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THIRD-PARTY LITIGATION FUNDING IN LUXEMBOURG: CURRENT PRACTICE AND FUTURE DEVELOPMENTS

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The *Conférence du Jeune Barreau de Luxembourg* (CJBL) and the *Conférence Saint-Yves* (CSY) organised a legal conference on 15 November 2022 about "*Third-party litigation funding in Luxembourg: current practice and future developments*"[1].

Third-party litigation funding ("**TPLF**") is a new subject for Luxembourg. Its development can potentially enhance Luxembourg's legal offering and the attractiveness of the Luxembourg financial center. However, TPLF can raise concerns in relation to the professional duties of Luxembourg lawyers. It may also present a number of potential risks to the proper functioning of the courts in Luxembourg.

To respond to these questions, this article will first present the history and development of TPLF (I). Next, it will describe the operational aspects of TPLF in civil law jurisdictions (II). The challenges and opportunities of TPLF for the Luxembourg legal ecosystem will then be explained (III). Finally, the ethical issues which TLPF raises for Luxembourg legal practitioners will be addressed in a critical manner (IV).

I. LITIGATION FINANCE OR THIRD-PARTY LITIGATION FUNDING BY FABIO TREVISAN

Definition of TPLF. Fabio TREVISAN[2] opened the session by stating that his aim was to provide the audience with an overview of third-party litigation funding. Before doing so, he noted the need to define the relevant terms: what is TPLF? Also referred to as "*litigation finance*", "*third-party funding*", or "*third-party litigation finance*".

TPLF is the funding of one party's legal costs in a dispute in exchange for the funder receiving a share of the proceeds (if any) of the litigation. TREVISAN purposely added the words "*if any*". This is the most surprising element and always provokes questions: a share of the proceeds is only possible if they exist. The risk is all on the funder.

Origins of TPLF. TPLF is extensively developed in Anglo-Saxon countries with a strong tradition of common law. Its appearance in countries with a civil law tradition came later.

The roots of TPLF are to be found in medieval England: to combat their political adversaries, nobles, royal officials and lords associated their names with other parties' claims in order to provide them with more credibility. These individuals fought not only on the battlefield but also in courtrooms. They needed claims. What they did was simply to fund other peoples' claims and associate their names with them. It was prestigious for them to bring forward a claim (including land claims and other types of claims). This practice was called "*maintenance*". Maintenance refers to an unconnected third party supporting (or maintaining) proceedings by providing, for example, financial assistance.

The related concept of "*champerty*" also emerged. Champerty is maintenance – with in addition: a share of the proceeds generated by the lawsuit (if it is successful). In a champerty contract, the aim of the funding party is to obtain a share of the litigation outcome proceeds. It is completely contingent upon the lawsuit's success. If there is no win... then there will be no share of the proceeds...

Ever since the advent of maintenance and champerty, there had been concern that these practices could corrupt justice. As a result, they were made illegal by the House of Commons, which stated that *"None shall commit Champerty, to have part of the thing in question"* (Statute of Westminster of 1275)[3].

The aim of Parliament was to prevent any speculation in litigation. This position was also shared by the XVIIIth century English legal thinker William BLACKSTONE, who stated: "[maintenance] *is an offense against public justice, as it keeps alive strife and contention, and*

1. For more details about the event and the proceedings, see Pierre Sorlut, « Face aux banquiers des prétoires », *d'Lëtzebuerger Land*, 02.12.2022, p. 10.
2. Partner at BSP law firm (Luxembourg).
3. Sir William David EVANS, *Collection of Statutes connected with the general administration of law*, Vol. VI, Publisher Thomas BLENKARN (London), 1836, p. 15.

perverts the remedial process of the law into an engine of oppression"[4].

This means that XVIIIth century legal thinking understood such a legal mechanism as an infringement of the rule of law. Indeed, the very purpose of the law was to enable the parties to reach a resolution and not to create a litigious situation. These concerns were further exacerbated by the nature of the English common law legal system, *i.e.* the Law Lords had more opportunity to influence and corrupt the individual judges who *in effect* determined the applicable unwritten laws.

The rationale behind this common law prohibition in medieval times was restated in a recent US State Supreme Court decision. The Minnesota Supreme Court ruled in 2020 that the common law prohibition against champerty was originally based on a desire to prevent abuse of the court system by individuals wealthy enough to finance lawsuits. The court notably mentioned that "*In medieval England, those with means played "the game of writs" to increase their power and harass their rivals through the medieval court system"*[5].

However, the Minnesota Supreme Court acknowledged the evolution of this concept from ancient times to today and decided in 2020 to *"abolish Minnesota's common-law prohibition against champerty"*[6]. In doing so, the State of Minnesota was the last US State to abolish the prohibition of champerty. Only the State of New York still maintains some limitations due to binding ancient laws.

Contemporary developments. TPLF evolved drastically after World War II. In the 1960s, Lord DENNING said: "*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. These fears may be exaggerated, but, be that so or not, the law for centuries had declared champerty to be unlawful, and we cannot do otherwise than enforce the law*".

This change of approach led the UK legislator to intervene and amend section 14 of the Criminal Law Act 1967 by abolishing criminal and tort liability for maintenance and champerty. This U-turn occurred in the 1960s.

A few decades later, the England and Wales Court of Appeal decided that alternative funding agreements were not against public policy. The Court ruled in 2016 that "*Litigation funding is an accepted and judicially sanctioned activity perceived to be in the public interest*"[7].

