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MASTERCLASS

Funding minefield

Paul Brehony, a partner at Stewarts Law, discusses how to negotiate the minefield of third-party funding

FOUR THINGS YOU WILL LEARN FROM THIS MASTERCLASS:

- 1** The benefits of third-party funding for litigation
- 2** What to look out for when choosing a third-party funder
- 3** How to secure the best terms for your client
- 4** What to watch out for in the post-Jackson era

Working in the largest litigation-only law firm in the UK, it's no surprise that the use of third-party funding is an area in which we have experience. Its growth in the UK has been steady and, used in the right cases, it can be extremely beneficial.

I am currently using third-party funding in an unfair prejudice action (section 994) on behalf of a minority shareholder in dispute with his former business partners. I've noticed a real spike in these types of disputes recently, perhaps it's a sign of the times or reflective of an increasing trend over the past decade to incentivise and lock-in key staff by offering equity as part of their reward packages.

Previously, I'd been highly sceptical about using a third party to fund litigation. I didn't see the point of using it because of the percentage of damages or the multiple of investment that would be charged.

However, in the right cases, it can present the best option for clients.

Although third-party funding can be used across a variety of disputes, typically, strong cases where significant inequalities in financial strength and resources exist lend themselves to third-party funding. These often involve entrepreneurial companies at a relatively early stage in their development and often have an employment angle.

Litigation funding, in tandem with ATE insurance, can also be an incredibly useful tool for applying leverage to settle a case and so I expect this will lead to more widespread use over time.

to be aware of and present all of the funding options available.

To those using third-party funding for the first time, I suggest accepting it for what it is: an investment. I liken it to a hybrid form of private equity. Like all investments, the funder takes the risk and will look for a return that reflects the risk taken. The claimant makes no cash commitment.

There is now greater choice for solicitors looking for a third-party funder than ever before. By a recent count, there are 19 funders currently available. Yet the biggest issue facing the third-party funding market is transparency: how many are brokers or actually have the funds to invest?

“Pay particular attention to the funders’ waterfall provisions, which cater for circumstances where the recovery isn’t sufficient to pay everyone in full”

The credibility of a case, given the due diligence funders will do on the merits, is also significantly bolstered by funding. These people really are putting their money where their mouths are.

