



# THE EMERGENCE OF THIRD PARTY FUNDING

Joe Durkin, an Investment Manager at third party funder, LCM Finance, gives insight into how contractors are increasingly turning to litigation funding across the Middle East and Asia Pacific.

News in the legal press towards the end of last year, that a global construction firm had entered into a funding arrangement, supporting the funding of up to 20 arbitrations seated in jurisdictions ranging from London to Dubai, seeing the engagement of several international law firms, claims consultancies and expert service providers, has created a stir and caught the attention of contractors, experts and arbitrators across the GCC and APAC (Asia Pacific).

What grabbed the attention of CEOs of regional and international construction firms, from Turkey to Korea and further afield, was that there had been up until then, little insight of funders involvement in construction disputes in the Middle East.

Where third party funding has long been a resource to contractors involved in disputes in common law arbitration hubs such as London, New York and Sydney, what is really interesting now is the sea change in how third party funding is being used by contractors across the Middle East and Asia, which appears to be the tip of the iceberg.

There are several reasons for why this change has come about and how contractors are benefiting from it.

## WHY CONTRACTORS ARE TURNING TO THIRD PARTY FUNDING.

Construction disputes are on the rise. There has been the announcement across GCC jurisdictions of the insolvency of several high-profile contractors, which has had a domino effect on the supply chain.

Prior to the disruption caused by COVID-19, the numbers of disputes in the construction sector had been increasing. Pre-COVID there had been the insolvency of several high-profile contractors across the GCC, which has worsened in the past year, having had a domino effect on the supply chain.

The DIFC-LCIA recorded a 300% increase in cases registered in 2017 which had doubled by the first half of 2018. All other major arbitration institutions have shown increases in disputes registered.

The construction/engineering and energy sector often generates the most cases in leading arbitration institutions. It was the largest sector in the ICC accounting for 40% of the ICC caseload. It is also a significant sector in the LCIA, in SIAC and in regional centers such as ADCCAC and DIAC.

The construction industry has been further disrupted by the impact of COVID-19 with reduced profit margins, late payments and time overruns.

The construction industry is well suited to third party funding.

At its simplest, third party funding in the construction industry sees a funder, a party with no direct interest in a piece of litigation, who deploys capital to a contractor who is typically the claimant in a dispute. In return, the funder receives a return on its investment. In the most common form of litigation finance, the return received is conditional on the success of the case and is paid to the funder from the proceeds of it. It is usual for the return on the funder's investment to be a multiple of the amount advanced, or a percentage of the proceeds, or a combination of both.

## FUNDING MANAGES THE COST OF A CONTRACTOR'S LEGAL CLAIMS AND TURNS THE LEGAL DEPARTMENT INTO A PROFIT CENTRE.

**There is also a growing understanding by CEOs and CFOs of Middle East construction and energy companies, about how dispute finance can be used as an effective and profitable financial solution.**

There has been a shift in the mindset of leading contractors about how third party funding can help a company manage the cost of its legal claims, turn the legal department into a profit centre and even offer the potential for monetisation straight into the P&L.

Most contractors will have numerous disputes, which can be viewed as a portfolio by grouping together some, or all cases. By funding a portfolio of cases, financing is secured against

the book as a whole, not just the strongest case(s), which allows the funding of claims which may not be funded on an individual basis.

This portfolio approach considerably lowers the cost for the business as the risk is spread across multiple cases and has the additional benefit of potentially creating a financial provision for any defense cases.

**When dispute finance is used in this manner, more commonly known as corporate portfolio financing, it results in a company being able to:**

- Move the financial risk of disputes;
- Remove the costs associated with disputes from the company's balance sheet; and
- Release the financial upside of multiple claims where returns are generated at zero cost.

## WHAT TO KNOW ABOUT THE DRIVING FACTORS IN THE MIDDLE EAST AND FURTHER AFIELD

Several key factors have emerged in recent years. Regulators have addressed lingering uncertainty in many jurisdictions concerning the acceptance of funding.

Sydney, London and New York have permitted third party funding for years. In recent times Singapore and Hong Kong have adopted regulations to permit third party funding in international arbitrations. The DIFC and ADGM soon followed by separately recognising and regulating the use of third party funding for litigation in their courts.

This has coincided with the expansion of the arbitration infrastructure across the region and further afield. The DIFC-LCIA is strategically located in the Dubai International Financial Centre.

Recent legislative improvements are also a factor. The introduction of the UAE Federal Arbitration Law was introduced in the UAE in 2018. We now have over two years of implementation of the law which highlights how increasingly arbitration-friendly the jurisdiction has become. A set of new laws and the introduction of an international arbitration centre in Saudi Arabia in recent years also indicates improvements in the Kingdom.

The ICC announced just in December 2020 the opening of its case management office for the ICC Court Secretariat in the Abu Dhabi Global Markets. The regional arbitration centres of DIAC and ADCCAC are also very active and their rules appear in a significant number of construction and energy contracts.

Indian contractors operating in the Gulf are well used to the appearance of SIAC as the arbitral institution in their contracts, where SIAC has representative offices in Mumbai and Gujarat, which has seen a considerable increase in disputes involving contractors from the sub-continent. We are finding that awareness of litigation funding among Middle Eastern clients is high. CEOs and CFOs see funding as a tool



to unlock asset value. Law firms see how funding brings in more work from existing clients and how to attract more clients by offering an innovative, complete solution for corporate and law firm litigation portfolios. Insolvency practitioners see it as a means of financing the disputes of an insolvent business.

## LOOKING FORWARD

Awareness and interest in third party funding continues to grow. The sheer number of high value construction disputes in the Middle East, which had difficulties before the pandemic, has led the industry to look at alternative ways to address its legal spend on disputes.

There always will be a place for single case funding where a contractor has a single high value dispute. The construction and energy sectors are also poised to benefit from the new and developing corporate portfolio approach to third-party funding.

We are already seeing a wave of COVID-19-related litigation and arbitrations. As in other regions, insolvencies and bankruptcies are likely to follow in the aftermath of the pandemic. Saudi Arabia and the UAE have modernised their insolvency legislation. Litigation funders are often essential in the insolvency context to assist insolvent, distressed or cash-poor contractors recover receivables.

Joint ventures are another specific feature of business in the Middle East. Many joint ventures are facing liquidity challenges. We are seeing an increase in disputes between joint venture partners.

There is an increase in the demand for third-party funding from all types of claimants.

Third party funding's effect on the legal landscape has been accelerated by the pandemic. The increasing awareness of funding by CEOs and lawyers, together with regional legal developments will see significant use of third-party funding across the Middle East and APAC.