Such arrangements are still prohibited in some common law countries, such as Ireland. The Supreme Court of Ireland confirmed recently that third-party litigation funding by an entity with no independent interest in the underlying proceedings is prohibited under Irish law – but for how long?[8]

Present situation in the EU and Luxembourg. Is there any regulation related to TPLF in civil law countries? For the time being, the answer is negative.

At the level of the European Union, the EU bodies have not taken any definitive position either for or against TPLF. TPLF is understood, on the one hand, to allow better access to justice but also, on the other hand, to generate new risks which may encourage abusive appeals.

An extensive European Parliament report on "*Responsible private funding of litigation – European added value assessment*" was published in 2021. This study states that "*TPLF could offer some benefits if the associated risks are mitigated. In particular, it may represent a tool to support private citizens and businesses in accessing justice and constitute a mechanism for transferring the risk of the uncertain outcome of the dispute to the litigation funder. At the same time, it may pose risks and entail conflicts of interests. If not properly regulated, it could lead to excessive economic costs and to the multiplication of opportunity claims, problematic claims and so called 'frivolous claims'. It could also be used for the pursuit of strategic goals by competing businesses, and the cost and time wasted in frivolous litigation in some instances could also potentially directly affect aggregate productivity and competitiveness*"[9].

At the national level, there is no specific legislation and there is no explicit prohibition against TPLF. The principle of contractual freedom applies for the time being.

The only existing *legal framework* in the Luxembourg legal regime which refers to TPLF is bill of law number 7650 on class actions, which is currently being discussed

4. Henry John STEPHEN, *New Commentaries on the Laws of England*, Vol IV, Publisher John S. VOORHIES (New York), p. 263.
5. *Maslowski v. Prospect Funding Partners LLC, et al.,* A18-1906, 2020 WL 2893376 (Minn. June 3, 2020), p. 3.
6. *Ibid*., p. 13.
7. *Excalibur Ventures LLC v Texas Keystone Inc* [2016] EWCA Civ 1144, point 31.
8. The Irish Government has signaled that it will legislate to permit third-party funding of international commercial arbitration. See *Litigation funding – new rules on the way?* Online publication of the Irish law firm McCann FitzGerald LLP, 21 September 2022: https://www.mccannfitzgerald.com/knowledge/disputes/litigation-funding-new-rules-on-the-way.
9. "Responsible private funding of litigation – European added value assessment", European Parliamentary Research Service, March 2021, p. 1-118: https://www.europarl.europa.eu/RegData/etudes/STUD/2021/662612/EPRS_STU(2021)662612_EN.pdf.

in the Luxembourg *Chambre des Députés* (transposing EU Directive 2020/1828)[10].

This bill of law will authorise class actions in consumer matters. The overall aim of the bill is to improve access to justice for consumers, particularly by introducing the option to finance class actions via financing from a private third party. Interestingly, the bill expressly refers to the supervision of third-party class action financing. It further states that the funder is prohibited from influencing the client's decisions and that the court may request a financial overview if doubts exist on any potential conflict of interests.

The bill of law is still under discussion and its drafting may evolve during the Parliamentary phase. The final version of the bill of law will have an impact on any potential regulation of TPLF.

Litigation finance contract. A litigation funding agreement can be described as a tri-lateral *sui generis* contract. It is a contract between three parties comprising:

- an investor who finances the litigation;
- a plaintiff who holds the claim; and
- the lawyer who represents the claimant and drafts the terms of the agreement.

The agreement includes as a minimum:

- the description of the claim and the risk factors;
- a budget and its allocation amongst the various players (such as law firm, expert and arbitration costs);
- an expected return on investment and description of how funds will be distributed among investors and the claimant;
- the role of the funder;
- a resolution mechanism if there is a settlement offer;
- it is crucial to state who is in control of the claim: this is a sensitive issue because the parties may have conflicting interests. Usually, it is the claimant who has the final say in decisions; and
- naturally, no recourse if the case fails in court/arbitration.

What are the potential legal challenges to TPLF's development in civil law countries?

– TPLF is not covered by banking monopoly or credit transaction

The banking monopoly is not applicable to the extent that there is no loan involved nor interest to be paid. The risk is completely borne by the funder.

Credit transaction is defined as an advance of money by a creditor to another party, followed by the remuneration of the creditor and the return of the monetary advance. TPLF does not necessarily entail any remuneration, nor restitution, to the extent the risk is entirely borne by the funder. TPLF can be better qualified as a partnership.

– Legal challenges: rules applicable to lawyers registered with the Luxembourg Bar

A *pactum de quota litis* (*Quota Litis Pact – QLP*) is a pact where one party provides funds for the other party's legal costs in exchange for a share of the proceeds should the case be successful. QLPs are prohibited in France and Luxembourg. As a general rule, under the Code of Conduct issued by the Council of Bars and Law Societies of Europe, European lawyers are not permitted to charge for their services on the basis of QLP.

In TPLF, the lawyer's fees are paid by the funder and are not dependent on the outcome of the case. As a result, TPLF remains compatible with the QLP prohibition to the extent the pact only concerns lawyers and not funders.

– Civil law countries: cultural issues at play influencing its growth?

Civil law countries show a strong resistance to TPLF. The cultural obstacles to TPLF's development in civil law countries include:

- *A different legal philosophy*: the law is used to give to each his due (*suum cuique*). There are no political or financial goals in the civil law system.
- *A different understanding of the cost of legal procedures*: they are cheaper in civil countries, reducing the demand for funding as it is less problematic.
- *Class Actions*: these have been a huge success in the US but are not yet available in continental Europe. Continental Europe has less demand for TPLF because of the later arrival of Class Actions (Luxembourg still has yet to implement them, as mentioned above).

