ORDE VAN VLAAMSE BALIES

Note

Recommendations Third-party funding

Approved by the general assembly of the Orde van Vlaamse Balies on 28 June 2023

Translation from Dutch

1/ Third-party funding: state of play

1. Third-party funding (TPF) is increasingly present worldwide, in Europe and also in Belgium. In Europe, TPF is most present in neighbouring countries, namely the Netherlands, Germany and the UK. In France, TPF is present but less of a fixture than in the other neighbouring countries (except as far as arbitrage is concerned). Third-party funders are now exploring new markets in search of new opportunities.

2. The focus seems to be mostly on financing disputes where significant sums are at stake, which is currently most common in international trade or investment arbitration or collective claims *(class actions*). Both in the Netherlands, Germany and the UK (and France), TPF is often used in arbitration proceedings. In the Netherlands, TPF is furthermore particularly popular as funding for collective claims. These have gained in importance in recent years thanks to the Dutch WCAM Act. Insolvency cases and damages claims arising from competition law infringements also receive considerable attention from TPF in some neighbouring countries. However, precise statistics are lacking.

3. In its classic form, TPF occurs through the funder's intervention in the payment of lawyers' fees in exchange for a share of the proceeds of the case. However, it also happens, particularly in *securities litigation* or in disputes concerning the consequences of competition law infringements, that the funder sets up an SPV, a separate company, to act as a plaintiff itself after taking over the claims.

TPF is distinct from other forms of financing, such as , insurance, assignment, etc. This distinction is of little relevance to this paper. More information and the differences between TPF and these forms of financing under Belgian law were discussed in detail in the contributions by F. Lefèvre, P. Callens and G. Croisant and by J.-P. Fierens. [1]

4. The parties rely on TPF mainly on liquidity management considerations. Among other things, they aim to free up working capital for purposes other than financing litigation by their own resources, to avoid reporting costs related to proceedings in the financial statements or making a provision for them, and to spread the risks associated with litigation and its financing. They do so even if they do not have sufficient funds to pay lawyers' and litigation costs - this is often the case for insolvency trustees - as well as to participate in a *class action*.

5. TPF is available both to plaintiffs and - less often - defendants with counterclaims.

6. Before providing funding in a given case, funders conduct extensive *due diligence* to determine the risk of the funding investment. This *due diligence* is done internally, but often with external expertise from a network of law firms with which the funders cooperate on a regular basis.

7. The funding and the rules of cooperation between the funder and the funded party are set out in a comprehensive agreement.

8. TPF encounters controversies that are currently unresolved. TPF has both principled supporters and opponents. The main criticism from the second group is that TPF would create a tension between the interests of the funder and the client litigant and that TPF would give rise to a significant increase in litigation. TPF - focused on profit - would also be fundamentally incompatible with the justice system, which seeks justice and the resolution of disputes. Supporters of TPF dispute these criticisms and point to its benefits. TPF broadens access to justice for less wealthy parties through intervention, not only in lawyers' fees, but also in court costs (in countries where, unlike in Belgium, these can be high). TPF,

[1] F. Lefèvre, P. Callens en G. Croisant, Legality of third-party funding mechanisms under Belgian law, b-Arbitra 2017/1, p. 25 e.v.; J.-P. Fierens, Fundering van geschillen door derden, Arbitrage en verzekeringsrecht, Brussel, Larcier 2015, p. 183 e.v.

thanks in part to the high level of expertise of funders, and the additional *due diligence* they perform, would further lead to the reduction of manifestly unfounded claims[2] and thus improve the functioning of justice.

9. However, the ongoing controversy does not prevent the development of TPF in several countries. TPF is an existing feature of the contemporary legal landscape.

10. However, despite the growing interest in TPF, its legal as well as deontological regulation is limited.

1.1 / Regulatory initiatives

11. There are hardly any countries where there is no overarching or explicit regulation of TPF. This is also not the case in Belgium's neighbouring countries. Existing legislation, including in neighbouring countries, only addresses partial aspects of TPF. This is often done indirectly, through the regulation of aspects of the lawyer's profession or through general contract law.

