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Third Party Funding

A paper for the Society of Construction Arbitrators

Third party funding of claims continues to be both a popular and controversial topic. Advocates of third party funding say it provides better access to justice, and opens up opportunities for investment that interested parties ought to be able to explore. Detractors see party funders as meddling in the affairs of others for personal gain, and fear a change in the litigation landscape in this jurisdiction to one more closely resembling the United States. Whichever school of thought one subscribes to, there is no denying that third party funding is a reality in the English courts. The number of high-profile cases financed by professional funders is likely to increase.

This paper considers the current law relating to third party funding, the restrictions and risks involved and explores the arguments both for and against allowing parties to finance enforcement of their own legal rights through financial means that are not their own.

Maintenance and champerty – common law 'evils'

Third party funding was at odds with the old common law rules against maintenance and champerty, although (as we will see) these rule have been sufficiently relaxed over the last four decades to permit third party in this jurisdiction.

Starting with the basic concepts, 'maintenance' is giving financial support to litigation in which the party providing the money has no personal or legitimate concern: it is, essentially, financing someone else's claim. Champerty is a variant of maintenance: here, the funder provides the money in return for a share in the proceeds of the claim. In other words, champerty means profiteering from other people's litigation.

As Lord Denning put it, the common law did not like the 'champertous maintainer'. He was seen as an unsavoury character who should not be let into the courts, else the 'purity of justice' would be sullied. The Master of the Rolls famously explained the concerns of the common law in *Re Trepca Mines (No 2)* [1963] 1 Ch 199:

> "*The reason why the common law condemns champerty is because of the abuses to which it may give rise. The common law fears that the champertous maintainer might be tempted, for his own personal gain, to inflame the damages, to suppress evidence, or even to suborn witnesses...*"

Do the rules of champerty and maintenance apply to arbitration?

Before we look at how the law has developed since 1963, it is easy to see that the concerns identified by Lord Denning would apply, with equal force, to arbitration claims. Arbitrators often determine disputes where large amounts are in issue, and while arbitration is a 'private' system of justice, awards are no less binding than court judgments (indeed, appeals against arbitration awards are considerably more difficult than appealing a court judgment). Disputes before arbitrators would generally have gone to a judge had the parties not agreed to arbitrate. Yet despite Lord Denning (in *Trepca Mines*) noting that in his view, the doctrine of champerty extended to "… *any contentious proceedings where property is in dispute which becomes the subject of an agreement to share the proceeds.*", the point did not seem settled until 1998.

Prior to that, in 1993 in Steyn LJ (as he then was) saw the doctrine of champerty as confined to the protection of English public justice before the courts. In his view, it would be a "*radical and new step to extend the doctrine to consensual arbitration.*" - Steyn LJ's remarks in *Giles v Thompson* [1993] 3 All ER 321 were not commented on by the House of Lords, who ultimately decided the case. Steyn LJ was not the only judge who saw a difference between public and private justice. In a Hong Kong decision, *Canonway Consultants Ltd v Kenworth Engineering Ltd* (1997 ADRLJ 95), Kaplan J held that the English law of champerty applied in Hong Kong but not to arbitration proceedings. He followed Steyn LJ's remarks, and refused to apply the rules of champerty to the consensual, private system that is arbitration.

Nevertheless, since *Bevan Ashford v Geoff Yeandle* [1998] 3 WLR 172 it has been clear that champerty does extend to arbitration. The Vice Chancellor, Sir Richard Scott, noted that:

> "*Arbitration proceedings are a form of litigation. The lis prosecuted in an arbitration will be a lis that could, had the parties preferred, have been prosecuted in court. The law of champerty has its origins in, and must still be based upon, perceptions of the requirements of public policy. I find it quite impossible to discern any difference between court proceedings on the one hand and arbitration proceedings on the other that would cause contingency fee agreements to offend public policy in the former case but not in the latter. In principle and on authority, the law of champerty ought to apply, in my judgment, to arbitration proceedings as it applies to proceedings in court. If it is contrary to public policy to traffic in causes of action without a sufficient interest to sustain the transaction, what does it matter if the cause of action is to be prosecuted in court or in an arbitration? If it is contrary to public policy for a lawyer engaged to prosecute a cause of action to agree that if the claim fails he will be paid nothing but that if the claim succeeds he will receive a higher fee that normal, what difference can it make whether the claim is prosecuted in court or in an arbitration?*"

In this quote, we see something of the traditional enmity felt by the English courts towards the intrusion of commercial funding into dispute resolution: champerty and maintenance were once criminal offences and torts[1]. Are third party funders really evil enough to be called 'traffickers', and will they always be so avaricious as to implement schemes for the manufacturing of evidence in the hope of inflating their gains? Or can they be tolerated provided sufficient control is imposed? As we will see, the principles of champerty and maintenance continue to apply, but their scope has been reduced.

