Third-Party Funding

September 2021

What is Third-Party Funding ("TPF")?

TPF is an arrangement between a specialist funding company and a client (typically the claimant in either a litigation or an arbitration), whereby the funder agrees to finance some or all of the client's costs in bringing the claim in exchange for a share of the 'case proceeds' (usually the recovered damages).

We have close association with a Funder in London, and we believe we can obtain the best possible terms available on the market. The granting of recognition is a landmark ruling for Hong Kong. This article analyses the details of the case, including the parties in the case, the issues the Court needed to determine, what the court held, and its potential benefits to the Hong Kong-PRC relationship.

How the TPF Model works?

Subject to legal and economic due diligence and budget, the Funder agrees to finance legal fees, counsel fees, and other costs, including expert costs and, where necessary, Arbitral Tribunal costs.

Key features of the funding model include:

- The funding is provided on a no-recourse basis.
- If the case is lost, the Funder loses its investment, i.e. the financial risk of the case is effectively assumed by the Funder.
- The client is entirely shielded (ring fenced) by any financial risk.
- The Funder's role is passive, as it does not control the case and most importantly any settlement. It is therefore the client's decision, subject only to a requirement that he acts within the legal advice he receives from the lawyers mutually selected by the client and the Funder, when to settle and at what level.
- The effect of the above is that Funder is exposed to the full risk to the downside but cannot control the level of any recovery and therefore return.

Requisites / Conditions for Obtaining Funding

- Positive outcome of legal and economic due diligence.
- Substance of the case, i.e. the case "has legs".

- Defendant/Respondent must be financially viable, i.e. reasonable expectation that, if the case is won, then the Defendant/Respondent is able to pay whatever comes due and payable under the award/judgment.

- Funding-to-damage ratio of a least 1:8 ratio, i.e. ratio between damages to be claimed (as assessed on a conservative basis) and required amount to be funded. This means that if funding is required for Euro 500,000 then the likely damage which can be awarded (if the case is won) would be no less that Euro 4,000,000.

- The case is to be adjudicated before judicial bodies which can ensure transparency and effectiveness for the proceedings and balanced judgment over the dispute.

- The client is represented by a law firm, and other advisors involved in the dispute (e.g. damage expert), acceptable to the Funder.

Win-Win Situation

The Client is not taking any financial risks, if the case is lost. Client can offload recurring expenses from their balance sheet, given that legal costs are typically accounted for as expenses (reducing client's revenue and corresponding profit margins).

Lawyers may gain flexibility with their fee arrangements, when cases are funded. They are not required to work a considerable amount time without remuneration, something which may ensure consistency in their services quality.

If the case is won, the Funder will receive substantial return over its investment. The Funder is also best able to bear the risk of loss, which they can spread across their entire investment portfolio. Moreover, the Funder has usually the lowest cost of capital since it is in the business of financing lawsuits, client is not.

Funder's Remuneration

The market has evolved a typical formula for TPF terms, whereby the funding is provided for:

- return of capital plus a multiple of funding commitment (usually 3X); or

- return of capital plus a percentage of the net damages after costs.

However, terms can be negotiated on a case-to-case basis.

- Using the example from the previous slide under scenario (a), capital x 3 times:

- If funds committed by the Funder equal EUR 500,000 and damages awarded by the competent court/tribunal in favour of the client equal to EUR 10,000,000;

- then the Funder will be entitled to EUR 2,000,000 (EUR 500,000, plus a multiple of 3 times the funds committed), and the client will be entitled to EUR 8,000,000; and

- the Fund remuneration (EUR 2,000,000) shall be paid with priority over the amount payable to the client (EUR 8,000,000).

After the Event ("ATE") Insurance

ATE insurance policies cover the legal costs which a Claimant must pay to a Defendant/Respondent when its claim is unsuccessful.

We usually advise clients who decide to engage in complex and sophisticated disputes to apply for ATE insurance in order to be ring fenced by any liability in the event that the claim is lost and costs are awarded in favour of the other party.

ATE insurance can be obtained under favourable terms through the Funder, and the costs can be allocated and paid out of the budget agreed upon by the Funder.

In international arbitration cases, claims can be dismissed if an arbitral tribunal orders the claimant to post a security for costs and the claimant is unable to offer such security. In that scenario, ATE can greatly assist the client.

Defence Financing

TPF is usually required by claimants who wish to pursue their meritorious claims.

However, funding for the defence against weak claims can also be available, in certain circumstances, as companies which are involved as defendants/respondents may value eliminating defence costs from their budget and Profit and Loss statements.

Typically, TPF for "pure defence" cases (where client has no counterclaim) is made available in return for a success fee, the parties might agree the case is "successful" if it is settled or “lost” below a certain threshold.

In this scenario, the Funder agrees to finance the legal fees, and in some instances to cover the settlement payment in excess of a certain amount. The client agrees to pay the Funder a multiple of the funder’s investment if the case is "successful."

Please reach out to Marco Pocci (marco.pocci@kempllp.com) or Salah Mattoo (salah.mattoo@kempllp.com) if you have any questions.