



Welcome to the January 2016 edition of *Insight*, Fenwick Elliott's newsletter which provides practical information on topical issues affecting the building, engineering and energy sectors.

**This issue considers the main options<sup>1</sup> that are available for the funding of disputes; their principal advantages and disadvantages and how litigation funding is likely to develop in the future.**

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## Litigation funding

When deciding whether to bring or fight a claim, a crucial (and often deciding) factor is cost. In addition to the commercial costs that invariably accrue when litigation is in prospect, potential litigants have to consider their own legal costs, and also the potential exposure to their opponents' costs, which may double the overall costs risk in the event the claim or defence is unsuccessful.

Historically, other than insuring against an adverse costs liability, there was little litigating parties could do to minimise their costs exposure. But in recent years, there has been a shift in attitudes towards the funding of litigation, as a result of which there are now various options available to both claiming and defending parties to help minimise their exposure not only to their opponents' costs, but also their own costs.

### Main funding options

#### Traditional private retainer

The private solicitor—client retainer is the conventional way of funding for commercial disputes, under which the client enters into an agreement with the solicitor to conduct the claim or defence at agreed hourly rates on a "time spent" basis, regardless of the outcome. Billing is on an interim basis, and bills are usually rendered monthly.

In addition to the retainer, the preparation of a detailed costs budget is usual during the course of the matter and any subsequent proceedings,<sup>2</sup> which will be subject to review. The ability to review the costs budget is necessary both for certainty of costs, and to enable the client to be made aware of any changes that may need to be made to the anticipated fees so that decisions can be made with regard to ongoing fee expenditure and the conduct of the claim or defence as the matter progresses.

#### Advantage

- The private retainer is the traditional approach with which solicitors and clients are both familiar.

#### Disadvantage

- It may be challenging to provide a completely accurate budget from the outset of the matter, particularly if new issues arise, or the case develops in unexpected ways, in which case the budget may need to increase.

#### Fixed fee agreement

As an alternative to the conventional private retainer, clients can enter into a fixed fee arrangement which provides for the whole or part of the matter to be conducted for a fixed fee that is agreed from the outset. As for the private retainer, the fixed fee will be payable regardless of the outcome of

the matter, and fixed fee agreements are suitable for both claiming and defending parties.

#### Advantage

- The main advantage is costs certainty as costs exposure can be ascertained from the outset.

#### Disadvantage

- In more complex cases, the fixed fee may need to be subject to contingencies, which may cause the fixed fee to increase if new issues arise and/or the case develops in unexpected ways.

### Conditional Fee Agreements ("CFAs")

A CFA<sup>3</sup> is an agreement under which the solicitor and client agree to share the risk of the litigation by agreeing that part or the whole of the solicitor's costs will only be payable if the claim (or defence) is "successful". The definition of "success" will be precisely defined by the CFA and will usually provide for an agreed rate of damages to be paid by the losing party, or for a particular issue to succeed at trial. For defending parties, "success" is usually defined in terms whereby the defendant does not settle above a pre-determined level, or where its defence succeeds at trial. Due to the difficulty in defining what constitutes "success", CFAs are most often used by claiming parties or defendants with a substantial counterclaim, and are entered into less often by defending parties who do not have a substantial counterclaim.

CFAs can be structured in various ways. Under the classic CFA, if the success defined by the CFA is achieved (i.e. the client wins its case), the solicitor receives its normal or base fee, plus an uplift on its fees of up to 100%. This uplift is known as the "success fee". If "success" is not achieved (i.e. the case is lost, or the agreed level of damages defined by the CFA is not achieved), the client will not be obliged to pay any of the solicitor's normal or base



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fees. Disbursements such as counsel's fees will, however, still be payable unless they are also covered by the CFA.

The level of the success fee is based upon the solicitor's assessment of the risk of not achieving the defined success criteria in the CFA, which is usually expressed as a percentage of the solicitor's base or normal fees. In assessing what might be an appropriate success fee, the solicitor will prepare a risk assessment which will take into account issues such as the merits of the claim or defence; its likely value; how likely a negotiated compromise is; the level of costs that are likely to be incurred in pursuing the claim or defence; the strength of the witness evidence of fact and expert evidence; and any other information that is available in relation to the claim or defence at the time the CFA is entered into.

### Advantages

- The main advantage of using a CFA is that it can minimise exposure to the claiming party's own legal costs if the case is not successful.
- CFAs are also flexible in that they can be entered into at any stage of the proceedings.