Lawyer funding - conditional fees vs contingency fees

The most obvious source for funding for a claim would be counsel or solicitors acting in the claim themselves, taking on the matter in return for a share in any recovery. Of course, in the United States lawyers routinely conduct claims on the basis of being paid exclusively out of any proceeds if the claim succeeds. Since in the United States there is little risk of having to pay the other side's costs if the claim fails (there is no general principle of cost-shifting as is the case in England and Wales), contingency-funded claims are low risk for the party pursuing the claim. Plaintiff lawyers in the United States have shown that they are adept at building up a profitable book of contingency cases, playing the odds that some will ultimately succeed.

[1] Sections 13 and 14 of the Criminal Law Act 1967 abolished the crimes and torts of maintenance and champerty. Under Section 14(2), a contract that fell foul of the rules against maintenance and champerty continued to be unenforceable because it was against public policy.

However, pure contingency fee arrangements for lawyers conducting litigation are still prohibited in England and Wales. The sole exception to this rule is a statutory framework introduced by the Administration of Justice Act 1999. This statutory regime is more restrictive than the general common law rules: we will briefly look at the statutory rules as they apply to lawyers, before turning to the general common law principles that govern what third party funders can and cannot do.

Since 1999, 'no win, no fee' arrangements[2] have been possible. These arrangements also allow solicitors to charge an uplift on their ordinary fees (or a "success fee"), payable on a successful outcome. Conditional fee agreements are valid in this jurisdiction, provided they comply with the statutory framework regulating them. While, in practice, the success fee may well be paid out of damages that are recovered, nevertheless the distinction between conditional fees and contingency fees remains key in this jurisdiction. Conditional fee arrangements generally envisage that the solicitors normal charges (billed by way of hourly rates and time recording) are increased by a set percentage (perhaps 20 or 30%). There is no direct link between the solicitor's remuneration and the damages recovered. Indeed, the English courts have been fairly clear in indicating that it is for Parliament to pass legislation allowing contingency fees, rather than the common law doctrine being developed further by the courts.[3]

The statutory rules regarding conditional fees apply only to lawyers who conduct litigation, or have rights of audience before the courts – but not to, say, accountants assisting in litigation, see for example *Factortame & Ors, R (on the application of) v Secretary of State for Transport* [2002] EWCA Civ 932, a case we return to below. Outside of this statutory regime, the common law rules of champerty and maintenance will apply to any third party funding regime.

The modern common law principles applying to third party funding

A review of the modern principles of maintenance and champerty can be found in Lord Mustill's speech in *Giles v Thompson* [1993] UKHL 2.

> *"Meanwhile, I believe that the law on maintenance and champerty can best be kept in forward motion by looking to its origins as a principle of public policy designed to protect the purity of justice and the interests of vulnerable litigants. For this purpose the issue should not be broken down into steps. Rather, all the aspects of the transaction should be taken together for the purpose of considering the single question whether, in the terms expressed by Fletcher Moulton L.J. in the passage already quoted from in British Cash and Parcel Conveyors Ltd. v. Lamson Store Service Co. Ltd. [1908] 1 K.B. 1006, 1014, there is wanton and officious intermeddling with the disputes of others where the meddler has no interest whatever, and where the assistance he renders to one or the other party is without justification or excuse."*

In that case, a hire car company offered replacement cars to motorists who had been involved in road accidents. The hire car company then funded claims by the motorists against the parties who had caused the accident (including for the cost of hiring the replacement vehicle), and was paid exclusively out of damages recovered from. The House of Lords found that there was nothing unsavoury in this arrangement. Lord Mustill explained his reasoning as follows:

> "*Returning to the company, is it wantonly or officiously interfering in the litigation; is it doing so in order to share in the profits? I think not. The*

[2] Section 27 of the 1999 Act amended Section 58 of the Courts and Legal Services Act 1990.
[3] See further *Geraghty & Co v Awwad & Anor* [1999] EWCA Civ 3002.

company makes its profits from the hiring, not from the litigation. It does not divide the spoils, but relies upon the fruits of the litigation as a source from which the motorist can satisfy his or her liability for the provision of a genuine service, external to the litigation. I can see no convincing reason for saying that, as between the parties to the hiring agreement, the whole transaction is so unbalanced, or so fraught with risk, that it ought to be stamped out. The agreement is one which in my opinion the law should recognise and enforce."