Among Belgium's neighbours, Germany traditionally regulates parts of the exercise of the lawyer's profession in legislation, namely as regards lawyer's fees *(Bundesrechtsanwaltsgebührenordnung*), deontology *(Bundesrechtsanwaltsordnung*) and regulation of legal services *(Rechtsberatungsgesetz*). These laws contain general principles concerning the legal profession, which have since been applied by the judiciary also in the TPF context.

The case law of Belgium's neighbouring countries regularly discusses TPF, mainly with regard to the legality of TPF[3] and disputes regarding the remuneration of funders. [4]

Among the countries studied in which TPF has a long tradition or has been present for a long time, only Singapore has (partial) explicit legislation on TPF. [5] Indeed, as one of the exceptions, Singapore has a law since 2017 that explicitly provides that TPF is lawful in specific types of disputes (mainly related to international arbitration) and funders are subject to specific conditions. The Singapore Lawyers Act further expressly provides that a lawyer is not prohibited from (a) introducing or referring a funder to his client as long as the lawyer does not derive any direct financial interest from it, (b) intervening in the negotiation and drafting of the funding agreement and (c) assisting the client in a dispute arising out of a funding agreement. The legislation further includes an obligation on the lawyer to disclose the existence of TPF and the name of the funder to the court or arbitral tribunal, as well as the prohibition on taking shares or "*ownership interest*" in a funder.

12. In all countries surveyed, TPF is considered lawful in principle. However, doubts about this were expressed in Irish jurisprudence.

13. Recently, European regulation of TPF was initiated through a directive.

14. During the 37th and 38th[h] sessions of the UNCITRAL Working Group[6] it was proposed to prepare a model regulation of TPF in investment arbitration (ISDS = *Investor-State Dispute Settlement* done through investment arbitration). These *soft law* regulations are intended to be model legislation for inclusion in international investment treaties. These intended regulations, which are still

[2] "Frivolous claims".
[3] See especially discussions in Anglo-Saxon countries with case law around so-called "champerty" and "maintenance".
[4] For an up-to-date overview, see the annex to the EU draft directive on DPF.
[5] See "The Law Society of Singapore. Guidance Note 10.1.1", p. 2.
[6] United Nations Commission On International Trade Law, Working Group II (Investor-State Dispute Settlement Reform).

the subject of discussions and further work, concern, on the one hand, the fundamental question whether TPF should be allowed in the ISDS system at all and, inter alia, the obligation to disclose TPF, i.e. what data relating to TPF should be disclosed, and, on the other hand, some related punctual questions, i.e. the possible obligation to provide *security* for costs and the question to what extent the costs related to TPF are part of the recoverable arbitration costs.

1.2 / Other initiatives

15. The discussion on the regulation of TPF has a strong presence in the context of arbitration, both in commercial arbitration and as far as investment arbitration is concerned. This discussion mainly concerns whether and to what extent TPF should be disclosed in the context of arbitration proceedings ("*disclosure*"). Indeed, one of the characteristics of arbitration is the requirement of independence and impartiality of the parties' arbitrators. This requirement is guaranteed by the *disclosure* of conflicts of interest that the arbitrators might have in an arbitration case. These conflicts of interest traditionally related mainly to the parties in the arbitration proceedings, but are now also viewed more broadly, namely, among others, vis-à-vis the parties' lawyers, between arbitrators and - now - vis-à-vis funders.

16. The *International Bar Association* was among the first to focus on TPF. In 2014, a provision on TPF was included for the first time in the guidelines on conflicts of interest in arbitration issued by this organisation *(IBA Rules on Conflicts of Interest in Arbitration).*

Since then, several arbitration institutions have also developed their own guidelines on the obligation of TPF disclosure in arbitration. These guidelines mainly provide that the existence and identity of TPF should be disclosed in arbitration proceedings (on this subject ICC, VIAC, SIAC, SIArb) [7], or (also) that arbitrators have the power to order the parties to produce additional information about TPF (such as on the scope of coverage provided by the funder). [8] The latter is particularly relevant to investment arbitration. In court proceedings, there is as yet no such obligation.

1.3 / Deontological regulations

17. At the deontological level, TPF is currently approached from the perspective of the lawyer's deontology, from the perspective of investment funds operating as funders and from the perspective of other stakeholders such as Dutch foundations and associations engaged in the settlement of collective claims.