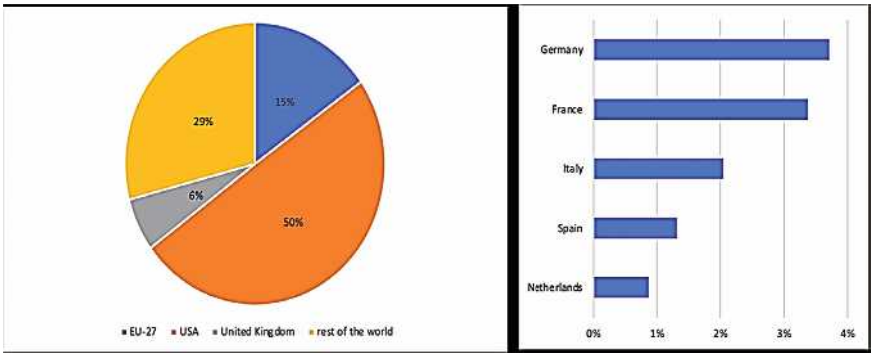
– An exclusively Anglo-Saxon phenomenon?

This was the case, but it is not the case anymore. Although tracing its origins and development to the Anglo-Saxon countries, today, TPLF has largely found its place in the rest of the world, particularly in Europe (notably Germany).

Large collective actions and subsequent individual commercial claims started to be funded in Germany in the early 2000s, notably after the *dot.com* bubble burst. Then came the EU countries' collective actions for consumers and antitrust actions for victims of illicit cartels. These areas are growing fast in Europe. In 2020, this market was estimated to be USD 486 million (source: Deminor).

10. Projet de loi numéro 7650 portant introduction du recours collectif en droit de la consommation déposé le 14.8.2020 : https://legilux.public.lu/eli/etat/projet/pl/20170316.

Slide 1: Size of the global litigation funding market in USD (2020) (source BSP)
Compare the size of the US market versus the other markets!



Slide 2: This is another interesting data set: the US is half the global market (source BSP)
Europe represents 15%. It is clearly not "non-existent". There is room for growth!

The benefits and opportunities of TPLF. TPLF enables better access to justice, funding of class actions (which could not otherwise exist), and recovery by bankruptcy trustees (some funders specialise in this). Further, responsible funders could act in ESG cases (there is a lot of discussion about this) and law firms could create new business themselves (with their own cases).

Is it a win-win deal? It is difficult to say. Lord Justice Jackson stated (in relation to the reform of civil litigation in England and Wales): "*Third Party funding provides an additional means of funding litigation and, for some parties, the only means of funding litigation. Thus third party funding promotes access to justice*"[11].

The benefits for the claimants are (i) externalisation of the risk of failed litigation costs, (ii) having liquidity without waiting for the litigation payout, and (iii) shifting the risks of litigation (if the litigation is lost, the plaintiff will not have to reimburse expenses).

In relation to the funder, they will be reimbursed and make a profit if the case is won (their share of the outcome is usually 20%-40%).

Of course, TPLF is subject to criticisms and limitations. The main criticism is the creation of speculation on litigation, meaning turning justice into a financial market and disputes into financial assets. This is a philosophical issue. Speculation can indeed lead to the natural selection of disputes by third-party funders (because the funders need to have a good chance of recovery). However, does speculation lead to an increase in the number of proceedings? There is no evidence in this respect. A recent study has disclosed that there has been a 16% increase in litigation in Australia since the authorisation of TPLF.

Is there a nexus? Does TPLF increase the litigious nature of plaintiffs? There is again no evidence in this respect. The funder will be prudent and only take on good cases.

But what about the funder-lawyer relationship: is there a risk of conflict of interests? There is a risk of the funder seeking to influence the client's choices against the client's interest, but can it really happen?

11. *Review of Civil Litigation Costs: Final Report*, December 2009, p. 117.

II. INTRODUCTION TO THIRD-PARTY FUNDING IN CIVIL LAW JURISDICTIONS BY ISABELLE BERGER

The basics of litigation funding from the funder's perspective. Isabelle BERGER[12], a former disputes resolution lawyer now working for the Swiss funder Nivalion, provided a detailed overview of the business model of funding, the relevant funding processes, and its evolution.

The funder's core offering. A TPLF offering has three main characteristics:

- The funder pays all the costs related to the litigation or arbitration procedures including adverse costs (unless the funded party is able and willing to self-fund).
- If successful, the funder receives a share of the proceeds. If the case is unsuccessful, the funder loses its investment and this is irreversible. This also means that the funded party does not repay the funder. It is the non-recourse nature of funding.
- There is a clear separation of roles between (i) the lawyer (in charge of the proceedings and defining the litigation strategy based on instructions received from their client) and (ii) the funder who does not control the litigation/arbitration (they are on the sidelines). This hands-off approach is only possible if detailed due diligence is conducted by the funder before deciding to fund a case.

TPLF users and areas of law. TPLF is used by the following: corporate claimants (and also defendants), insolvency practitioners and private claimants (mainly in relation to employment disputes, inheritance disputes or class actions).

The vast majority of cases are active cases, but TPLF can also be possible for defendants. This would work if the proceedings generate assets that can be the source of the success fee for the funder.

Most cases derive from corporate and commercial cases. The funding generally works in all areas of law.

The Luxembourg market is in its infancy. Not many cases have been seen yet but there is potential in relation to investment losses, financial products, cross-border enforcement cases, and arbitration cases.