Some nine years after Lord Mustill's speech, the long-running *Factortame* EC litigation made its contribution to developing the modern law of champerty. The Spanish fishermen brought claims for damages in the English courts for their unlawful exclusion from British territorial waters. To support the quantum of these claims, they entered into an arrangement with Grant Thornton whereby Grant Thornton provided assistance as regards an expert opinion in return for receiving an 8% share of any damages. Of course, no solicitor or counsel could have entered into such an arrangement in this jurisdiction, but the Court of Appeal found that the agreement with Grant Thornton was not against public policy. Grant Thornton's work under the arrangement was limited to assistance, and did not extend to providing an independent expert witness (which would have been impossible):

"*Grant Thornton's work consisted largely of important back-up services for the two independent experts, Mr Banks and Mr Anton. Many of those services, such as the collection of documentary evidence and liaison with the clients in Spain, could have formed part of the services provided by Thomas Cooper themselves. Most of the services would, however, more naturally have formed part of a package of forensic accountancy services which would have included the provision of the expert evidence itself. It was only the fact that they considered that they were precluded by their interest in recovering their outstanding accountancy fees from their clients' damages that led Grant Thornton to engage Mr Anton as an independent accountancy expert*"

In allowing the arrangement, the Court of Appeal recognised a number of factors as being relevant: (i) Grant Thornton were members of a regulated profession and did not seek to control the conduct of the litigation, (ii) a recovery of 8% would not exceed a reasonable fee for an accountant charging for similar work on a traditional basis – and could indeed be seen to act as a 'cap' on fees and (iii) the arrangement was necessary to allow the fishermen to have access to justice, since they could not afford to pay the fees in any event.

So a third party funding arrangement will not be unenforceable simply because an element of damages is 'up for grabs'. What other factors have the courts taken note of when deciding whether a particular arrangement endangered the administration of justice?

Relevant factors when considering whether an arrangement is champertous

Excessive control over the proceedings by the funder may very well lead the courts to conclude that an arrangement is champertous. Ideally, the funded party should be the true party to the action rather than a front for the funder, and all strategic decisions should be matters for the solicitors / counsel and their client, the funded party. It is when the funder seeks to intrude on the solicitor / client relationship, or is attempting to control the proceedings for its own interest (for example, when it comes to settlement discussions) that real difficulties will arise.

Where the funded party is not the first line of communication for the solicitor, or where only little information about the litigation is passed to the funded party, the courts are more likely to reach a conclusion that the solicitor / client relationship is a sham because the client is not in a position to make an informed decision about the case – and the underlying funding arrangement would then be unenforceable.

The solicitor in any case involving a third party funder should of course be alive to the possibility that a conflict of interest between the funder and the client might arise: in such circumstances, the solicitor will owe a duty to the client, but not to the funder. In practice, difficulties might occur – by way of example – where the funder's perceived interests require that the claim continue, but where the client is minded to accept a settlement offer.

Going back to Lord Denning's expression, the courts will also look for any danger of 'inflaming the damages' or for a temptation to tamper with the evidence. This risk is of course greater if there is a contingency agreement, where the funder has a direct financial interest in maximising damages. But looking at the Factortame situation, one can see that a stake in the damages is not fatal to any arrangement: Grant Thornton had a legitimate interest in receiving a reasonable remuneration in the form of a share in the damages instead of billing their professional fees in the normal way. Questions might also be asked where the funder was not able to benefit at all from the outcome of the litigation for a legitimate reason – the court might then wonder why the arrangement existed in the first place, and could be tempted to conclude that it was champertous. The greater the stake in damages that the funding party is entitled to, the greater the perceived temptation to inflame the damages might be.

