Calunius

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MEMORANDUM

To: Roundtable on Third Party Funding of International Arbitration Claims: The Newest "New New Thing", Fordham University School of Law

From: Calunius Capital LLP

Subject: A European Perspective

Date: 15th June 2011

This Memorandum is submitted to the delegates of the "Roundtable on Third Party Funding of International Arbitration Claims: The Newest "New New Thing", Fordham University School of Law, 113 West 60th Street, 12th floor Lounge, New York, NY on 15th June 2011.

It offers a European perspective on the subject from an active funder in the relevant area and addresses

- The current state of affairs;
- Typical scenarios for funded arbitration s, and
- Lawyers' duties on advising clients about available finance options.

1. Introduction

The UK and certainly continental Europe can be considered more grown up about funding of large commercial disputes than the US. Germany, Europe's largest economy, has enjoyed an active and mature funding market for more than 10 years, which makes it – together with Australia - one of the world's early movers in this respect. Since about 2007 the UK has embraced litigation funding for commercial disputes also outside the insolvency arena, where the early activities in the market took place. Politically litigation funding is considered to be a 'good thing' in these jurisdictions through which access to justice is improved. The hostilities that appear to have taken place in the US towards litigation funding have not occurred in Europe.

A key difference between the common law countries and the civil law countries is that the ancient doctrine of champerty and maintenance that occasionally still plagues the industry in the common law world does not exist in the civil law countries, which is one of the reasons why a balanced market was able to grow in Europe before this happened in the US. There are of course other limitations to what a funder can and cannot do, but these are largely to do with commercial terms in the context of protecting consumers; consumers are almost certainly never going to be party to an arbitration.

2. Current Market in the UK/Europe

Besides the Fund that is advised by the authors of this memorandum, the Calunius Litigation Risk Fund, there is only Harbour Litigation Funding as the other disclosed litigation funding specialist that also funds arbitrations.

In Germany a subsidiary of Allianz is interested in all types of claims, including arbitrations, and there are a handful of other resourceful market participants that provide capital to the market.

We would estimate that the available capital for arbitrations of commercial disputes in Europe is currently between circa £50 and £100mm. As each arbitration case has a capital need of typically between £1 and £5m it is clear that there is not a lot of capital available today.

Investment treaty arbitrations are a special category in the arbitration arena, and only very few funders have the appetite to get involved in these types of cases, which feature a longer investment period due to longer case duration, and have more pronounced risk profiles.

Most of the other disclosed funders are specialised on a domestic level and do not concentrate on international arbitrations, but rather focus on aggregating claims in group actions, or simply servicing the domestic litigation markets.

3. Typical scenarios

- SME David v Goliath:

  A large number of cases that are funded in commercial arbitrations relate to cases where the claimant is a small, but by no means impecunious, corporate entity, that entered into a contractual arrangement with a very much larger counterparty, often a global corporate giant. When the cooperation is successful and money starts to be made, it is astonishing to see the similarity of the following recurring fact pattern: the global corporate Goliath decides to ignore contractual restrictions and obligations, and essentially takes all the future benefits of the business that is at the heart of the agreement with David, but without letting David participate in the spoils of a success that David was central to achieve. It appears that Goliath applies a 'strangle at birth' policy in order to keep the suffering small party from claiming what is or should have been theirs. This often leads to a situation where the SME is forced to accept a small settlement, simply because it is heavily outsized and correctly expects to be outspent by the opposition.

- Expensive proceedings/forums

  As a general rule it is fair to say that the more expensive the jurisdiction, the bigger the need for funding: the UK as a forum and international arbitration proceedings are probably the most expensive examples, and the jurisdictions and forums where the

required legal budget for a case is measured most frequently in millions of pounds, whereas most other countries run legal systems that are arguably less sophisticated, but certainly much less expensive.

- Front loading of costs in arbitrations

  Arbitrations are even more 'painful' than domestic court proceedings for a claimant with finite financial resources and a limited legal budget because of front-loading of fees; very soon after proceedings have been started, the arbitral organisation will request an advance on the likely costs of not only the arbitral panel but also its expenses; this advance is inevitably measured in many hundreds of thousands of pounds in every large commercial dispute, and leads to an early reality check whether the claimant really has the stomach to last the distance; this can of course be aggravated if – as is frequently the case – the much larger defendant raises a tactical (but often weak) counterclaim in an effort to drive costs up and intimidate the claimant, a very effective and commercially understandable but ethically questionable approach.

4. Lawyers' duties

It is undisputed that (at least in the UK) solicitors are under an obligation to the client to advise him of the available funding options; Solicitors' Code of Conduct, r2.03(1)(d) states that the solicitor has to '*discuss with the client how the client will pay*'. We believe that if this duty were taken more seriously, and the expected overall cost of proceedings were discussed in realistic terms, many potential commercial claimant clients would think carefully about rational risk hedging mechanisms like litigation funding, much as these same business people do when considering their approach to currency fluctuation risk or interest fluctuations.

5. Privilege

The 'European' system appears to be more 'user-friendly' and sensitive to the claimant's and funder's natural and legitimate interest to discuss, and exchange views on, the strengths and in particular the weaknesses of the case, without facing the risk of having to disclose these discussions to the defendant. We are not aware of a single case or decision that would have led to the loss of privilege of communication with a funder. Incredible as it may sound to a European funder's ears, at a recent conference in London on the subject a US funder was asked how they carried out their due diligence of a case in light of the loss of privilege problem, and replied that 'they do not write a lot down'. It seems hard to believe that investment decisions worth many millions would be made on the basis of essentially only oral assessments and communications, yet it reflects our (limited) experience of dealing with US based attorneys in enquiries for litigation funding. It would appear to us that the European system provides an important advantage in this respect over American law because it allows an open and frank discussion in writing about the merits of a case.

6. Conclusion

While the market is still relatively small regarding the number of providers and available capital, there are relevant funds available for arbitrations, and they are currently being invested in cases that are considered to be strong and to have good recoverability prospects.

Because of the differences compared to the US, the existing European legal framework is more suitable for litigation funding, and – insofar as the UK is concerned – is expected to become even more favourable in the near future.

We think it is fair to say that the development of litigation funding for arbitrations in Europe has been slow but steady, and it points towards an increase in in the number of well funded providers and an influx of further capital.

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