### Disadvantages

- Prior to entering into a CFA, solicitors will need to undertake a detailed assessment of the strengths and weaknesses of a case and may need to seek an opinion from counsel as to the merits prior to agreeing to act. The CFA will also need to be negotiated and prepared. The CFA

preparation costs and any "success fee" can no longer be recovered from the losing party even if the case is successful, following the Jackson reforms, as a result of which CFAs have become a less popular option than they have been historically.

### Discounted rate CFA

Discounted rate CFAs are also worth mentioning as they have become increasingly common now that success fees are no longer recoverable. Under a discounted rate CFA, the solicitor may agree to charge a reduced hourly rate throughout the course of the proceedings. If the case meets the criteria of "success" as defined by the CFA (the same considerations for "success" apply to CFAs and discounted rate CFAs), the higher hourly rate provided for by the discounted rate CFA will apply.

### Advantages

- This type of agreement is of particular benefit to clients who wish to keep their monthly outlay at a reduced level, but are prepared to pay the market rate (or possibly higher) in the event of a successful outcome.
- Unlike traditional CFAs, if the case is successful the higher hourly rate will be recoverable from the losing party (subject to the usual cost recovery rules of proportionality).<sup>4</sup>

### Disadvantage

- The solicitor would have to be prepared to act for a reduced hourly rate and may only be prepared to do so in more substantial matters.

### After the event ("ATE") insurance

ATE insurance is taken out to protect claiming and defending parties from any adverse costs orders that may be

made against them during the course of the proceedings. Unlike traditional insurance that is taken out ahead of an insured risk occurring, ATE insurance is only available to parties who are already involved in litigation, and is often taken out alongside other forms of funding such as CFAs, which enable the litigating party's own costs liability to be covered in order to minimise the overall costs risk.

ATE policies can be tailored to the requirements of the litigating party, but the starting point for most policies is to provide cover for any adverse costs orders that may be made by the court against the funded party, and additional cover may be possible for the funded party's own disbursements (such as expert, counsel and court fees) for an increased premium. As a general rule, ATE insurers are only prepared to offer cover for cases they believe have good prospects of success and the usual requirement is for claims to have a 60% chance of success or more, supported by counsel's opinion.

### Advantages

- Unlike other types of funding, ATE insurance is not reliant on the outcome of the proceedings: ATE insurers' only concern is that the insured party pays the premium.
- ATE policies can be arranged at any stage in the proceedings, albeit cover tends to be more difficult and expensive to secure as the case progresses.
- New, cost-effective pricing models for ATE premiums are coming onto the market all the time and the payment of premiums is flexible. The premium can be paid (i) as an upfront lump sum; (ii) in stages (with the premium increasing as the matter progresses, making the premium proportionate to the costs incurred), or (iii) it can be deferred such that it only



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becomes payable at the conclusion of the case if the case is successful.

## Disadvantages

- ATE insurance is unlikely to be provided for cases that involve novel issues or appeals without a very high premium to reflect the risk taken by insurers of the case being unsuccessful.
- Additional costs will invariably be incurred in identifying a suitable insurer, presenting the claim to the insurer, negotiating policy exclusions and securing the insurance. These costs, as well as the ATE premium, will not be recoverable from the opposing party.

## Third party commercial funding

Third party commercial funding is the funding of the whole or part of a claimant's claim by a specialised funding company that has no direct interest in the proceedings (usually private equity, hedge funds, or private or listed companies) in return for a pre-arranged percentage of the damages that are obtained from the losing party. Third party funding should be hedged with ATE insurance to protect against the possibility of adverse costs orders.

Typically, third party funding will cover the litigating party's own solicitors as well as counsel's fees and disbursements. In most cases, as for ATE insurance, funders will require prospects of success in excess of 60% supported by counsel's opinion and they may also impose a cap on funding based on an estimate of the total likely cost of the claim in order to limit their exposure.

In return for their stake, third party funders ask the claiming party to enter into an agreement whereby the funder receives a pre-agreed share of the "case proceeds" which is usually in the region of 30—50% of the damages or, alternatively, a multiple of their costs outlay, if greater than the pre-agreed share of the damages. If the claim is unsuccessful, the funder loses its investment and has no recourse to the claiming party.

## Advantages

- Whilst there is no obligation to disclose the involvement of a funder, it may be advantageous to do so, as disclosure may persuade the other party that an independent third party has sufficient confidence in the merits of the claim that they are prepared to invest in the outcome.
- Lord Justice Jackson endorsed third party commercial funding in his final report as being valuable in boosting "access to justice" and was supportive of the voluntary code by which third party funders are regulated.