Which cases are suitable for funding? In practice, the majority of the cases in funding requests are at a pre-filing stage. However, funding is possible at any stage (outset, during proceedings or enforcement).

Most funders will require a minimum amount in dispute which at Nivalion is set at EUR 7.5 million. The most important element is the chances of success. The funder will pay very close attention to the facts and evidence, the merits of the case, and the overall predictability. Scrutiny is also given to solvency and enforceability issues. Finally, the case must be managed by a trusted and experienced case team.

To sum up, the risk appetite of a funder is in principle quite low, and there is no willingness for professional and sophisticated funders to fund unmeritorious claims. If funders were to support claims which were not serious, they would quickly run out of investors' money and close their business.

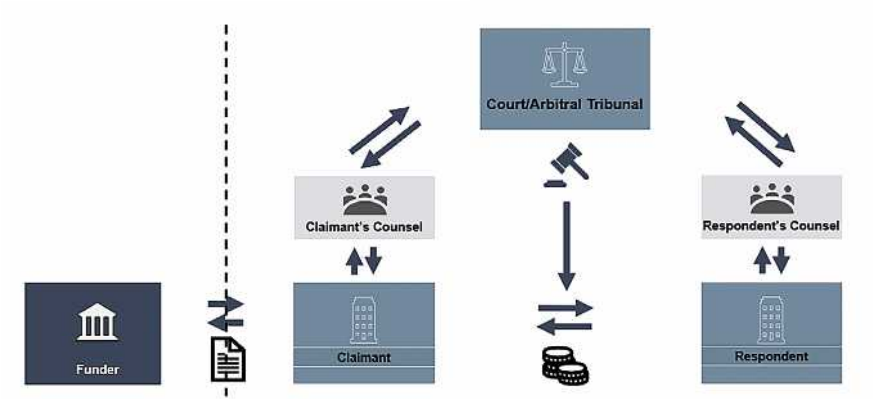
The slide below clarifies that a typical delegation funding agreement is entered into between the funded client and the litigation funder. The lawyer is not a party to the litigation funding agreement (at least not in Nivalion's contracts), but the lawyer is invited to sign the agreement to ensure that they are aware of the terms their client needs to abide by.

Funding process. Following preliminary exchanges (call or email) between the funder and the lawyer of a client who has an interest in funding, the lawyer provides a high-level overview of the case. A conflict check is carried out by the funder, an NDA signed, and a high-level investment review is conducted. If the funding request meets the relevant thresholds, the funder asks the lawyer to produce a Memorandum which provides an overview of the facts, merits, quantum and solvency/enforcement, as well as the budget required for the project.

After review, the funder either declines the case or preliminarily accepts it by presenting an offer/term sheet (this document contains the main elements of the future funding agreement, if any). If the client accepts the term sheet, they also agree to a period of exclusivity in favor of the funder to enable the funder to conduct extensive due diligence (including, in particular, the involvement of external lawyers at the funder's expense).

If the due diligence confirms the funder's interest in funding the claim, the parties negotiate and enter into a funding agreement. Once the agreement is signed, the funder acts like a "passive investor" (not attending court or interfering in settlement negotiations). The funder will however be kept duly informed of any developments.

12. Isabelle BERGER, Attorney-at-law, is Nivalion AG's Chief Investment Officer, responsible for Investment Underwriting & Management.



Slide 3: Basics of Litigation Funding (source: Nivalion)

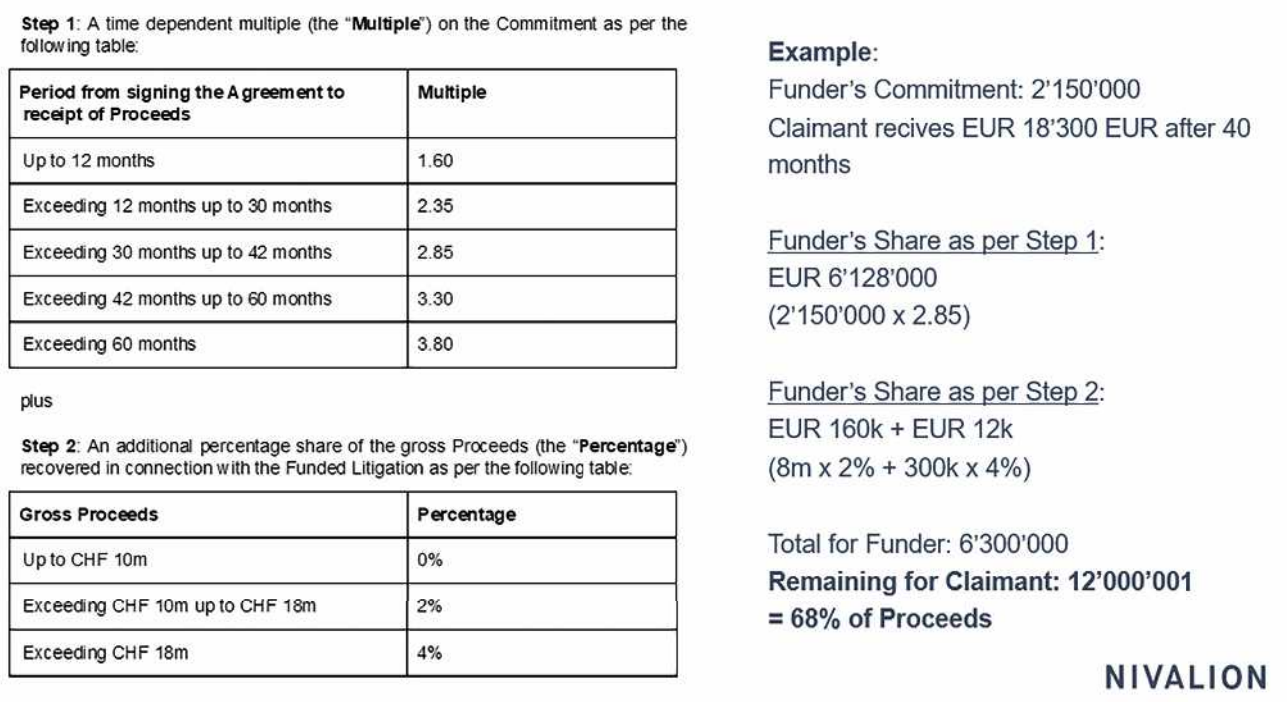
Slide 4: The funding process (source: Nivalion)

