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GLOBAL LITIGATION FUNDING OPPORTUNITIES SET TO INCREASE

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New rules mean third-party litigation funding has become acceptable in the Cayman Islands and Hong Kong in certain instances, opening up new investment opportunities for the growing number of hedge fund operating in the space.

The legal amendments relating to third-party litigation funding in both jurisdictions have fund managers investing in the space excited by the new options that could be presented.

“We’ve been following recent developments in funding activity with great interest and I expect that with the continued whittling away of traditional laws of maintenance and champerty in common law jurisdictions, we will see more funding activity going forward,” predicts Tania Sulan, chief investment officer, Canada at IMF Bentham.

IMF Bentham has been at the forefront of a move by hedge funds into litigation financing in recent years. Fortress Investment Group partnered with Bentham last year to launch a dedicated US fund with up to $200m in starting assets while the firm established Bentham Ventures with affiliates of Paul Singer’s Elliott Management in 2014, with Elliott understood to have purchased IMF Bentham’s stake in the entity two years later.

Other firms operating in the space include New York-based Tenor Capital, while BlueCrest founder Michael Platt has backed a new start-up, Curiam Capital, which was launched last week by former Grais & Ellsworth lawyers Owen Cyrulnik and Ross Wallin.

William Farrell, co-founder at commercial litigation funder Longford Capital agrees legal developments in Cayman and Hong Kong open the jurisdictions up to greater litigation funding activity. “While the allowances are not as

clear-cut as the use of funding in the US or in the UK, the common law jurisdictions are quickly moving toward a more liberal use of litigation funding for companies to access justice. That is very encouraging."

Of the Cayman decision, Christy Searl, a director of the litigation finance firm Burford Capital, which provided the funding in the Cayman case, says: "It removes the previous ambiguity about funding outside of insolvency. The court has said funding agreements will be accepted so long as the funders involved meet the laid out requirements, so I think with this guidance you will see more litigation funding agreements."

Before the recent amendments in Cayman and Hong Kong, the main prohibition on third-party funding was the common law rules against maintenance and champerty.

Peter McMaster, a partner at law firm Appleby, explains that champerty is where a litigant party pays a third party a cut of its damages in return for the third-party funding litigation. Maintenance is where a third party provides funding to allow legal proceedings to be brought. "Not every circumstance where third-party funding is done is illegal; there are certain types of acceptable maintenance of legal proceedings and it's a question of whether what is being proposed is contrary to the public policy outlawing maintenance," McMaster explains.

In Cayman, the Grand Court has confirmed that litigation funding is not contrary to public policy on maintenance and champerty. In a recent landmark case, A Company vs A Funder, the court set a list of considerations when presented with a funding agreement and offered some circumstances under which the court may permit them.

Searl says: "We found the decision to be helpful in providing a roadmap on what is acceptable in third-party funding agreements."

Nick Dunne, a partner at Walkers, says he expects the court decision will encourage people to resort to third-party funding agreements. And as more of these agreements are considered by the courts, the guidelines will be refined. "The A Funder case is carefully reasoned, which is very helpful, but it is likely to have some evolving to do before we're sure exactly where it will take us."

In allowing third-party funding in the A Funder case, the Cayman court said it is willing to allow such agreements. However, Dunne notes that agreements must comply with particular requirements and, consequently, the terms are going to be scrutinised by the court before litigants can enter into the agreements.

Marc Kish, a partner at Ogier and the advocate in the A Funder case, says Cayman third-party funding agreements need court approval before a funding agreement can be implemented. The court will review the contracts to determine whether the various provisions offend public policy.

In the A Funder decision, the court ruled that a funding agreement will not violate rules of maintenance and champerty if it does not corrupt public justice. Whether or not an agreement corrupts public justice will depend on several factors, including whether the funder controls the litigation. Control is a major concern in these agreements, McMaster says. "In the extreme case where the funder is completely in control of the litigation, the risk of abuse of the proceedings is believed to be enhanced. There is a balance to be struck."

"If the funder builds into the agreement the ability to dictate the course of the litigation, then there is public policy concern," Kish explains. "If the plaintiff is allowed to control the direction of the litigation then the court shouldn't have any problem with the funding coming from a different source as it's purely a commercial decision by the plaintiff and the funder."

