

## ■ Easing access to justice in finance disputes: three mechanisms for reducing costs risk and outlay in litigation or arbitration

BY MARK BROWN

As reflected in the press, it is clear that litigated disputes across a broad range of financing arrangements and corporate transactions are starting to materialise, and will continue to do so over the coming years, as a result of the fallout from the tightening of available credit since the events of Autumn 2008 and the recession which ensued.

Such disputes have been taking several different forms, including: (i) the unexpected withdrawal of committed financing for a whole gamut of corporate transactions; (ii) abandoned IPOs in progress; (iii) investors' claims against hedge or investment funds for trading losses said to be caused by breach of their terms of mandate, or for refusal to redeem invested funds within prescribed time limits; (iv) hedge or investment fund claims against directors for breach of directors' statutory obligations in companies in which the fund has a long position and whose share price has dropped unusually far for that sector or remained inordinately low; (v) claims against prime brokers for breach of mandate; (vi) claims in the corporate insolvency context where investors had positions in companies that were wound up or went into administration; and (vii) an increase in FSA regulatory disciplinary claims for breaches of FSMA rules and principles.

It can take many months, and in some cases years, for these disputes to grind their way through the system and come to the fore. Unravelling events leading to sustained losses can be a complex and time consuming exercise, as can finding which person or entity is to blame, and worth pursuing.

Surprise has been expressed by City litigators that the expected deluge of post credit crunch disputes has not yet come about. At last month's meeting of the City Disputes Panel (CDP), the alternative dispute resolution adviser, and the Financial Markets Law Committee (FMLC), chaired by Lord Hoffmann and composed of influential City litigators and senior corporate counsel, it was found that "lawyers are surprised that there has been no cascade of litigation so far [nor] a more active fall-out from the crisis".

The extensive investigations being undertaken by corporations before commencing litigation, and some 'jousting' in the courts over jurisdiction, might explain why the expected flow of cases has not yet arrived.

However, there is in many cases a more fundamental, pervasive and obvious cause for this hesitancy to assert, or defend, one's commercial and legal rights (even where there is a strong case to pursue and deep pockets at the end of it): the potentially substantial legal costs risks and cash outlay in pursuing or defending litigation or arbitration. They are

very real factors making potential claimants or defendants (corporate or individual) understandably jittery about launching into litigation, especially in these times of lingering financial and economic uncertainty. But for those relatively few in the know, cost risk and cost outlay can potentially be reduced to very little, or even nil, with judicious use of certain products and mechanisms.

Before setting out these potential solutions, it is worth first explaining the two principal problems barring access to justice, namely, the entirely separate notions of (i) litigation cost risk and (ii) litigation cost outlay.

### *Cost risks if you lose*

In the UK and most Commonwealth countries where a 'costs follow the event' legal tradition exists, if you lose a case there is a high risk of incurring a liability to pay the opposing party's disbursements and lawyers' fees. Lawyers includes solicitors and barristers and disbursements includes court or arbitration fees, expert witness fees, travel and accommodation expenses, transcribers' fees, and so on. The other principal risk of losing a case, and which is rarely expressed as such, is the lost opportunity of recouping most of your own legal costs from your opponent. Neither of these financial risks carry an immediate cash flow impact, but they represent a substantial future contingent liability.

### *Cash flow outlay*

Paying your own lawyers' fees as they fall due to fund the case does, on the other hand, have an instant adverse cash flow effect, as does paying your own disbursements as they fall due. The result of this risk and outlay is that litigation and arbitration is rendered an unwanted crisis purchase which can carry significant cash flow strains and financial risk.

There are three particular mechanisms available which can serve to reduce substantially not only litigation costs risk but also litigation costs outlay as a case progresses.

### **After the Event Insurance (ATE insurance)**

ATE insurance controls and reduces litigation or arbitration costs risk, as opposed to cash outlay. It can be taken out after the dispute in question has arisen and is triggered when an insured party to a litigated or arbitrated dispute *loses* a court or arbitration case. The insurance covers: (i) adverse costs orders requiring the insured losing party to pay the winning party's costs; (ii) the insured losing party's own disbursements (including barristers' and expert's fees); and (iii) increasingly

often, the insured losing party's own solicitors' fees, especially if a CFA is in place.