The courts will also consider whether there is a risk of distorting evidence – and this will really depend on the facts of the case. In one High Court claim in which the writer was involved, an agreement between the claimant (funded by insurers) and a witness was disclosed showing that the witness, who had previously been employed by the claimants, was contractually obliged to review his witness statement and that he would be paid an hourly rate for his work on the case. Witnesses are entitled to be paid a reasonable amount for their time, but could never be promised a share in the damages. This particular witness proceeded to give very truthful evidence (not quite in line with his witness statement), and duly destroyed the claimant's case on the first day at trial. Any suggestion that the witness stood to benefit from the outcome of the case would of course have led to his evidence being excluded.

The final factor relates to whether or not the funding party is regulated – as was the case with Grant Thornton in the *Factortame* decision. It seems the courts will take note of whether a funding party is seen as respectable.

Third party funding arrangements reviewed by the courts, and liability for costs

The courts have usually considered third party funding arrangements after the claim has failed, in the context of whether or not a costs order is to be made against the funders, requiring them to pay the costs of the successful opponent (a 'third party costs order'). The High Court has jurisdiction to make costs orders against non-parties, and there are good arguments for making such an order if the funding party has in fact caused the successful opposition from incurring legal costs in defeating the claim.

Broadly speaking, one can draw a distinction between what the courts call 'pure funders' and professional (for profit) funders.

Pure funders are perhaps unusual in that they provide financial support without any ulterior motives (they will not profit themselves) and without controlling the litigation. It is hard to see how a pure funding arrangement could be found to breach the rules. The main issue likely to arise as regards a pure funder is whether they, rather than the claimant, might be held liable for the defendant's costs if the claim fails.

One example of a pure funding arrangement concerns Neil Hamilton's battle against Mohammed Al Fayed. Neil Hamilton, described in the Law Reports as "*an impecunious former MP*" brought an unsuccessful libel claim against Mr Al Fayed ("*an extremely wealthy man*"). Mr Hamilton alleged that he had been libelled by Mr Al Fayed in the 'cash for questions' scandal. Mr Hamilton's supporters had made donations into a legal 'fighting fund' to allow him to pursue Mr Al Fayed. The supporters had no standing to interfere in the running of the claim, and had no say in how their donations would be used. Their only expectation was to be reimbursed if Mr Hamilton were to be awarded damages. However, Mr Hamilton's claim failed, and so Mr Al Fayed sought to have his legal costs paid by Mr Hamilton's supporters.

The Court of Appeal rejected the application, and found that pure funders – "*being those with no personal interest in the litigation, who do not stand to benefit from it, are not funding it as a matter of business, and in no way seek to control its course*" – should not be liable for an order for costs unless there were exceptional factors requiring a departure from this general rule (where the proceedings were brought maliciously or were oppressive). There is obviously a clash here between the successful defendant's expectation to recover legal costs, and the position of the claimant and his financial backers. That clash is resolved in favour of the claimant where the funders are 'pure', as the Court of Appeal noted in *Abraham v Thompson* [1997] 4 All ER 362:

> *'It may be unjust to a successful defendant to be left with unrecovered costs, but the plaintiff's freedom of access to the courts has priority … It is preferable that a successful defendant should suffer the injustice of irrecoverable costs than that a plaintiff with a genuine claim should be prevented from pursuing it.'*

'Professional funders' are in a different position. The leading case concerning professional funders is *Arkin v Borchard Lines Ltd & Ors* [2005] EWCA Civ 655, in which the Court of Appeal looked at "*the fall-out of a disastrous piece of litigation"*.

Mr Arkin, a man without means, was represented by lawyers acting under a conditional fee agreement. He sought damages for anti-competitive actions from a number of shipping conferences, alleging that they had been guilty of predatory pricing which had driven Mr Arkin's shipping company from the market. However, Mr Arkin was unable to proceed with his claim to trial without the help of £1.3 million from a professional firm of funders. Much of that money was needed to finance the expert evidence, which (as noted) cannot be funded in this jurisdiction on any contingency or conditional basis.

The funders agreed to instruct Ernst & Young to provide expert evidence, accept that they (the funders) would only be paid if the claim succeeded. The funders would take 25% of damages awarded up to £5 million, and 23% thereafter. In addition, the funders were entitled to be reimbursed the costs of Ernst & Young, based on actual payments to them, out of any monies recovered from the defendants. If Ernst & Young's initial expert report had concluded that potential damages would be insufficient to compensate the funders, they had an option to withdraw – but if that was not the case, the funders were committed (or "locked-in"). Mr Arkin (through his solicitors) was to have conduct of the action, but required consent of the funders for any settlement. In the event of a dispute between Mr Arkin and the funders, Mr Arkin's leading counsel was to decide.