The court will also look at the ability of the funder to terminate the funding agreement at will or without reasonable cause because it is concerned the funder would be in a position to use that ability to impose its will on the funded party. Another important consideration is the extent to which any funding party can make good any cost of liability because Cayman is a 'loser pays' jurisdiction, Dunne says. "The court may be unwilling to sanction a situation

where a funder provides funding for litigation, that litigation is unsuccessful, and the funder disappears when it is time to pays costs."

Kish says that because Cayman is a cost-shifting jurisdiction, it creates an aspect of third-party funding cases that doesn't exist in the US. "If a funder agrees to fund a claim and the plaintiff loses, and the plaintiff doesn't have the means to pay the costs, then the funder has to satisfy the court that the costs will be paid or there is after the event (ATE) insurance in place to cover court costs."

Approval of funding agreements will also depend on how much information is provided to the funded party. It should only have enough information to make informed decisions concerning the litigation. The court will also look at how much profit the funder stands to make, and whether the funder is a professional and regulated one.

Although more common law jurisdictions (including England and Wales) abolished maintenance and champerty laws, the Cayman Islands has not yet done so, but the A Funder case signals this may need to change. As such, third-party litigation funding agreements meeting the court's guideline will likely be approved, paving the way to more third-party funders participating in Cayman litigation.

"If you look at other jurisdictions, like the US and the UK, third-party funding is fairly common and there is no reason to believe that the trend will be any different in Cayman now that the court has indicated it is willing to look at potential funding agreements," Dunne says.

Kish agrees the case will result in more instances of third-party litigation funding being allowed, "as long as the other issues have been settled to the satisfaction of the court and as long as the agreement itself doesn't offend the principles of maintenance and champerty."

In Hong Kong, third-party funding for arbitrations and mediations are now allowed after the passage of the Arbitration and Mediation Legislation Bill 2016, which amended the Arbitration Ordinance Cap 609 last year. Farrell says Hong Kong modified its arbitration mediation law to allow the use of third-party litigation funding in arbitrations. "That revision abrogates the prohibition against maintenance and champerty and litigation finance will not be prohibited in arbitration cases. We're encouraged by this development."

The new rule requires the funded party to give written notice of the funding agreement and the name of the third-party funder to the arbitration body and each of the other parties to the arbitration.

However, funding for court litigation is still proscribed by the criminal law on maintenance and champerty, except in liquidations where the insolvent company's claims can be assigned third-party funders. Melissa Chim, dispute resolution consultant at Simmons & Simmons says that, "to date, this has been the area where most of the significant litigation funding has been seen."

Chim says more funders have been setting up in the region and this is expected to increase, particularly as funding likely will be broadened out to all forms of litigation. "I expect there will be a push in that direction, but if it is to happen it ought to be accompanied by a framework that ensures transparency and a level playing field in the litigation."

Added Kelly Naphtali, a partner at Kirkland & Ellis, "Third party litigation funders have been active in Hong Kong for several years. The recent legislative reforms concerning arbitration have prompted considerable interest. Additional funders have been looking for opportunities to enter the market, and more are also expected to show interest going forward."

Farrell agrees funding activity is expected to increase in arbitrations and that additional litigation funding allowances will be expanded beyond arbitration. "It was first accepted in the bankruptcy, liquidation and distressed situations. With the expansion into arbitration, there is a recognition that there are many reasons why companies

prefer to use litigation funding to finance the cost of litigation and this will lead to more expansion into other areas of litigation." Liz Bigham chief marketing officer at Burford Capital said the growing interest in the use of litigation finance is an outgrowth of the successful use third-party financing arrangements in other jurisdictions and firms and lawyers "are interested in learning whether similar results can be achieved in Asia" and "there is every reason to expect increased use of outside finance."

While there is an expectation that the legislature will extend third party funding to other types of litigation, Naphtali doesn't see that happening soon. But she added that there have been a number of cases from the Hong Kong courts in recent years which have provided further guidance around litigation funding for claims brought in court that help funders identify opportunities in other types of claims which would not be considered "objectionable on the grounds of maintenance and champerty, both of which are still crimes and torts in Hong Kong."

While funding activity is expected to increase, Chim says there are still barriers to entry for hedge funds looking to enter the Hong Kong litigation market. "Funders wishing to invest in Hong Kong will need to be much more transparent about how they operate, and be prepared to bear the downsides of litigation as well as the benefits to foster acceptance of something that has the potential to make access to justice easier for many more genuine claimants."