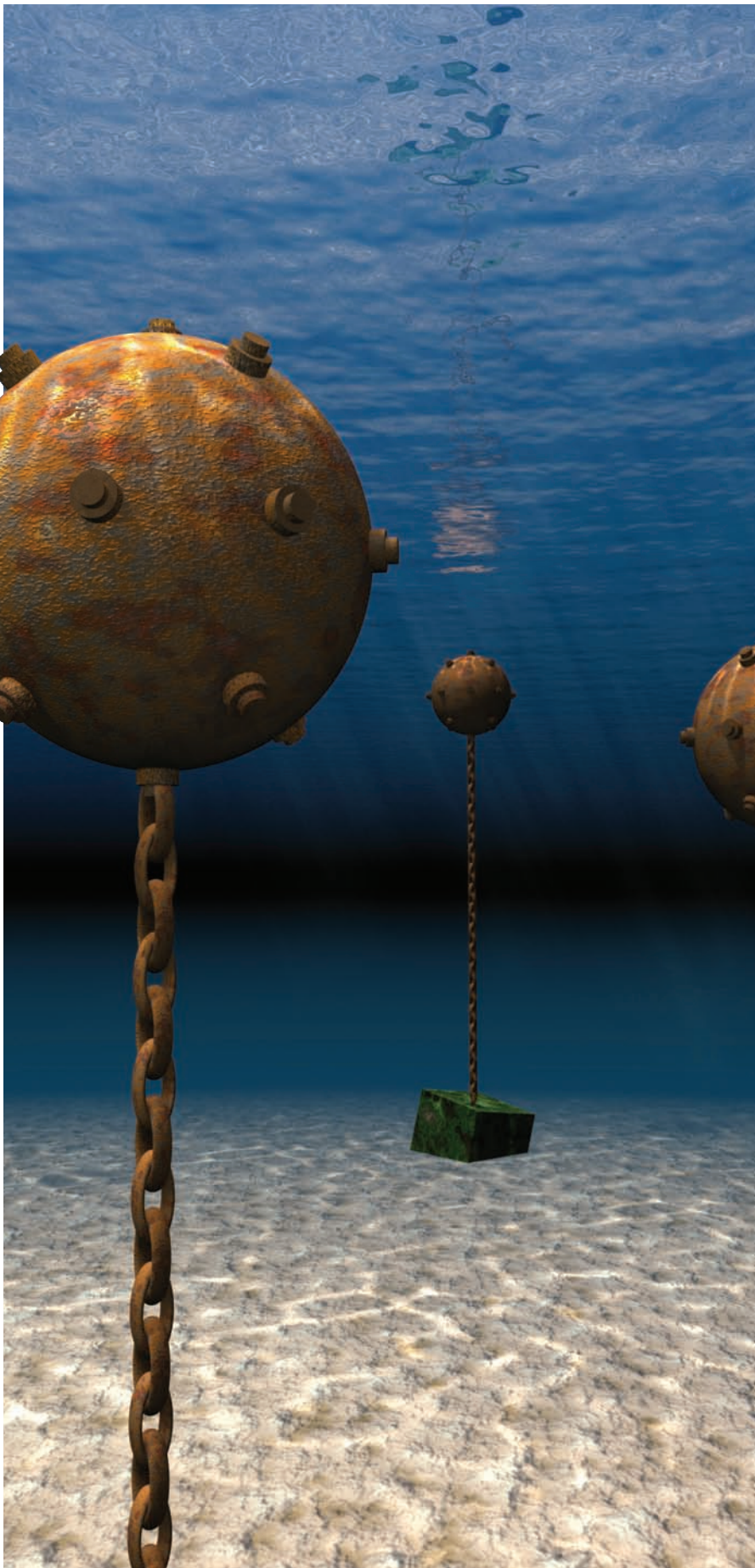
Funding options

Regardless of whether the right option for your client is a standard retainer, fixed or staged fee, full conditional fee arrangement (CFA), discounted CFA (with the client paying), or a legal expenses insurer, the onus has and always will be on solicitors

It is therefore crucial at the outset that you survey the market as widely as possible and speak to as many funders as you can. Even if the funders you favour are highly recommended, you can still learn a great deal in terms of benchmarking from others.

These initial conversations are invaluable for unearthing different approaches and will, from time to time, force you to think about something in a completely different way to how you were intending.

In the dispute in which I am currently using third-party funding, the funding



has come from Vannin Capital. It's a new entrant to the market but is well capitalised and has shown itself to be highly proactive and responsive.

Measuring standards

At the moment there is little guidance or help for choosing a litigation funder. However, a code of conduct that aims to add stability and credibility to the market for third-party litigation funding is in progress.

The need for a code has been given extra impetus by the Jackson report, which backed third-party funding and self-regulation of it, but said a "satisfactory voluntary code, to which all litigation funders subscribe, should be drawn up". This should contain "effective capital adequacy requirements and should place appropriate restrictions upon funders' ability to withdraw support for ongoing litigation".

"Internally, each case being funded through a third party should be carefully scrutinised in the same way that any other case would be"

The Civil Justice Council (CJC) has brought in Irwin Mitchell senior partner Michael Napier to chair a working party to draft the code this year. The code will go hand-in-hand with the creation of an Association of Litigation Funders, which I hope will provide solicitors with security and reassurance when dealing with funders. I will certainly be looking to funders who are members of the association to fulfil my future funding requirements.

Due diligence

Once you have identified funders you think you could work with, due diligence into them is key. Don't allow yourself to get too far down the line with a funder without having done your homework first.

There's no use having protracted talks with a funder if it will then turn around and tell you that its own due diligence process will take two to three months. Cases often gather momentum

very quickly and your funder's timescales need to match your own.