18. There is no general international **deontology of investment funds**. Local initiatives are undertaken in some countries, such as the UK.

UK funders united in the *Association of Litigation Funders of England and Wales* (ALF). The purpose of this association is "*delivering self-regulation of litigation funding*". ALF issued a *Code of Conduct for Litigation Funders*. [9] A large proportion of funders in the UK market become voluntary members of this organisation. Members of ALF undertake to comply with the provision of the *Code of Conduct*, including those outside the UK, are often calling for greater transparency. Funders recognise that transparency and appropriate regulation, whether through voluntary "codes of conduct" or otherwise, is a route to wider acceptance of TPF in those countries where TPF proves controversial.

Briefly, ALF's *Code of Conduct* (among others):

[7] See, e.g., Article 11(7) of the ICC Rules.
[8] Article 13a of the VIAC Rules on Investment Arbitration.
[9] https://associationoflitigationfunders.com/wp-content/uploads/2018/03/Code-Of-Conduct-for-Litigation-Funders-at-Jan-2018-FINAL.pdf

- defines how a funder operates, including the requirement regarding available investment capital;
- obliges the funder to keep all information received about the case confidential;
- obliges the funder to provide transparent information and ensure that the funded party obtains adequate advice on the terms of the financing agreement to be entered into;
- prohibits the funder from inducing the acting lawyer to breach his deontological obligations or to leave control of the (strategy of the) case to the funder;
- provides some basic provisions that the TPF agreement must contain. These relate to the financial intervention that the funder must provide under the agreement, the manner in which the funder intervenes in the event of amicable settlement of the dispute, and the circumstances in which the funder can terminate the TPF agreement.

The UK funders' code of ethics has a broad impact on their conduct, and that impact extends beyond the UK.

19. The lawyer's deontology in relation to TPF has, to date, only been explicitly addressed by the ABA and the Paris and Singapore bars. These bar associations have adopted recommendations or short "resolutions". The three approaches differ both in nature (more elaborate recommendations like ABA or *The Law Society of Singapore*, or a short resolution with a few points as in Paris) and in content.

20. The recommendations of *The Law Society of Singapore* contain very detailed guidelines on the one hand on the provisions that can be included in the funding agreement and on the other hand on the obligation to notify TPF in the context of a dispute. These recommendations are complementary to Singapore law on TPF.

21. The Paris guidelines include some brief points only on international arbitration. These recommendations underline the lawyer's independence, the prohibition of communicating any information to the funder, the encouragement to communicate TPF in the context of arbitration as well as a specific regulation regarding the intervention of the CARPA (which has a special function in French practice on third-party funds).

22. The *American Bar Association* also presented its *Best Practices for Third-Party Litigation Funding* in August 2020. These guidelines are very detailed and regulate TPF in a comprehensive manner.

23. Furthermore, the CCBE is paying attention to work on TPF, such as the European draft directive on TPF.

24. Dutch foundations and associations have issued a "*governance code*" that includes explicit provisions on external funding of collective claims (under the name "Claim Code"). This code is not applicable to lawyers, but nevertheless sets out principles relevant to TPF and the legal profession. According to the code, the lawyer will only act "*for the benefit of the interest group and its statutory constituency*" and will not receive instructions from the funder.

25. Other foreign bar associations have general rules regarding the lawyer's independence, fees or professional secrecy, which provide a broad framework that also applies to TPF.

2 / Recommendations of the OVB regarding TPF

26. The OVB is considering the purpose of TPF and the role of the lawyer in it. The OVB's recommendations fit into that framework.

27. These recommendations do not take a position on the controversies surrounding TPF.

28. The recommendations are drafted in Dutch but also made available in English and French, given the international interest in TPF. Unlike in the other countries where similar decisions were adopted, the OVB's recommendations apply not only to arbitration but to all forms of commercial TPF. The conclusion focuses on TPF by professional funders but can also serve as inspiration for other situations similar to such financing.

29. The decisions of foreign bar associations and other initiatives have served as inspiration. It should be taken into account that TPF in Belgium as it stands is neither legally nor deontologically regulated.

