Kicking (all) the Tyres

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The controversial topic of third-party funding in international arbitration continues to generate much debate across the conference circuit and in the legal press. On the one hand, supporters claim that such third-party funding arrangements improve access to justice since they allow otherwise cash-poor claimants to pursue meritorious claims; on the other, detractors believe that third-party funding arrangements "sully the purity of justice" and help to create a US-style litigation landscape. This article sidesteps such legal arguments, with which this forensic accountant is not qualified to deal, and considers instead important commercial realities that continue to be overlooked. As I will explain, in my view, if disputing parties and their lawyers would only follow certain practices adopted by funders, this could make a tremendous contribution to the battle to reduce time and cost in international arbitration.

For the benefit of those not familiar with this burgeoning new industry, third party funding involves the funding of legal costs by an individual or commercial funder not connected to proceedings, in return for a share of the eventual proceeds. Whereas the old common law rules against champerty and maintenance used to forbid third party funding, these rules have been somewhat relaxed recently, although a discussion of this area is outside the scope of this article.

In order to set the stage, I will briefly contrast the respective objectives of the funder and the party whose claim it is funding. The funder's sole interest in a dispute is the return it will make on its investment; it will therefore approach the dispute like any other business decision involving the allocation of capital – in short, does the size of the funder's potential reward, and the probability of achieving that reward, justify the risk of losing its investment? The funder thus views the dispute with a highly objective and commercial mindset.

In contrast, whilst obtaining damages or some other compensation is often an important factor when a party decides to begin arbitration proceedings, the party may have many other objectives. By way of example, some parties use (private) arbitration in order to resolve disputes amicably in order to be able to continue important business relationships. More generally, we live, rightly, in a world where businesses make proper agreements to do business. They need to be able to rely on these agreements. Sometimes, sadly, there are problems with the agreements which lead to breach or premature termination, etc. The parties then need a judicial system to correct their agreements or replace them.

Whatever the claimant's objectives are, it remains a fact that arbitration is expensive and that the outcome of the majority of disputes will involve a (often sizeable) transfer of consideration from one party to another. For these reasons, it behoves would-be claimants to consider quantum issues seriously from the start, including obtaining independent expert advice, in order to assess whether the risk/ reward ratio justifies formal arbitration proceedings. Does this always happen, however? Again, it is helpful to contrast the approaches of the third-party funder and the disputing party in this

respect.

The funder's decision to invest (or not) in any given dispute will depend on the outcome of its due diligence, which essentially consists of two areas of focus. Firstly, the funder appraises the legal merits of the case and the supporting factual evidence/ witnesses. Sometimes this legal analysis is performed in-house by experienced dispute lawyers in the funder's employment; if not, the funder will instruct outside counsel to opine on the strengths and weaknesses of the legal arguments and factual evidence/ witnesses. The other area of due diligence involves the assessment of how much the claim is worth. Clearly, the funder will not invest in a dispute, even one with robust legal arguments, if the claim's value itself is minimal. For this reason, the funder will itself seek expert advice either from independent quantum/ valuation experts or else instruct the party to do so; it will not rely on the party's own internal assessment of the likely damages, knowing that this is rarely objective. Only once the funder is satisfied as to both the legal basis of the claim and the likely resulting damages will it agree to fund the claim. By analogy, the funder kicks all the car's tyres before buying. From anecdotal evidence, funders will, on average, depending on the size of the claim, invest anywhere between US$100,000 to US$1 million on due diligence, covering both legal and quantum issues. In other words, if a funder needs to spend many thousands just to decide whether to fund, the case itself must be worth many millions.

The situation for most parties whose claims are not funded by third-parties appears to be somewhat different. Based on my own experience, and apparently that of many of my fellow professionals with whom I have discussed this issue, too often arbitration proceedings are entered into without parties obtaining any independent assessment of the strengths and weaknesses of their arguments on quantum, the financial and accounting evidence to support the claim, or the value of the claim itself. This is understandable in cases where quantum is a relatively straightforward issue (e.g. a routine claim for actual past expenditure) or else the claim itself is really about rectifying issues with business agreements; however, for damages claims that are intrinsically difficult to quantify and which require deep economic and/ or financial analysis, I would argue that parties ought to obtain early advice from an independent damages expert. Contrary to the perceptions of some, a preliminary discussion and/ or appraisal of a party's damages claim is relatively inexpensive and can actually save time and cost later on.

Instead, an independent expert is all too often retained very late in the proceedings, usually with only a matter of weeks to go before the claimant's statement of claim is due to be served. By this stage, of course, sizeable costs will already have been incurred in laying the legal groundwork. In cases that are bifurcated, the expert will not usually be instructed until after liability has been decided. In short, the first time that damages issues are first considered may be many months, or even years after the decision to go to arbitration has been taken. A number of issues commonly arise as result of this.

Firstly, without the claimant and its legal advisers being aware of it before, the claimant's initial valuation of its claim may turn out to have been based on unreasonable/ flawed assumptions and/ or an overly speculative view of future cash flows; it may even have been determined using an entirely unsuitable valuation methodology. Alternatively, or in addition, it may turn out that there is little or no accounting and financial evidence to support either the quantum of the claim or the assertion that the claimed damages resulted from the alleged breach/ action by the respondent. In my experience, it is not uncommon to see any or all of the above in claimant's initial estimates of their damages and therefore it is important that such issues are spotted and dealt with early on. This explains why funders are willing to invest in independent analysis of quantum issues before deciding to fund a claim.

Unfortunately, however, the above issues are not always identified at an early stage, precisely because suitably qualified independent experts are not brought in until much later. As a consequence,

and not uncommonly, the claim may turn out to have been significantly overstated. Where this is the case, the claimant may discover in hindsight that entering into formal arbitration proceedings may not have been a sensible use of time and resources at all. By this time, of course, it is too late and the fact that it has incurred significant (sunk) costs may cause the claimant to disregard any other action than pursuing its claim to the bitter end. As above, this is less of an issue where a claim is brought to rectify a business agreement and damages are of lesser importance.

In summary, in my view, there is a real need for parties to follow the example of funders and involve independent damages experts at an early stage, whether funded internally or externally. I would note in particular that:

- Some major law firms themselves employ full-time “forensic experts” in their dispute resolution practices to assist with quantum issues; this approach enables them to consider properly the quantum aspects of claims and to determine the scope of instructions for independent damages experts they retain. Note that this approach does not remove the need for experts; it merely narrows the focus with the aim of saving time and costs.
- As I explain above, the majority of claims in arbitration will likely involve the transfer of consideration from one party to another. Where such consideration is difficult to estimate isn’t it appropriate that independent experts with the requisite skills be instructed to do this?
- Finally, where stakeholders in an arbitration act from a purely commercial standpoint (i.e. the funders), in practice, they turn to ‘forensic experts’ at the outset of the case. Shouldn’t this be considered best practice?

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