to merely a similar interest.¹⁶⁵ In this regard, at least one court has ruled that the privilege does not protect information shared with the third party funder and thus required the litigant to produce documents it shared with the lender.¹⁶⁶

¹⁶³ See 81 AM. JUR. 2D WITNESS, § 381. The “common interest” privilege enables counsel for clients with a common interest “to exchange privileged communications and attorney work product in order to adequately prepare a defense without waiving either privilege.” *Haines v. Liggett Group Inc.*, 975 F.2d 81 (3d Cir. 1992), p. 94; see also *Walter v. Financial Corp. of America*, 828 F.2d 579 (9th Cir. 1987), p. 583 (n. 7) (“[C]ommunications by a client to his own lawyer remain privileged when the lawyer subsequently shares them with co-defendants for purposes of a common defense”) (quoting *U.S. v. McPartlin*, 595 F.2d 1321 (7th Cir. 1979) cert. denied 444 U.S. 833 (1979), p. 1326); *In re Grand Jury Subpoena Duces Tecum Dated Nov. 16, 1974*, 406 F. Supp. 381 (S.D.N.Y. 1975), p. 389 (“[T]he attorney-client privilege covers communications to a prospective or actual co-defendant’s attorney when those communications are engendered solely in the interests of a joint defense effort”). See also L. Cole, *Revoking Our Privileges: Federal Law Enforcement’s Multi-Front Assault on the Attorney-Client Privilege (And Why it is Misguided)*, 48 VILL. L. REV. 469 (2003), pp. 510-513.

¹⁶⁴ *In re Grand Jury Subpoenas, 89-3 & 89-4, John Doe 89-129*, 902 F.2d 244 (4th Cir. 1990), p. 249.

¹⁶⁵ *Id.* However, no two individuals’ or entities’ interests will be totally identical or nearly identical. Therefore, this strict rule has been sometimes softened in order to require instead that the parties have a “common purpose.” See *U.S. v. McPartlin*, 595 F.2d 1321 (7th Cir. 1979), pp. 1336-1337.

¹⁶⁶ At least one court has ruled that the privilege does not protect information shared with the third party funder and thus required the litigant to produce documents it shared with the lender. *Leader Tech. Inc. v. Facebook Inc.*, 719 F. Supp. 2d 373 (D. Del. 2010), pp. 375-377. In addition, the U.S. District Court, M.D. Florida, Orlando Division, was asked to deal with this issue but the judge’s ruling did not reach the merits of the privilege assertion. *Bray & Gillespie Mgmt. LLC v. Lexington Ins. Co.*, 259 F.R.D. 568 (M.D. Fla. 2009) *aff’d in part, quashed in part sub nom. Bray & Gillespie Mgmt., LLC v. Lexington Ins. Co.*, 607CV-0222ORL-35KRS, 2009 WL 5606058 (M.D. Fla. Nov. 16, 2009). See also *Abrams v. First Tennessee Bank Nat. Ass’n*, 3:03CV428, 2007 WL 320966 (E.D. Tenn. Jan. 30, 2007), at *1; and N. Raymond, *Litigation Funders Face Discovery Woes*, NAT’L L.J., dated February 21, 2011. Furthermore, a fee agreement, or who paid it, and the amount paid “has no relevance to the legal advice to be given. It is a collateral matter which, unlike legal advice and communications, relates to the subject matter of the attorney’s professional employment, and is not privileged.” *Priest v. Henneessy*, 51 N.Y.2d 62 (1980), pp. 69-70. See also *In re Grand Jury Subpoena (Slotnick)*, 781 F.2d 238 (2d Cir. en banc), cert. denied, 475 U.S. 1108 (1986).

9. CONCLUSION

Many other markets – including the stock market – have regulations and safeguards in order to avoid abuse or misuse of the system by the players involved. In the author’s opinion, the same rationale may be applied to the litigation funding market. Such regulation may help to avoid undesirable situations like those in the *S&T Oil v. Romania* case described above in section 7.

Domestically, the first step would seem to be to abandon, at least to some extent, the doctrines of maintenance and champerty. As described in section 3 above, many states have already abandoned these doctrines or have opened the door to third party funding under certain conditions.