Commercial side of third-party funding. The budget allocated for a case should not exceed 10% of the expected litigation recovery (so-called "1:10 rule"). If you expect a case outcome of 50 million, the budget should not exceed 5 million. The reason for this is that the greater share of the recovery should remain with the funded party. A high budget combined with small expected recovery makes a case unsuitable for funding.

The mechanics of the "success fee" are set out in the litigation funding agreement. It is noteworthy that the success fee increases over time. In other words, the longer the proceedings last, the more expensive the funding becomes.

There are different ways to structure the success fees. Some funders want a pre-defined percentage of the proceeds. This method is rather outdated, and it is definitely not suitable for large cases (because the funder's success fee is far too high compared to their investment). More sophisticated funders set up a success fee model based on the case budget by requesting a time dependent multiple on the capital provided. This model is sometimes combined with a (limited) percentage approach. The success fee of the funder can never be higher than the amount the claimant can actually enforce (non-recourse nature of funding).

The order of payment of the proceeds (or the waterfall of payments) is usually as follows. First, the funder receives the success fee and, if the lawyers have agreed on a partial contingency fee, they come second. The funded party receives the remainder.



Step 1: A time dependent multiple (the "**Multiple**") on the Commitment as per the following table:

Period from signing the Agreement to receipt of Proceeds	Multiple
Up to 12 months	1.60
Exceeding 12 months up to 30 months	2.35
Exceeding 30 months up to 42 months	2.85
Exceeding 42 months up to 60 months	3.30
Exceeding 60 months	3.80

plus

Step 2: An additional percentage share of the gross Proceeds (the "**Percentage**") recovered in connection with the Funded Litigation as per the following table:

Gross Proceeds	Percentage
Up to CHF 10m	0%
Exceeding CHF 10m up to CHF 18m	2%
Exceeding CHF 18m	4%

Example:
Funder's Commitment: 2'150'000
Claimant recives EUR 18'300 EUR after 40 months

Funder's Share as per Step 1:
EUR 6'128'000
(2'150'000 x 2.85)

Funder's Share as per Step 2:
EUR 160k + EUR 12k
(8m x 2% + 300k x 4%)

Total for Funder: 6'300'000
Remaining for Claimant: 12'000'001
= 68% of Proceeds

NIVALION

Slide 5: Pricing / real life example (source: Nivalion)

Access to justice vs managing legal cost and risk. Take a step back and understand how TPLF has evolved since its inception. At the beginning, TPLF was a tool to provide access to justice. The users of TPLF were natural persons with limited financial resources. With time and the development of products by funders, the profile of users has changed. Today, TPLF is also used by financially sound corporate entities with a different motivation. TPLF is seen by corporate entities as a corporate finance tool and as a tool to manage risk. They appreciate the removal of litigation costs from their balance sheet and the positive effects on their profit and loss statement.

Practical tips. It is important to become familiar with litigation funding (to acquire basic knowledge of this new practice) and assess the market and available funding options/products.

The funding process can be lengthy and can take several weeks, sometimes more.

It is also important to be selective when choosing a funder. Check if the funder is a professional and trustworthy funder. Do they adhere to industry best practices? For example, are they a member of the International Legal Finance Association? Do they have a strong track record?

You also need to know how to scrutinise a litigation funding agreement, notably by reviewing the following points:

- Are all costs covered? For example, adverse costs, security for costs and historical costs.
- How is the funder's return calculated?
- What are the termination rights?
- What is the funder's involvement in the conduct of the proceedings? This can vary from funder to funder.

III. CHALLENGES AND OPPORTUNITIES OF THE LUXEMBOURG LEGAL ECOSYSTEM FOR THIRD-PARTY FUNDERS BY OLIVIER MARQUAIS

Introduction. According to Olivier MARQUAIS[13], what is striking about TPLF is that, in most places where funders are present, their activities are not subject to any specific laws or regulations. This is notably the case for Luxembourg. However, the fact that no legal framework exists in a jurisdiction where TPLF is practiced may create a certain level of uncertainty which might be detrimental to the development of TPLF. Yet, TPLF seems to be increasingly accepted as a valid practice by scholars and practitioners[14].

13. Olivier MARQUAIS is an Attorney-at-law (*Avocat à la Cour*) in the Litigation and Risk Management Practice Group of Loyens & Loeff (Luxembourg).
14. See notably the article: Alain GREC & Olivier MARQUAIS, *"Investment Management and Corporate Structuring Considerations for Third-Party Litigation Funders in Luxembourg"*, *ASA Bulletin*, Vol. 38, issue 2 (2020), p. 296-413 available at: https://www.loyensloeff.com/globalassets/02.-publications-pdf/02.-external/2020/marquais_offprint.pdf.

