Kluwer Arbitration Blog

Lines in the Sand: Funder, Funded, Lawyer

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Recently, a ripple has created a current through the usually calm waters of the litigation funding world: Reports in the media of disputes between funders, clients and lawyers. Over the past months, cases have featured prominently in the public eye, including for example the dispute between Burford and Sysco. At the heart of these disputes are the terms of the litigation funding agreement (LFA), and the interplay between the three parties – lawyer, client and funder, the agreed extent of control over the proceedings afforded to the funder, and the terms by which the funder is to receive its entitled share of the proceeds on success. Although the exception within the industry, and while we could shrug off these instances as normal, business-as-usual contractual disputes—which can be expected when the stakes are high and the sums involved are significant—these disputes are instructive. They demonstrate the central importance of clear contractual terms, the need for clarification of the parties' understandings of the same, and the role which mutual trust plays throughout the parties' relationship. The following is not a commentary on the rights and wrongs of the respective parties' positions, but rather seeks to act as a distant lighthouse highlighting the very rare, but nonetheless possibly stormy waters that parties and counsel may face when funding a case.

Client vs. Lawyer & Funder

The case of claimant/client Trinh Vinh Binh and his former counsel, King & Spalding, demonstrates the importance of having a clear and defined formula for calculating a funder's and lawyers' success fees: After claimant succeeded in its arbitration against Vietnam (Trinh Vinh Binh and Binh Chau JSC v. Vietnam (II)), he then commenced an action for malpractice before the Texas Harris County District Court, asserting that his counsel in the arbitration had colluded with the funder (Burford) to secure overpayment through a shared success fee and had refused to provide the arbitration file to his new counsel. Counsel "deny all allegations of wrongdoing and intend to aggressively defend the case"; the funder declined to comment. In essence, claimant alleged the formula for calculating his counsel's success fee was open to manipulation.

The claimant later amended his petition to include a claim for defective legal representation, and on counsel's application to remove the matter to the Federal court, was referred to arbitration under the terms of the LFA. Also on counsel's application, the terms of the LFA were sealed so as not to prejudice the signatories, including to prevent the disclosure of confidential business information.

Heading into a funding arrangement brings with it the promise of sharing the victor's reward, but

such reward is obtained at the expense of the funder putting its capital at total risk and (where permitted) counsel acting on contingency rates. Circumstances such as these in the Binh matter demonstrate the importance of clear terms in an LFA and perhaps, more poignantly, can help ensure that the client has a clear understanding of their obligations under an LFA, including its counsel's entitlement to a success fee. Although this may appear to be overkill in most scenarios in which a client is already represented by counsel in a pending dispute, it is worth considering the benefit that client, counsel and funder may have obtained if the client had received separate legal advice on the LFA before entering into the same. This would help to ensure that all interests were aligned, that the terms were watertight, and that any ethical or other professional rules of conduct applicable to client-lawyer fee agreements are followed, thereby providing further safeguards against any subsequent allegations of breach. In practice this may complicate matters for the funder – dealing with two and not one set of lawyers and the client – but it does potentially reduce risk.

In any event, the case highlights that even when sophisticated parties are involved, there remains scope for clients to allege misinterpretations of an LFA, perhaps not coincidentally when counsel and funder are owed significant sums under the same. As this case shows, the initial goodwill can be at great odds when the client is obliged to pay.

Funder vs. Client

Having funded the claimant Mohamed Abdel Raouf Bahgat against Egypt in an UNCITRAL arbitration under the Egypt-Finland BIT, the funder (Buttonwood Legal Capital) filed a claim to recover its share of the success fee allegedly owed to it. Mr. Bahgat claimed the LFA and related funding documents were unenforceable against him. Without commenting on the case itself, it does demonstrate a scenario of a client apparently seeking to avoid its obligations to its benefit and to the detriment of the funder, without whose financial support the client would not have been in a position to benefit at all.

This case follows a similar pattern to the above, namely that the dispute between funder and client arises only once the client is due to receive, or receives, payment under an award/judgment. It is at least questionable whether Mr. Bahgat would have claimed that the LFA were unenforceable either during the arbitration when the funder was financing the proceedings, and/or if he were wholly unsuccessful in the arbitration and required to repay the funder in full for the alleged unenforceable agreement.