Once such prohibitions are lifted, either the legislature or the local courts might adopt clear rules in order to prevent any abuses or misuses of the litigation finance system. Some states, such as Maine,¹⁶⁷ Nebraska¹⁶⁸ and Ohio,¹⁶⁹ have already enacted legislation requiring litigation financing companies to register with the state authorities and mandating specific provisions that must be included in litigation financing contracts. Additionally, these laws prohibit the financier from making any decision with respect to strategy in the course of the litigation. In other states, such as New York¹⁷⁰ or Texas,¹⁷¹ the state courts have opened the door to litigation finance provided that certain requirements are met. Without doubt, these key developments geared toward

¹⁶⁷ MAINE REVISED STATUTES ANNOTATED, Title 9-A, §§ 12-104, 12-106 (2009).

¹⁶⁸ NEBRASKA REVISED STATUTES ANNOTATED, § 25-3303 (2010).

¹⁶⁹ OHIO REVISED CODE ANNOTATED, § 1349.55 (2009).

¹⁷⁰ *Trust For the Certificate Holders of Merrill Lynch Mortg. Investors, Inc. v. Love Funding Corp.*, 918 N.E.2d 889 (2009), p. 895 (“[T]he champerty statute does not apply when the purpose of an assignment is the collection of a legitimate claim. What the statute prohibits . . . ‘is the purchase of claims with the ‘intent and for the purpose of bringing an action’ that [the purchaser] may involve parties in costs and annoyance, where such claims would not be prosecuted if not stirred up . . . in [an] effort to secure costs.’”). See full discussion in Section 3.2, *supra*.

¹⁷¹ *Anglo-Dutch Petroleum v. Haskell*, 193 S.W.3d 87 (Tex. 2006). The Court of Appeals of Texas, when discussing litigation financing agreements, held that “the[se] agreements do not violate Texas public policy.” *Id.*, p. 105. Nevertheless, the Court appeared to require that: (i) the funding agreements shall not prey on financially desperate litigants; (ii) the return on the investment by the funders should be bargained by the parties; (iii) the investors should not maintain any control over the litigation; (iv) the agreements should not increase or prolong litigation; and (v) the investor should not have the right to repayment unless the plaintiff receives a recovery. *Id.*, pp. 104-105.

the protection of consumers would help to ensure that the litigation finance industry and its participants operate in a safer and more transparent environment domestically.

However, among the questions yet to be answered when crafting the regulation of third party funding, two have special importance: (i) as discussed in Section 7 above, whether the third party funder should bear the costs and legal expenses of the litigation or arbitration if the funded party loses; and (ii) as discussed in Section 8.2 above, whether the privilege doctrine should extend to third party funders.

The litigation finance system might be supervised by either: (i) an *ad hoc* government agency in the same way that the U.S. Securities and Exchange Commission (also known as the “SEC”) oversees and supervises the stock market; or (ii) by the ordinary courts. For example, both Massachusetts¹⁷² and North Carolina¹⁷³ have expressed the view that the courts will retain the power to review litigation finance agreements. This supervisory power of the courts could, in the future, be extended beyond the supervision of the financing agreement itself to other areas, including: (i) approval of any settlement agreement, mainly in order to avoid any pressure by the funder to enter into an early settlement; (ii) supervision of the degree of power exercised by the funder in taking strategic decisions of the case; and (iii) supervision of the level of disclosure of key documents to the funder with the aim of protecting them from discovery. Perhaps the court supervision may be modeled after the U.S. Federal Rules applicable to class actions.¹⁷⁴

An interim solution may be to regulate litigation finance through soft-law by the International Bar Association, the American Bar Association or any other bar association (whether in the U.S. or abroad). Another possibility may be that the American Legal Finance Association (ALFA) – or another analogous association or institution – issue self-regulations. In the realm of international arbitration, including both commercial and investment disputes, such soft law solutions may be the only options reasonably available in the near future.

¹⁷² *Saladini v. Righellis*, 687 N.E.2d 1224 (1997), p. 1227.

¹⁷³ *Osprey, Inc. v. Cabana Ltd. P’ship*, 340 S.C. 367 (2000), pp. 382-283.

¹⁷⁴ FED. R. CIV. P. 23.

In sum, whether the benefits of third party litigation funding outweigh the issues that may arise from introducing a stranger to the attorney-client relationship remains an open question for debate but, with a number of sophisticated entities already committed to such funding, it appears to be a question that will be debated for some time to come. In any case, if we decide to go forward with third party funding, laws and regulations, whether formal or soft, might help to avoid abuses or misuses of these new financing tools.