TPLF and the Luxembourg agenda. TPLF and the dispute resolution system (including courts and alternative systems) can benefit from each other.

Big arbitration centers realised a long time ago that the development and regulation of TPLF benefits the dispute resolution ecosystem generally. Benefits for the Luxembourg legal community may include improving access to justice while operating at arm's length, bringing forward meritorious claims (following a thorough scrutiny of the cases by funders), providing a cold hard objective look at the cases' financials, and also externalizing the costs of litigation.

Further, TPLF can contribute to increasing the visibility of Luxembourg as an arbitration center. Luxembourg has already taken a number of steps in this respect, including: (i) the ongoing modernization of the arbitration law, (ii) the adoption of ICC-inspired rules by the Chamber of Commerce, (iii) good logistics and hearing facilities, and (iv) an increasing number of Luxembourg based arbitration practitioners and potential arbitrators.

Whether and how to regulate TPLF? Olivier MARQUAIS' position is that we cannot afford to let the industry regulate itself. Active steps must be taken to protect all parties involved.

A funder making bad decisions will drive themselves out of business quickly. However, this will also have negative consequences for lawyers, clients, opposing parties, and others who need to be protected against opportunistic funders and newcomers on the market seeking a quick return.

A recent example illustrates the importance of providing an adequate legal framework for TPLF. A few years ago, wealthy but inexperienced individuals provided funds to sustain a claim before the English courts. The individuals valued the claim at around USD 1.6 billion and failed on every point. At most, the claim would have been worth USD 3 million. The English Court of Appeal found that the funders who enabled the conduct of the litigation were jointly and severally liable to indemnify the defendants as the claim was "*essentially speculative and opportunistic* [...], *was based on no sound foundation in fact or law and it has met with a resounding, indeed catastrophic, defeat*".[15]

Regulating TPLF would increase funders' offering. Funders typically provide funding on a risk-based pricing basis, screening the market for opportunities and assessing them on a risk/reward basis, but they also have different areas of focus and expertise, specialize in different markets and may have different investment policies and strategies. In any event, strong competition among funders is good. The development of TPLF overall increases tools available to litigants.

In terms of regulating TPLF in Luxembourg, instead of reinventing the wheel, we should consider the successful foreign models sharing similarities with the Luxembourg financial center. For example, Singapore was able to establish itself in a very short period of time as a major arbitration hub, and providing an appropriate framework for TPLF was an important step in that respect. The Singapore Parliament introduced the "Funding Bill" in 2016, and it was voted through in 2017. The following year, several litigation funders opened offices in Singapore and accepted arbitration cases seated in Singapore.

The Singapore law sets out very general principles and requirements: funding has to be the funder's principal activity, a minimum amount of paid-up share capital is required, funders must allow the funded party to meet the costs of the proceedings, and there has to be a litigation funding agreement in place.

Other laws in Singapore were also amended, such as the Legal Profession Act and the Legal Profession Rules, and all key players in the arbitration community contributed by issuing soft laws and guidelines to establish best practices.

How should TPLF be regulated? MARQUAIS provided high level suggestions and objectives for regulating TPLF in Luxembourg by:

- discouraging models where funders can take excessive risks and conduct weak due diligence;
- encouraging merits-driven funding and alignment of interests. There is a natural alignment of interest between the funder and the client, and possibly also lawyers; and
- educating external counsel and clients.

How should TPLF be implemented? The rights and activities of the funder should be contractually set out in the funding agreement. Reasonable compensation (allowing the lion's share to the client) should be provided for. Further, there is a need for clarity on the terms, roles,

15. Excalibur Ventures LLC v. Texas Keystone LLC [2016] EWCA Civ 1144, see: https://7kbw.co.uk/wp-content/uploads/2016/11/EXCALIBUR-VENTURES-LLC.pdf.

involvement, and degree of control (*e.g.* choice of counsel, strategy, settlement and termination).

Which corporate structure? Another way to regulate funders – which would be more creative – is to look at leveraging the Luxembourg funds legislation and investment vehicles to provide better investor protection. A number of funders are listed companies. Many funders are based in offshore jurisdictions out of convenience and the rationale would be to bring them into Luxembourg. Such funders would voluntarily apply stricter standards and benefit from a mix of Luxembourg flexibility and compliance to provide better service (such as more investor reporting, KYC, transparency as to the origin of the funds, adequate internal management requirements, cooperation with authorities concerning AML and CFT procedures, better certainty as to the investment strategy, handling of risks, processes). From an organizational standpoint, the management company responsible for AML/KYC, risk management, administration and so on could be in Luxembourg, while the operating (advising team) with knowledge of the asset class could be located in the leading arbitration places to facilitate sourcing and following up on cases.

Investment vehicles and legal forms. Assuming that investors in funding vehicles are well-informed and sophisticated (litigation funding being a high-risk long-term investment), *Specialised Investment Funds* (SIFs) and *Reserved Alternative Investment Funds* (RAIFs) are obvious choices. Institutional investors would appreciate these for compliance and transparency and to satisfy their own investment restrictions, and for the fiscal regime and risk spreading and diversification principles built into the SIF and RAIF laws. In terms of the corporate form, the *special limited partnership* (SCSp) is a natural fit in terms of, for example, flexibility, contractual freedom, and proximity to certain Anglo-Saxon models.

IV. ETHICAL ASPECTS FOR LUXEMBOURG LEGAL PRACTITIONERS BY FRANÇOIS KREMER

Critical remarks. François KREMER[16] introduced the last part of the conference with the following words (expressing himself as a member of the Luxembourg Bar and not as a former "*bâtonnier*"):

"I see many lawyers in the room. There is money flowing from heaven into the legal profession. This is an excellent opportunity, and we should grab it. I also see one funder in the room that made 300% in three years. Good fare. We should all invest in that.