It is a flexible tool because the insured party can be a claimant or a defendant and the type of relief sought in the case (monetary or otherwise) is irrelevant, as is the subject matter of the dispute.

The main general requirement for obtaining ATE insurance is to satisfy the underwriters, usually by your solicitor's or barrister's written opinion, that your chance of success on the merits of the case is at least 60 percent.

The level of the premium payable for this cover can be staggered, increasing in amount the further the litigation / arbitration progresses, so that if the case settles early the premium is lower.

It is the way in which liability for the insurance premium can be structured that makes ATE insurance so attractive. The premium is usually hefty, often between 20 percent and 40 percent of the amount of costs being insured, but it can be "deferred and contingent upon success". This means that you as the insured party need not pay the premium up front and are only liable to pay it if you win the case, in which case it can then be recoverable from the opposing losing party as part of an adverse costs order against that party. The opposing party thereby bears an additional financial risk of paying your ordinary costs as well as the ATE premium if it loses the case.

An insured party can therefore have its cake and eat it: the risk of paying the opponent's costs and of not recovering one's own costs is 'hedged' or hived away to a third party (the insurer) while the price for this protection – the premium – might never be payable except by your opponent.

#### Conditional fee agreements (CFAs)

CFAs reduce the cash outlay problem of funding a case. The acting law firm (and barristers too at their option) charges up to a 100 percent discount to its normal hourly rates unless and until the case achieves a successful outcome, in which case the firm may charge an increased fee. 'Success' or a 'win' is usually a court or arbitration final decision, or an agreed settlement, from which the client derives benefit.

If the client is successful, the law firm's normal or 'basic' hourly rates are payable, plus a percentage uplift on those fees (up to 100 percent) known as a 'success fee'.

The significant advantage is that part or all of the *basic rate* and *success fee* can be recovered from the opposing losing party under the usual Court costs order requiring the losing

party to pay the winning party's costs. So a CFA allows a party to a dispute to pay discounted or no fees if unsuccessful and if successful, the increased fees may be payable by the opposing party. This also presents a discouraging downside for your opponent to contest the case.

The two main criteria for a law firm entering into a CFA with a client are usually that: (i) the merits of the case are at least reasonably strong; and (ii) the opposing party is financially sound and/or insured to be able to satisfy any judgment and costs order against it.

#### Third party funding (TPF)

TPF reduces both litigation costs risk as well as cash outlay. Professional third party funders will fund the legal costs of a party to a dispute as they fall due. The funded party must be claiming monetary relief such as a liquidated debt or damages.

The main criteria are: (i) the claim must be considered to be reasonably strong to strong (at least 60 percent chance of success); and (ii) the opposing defending party must be insured or have sufficient financial means to be able to pay an eventual judgment or award against it.

If the funded claimant party wins, on receipt of the proceeds from the other party, the usual arrangement is that the funder is paid an amount based on the return of all money spent by the funder ('Outlay') and an additional sum being a multiple of Outlay or a percentage of the proceeds. The Outlay is recoverable by an adverse costs order against the opposing losing party in the usual way. The additional sum is not so recoverable and is taken from the damages recovered.

If the funded party loses, or wins but fails to recover sufficient damages to pay the Outlay and/or the additional sum, the *funder* takes the risk so that the funded party is not liable for any shortfall between the amount actually recovered from the losing party and the Outlay/Additional Sum.

#### Conclusion

The more common recent deployment in the financing sector (and in others) of these increasingly available sophisticated litigation costs-reducing products and mechanisms can make the difference between litigation being an unwanted crisis purchase and, instead, simply another commercial tactical tool to enhance or protect value.

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## ■ The importance of investigations in arbitration

BY ASUNCION C. HOSTIN AND ANNIE CHENEY

Businesses are increasingly turning to arbitration to settle disputes. According to the American Arbitration Association (AAA), the total number of cases filed in 2008 rose to 138,447

from 127,729, an 8 percent spike over 2007. In the same period, international cases filed with the AAA's International Center for Dispute Resolution jumped 13 percent.