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COVID-19 Legal Insights



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The possibility of litigation funding in the current context. Questions and answers

This material proposes a series of succinct answers to basic questions on the possibility of litigation funding, which has been used for some time in other jurisdictions. In the context of the financial crisis caused by the COVID-19 pandemic, the entrepreneurs from Romania could also be attracted by this type of funding, which allows them to engage in costly litigation, while saving liquidity for investment at the same time.

1. **What is a third-party funding of a litigation?**

A third-party funding agreement (in short, a “TPFA”) is a mechanism by which a party (claimant or respondent) can finance its costs in connection with a dispute with the help of a third-party funder.

The funder, usually a specialized enterprise, advances the expenses incurred for the proceedings in exchange for a percentage of the profit obtained by the effect of a court or arbitral decision or by the parties’ settlement. In other words, the funder assumes the risk of litigation loss by the funded party, at least within the limit of the funded amount.

For this reason, prior to concluding a TPFA, the funder conducts a comprehensive study (due diligence) to assess the chances of being successful in the legal proceeding. Thus, it analyzes a variety of elements, such as liability in the event of litigation loss, the amount of expenses involved or the term of recovery of the investment.

2. **Who can access this type of funding?**

Most often, the ones using this type of funding are the claimants. Respondents may also benefit from this mechanism, insofar as they make counterclaims capable of bringing financial benefits.

It should also be noted that the mechanism of litigation funding is focused mainly on cases with high monetary value and high degree of complexity, where the costs triggered by the proceedings are considerable or even prohibitive for the funded party. Consequently, the recipient of the funding may be, for instance, an entrepreneur who either cannot or does not want to incur such important costs from his own sources.

3. What are the benefits of concluding a TPFA in the context of the COVID-19 outbreak?

A TPFA is an aleatory contract, in the sense that it gives the funder the chance of profit, but also exposes it to the risk of loss, depending on the resolution of the dispute. The transfer of the risk of bearing the legal costs from the party to the funder leads to a reduced degree of uncertainty regarding the decision to commence or continue legal proceedings.

Moreover, the preliminary analysis carried out by the funder also delivers an independent and objective assessment of the chances of success, contributing to a more realistic expectation of the results that could be obtained.

In the context of a potential liquidity crisis generated by the COVID-19 pandemic, the presence of funders willing to fully cover the costs of legal proceedings effectively supports free access to justice.

Thus, if a party is confronted with the inability to cover significant costs of litigation, funding allows for an unrestricted and informed decision on going through with the proceedings. Even if a party would be able to incur such legal costs, funding allows the beneficiary to use existing capital for its core business, hence also avoiding locking in important resources.

4. What are the risks related to concluding a TPFA?

An entrepreneur could question whether he loses his autonomy in case of concluding a TPFA, respectively whether the funder acquires responsibilities in the process of decision-making for the strategy of the litigation.

We consider that this issue is subject to negotiations prior to the conclusion of the TPFA, as the provisions of the contract should clearly establish the dynamic of the relationship between the parties. However, given that the nature of the contract implies mutual benefits in case of success, the possibility of conflicting interests seems relatively low.

The participation of the funder could be reduced only to the performance of a preliminary assessment on the feasibility of the investment and the probability of success, especially since this assessment takes into account a multitude of factors, such as: expertise and competence of the beneficiary, quality of the legal representation, proposed legal strategy, merits of the legal arguments.

It was suggested that the proliferation of this form of funding could stimulate contentious tendencies or that it would lead to an increase in the number of pending cases. However, the rigor of the analysis carried out by the funders should have a rather filtering effect of the proposed cases, therefore the fear of an increasing number of actions brought before court seems unsubstantiated.

5. Which are the practical aspects that must be considered?

A series of issues related to entering into a TPFA were discussed at international level. For instance, a question that arose was whether the funded party should notify the other participants to a litigation about concluding the TPFA.

In an international arbitration case, the tribunal ordered the applicants to disclose whether they were benefiting from third party funding and, if so, to indicate the funder, as well as the conditions under which the funding was granted. It appears that the tribunal believed that such measure would be justified in order to prevent potential conflicts of interest arising between arbitrators and funders.

The issue of confidentiality of the case documents was also discussed. Usually, such documents are available only to the parties, the court and the institutions administering the dispute. In order to provide financing based on a TPFA, the funder must study the facts that led to the dispute based on the relevant documents provided by the party requesting the funding. Likewise, after the proceedings have commenced and based on the terms of the TPFA, the funder will probably wish to be informed of the unfolding of the proceedings, including by receiving the relevant documents submitted by the other party, which may comprise information with confidential content.

The obligation of confidentiality was assessed in accordance with the procedural rules applicable on a case-by-case basis. As a rule, the funders expressly undertaking non-disclosure agreements was seen as a sufficient measure to ensure compliance with the obligation of confidentiality.

Lastly, in common law systems, where this type of funding is already in use for some time, the case law of arbitral tribunals and national courts indicates the possibility of awarding the expenses incurred by the party that signed a TPFA, as arbitration or court costs. In other words, the percentage paid to the funder could be recovered by the funded party as judicial costs under certain conditions.

However, the national courts do not appear to have ruled on these issues so far. In the future, a practice related to concluding TPFA's will probably start to take shape, which will clarify the approach as regards the matters described above.

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COVID-19 - Legal Insights is our response to the COVID-19 outbreak. We shall keep you informed on the various legal challenges posed by the coronavirus, thanks to a dedicated practice group comprising lawyers with different backgrounds, such as compliance/regulatory, corporate and commercial, insurance, labour and employment, litigation and arbitration, insolvency, public procurement, data privacy, tax and customs. In addition, our taskforce offers strategic advice on crisis-specific matters: corporate restructuring, review and (re)negotiation of agreements (including collective bargaining agreements and individual employment contracts), performance of the contracts which are affected by force majeure and hardship, unblocking pre-litigation relationships, etc. To be up to date with the news in these matters, you may access the resources available at the following link: <http://www.tuca.ro/covid-19/>



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