But there is another player in the room that is the court. Courts are for free.

And there are also claimant lawyers in the room: they are involved in a game which they do not control and that is why I would make some critical remarks from an ethical point of view."

Lawyers' involvement in TPLF. In Luxembourg, TPLF is something largely unknown. It comes from the Anglo-Saxon world. When we discuss any issue relating to TPLF, we must consider the law on the legal profession (*Loi du 10 août 1991 sur la Profession d'Avocat, telle que modifiée,* hereafter the "**LPA**")[17] and the Luxembourg Bar Association Rules ("**RIO**").

Article 6(2) of the LPA provides that lawyers will only defend cases in which they believe "*in their soul and conscience*"[18]. Article 33(2) of the LPA provides that lawyers cannot assist parties with conflicting interests, and Article 33(4) of the LPA provides that a lawyer must freely exercise their profession in order "*to defend justice and truth*"[19].

Regarding a Luxembourg lawyer's involvement in TPLF, the following distinctions need to be made:

- the relationship between the funder and the lawyer, which has no direct impact on the litigation;
- the relationship between the lawyer and the other parties, which does not raise any direct ethical issues related to TPLF either; and
- the relationship between the lawyer and the funded party, which raises major ethical issues. This will be addressed below.

Distinctive features of TPLF. Luxembourg does not have any established TPLF practice. Some other mechanisms share similarities with TPLF, notably:

16. François KREMER is a Partner in the Litigation & Dispute Resolution practice of Arendt & Medernach (Luxembourg) and is a former *bâtonnier* of the Luxembourg Bar.
17. The legal framework regarding Best Practice in TPLF includes:
International level: *IBA Guidelines on Conflicts of Interest in International Arbitration*, *Code of conduct for litigation funders* from the *Association of litigation funders of England and Wales*, *Guide pratique sur le financement de l'arbitrage par les tiers* from *ICC France*;
European level: *Charter of core principles of the European legal profession*, *Code of conduct for European lawyers*, *Model Code of conduct for European lawyers,* and the European Parliament resolution of 13 September 2022 with recommendations to the Commission on *Responsible private funding of litigation* (2020/2130(INL));
National level: *Loi sur la Profession d'Avocat* (LPA) and the Luxembourg Bar Association Rules (*Règlement Intérieur de l'Ordre* – RIO).
18. The French version of Article 6(2) of the LPA is as follows: "*Je jure* [...] *de ne conseiller ou défendre aucune cause que je ne croirais pas juste en mon âme et conscience*".
19. The French version of Article 33(2) and (4) of the LPA is as follows:
"(2) *L'avocat ne peut assister, ni représenter des parties ayant des intérêts opposés. Il en est de même d'une association d'avocats.*"
"(4) *L'avocat exerce librement son ministère pour la défense de la justice et de la verité*".

– *Legal insurance:* the insurer will cover the costs of the proceedings. The insurer will cover legal fees but will recover none of the proceeds.

– *Labour and Trade Union assistance*: the union will provide assistance to their members by covering litigation fees, but no mechanism of recovery from the proceeds is possible.

– *Lawsuit loans*: provided by a bank to fund a lawsuit, but the loan has to be repaid to the lender no matter the outcome. The risk is borne by the litigating party.

– *Quota Litis agreements*: lawyers make their fees solely or partially depending on the success of the litigation (it is cheaper if you lose and more expensive if you win). These fee arrangements are regulated by the profession.

TPLF, however, is a funding mechanism differing from the above mechanisms, none of which involve a direct profit incentive for the funder linked to the outcome of the litigation.

TPLF may be a useful tool in class actions and bankruptcy proceedings. Class actions are going to be increasingly relevant, and funding by a third party is needed if the proceedings are to get off the ground. Arbitration can also be added as an area where TPLF may become relevant, particularly given that substantial changes to arbitration law have been recently voted on the Luxembourg legislator[20].

What ethical issues arise from TPLF? From a lawyer's perspective, the main ethical issues relate to (i) privileged information and disclosure, (ii) litigation and settlement strategy, (iii) legal fees, and (iv) costs, including damages for frivolous proceedings.

– *(i) Privileged information and disclosure*

The lawyer has a mandate exclusively from its client. The lawyer is defending the client in the litigation. There is a single line of communication between the lawyer and the client. With TPLF, of course, the funder would also like to be informed about the prospects of their investment. However, any communication which is not between the lawyer and the client is not protected by client-attorney privilege. In this respect, communication with the funder should therefore be handled with care. To preserve attorney-client privilege, any communication to the funder should emanate from the funded party, and vice versa. The lawyer should not be involved in any such communication.

As a result, the client and the funder will usually include specific provisions in the funding agreement which frame communication and updates on procedural matters. The funded party might have a duty to disclose a financing agreement, depending on the applicable laws or procedures. In any case, the lawyer certainly cannot take the initiative to disclose the funding agreement to a court.

Is it a matter of importance that funding agreements be openly disclosed? The court and the public would know that the party is not fighting using its own money but with somebody else's. No conclusions have been reached on compulsory disclosure. The question remains as to whether the court would take a different attitude if they knew a party was funded.

