

In the ongoing search for new categories of assets with increasingly attractive rates of return, family offices and investment funds are increasingly looking to litigation and arbitration disputes for new opportunities.

This is the first in a series of notes that touch on key aspects of this still developing asset class, and the growing trend for the commercialisation of disputes. The aim of this initial note is to provide a general introductory overview of the prospects of third-party funding, with later notes in the series providing more detail around matters such as (i) the structuring of specific funds to invest in disputes; (ii) important factors when investing in claims, in particular the appropriate contractual framework of funding agreements; and (iii) key considerations when acquiring final judgments and/or arbitration awards, including potential follow-on investment in enforcement proceedings in order to realise the full value of a purchased asset.

### **What Is the Investment Opportunity Presented by Third-party Funding?**

Whereas legal advice around disputes was once regarded by clients as a “distressed” purchase, and an inevitable even if sometimes necessary drain on resources, increasingly, disputes are being regarded from various quarters in a quite different way. For example, it is now widely accepted that a claim (or indeed an order/judgment) can have intrinsic value, and therefore properly can be regarded as an asset, which, in the right circumstances can be bought, sold and financed.

The proposition is, on its face, relatively straightforward. A fund advances an agreed sum of money to an unrelated third party that has a legal claim, either advancing this money in a single tranche or in multiple tranches, and either in order (i) to assist the third party to fund the pursuit of a potential or ongoing claim, or (ii) to acquire a judgment or arbitration award that has already been obtained. Then, after successfully pursuing legal proceedings in the relevant jurisdiction, the fund enjoys its returns – in the case of ongoing litigation/arbitration, this will be paid out of the total damages recovered by the third-party claimant, and in the case of an existing judgment/award, the reward is the net difference in the amount the fund paid for the judgment/award and the amount recovered upon its successful enforcement.

### **What Are Some Key Considerations and Risks?**

When considering a third-party funding investment, core considerations tend to fall under two main headings – the economics and the legal merits.

#### **The Economics**

First, there is the question of how much funding is likely to be needed and whether there is sufficient headroom available. Typically, market participants expect at least a 10-to-1 ratio as regards (i) the minimum realistic claim value and (ii) the total expected funding investment to pursue it. The equation is slightly different when acquiring a judgment or arbitration, and the economics then tend to focus on what might be a reasonable reduction/discount to the overall value of the judgment/award making it worthwhile acquiring it, particularly given the possibility of then having to fund enforcement proceedings.

In a similar vein, in most cases there will be a keen upfront focus on ultimate recoverability and enforceability; where will money ultimately come from on a win, and how easy would it be to get hold of it? It is no use to anyone if a huge victory is scored but there are then no assets available to pay it out.

#### **The Legal Merits**

In the event the numbers do work, and there seem to be suitably deep pockets in play, then, unsurprisingly, the next crucial issue is consideration of the legal merits, i.e. the likelihood of winning a dispute, and/or the chances of a near 100% recovery following enforcement of an award (either after a successful trial or having acquired it outright). Overall chances of success that from the outset are deemed to be, at best, 50-50 are not likely to be that attractive when a fund is being asked to deploy significant sums. Accordingly, investors typically look for initial assessments of the chance of success of 60% or better and will want this view backed by an opinion from a senior lawyer, often one who has a level of independence from the lawyer who will actually pursue the case.

Of course, it is also a factor that disputes do settle, with statistics suggesting this might even be the case for around 80-90% of matters. However, when pricing up the cost and risk of a potential investment, there is no guarantee a settlement will occur, or that, even if it does, it will be of sufficient value to recoup a fund’s investment, let alone any upside. Therefore, the initial cost/risk balance must still be assessed in terms of a matter that might go to trial and thus require deployment of the full investment requested. Indeed, it is often a requirement in a funded deal that the full amount of funding be set aside/ring-fenced so that the third party knows it can be reliably drawn down during the life of a matter.

Another feature of some jurisdictions, including England and Wales, is that at the end of a dispute, a court or tribunal may order the loser to pay a proportion of the costs of the proceedings incurred by the winner. This is, therefore, another expense that may need to be accounted for when finalising a funding deal for certain disputes. That said, there are now a number of ready-made solutions that have grown up to address such risks, most notably after-the-event (ATE) insurance policies. These provide, in return for payment of an insurance premium (which itself sometimes can be deferred or made wholly or partially contingent), that the insurer promises to satisfy an adverse costs award made in the event the insured third party loses the dispute.

## Is Third-party Funding Available in Every Jurisdiction?

While the interpretation of relevant local doctrines and laws continues to develop around the world, there remain some jurisdictions (e.g. Ireland) where providing financial support in the context of an unrelated dispute is not as straightforward as it may be in jurisdictions like the UK, the US and Australia, all of which presently lead the way in the development of third-party funding markets.

## What Are the Barriers to Entry?

Provided a fund is properly advised, and the jurisdiction is one of the more favourable ones, then there may be multiple opportunities that can be pursued with relatively little difficulty. It may be that a fund wishes to join in with a larger, more established funder and deploy its capital as an investor into those vehicles, or a fund may wish to pursue its own path and directly invest in claims and awards itself. The latter path will necessarily be the more involved, as then the fund will be responsible for commissioning its own due diligence of opportunities and the drafting and negotiation of key agreements, but similarly it can be the more rewarding.

An alternative approach growing in popularity is the direct funding of law firms rather than individual third-party claimants. While this of course brings other considerations, including solvency risks of the law firms, it nevertheless can help expose funds to multiple claims that can work as a hedge in the event one or more lose but the others succeed.

## How Might We Help?

Our team already has a great deal of experience advising funds and litigating parties in the broad context of third-party funding deals. Our lawyers can help not only with the pursuit and/or assessment of the prospects of active or potential disputes, but also as regards appropriate fund structures; drafting and negotiating the key litigation funding documents; as well as the nuances around the acquisition and enforcement of existing judgments and awards. In the event you would like to discuss any of these matters further, please do not hesitate to reach out to us.

## Contacts

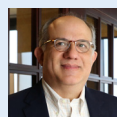
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