30. The recommendations consist of six sections. To ensure wide application, the points have been kept general rather than detailed.

31. The comments below the recommendations are intended only as explanatory notes.

2.1 / Lawyer independence

32. As Articles 2 (independence) and 4 (partiality) of the *Codex Deontologie voor Advocaten* prescribe, the lawyer acts in complete independence and always defends the client's interests.

33. The lawyer intervenes either as the lawyer of the funder or as the lawyer of the litigant. The lawyer cannot act simultaneously for both the funder and the litigant, without prejudice to Article 6 of the *Codex Deontologie* (prohibition of conflicts of interest).

34. The lawyer may not have any direct or indirect (financial) interests in a TPF fund serving its clients.

35. The lawyer may introduce funders to his client and he may also introduce clients to the funders, as long as he does not receive any remuneration or other consideration for the presentation or referral.

36. The lawyer will not receive instructions from the funder, except in the hypotheses provided for in Article 66 of the *Codex Deontologie* (lawyer who does not receive his mandate directly from the client).

37. The lawyer is careful not to have contacts with a funder without the presence of the litigant or without the express prior consent of the latter.

38. Payment of the lawyer's fees by the funder does not prevent the lawyer's independence.

Comment:

39. Lawyers are often engaged by funders as part of *due diligence* of a case. Certain funders work with the same lawyers on a regular basis, for example when putting together a group action or class action. In that context, the funder often seeks advice from a lawyer on the law of the country in which that lawyer operates.

Thus, the funder becomes the lawyer's client. This prevents the lawyer from intervening in the same case as the plaintiff's or defendant's lawyer, except in possible cases where the *Codex Deontologie voor Advocaten* already allows it.

40. The recommendations clarify the interaction between the lawyer and the funder in light of the lawyer's independence.

2.2 / The lawyer's fees

41. The lawyer may receive payment of fees directly from the funder.

42. The lawyer does well to make adequate arrangements with the funder regarding the payment of his fees. The lawyer is transparent about this with the client. The lawyer's deontological obligations are without prejudice to the lawyer's obligation to comply with applicable legal obligations, e.g. under the Economic Law Code or under Article 446ter of the Judicial Code, which prohibits a stipulation on fees linked solely to the outcome of the dispute.

Comment:

43. The agreements with the funder should preferably include not only the terms of payment, but also the choice of forum and applicable law for the resolution of any disputes over the fee (see below the recommendation on agreements with funders). There is no deontological impediment to the lawyer agreeing to the application of foreign law or to a foreign forum, but he should make this choice consciously. Choosing a forum other than Belgian courts may be a barrier to the recovery of fees.

2.3 / Information obligations of the lawyer and their impact on professional liability

44. It is good practice for the lawyer to inform the client about the possibility of invoking TPF.

45. The lawyer provides adequate information to the client and advises on the content of the funding agreement and its consequences.

46. In arbitration disputes, the lawyer encourages the client to communicate the existence of TPF and the identity of the funder and informs the client of the consequences of the lack of this information (i.e., inter alia, the risk of annulment or refusal of the declaration of enforceability of the arbitral award due to a possible conflict of interest). The lawyer considers whether or not the communication regarding TPF is mandatory (see marginal notes 61 - 62 below). If the client refuses to give notice against the lawyer's advice, the lawyer will have to consider whether he or she can take on or pursue the case.

Comment:

47. As a professional practitioner, the lawyer has a special duty of disclosure. In some countries, the lawyer's failure to disclose the possibility of TPF was considered a professional misconduct. The recommendations encourage the lawyer to adequately inform the client in order not to compromise his or her professional liability.

48. When advising on whether or not to invoke TPF, the lawyer draws the client's attention to issues such as:

/ the role of the funder, including with regard to intervention in the choice of lawyer,
/ the funder's role, in ADR proceedings, in choosing arbitrators, mediators or other third parties,
/ the funder's role in strategic decisions, in considering a possible settlement, the choice of law and forum clauses, the termination options of the agreement by the funder and their impact on the conduct of the proceedings and, if applicable, on the funder's claim for reimbursement of the lawyer's fees already paid.