Review the funder's accounts, read about it online and talk to as many colleagues and associates in the industry as you can – good old-fashioned word of mouth is still as powerful as ever.

It is imperative that you identify the following early on:

“The way in which a funder responds to the unexpected twists and turns that cases throw up is crucial”

- the funder's source of funds;
- the liquidity of the funds;
- how long it will take for it to make a decision to fund you; and
- the percentage of damages or multiple of investment being sought (i.e. the cost of capital).

Terms to negotiate

One of the biggest challenges lies in ensuring that you secure the best terms in the market for your client. This requires a combination of hard negotiation and industry insight, and is where all the knowledge you've gleaned from talking to other funders at the beginning of the process should stand you in good stead.

At this stage, also pay particular attention to the funders' waterfall provisions, which outline the distributions or allocations between various stakeholders in the litigation (usually the funder, ATE insurer, counsel and solicitors). These cater for (and are most controversial in) circumstances where the recovery isn't sufficient to pay everyone in full and outline who gets paid in what order.

Generally, these provisions are loaded in the funder's favour – with some justification, they would say. The funder tends to have the whip hand in these negotiations and, while lawyers should do their utmost to improve the priority-based payment formula, lawyers' success fees tend to be at the lower end of priority – particularly where counsel is not acting on a CFA.

Another practical difficulty is that settlements may be global, so there

UTILISING THIRD-PARTY FUNDING

- ✓ Speak to as many funders as possible before narrowing your search. Different funders have different approaches and, if you're new to litigation funding, you can learn a great deal from these initial discussions.
- ✓ Undertake extensive due diligence on your chosen funder before signing an agreement. It is crucial to know if they have readily available funds and will be able to act within the timeframes dictated by your case.
- ✓ Manage your clients' expectations around global settlements early on.
- ✓ Ensure your third-party funded case undergoes the same levels of internal scrutiny as any other case. If necessary, set up an internal committee to ensure the funding and funder is right for you, your firm and your client before proceeding.
- ✓ When published, familiarise yourself with the code of conduct for litigation funders. As well as setting the right standards for funders, the code should provide appropriate, consistent and informative guidance for solicitors.

will be no neat division of funds. More often than not I suspect, an all-inclusive settlement figure will be arrived at in a negotiated settlement (whether via mediation or otherwise).

Where a matter does go to court, obviously an order in relation to costs will generally be made whereby things like the ATE premium and the solicitors' and counsels' success fees are paid by the other side separately and don't come out of the damages pot.

In a negotiated settlement – where most often an all-inclusive lump sum is paid – the distributed fund, the undistributed fund and the funder's mark up have to be taken out of the settlement amount, as well as the ATE and success fees. This can leave a very big hole and it is important that the client fully understands this and that expectations are managed accordingly.

On your toes

Managing your internal processes is always important and that should be the same with funded cases. Internally, each case being funded through a third party should be carefully scrutinised in the same way that any other case would be.

Many firms already have well-developed systems for scrutinising CFAs, for example, often through an internal committee, and should apply similar thorough scrutiny to third-party funded cases.

In the post-Jackson era, the landscape is likely to change. The anticipated expansion of damages-based agreements and the end of recoverable ATE premiums will undoubtedly bring about change, which both funders and lawyers will have to consider carefully. Lawyers are likely to rely on ATE and funding to help manage both liquidity and risk. However, the principles of champerty and maintenance will remain.

Funders will need to continue to take a back seat, but many bring a wealth of commercial, legal and financial experience and it is incredibly beneficial to be able to tap into their insights and experiences.

The way in which a funder responds to the unexpected twists and turns that cases throw up is crucial – a common sense and flexible approach is often required but may not be apparent in all funders.

At the end of a case, I will look at the funders' responsiveness and commerciality throughout our relationship – all of which will have a bearing on whether I'd use them again or recommend them.

My experience to date of third-party funding has been positive. I believe that, for the right cases, third-party funding can be a viable long-term working partnership. However, this only holds true if you go in with your eyes wide open, ensure your client adopts the same approach and you've done thorough due diligence. ¹⁰⁰

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