The funders went into the case expecting that it would cost about £600,000 to take it to trial, and their expected settlement range was between US$ 5 and 10 million. In addition, counsel advised Mr Arkin that he had a strong claim, although there were some issues on causation and loss. In the event, both costs and the outcome were very different than expected. Mr Arkin was soundly defeated. The only good point in the trial at first instance for the funders was that the judge (Colman J) refused to hold them liable for the other side's costs, noting that doing so would go against the important public policy objective of facilitating access to justice.

However, the successful defendants and third parties, saddled with a total of £6 million in legal costs, then appealed. One of the central issues in the appeal was whether the judge had been right to conclude that since the funding arrangement was not champertous, there should be no costs order against the funders – essentially applying the same test to both the issue of champerty and that of costs. The Court of Appeal disagreed with the judge, who in their eyes had not placed sufficient weight on the cost-shifting rule that is a fundamental part of English law (costs follow the event, or 'loser pays'). While there was a public interest in ensuring access to justice, the Court of Appeal found that a professional funding party ought to be liable in costs even where the funding arrangements were not champertous. However, there had to be a limit to the funder's potential liability, else funders would be deterred because of the risk of an unlimited liability.

The Court of Appeal set out the following principles for commercial funders, concluding that the funder's liability could extend to the amount of their contribution:

> *"The approach that we are about to commend will not be appropriate in the case of a funding agreement that falls foul of the policy considerations that render an agreement champertous. A funder who enters into such an agreement will be likely to render himself liable for the opposing party's costs without limit should the claim fail. The present case has not been shown to fall into that category. Our approach is designed to cater for the commercial funder who is financing part of the costs of the litigation in a manner which facilitates access to justice and which is not otherwise objectionable. Such funding will leave the claimant as the party primarily interested in the result of the litigation and the party in control of the conduct of the litigation.*
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> *We consider that a professional funder, who finances part of a claimant's costs of litigation, should be potentially liable for the costs of the opposing party to the extent of the funding provided. The effect of this will, of course, be that, if the funding is provided on a contingency basis of recovery, the funder will require, as the price of the funding, a greater share of the recovery should the claim succeed. In the individual case, the net recovery of a successful claimant will be diminished. While this is unfortunate, it seems to us that it is a cost that the impecunious claimant can reasonably be expected to bear. Overall justice will be better served than leaving defendants in a position where they have no right to recover any costs from a professional funder whose intervention has permitted the continuation of a claim which has ultimately proved to be without merit.*"

Assigning causes of action

Another method of potentially profiting from litigation is to buy someone else's a right to a claim, and then to enforce it – an assignment of a cause of action (on one view, an intangible right or a chose in action just like any other).

Assignments of causes of action are by no means unusual and indeed uncontroversial in the field of insolvency. A liquidator, for instance, is perfectly able to sell any claims which the company may have in exchange for a proportion of any sums recovered (paragraph 6, Schedule 4, Insolvency Act 1986).

But beyond the insolvency context, the principles of maintenance and champerty apply to assignments of claims. Where the assignee had no ‘legitimate interest’ in the cause of action, it will be void and unenforceable: see *Trendtex Trading Corp v Credit Suisse* [1982] AC 679. More recently, the Privy Council in *Massai Aviation Services v The Attorney General (The Bahamas)* [2007] UKPC 12 upheld an assignment of a cause of action by a company to a shareholder. The original claimant was a service company with business at Nassau International Airport. The company leased a site from the Bahamian government intending to develop it for new facilities, and then found that Bahamasair refused to vacate premises on the site. After the company commenced litigation, the shareholder in the company decided to sell the business but retain the right to claim against the Bahamian authorities and the airline. The Privy Council found that the shareholders had a genuine commercial interest in the claim (they were the sole shareholders) and had only paid a token US$ 10 for the right to pursue the claim. The nature of the claim will also be a relevant consideration.