The lawyer of the client entering into a third-party funding agreement in the context of a class action will ensure that the funding agreements are compatible with the governing rules in the class action and consider the impact on an *opt-out*.

The funder will often wish to include provisions allowing it to terminate the funding agreement upon the discovery of new facts or loss of evidence, upon significant changes regarding the applicable law (e.g. a reversal of case law that will have a significant impact on the pending case), upon significant changes in the solvency of the opposing party, upon divergent views on the strategy in the case (e.g. regarding the acceptance or non-acceptance of a settlement agreement), upon default by the funded party.[10] In the latter case, this party will often be obliged to repay the amounts to the funder.

49. TPF is usually specific to each file. Since the funder has an interest in the outcome of the case, it will want to supervise and, in certain cases, control the proceedings. This can lead to a tension between the interests of the client and those of the funder. If the client opts for TPF, he accepts this tension and the limitations inherent in TPF.

50. However, it does not seem to be a task for the Bar Association to draw up a manual for a model financing agreement, or to advise on the scope of the provisions that ideally belong in this agreement.

2.4 / Intervention of the lawyer in the conclusion of the agreement with the funder

51. The lawyer's intervention in the negotiation of an agreement between the client and the funder is not prohibited.

52. The lawyer ensures that the agreement with the funder does not contain provisions that could compromise his deontological obligations.

53. It is good practice for the lawyer to clarify his brief when negotiating with the funder. It is also good practice to set out in a separate agreement with the client the consequences of the solutions prescribed by the funding agreement for cooperation with the client.

54. It is appropriate for the lawyer to ensure that the agreements between the client and the funder take into account the lawyer's own rights and obligations regarding fees and expenses and professional liability.

55. To this end, the lawyer may become a party to the agreement with the funder.

Comment:

56. The provisions that may cause particular tensions in cooperation with the lawyer under TPF are, in particular:

/ information rights of the funder: the manner of communicating to the funder the procedural documents and the documents received and exchanged during the proceedings;
/ co-decision powers of the funder over the case: the possibility for the funder to supervise the case and co-decide on the case;
/ obligations regarding transfer of funds received into and from the trust account of the lawyer.

2.5 / Confidentiality and professional secrecy

57. The lawyer remains bound by professional secrecy. He shall not transfer any information to the funder without the client's prior consent to do so. Such consent may be included in the agreement with the client. Even then, the lawyer will only provide such information as is necessary to safeguard the client's interests.

58. If the lawyer is acting jointly with a lawyer from a common law country, he is well advised to inform the client that in common law systems, disclosure of information to the funder may affect the *client-attorney privilege*, i.e. that such information will no longer be protected by this privilege. In some cases, it may therefore be useful to have the funder appoint its own attorney to defend its interests.

Comment:

59. The lawyer's professional privilege is fundamental to the exercise of the profession. On the other hand, it is common practice that funders wish to remain informed of all relevant events during the course of the dispute. The recommendation meets this common practice. However, this recommendation may encounter controversy among advocates of a very strict concept of professional secrecy. The alternative would be, as the Paris Bar suggests, that under no circumstances can the lawyer pass on information about the case to the funder. In that case, it seems useful for the lawyer to warn the client about the consequences of any failure to disclose information to the funder.

60. Further, before deciding to grant TPF in a particular case, the funder will conduct research *(due diligence*) into the chances of success. For this purpose, he will want to gather information from the client. To avoid information, which the client conveys to the funder, being used against him, it is good practice for the lawyer to advise the client to enter into an adequate confidentiality agreement with the funder.

2.6 / Disclosure of TPF

61. Where TPF is required to be disclosed, such as in the application of a law or an arbitration regulation, the lawyer should communicate vis-à-vis third persons identified in the applicable regulations, as soon as possible, the existence of a funding agreement and the name of the funder as well as any other information required as appropriate.

62. In doing so, the lawyer shall ensure that he obtains the necessary consent from his client and must comply with the applicable procedural rules, such as the rules of the arbitration institution governing the procedure. The lawyer shall inform the client of the implications of the applicable procedural rules on the financing agreement and on its content.

63. The lawyer will not use the mandatory notice for dilatory purposes.