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Third Party Funding – Investment of the Future?

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Third party funding is currently receiving a lot of attention in the international arbitration community. An ethical topic for sure, third party funding can provide the financing necessary for an international arbitration to move forward. This logically opens doors to those who may otherwise not be able to pursue the claim or assist those clients with many ongoing claims in mitigating their risk exposure.

How does it work? A fund is created which operates to finance a dispute proceeding. This includes covering the attorneys' fees and the tribunal's fees. In exchange, the fund shares a portion of the awarded damages, but also takes on the risk that no damages are awarded. It is possible that the third party funder will also cover the costs of the winning party, which in large part may depend on the agreement involved and the norm of the applicable jurisdiction. In the United Kingdom, for example, the norm is that the loser pays; however, in the United States the loser only pays if a statute indicates such, which is definitely not the norm. This may or may not control the terms of the agreement with the funder, but is interesting nonetheless.

Could this be the answer to greater access to justice? Possibly, but not all claims are created equal. And, when looking at it from an investor's standpoint, not all are worth the risk. Therefore, a significant amount of due diligence may be required early on in the process. The funders are going to want to know the ins and outs of the claim – whatever is available. This means already knowing and planning the entire case strategy – which witnesses are available and what can they say? What documentation exists? How likely is it that this claim will succeed on the merits? And, if it does, (and arguably most importantly) what do the damages look like? This often means bringing in valuation experts to already access the quantum stage. Often funders are looking for a claim with a likely success rate of 60% or even more.

In other words, a deep, thorough look into the party's claim and its likelihood of success may already happen very early on –perhaps even before the request for arbitration is filed. Of course, evaluating and researching a case is always an important part of an attorney's process from the start, but this may require already being "prepared" for presenting everything to the third party funder, right from the start. Moreover, the funders will consider the reliability of the damages being collected. What is the asset situation of the other party and how does their history on paying up look? In other words, what does the other party's credit look like?

It is easy to already see what kinds of concerns and considerations could arise. Not only ethically but just the practical aspects. Timing may be very important when bringing a claim and not knowing about financing the claim may delay the timing. On the other hand, of course, this could provide a very appealing alternative to a client bearing the entire financial risk. There are presumably many worthwhile claims that may not go pursued in part or even entirely due to the funding limitations.

To date, my experience has been only with third party funders as they have traditionally developed – those focusing on claims with large damages (large enough to provide them with a significant return after paying the costs of the proceedings). There are often claims from parties who neither have the cash flow to handle a full proceeding (despite a great likelihood of success), but whose prospective damages, although small to BigLaw or third party funders, are nevertheless quite a large sum from the perspective of the client – this then begs the questions, does it matter? Would the costs of the attorneys make a smaller claim simply not economically smart anyhow? Not always, with the recent rise in boutique law firms offering more competitive rates and flexible billing structures, smaller claims which are simply too small for BigLaw, have a viable chance at pursing a claim with a price tag more appropriate for their claim.

Are there also funders popping up who may also be in a position to target these smaller clients? From the financial risk-return-rewards and economic reality of pooling the funds to finance the funder itself, is it possible? I welcome comments and input on this.

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