Consequences of a finding of maintenance or champerty

So what happens if a funding arrangement does fall foul of the rules on maintenance and champerty? The consequences are as follows:

- The funding agreement itself is unenforceable, as a matter of public policy – meaning the funder cannot legally claim his ‘spoils’ from the funded party, even if the claim succeeds. The funded party could, in theory, walk away without paying anything.

- As a corollary (still assuming that the claim succeeds but there is champerty), since the winner is under no obligation to pay his funder, he cannot claim any legal costs from the other side. This is because of the so-called indemnity principle, which precludes a claim for legal costs unless a claiming party has actually paid those costs.

- However, the substantive elements of the claim are <u>not</u> affected by champerty or maintenance, and it is no defence to the claim to say that it is being improperly funded. If a defendant in such a claim wishes to seek a stay of the proceedings, he must do more than merely point out the champertous funding arrangements – for instance, by showing that the proceedings are vexatious or an abuse of process[4].

- Finally, as was noted in *Arkin v Borchard*, an improper funding arrangement may expose the funder to a liability for the entire costs of the litigation, if the other side prevails.

Third party costs orders

While a funder will not be a party to the litigation, it is well established that third parties may be liable for the costs of proceedings. The Court of Appeal in *Arkin v Borchard* stressed that the liability of funders was only capped provided the arrangement was not champertous. As will be seen, where the arrangement is champertous, a funder is likely to be caught by the principles that determine whether a third party is liable for the costs of litigation which he or she controlled, causing the other side to incur costs by allowing the claim to proceed.

[4] *Stocznia Gdanska Sa* v *Latreefers Inc* [2000] EWCA Civ 36

The power of the courts to make costs orders is conferred by statute in case of the High Court and the Court of Appeal - Section 51(1) and (3) of the Supreme Court Act 1981 (now renamed the "Senior Court Acts" ("**SCA**"))[5]. Section 51(3) is widely phrased[6]:

> *"(3) The court shall have full power to determine by whom and to what extent the costs are to be paid."*

In 1986, the House of Lords confirmed that a costs order can be made against a non-party to litigation (see *Aiden Shipping v Interbulk Ltd, The Vimeira* (No 2) [1986] 1 AC 965). Ever since then, the High Court's power to make third parties liable in costs has been recognised. At the same time, the Courts have stressed that this power would only be exercised in exceptional cases - in accordance with the principles summarised below.

The leading case on the principles governing third party costs orders is *Arkin v Borchard Lines* [2005] EWCA Civ 655 - approving earlier statements made by the Privy Council and making these binding on the English Courts (paragraph 36):

> "*1) Although costs orders against non-parties are to be regarded as "exceptional", exceptional in this context means no more than outside the ordinary run of cases where parties pursue or defend claims for their own benefit and at their own expense. The ultimate question in any such "exceptional" case is whether in all the circumstances it is just to make the order. It must be recognised that this is inevitably to some extent a fact-specific jurisdiction and that there will often be a number of different considerations in play, some militating in favour of an order, some against.*
>
> *2) Generally speaking the discretion will not be exercised against "pure funders", described in paragraph 40 of Hamilton v Al Fayed as "those with no personal interest in the litigation, who do not stand to benefit from it, are not funding it as a matter of business, and in no way seek to control its course". In their case the court's usual approach is to give priority to the public interest in the funded party getting access to justice over that of the successful unfunded party recovering his costs and so not having to bear the expense of vindicating his rights.*
>
> *3) Where, however, the non-party not merely funds the proceedings but substantially also controls or at any rate is to benefit from them, justice will ordinarily require that, if the proceedings fail, he will pay the successful party's costs. The non-party in these cases is not so much facilitating access to justice by the party funded as himself gaining access to justice for his own purposes. He himself is "the real party" to the litigation, a concept repeatedly invoked throughout the jurisprudence - see, for example, the judgments of the High Court of Australia in Knight and Millett LJ's judgment in Metalloy Supplies Ltd (in liquidation) v MA (UK) Ltd [1997] 1 WLR 1613. Consistently with this approach, Phillips LJ described the non-party underwriters in TGA Chapman Ltd v Christopher [1998] 1 WLR 12 as "the defendants in all but name". Nor,*

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[5] The House of Lords was not within the 1981 Act, but had an inherent jurisdiction over costs of appeals before it (*Guardians of West Ham Union v Churchwardens etc. of St. Matthew, Bethnal Green* [1896] AC 478).

