ASA BULLETIN

Founder: Professor Pierre LALIVE
Editor in Chief: Matthias SCHERER

Published by:
Kluwer Law International
PO Box 316
2400 AH Alphen aan den Rijn
The Netherlands
e-mail: lrs-sales@wolterskluwer.com

Aims & Scope

Switzerland is generally regarded as one of the World's leading place for arbitration proceedings. The membership of the Swiss Arbitration Association (ASA) is graced by many of the world's best-known arbitration practitioners. The Statistical Report of the International Chamber of Commerce (ICC) has repeatedly ranked Switzerland first for place of arbitration, origin of arbitrators and applicable law.

The ASA Bulletin is the official quarterly journal of this prestigious association. Since its inception in 1983 the Bulletin has carved a unique niche with its focus on arbitration case law and practice worldwide as well as its judicious selection of scholarly and practical writing in the field. Its regular contents include:

- Articles
- Leading cases of the Swiss Federal Supreme Court
- Leading cases of other Swiss Courts
- Selected landmark cases from foreign jurisdictions worldwide
- Arbitral awards and orders under various auspices including ICC, ICSID and the Swiss Chambers of Commerce ("Swiss Rules")
- Notices of publications and reviews

Each case and article is usually published in its original language with a comprehensive head note in English, French and German.

Books and journals for Review

Books related to the topics discussed in the Bulletin may be sent for review to the Editor (Matthias Scherer, LALIVE, P.O. Box 6569, 1211 Geneva 6, Switzerland).

CORRESPONDENCE

ASA Bulletin
Matthias SCHERER
Rue de la Mairie 35, CP 6569, CH-1211 Genève 6
Tel: +41 58 105 2000 – Fax: +41 58 105 2060
mscherer@lalive.law

(For address changes please contact
info@arbitration-ch.org/tel +41 22 310 74 30)

Published by Kluwer Law International
P.O. Box 316
2400 AH Alphen aan den Rijn
The Netherlands

Sold and distributed in North, Central and South America by Aspen Publishers, Inc.
7201 McKinney Circle
Frederick, MD 21704
United States of America

Sold and distributed in all other countries by Air Business Subscriptions
Rockwood House
Haywards Heath
West Sussex
RH16 3DH
United Kingdom
Email: international-customerservice@wolterskluwer.com

ISSN 1010-9153

This journal should be cited as ASA Bull. 2/2020

The ASA Bulletin is published four times per year.
Subscription prices for 2020 [Volume 38, Numbers 1 through 4] including postage and handling: 2020 Print Subscription Price Starting at EUR 391/ USD 518/ GBP 287.

This journal is also available online at www.kluwerlawonline.com.
Sample copies and other information are available at lrus.wolterskluwer.com

For further information please contact our sales department at +31 (0) 172 641562 or at international-sales@wolterskluwer.com.

For Marketing Opportunities please contact international-marketing@wolterskluwer.com

Printed on acid-free paper

Investment Management and Corporate Structuring Considerations for Third-Party Litigation Funders in Luxembourg

OLIVIER MARQUAIS[1], ALAIN GREC[2]

Third-Party Funding – Investment funds – Investment vehicles – Specialized Investment Funds – Reserved Alternative Investment Funds – Special Limited Partnerships – Private Equity Real Estate – Luxembourg – Corporate structure

I. Introduction

Entering 2020, litigants seeking financing to bring forward or defend a dispute may now contact over thirty professional funders ("Third-Party Funders") with substantial capitals at their disposal. The Third-Party Funding ("TPF") industry has grown exponentially but heterogeneously over the past decade due to adverse domestic legislations. While common law jurisdictions first had to do away with the doctrines of maintenance and champerty, lawyers in civil law jurisdictions were typically exposed to a number of professional and ethical hurdles, including overly strict confidentiality obligations and legal privilege ("*secret professional*"). For example, Singapore's softening of these torts for "*prescribed dispute resolution proceedings*",[3] and subsequent immediate implementation of a combination of soft laws and mandatory legislation, contrasts greatly with the French approach. Indeed, France failed to take legislative measures and provide

---

1 Olivier Marquais is a New York, Ontario, Paris, Quebec and Luxembourg qualified Attorney-at-law in the Litigation and Risk Management Practice Group of Loyens & Loeff. Olivier's broad practice includes contract drafting, negotiations, advising and representing clients in complex cross-border technology, financial and investment management arbitrations and litigations.