– *(ii) Litigation and settlement strategy*

Who controls the proceedings? The funder, the funded party or the lawyer? Under Article 33(1) of the LPA « *dans l'exercice de sa profession, l'avocat est maître de ses moyens* ». This means that the lawyer retains the right and the duty to represent the client as they deem fit. This may, however, create tensions notably when the funder wishes to bring other arguments to support the claim than those desired by the client, *i.e.* the funded party. This question will inevitably arise. The funder may not be as neutral as is generally described, as they wish to protect their investment. This may be a concern for the lawyer if the client and the funder are not aligned. If the lawyer has agreed to advise both, the funder as well as the funded party, this may oblige the lawyer to step down from both mandates by reason of a potential or actual conflict of interests.

When it comes to termination of the client relationship, this could originate from the lawyer themselves. The lawyer can terminate the mandate at any moment, provided the conditions of the termination are not abusive. The termination may also come from the client. What then happens to the funding agreement remains an open question and a source of difficulties, particularly as it is likely to entail additional fees when a new lawyer is appointed.

Finally, there is the matter of the strategic issues related to the proceedings or to settlement. Who will ultimately decide the litigation strategy? Who decides on the right

20. Loi du 19 avril 2023 portant modification de la deuxième partie, livre III, titre I[er], du Nouveau Code de procédure civile, en vue de la réforme de l'arbitrage, *Mém. A*, n° 203 du 21 avril 2023, p. 1-12.

settlement amount? This is clearly another source of uncertainty and potential for conflict of interest for the lawyer.

– *(iii) TPLF and lawyers' fees*

TPLF is not illegal under Luxembourg law, albeit it is uncommon. Arguably, Article 1236 of the Luxembourg Civil code is the generally applicable rule for TPLF (the third party pays the fee debt of the client)[21].

Article 38(1) of the LPA and the Luxembourg Bar Association rules provide guidelines for setting the amount of fees. The following four criteria are taken into account: "the importance and degree of difficulty of the case, the work done by the lawyer or by other lawyers in his firm, his reputation and professional experience, the result achieved and the client's financial situation". Regarding the last criterion, how does the money provided by a third-party funder have an impact?

A case of interest issued by the Luxembourg disciplinary appeal committee[22] gives some guidance. In that case, there was an agreement on fees with a success fee between the lawyer and the client. It was a criminal matter. The contract provided that if the client was acquitted of rape, the lawyer would get an extra success fee. However, the client was not even accused of rape. Disciplinary actions were initiated against the lawyer, resulting in a decision of the disciplinary committee. It was held that the disciplinary committee does not have any competence in relation to contract law and cannot nullify a fee arrangement from a civil law point of view. But it was further held that ethics prevail ("*la déontologie prime tout*"). If the lawyer violates the requirements of the LPA or the RIO, then they may face disciplinary sanctions.[23]

A Luxembourg lawyer should therefore respect ethical rules when entering into a fee arrangement, especially in the context of TPLF. A valid contract under civil law does not free lawyers from their ethical duties and obligations.

Moreover, the Bar Association has the power to reduce the fees a lawyer may charge if they are excessive (*procédure de taxation*). This is not excluded in the case of TPLF. In the context of legal insurance, the Luxembourg Bar considers this remedy against price fixing to be available to the person actually paying the fees. Furthermore, and notwithstanding decisions within the Luxembourg Bar, the Luxembourg courts generally hold that they can fix a lawyer's fee according to the criteria set by the LPA.

– *(iv) Legal costs and damages for frivolous proceedings.*

When proceedings are unsuccessful, things can get more complex. The courts will require the losing party to pay the legal fees ("*Frais et dépens*"). This includes "*émoluments*" based on a tariffed percentage of the amount of the litigation (roughly 0.1% of the amount at stake). This can become substantial in larger disputes. The issue of costs must be clarified in the funding agreement: does the funder cover legal costs? Moreover, the court may impose a cost allowance ("*indemnité de procédure*") against the losing party.

Furthermore, there may be *damages* awarded against the losing party for frivolous proceedings. Would they also be covered in the funding agreement?

Finally, the Luxembourg lawyer may not necessarily be aware of the full extent of proceedings abroad, as many cases are referred by correspondent firms. The local lawyer may not be made aware of the funding details, nor even involved in the funding agreement. This may also cause difficulties in Luxembourg.

Final observations. What happens if the funder becomes insolvent? Who will compensate the lawyer for their work?

What happens if a criminal action is brought against the funded party? In a recent enforcement case in arbitration, a party was accused of using forged documents in the proceedings, which triggered criminal proceedings before the Luxembourg courts. It was the client who was pursued and not the funding party. This raises an additional source of conflict of interests between the funder and the client.

Last but not least, what happens if the funding derives from criminal sources? The funder will be eager to pay all the fees the lawyer wants to charge. The criminals will get money back from the judgment, which constitutes a perfect way to launder money. The lawyer must perform their due diligence: where does the money that pays their fees come from?

21. Article 1236 of the Civil code states: *"Une obligation peut être acquittée par toute personne qui y est intéressée, telle qu'un coobligé ou une caution. L'obligation peut même être acquittée par un tiers qui n'y est point intéressé, pourvu que ce tiers agisse au nom et en l'acquit du débiteur, ou que, s'il agit en son nom propre, il ne soit pas subrogé aux droits du créancier".*

22. Conseil disciplinaire et administratif d'appel (Luxembourg Bar), 07/12, 12 June 2012, unreported.

23. *"En l'occurrence, l'essentiel n'est pas de savoir si la convention d'honoraire est valable d'un point de vue civil. Les règles déontologiques dépassent les articles du code civil et définissent des exigences propres, notamment en matière d'honoraires, que les parties ne sauraient écarter par une convention".*