[6] Procedurally, the CPR supplements the SCA. CPR 48.2 provides that a third party is to be joined to the proceedings for the purpose of costs, and is to be heard before an order is made against them: "*(1) Where the court is considering whether to exercise its power under section 51 of the Supreme Court Act 1981 (costs are in the discretion of the court) to make a costs order in favour of or against a person who is not a party to proceedings – (a) that person must be added as a party to the proceedings for the purposes of costs only; and (b) he must be given a reasonable opportunity to attend a hearing at which the court will consider the matter further.*"

> *indeed, is it necessary that the non-party be "the only real party" to the litigation in the sense explained in Knight, provided that he is "a real party in ... very important and critical respects" - see Arundel Chiropractic Centre Pty Ltd v Deputy Commissioner of Taxation (2001) 179 ALR 406, referred to in Kebaro at pp 32-3, 35 and 37. Some reflection of this concept of "the real party" is to be found in CPR 25.13 (2) (f) which allows a security for costs order to be made where "the claimant is acting as a nominal claimant".*
>
> *4) Perhaps the most difficult cases are those in which non-parties fund receivers or liquidators (or, indeed, financially insecure companies generally) in litigation designed to advance the funder's own financial interests."*

Over the years, third party costs orders have been sought against a number of parties connected with litigation - liability insurers, parent companies, company directors etc. There is a long list of cases which I do not propose to summarise. In fact there has been so much case law on third party costs orders that by 2007, the Court of Appeal had become rather irritated with all these cases being cited to it. In *Alan Phillips Associates v Dowling* [2007] EWCA Civ 64, it was said that:

> "*There is now an abundance of authority on the absence of any need for abundant authority on the principles which should guide a judge as to whether to make a third party order for costs.*"

While the SCA allows the imposition of liability directly on the funder, the position is different in arbitration. An arbitrator does not have personal jurisdiction against the funder. As third party funding increases, arbitrators and arbitration users alike may need to consider dealing with the situation in a practical manner. The following may provide a solution:

- Provide in the relevant arbitration clause, or the rules of arbitration, that any party referring a funded claim to the tribunal must disclose this.
- Provide further, in the same manner, that any funder will issue a bond, or acceptable security, to the benefit of the respondent in the arbitration claim, to ensure funds are available to satisfy the funder's liability up to the *Arkin v Borchard* limit.
- Ensure that the provisions are drafted so that a failure by the funded claimant to procure the funder's agreement to the scheme, or the provision of adequate security, allows the tribunal to impose a (contractually agreed) stay of the arbitration proceedings, or make proceedings with the claim conditional on compliance with the security scheme.

Recent developments

Arkin v Borchard was decided some four years ago, in 2005. Since the Court of Appeal established that a funder may only be liable up to the amount of the contribution made to costs, the funding market is, by all accounts, enjoying a relatively prosperous period of expansion.

Third party funding continues to grow in this jurisdiction. New players are entering the arena. Calunius Capital, a third party funder that has attracted some publicity, through its co-founder, stated that:

> "*There is a plethora of investment funds involved with no public profile. I liken the known funders to the tip of an iceberg. If the proposition makes sense, there is plenty of capital.*"

Comments from litigators in City law firms echo this sentiment. The money now seems to be available. But it is also not plain sailing. *Stone & Rolls*, probably the largest claim ever funded by third party funders in England, foundered following an appeal to the House of Lords (*Moore Stephens (a firm) v Stone & Rolls Limited (in liquidation)* [2009] UKHL 39).

This was a professional negligence claim against auditors Moore Stephens. Damages claimed were just under £120 million. Mr Stojevic was a fraudster. He set up a fictitious trading company, Stone & Rolls, in order to defraud banks. He presented forged bills of lading and would draw funds under letters of credit. To create a façade of respectability, Mr Stojevic changed his auditors from a one-man band in Rotherhithe to a City practice, Moore Stephens. Appointing them was part of his plan. The fraudulent scheme collapsed when one of the banks that had been defrauded sued the company and put it into liquidation. It became clear that Moore Stephens had been negligent in failing to spot a pattern of fraudulent behaviour at the company. The liquidators, acting through the Stone & Rolls company, sued Moore Stephens for negligence, seeking to recover damages for the extended period of the fraud after Moore Stephens ought to have detected it.