This case shows the need for clear and enforceable contractual terms in the LFA and raises various issues concerning the preparation of the LFA, and attendant strategy that funders consider to enforce if/when push comes to shove. Enforceability may, of course, be a jurisdiction-by-jurisdiction issue, whereby what may be a permissible enforcement tool in one jurisdiction may not be permissible in another. However, some principal questions should be considered: Where would such enforcement be sought and why? What are the local laws, requirements, *etc.*, concerning funding in that jurisdiction, and does the LFA satisfy such requirements? What is the priority of payments (*i.e.*, who gets paid and in what order) and the mechanism for such payments – from the client to funder or, preferably, from counsel or an escrow account to funder, the latter aimed at removing the discretion of the client to determine if and when to pay the funder, regardless of the LFA terms?

At the core of this strategy and approach is for a funder to protect its investment before deploying funds. This underlines another reason why a funder's due diligence is fundamental to ensuring not only a successful cooperation between funder and client throughout the dispute, but perhaps more importantly a soft landing when the funds are to be distributed to funder and client. As this case shows, this framework can be attacked by clients, the success of which depends largely on the contractual terms and enforceability within the respective jurisdiction(s). It also shows that, even when clients are afforded the benefit of pursuing their claims at no risk to themselves but at risk of total loss to the funder, clients can raise allegations about the LFA in an attempt to retain the proceeds. *Caveat emptor*, or perhaps more aptly in this case, *caveat venditor*.

Client vs. Funder… and vice versa

The facts and circumstances currently unravelling in the Burford and Sysco dispute have brought to the fore the debate concerning the doctrines of champerty and maintenance in the US, and the extent to which a funder may control the funded dispute, if at all.

Indeed, Burford's senior management published their opinion in the Wall Street Journal that their LFA with Sysco confirms that the client controls the litigation decisions: *"Sysco's suit isn't exemplary of litigation finance—Burford has done many billions of dollars of legal finance transactions without any fanfare—but rather of an admitted breach of contract. As with any asset financing, among the basic conditions of financing in litigation finance is that the financed assets can't be sold or assigned away, because they serve as collateral for the financing. But that is what Sysco did."*

A separate opinion by a funder (not involved in the dispute) discussed how Sysco conducted a "*master class on how to breach a litigation funding agreement.*": *"Sysco chose to provide the right to Burford and received a release in exchange for doing so. It now seeks to disavow the right so it may settle beneath its own 'settlement floor.' Sysco thus materially breached, and now seeks to further breach by unreasonably settling away what remains of its claims for less than its own stated minimum. And it's only doing so because it is no longer incentivized to litigate due to its own misconduct."*

In the context of the funder's position, claims of control and breaches of the doctrines of champerty and maintenance seem far removed from an apparently clear case of breach of contractual terms. Entering stage left, however, are such claims of control and breaches of these centuries-old doctrines.

Weighing these issues, at first blush it appears entirely contradictory to a funder's position – even its existence – to act contrary to its primary objective of protecting its investment to ensure a return. This is amplified the more so with a sophisticated, experienced funder who has done similar deals "*without any fanfare*".

So… why the dispute? At the risk of being pessimistic, the same pattern appears in this case as in those referenced above: It is only after having benefitted from the financial support of a funder that the client is raising these allegations, seeking to avoid both the terms of the LFA and giving the funder the benefit of their bargain, despite having received a benefit themselves. Asking the courts to delve into the LFA terms and support the client's position may be a gamble from the client's position, or a blatant breach of the LFA from the funder's view.

Again, clarity of terms and ensuring all parties to an LFA are clear on their obligations and expectations is thus essential. Nonetheless, even when that is assured, parties may still try their hand.

Conclusion

The above cases provide a snapshot of some of the very rare, but nonetheless possible tensions, and at times potential fallout, that may arise in a funding relationship. Of course no party – funder, client or lawyer – desires any such disputes when entering into an LFA. However, for the sake of avoiding a delicate period when the money is on the table, all such parties may be well advised to step back and reflect upon how the LFA may be attacked. This would provide the parties with the opportunity either to discuss the same, to ensure a further alignment of interests, or the possibility to otherwise seek independent advice in order to identify blind spots in the LFA. While the latter approach may be desired more as the exception rather than the rule—as the addition of more negotiating parties no doubt adds further complications to the funding process—the efforts required in implementing these safeguards may provide a significant upside and further ensure against lengthy disputes in the long term.

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