## Disadvantages

- Third party funding is not available to defending parties or to those pursuing non-monetary claims as the sole interest of third party funders is to maximise the return to investors.
- If the defendant is impecunious, and/or it is questionable whether the defendant has sufficient means to satisfy the principal claim (plus costs and interest), third party funders may be unprepared to invest. They may also avoid defendants who would be likely to fight until the "bitter end".
- The costs of presenting the claim to the funder and keeping the funder involved will not be

recoverable from the opposing party.

## Crowdfunding

Crowdfunding was originally used as a device by start-up companies and charitable and environmental cases to raise finance from online platforms, but it has now started to extend to litigation funding through websites such as Crowdjustice, which supports public interest litigation such as judicial review and challenges to planning applications. In litigation crowdfunding, members of the public pledge money to worthy cases and once the target figure has been reached, the contributions are collected and the funds are released to the claimant's solicitor's client account. The most well-known example of crowdfunding in the public interest was by Mr Beavis, one of the claimants in the conjoined appeals in *Cavendish Square Holdings BV (Appelland) v Tatal El Makdessi (Respondent)*,<sup>5</sup> who raised £8,500 to cover his court fees within 48 hours of his pitch going live on <https://www.indiegogo.com/>.

## Advantages

Crowdfunding enables claimants to pursue claims they might otherwise have been unable to fund.

## Disadvantages

- Care must be taken not to waive litigation privilege<sup>6</sup> when drafting the pitch by placing sensitive details about the case, its merits and risk factors in the public domain.
- Crowdfunders may be subject to adverse cost orders following the decision in *Arkin v Borchard Lines Ltd and others* [2005] EWCA Civ 655.<sup>7</sup> Adverse cost orders can be hedged by ATE insurance but the cost of the ATE premium would be an additional cost that would have to be raised through crowdfunding.



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### Conclusion

The tried and tested methods of litigation funding (the private retainer, fixed fee agreements, CFAs and ATE insurance) are likely to remain, but it is third party commercial funding and crowdfunding that represent litigation funding of the future.

Although the third party commercial funding market is still relatively small in the United Kingdom in comparison with the United States, the number of funders and the amount of capital available are increasing such that litigation funding is now evolving into a specific “product” or investment activity. The last few years in particular have seen the exponential growth of third party commercial funding, particularly for international arbitration, and there are now dozens of professional litigation funding companies all over the world that are available to fund litigation (and arbitration) in England and Wales.

Turning then to crowdfunding, this is very much in its infancy, and is for the most part used to fund public interest litigation, but it is probably only a matter of time before it is used to fund commercial litigation, a test case or an industry “hot potato”.

Watch this space!

### Footnotes

1. NB: Damages Based Agreements (which are similar to Conditional Fee Agreements with the exception that the solicitor’s fee is calculated by reference to a percentage of the damages that are ultimately recovered by the client) are not considered, as the

Regulations that govern their use have been described by the Bar Council as being “unfit for purpose”, and the Law Society has cautioned against their use until such time as the Regulations have been reviewed and clarified.

2. If the claim is in excess of £10 million, a costs budget will be required for the litigation pursuant to CPR 3.12—CPR 3.18 and Practice Direction 3E in any event.
3. CFAs are commonly referred to as “no win, no fee” agreements and are most often seen in personal injury and road traffic accident litigation.
4. As a general rule, costs will be proportionate (and therefore recoverable) if they bear a reasonable relationship to: the sums at issue in the proceedings; the value of any non-monetary relief at issue in the proceedings; the complexity of the litigation; any additional work generated by the conduct of the paying party; and any wider factors involved in the proceedings, such as reputational or public importance (see CPR 44.3(5)).
5. See the 53rd issue of *Insight* at <http://www.fenwickelliott.com/research-insight/newsletters/insight/53> for full details.
6. Litigation privilege protects confidential communications between solicitors and their clients, and third parties that are made after legal proceedings are commenced or contemplated and which were created for the dominant purpose of seeking or giving advice in relation to such proceedings; obtaining evidence to be used in such proceedings; or obtaining information that may lead to evidence which is used in the proceedings.
7. In that case, the Court of Appeal limited the third party funder’s costs liability to the level of its contribution and the

same analysis may also apply to crowdfunders who may be regarded as being analogous to third party funders.

Should you wish to receive further information in relation to this briefing note or the source material referred to, then please contact Lisa Kingston. [lkingston@fenwickelliott.com](mailto:lkingston@fenwickelliott.com). Tel +44 (0) 207 421 1986

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