In defence, Moore Stephens relied on the fact that the claim was pleaded on the basis of the company's own fraud – and a claimant cannot claim if it has to plead its own wrongdoing in order to do so (*ex turpi causa non oritur actio*). The claimants on the other hand relied on the rule that an agent's fraud will not be imputed to his principal where the agent is defrauding the principal. Mr Stojevic was fraudulent, and he was a director or agent of the Stone & Rolls company, but since he was defrauding the company, the company was not tainted by the fraud and could sue the auditors.

IM Litigation Funding backed the claim all the way to the House of Lords – evidently having decided that there were reasonable prospects of succeeding in securing some of the £120 million that were claimed in damages. However, the initial reaction of the judges to the claim was a different matter. In the House of Lords, Lord Phillips, the Lord Chief Justice stated:

> "*My initial reaction to S&R's claim was that, as a matter of common sense, it could not succeed.*"

He was not the only senior judge to have had that reaction. In the Court of Appeal, Lord Justice Mummery succinctly put it in this way:

> "*Does common sense matter? Yes. It is contrary to all common sense to uphold a claim that would confer direct or indirect benefits on the corporate vehicle, which was used to commit the fraud and was not the victim of it, and the fraudulent driver of the fraudulent vehicle*".

Looking beyond the initial reaction to the claim, matters were in fact more complex on closer inspection. Ultimately, the House of Lords was split 3:2. The majority attributed the fraud to the company since here Mr Stojevic was the only human embodiment of it, and he was clearly the directing mind or will of the company. The minority found that the auditors owed a duty of care to the creditors of Stone & Rolls, who had done nothing wrong, and so *ex turpi causa* did not apply. In the end, common sense prevailed.

This begs the question: would a commercial entity have put its own money behind this claim? All we know is that IM Litigation Funding decided to invest in this case (the basis of that decision is unknown). As a result, it faces 'double exposure' under the principle in *Arkin v Borchard*. At the same time, the successful defendants may well be left out of pocket, if their costs exceed the amount of IM Litigation Funding's contribution.

In January 2009, Calunius announced a new chairman. Their press release said:

> "*Calunius brings with it the benefit of a unique and authoritative approach to the valuation of commercial litigation claims*"

It can be very difficult to predict the outcome of a complex claim. Indeed, winners or losers may be determined by the performance of the key witness before the judge on the day. However, professional funders will have assessed the risks at the outset of the proceedings, and will in all likelihood be locked in on the basis of a risk / reward model they have prepared long before all the evidence has come to light. If the litigation takes a course the funders do not like, there will invariably be tension. It seems naïve to assume that a funding company who has invested several million pounds sterling in a claim will simply take the back seat, and would not bat an eyelid if the lawyers proposed accepting a settlement offer for a fraction of the sum claimed[7]. In all likelihood, a representative of the funders will ask to be involved in the case if the litigation represents a significant investment. Even though a funder cannot legally control the claim, it may bet that in high-value funded claims, the funders will be involved at the major strategy meetings or conferences with counsel. The funders may have their own views as to the attractiveness of a settlement offer.

Of course, a requirement that in the event of any dispute between funders and the client, the lawyers prevail would ensure that ultimately, the funders cannot dictate the outcome. But any such dispute will be difficult to manage in practice, and could affect the conduct of the case to the detriment of the client. Arguments and tussles for control within the legal team on one side and their funders can only help the opposition. The more money is at stake for both clients and funders, the greater the likelihood that there will be tension.

Champerty and maintenance are common law principles that developed out of a need to protect the 'purity of English public justice', but also apply in the context of arbitrations. The common law has never had any difficulty with accepting that these principles do not apply to litigation or arbitration abroad, as English public policy is not applied extraterritorially (see *Mansell v Robinson* [2007] EWHC 101 (QB)). In the English courts, third party funding is now a reality and will not disappear. The controls imposed on third party funding seem appropriate from the perspective of a judge: the client, not the funder, should have control of proceedings, there should be no interference with a view to increasing the damages or influencing the evidence and so on. But the real difficulty is likely to arise in the day to day management of funded litigation, and in risk assessment. The difficulties inherent in identifying what cases to back should not be underestimated – and the eagerness of funders to support a dispute should not replace the careful and considered advice of experienced professionals.

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[7] This potential tension is not unique to third party funders. For example, a settlement offer could also give rise to similar tensions between solicitors acting under a Conditional Fee Agreement and the client.