2 Alain Grec is a director, co-founder and head of the quantum analysis division of Profile Investment, an international, regulated third-party funder specialized in international disputes based in Paris. Prior to founding Profile Investment in 2018, Alain founded and led La Française International Claims Collection from 2009 to 2018. Alain was also Head of the German branch of the banking group Natixis (1994-2002), and Head of Development of its Corporate and Investment Financing bank between 2005 and 2009.

3 Regulation 3 of the Civil Law (Third-Party Funding) Regulations.

judicial guidance, and essentially let professional bodies develop professional and ethical standards to guide counsels in their interactions with funders.[4]

Undoubtedly, domestic jurisdictions have a crucial role to play to guarantee that litigants benefit from a sound competition amongst funders and have access to a variety of funding products and solutions, and to prevent unscrupulous and unexperienced opportunistic players from backing unmeritorious claims, adopting inappropriate behaviour or creating conflicts of interest. Domestic jurisdictions may easily legislate, targeting TPF specifically, to ensure the availability of the capitals committed and the capacity to handle unexpected developments, and that the contractual arrangement with the funder is subject to certain mandatory provisions recorded in a Litigation Funding Agreement ("LFA"). Other important concerns, such as providing investor protection, investor reporting and transparency as to the origin of the funds, and addressing anti-money laundering and terrorism financing considerations, require submitting a funder's investment strategy, processes, risk management and policies to appropriate regulations. Indeed, these concerns may only be addressed if the right choices are made at the moment of determining the funder's investment management strategy and of setting up its corporate structure.

II. Regulating Disputes Funding Structures in Luxembourg

Similarities with "PERE" investments

Third-Party Funders invest capitals on a non-recourse basis. Thus, before putting equity capital at risk, Profile Investment conducts a deep dive due diligence of each file. This includes a counsel-driven case assessment of jurisdiction and legal merits, a thorough analysis of the heads of claim (excluding insufficiently supported heads of claim and assuming the longest duration of proceedings), a conservative evaluation of the amounts likely to be recovered, an examination of ethical considerations, an analysis of anticipated enforcement strategies, an assessment of the experience and qualification of external counsels and appointed experts, and a determination

4 Professional bodies include for example the *ad hoc* commission of the "Club des Juristes", the Arbitration Commission of the Paris Bar, the French National Council of Bars ("*Conseil National des Barreaux*") and the Paris Bar Council ("*Conseil de l'Ordre des Avocats du Barreau de Paris*"). For a more detailed analysis of the Singaporean and French approaches, please see Olivier Marquais & Alain Grec, *Do's and Don'ts of Regulating Third-Party Litigation Funding: Singapore vs. France*, Asian International Arbitration Journal (AIAJ), expected mid-2020.

of budget heads and of a global budget according to the realistic chances of recovery.[5]

Interestingly, from a financial and asset management point of view, the assessment of cases, the selection process, the asset's behaviour during its lifetime and the risk management process of financing disputes, bear many fundamental similarities with traditional Private Equity investments.[6] Thus, typical private equity fund structure, set up as professional and business activities turned to external equity capital providers, may be very well-suited for TPF vehicles.

Before the global financial crisis, Private Equity and Real Estate ("PERE") fund managers, focusing on sourcing investment opportunities and maximizing the prospective yield for their investors (often on a mere "price the risk" basis), established their funds with a view of fulfilling the investor's expectations with flexible structures. Offshore jurisdictions such as the Cayman Islands, the Anglo-Norman Islands and the British Virgin Islands were widely used because of their flexibility, fast incorporation and easy set-up of companies (including no minimum capital requirement and very limited substance requirements).

However, the global financial crisis experienced from 2007 to 2011 triggered a regulatory wave within the financial sector aiming at protecting the investors. This forced PERE fund managers operating in Europe to consider setting up their funds in jurisdictions offering flexibility, efficiency, transparency and cooperation with anti-money laundering and terrorism financing procedures ("AML procedures") and compliance with newly emerged regulation. This included in particular the Alternative Investment Fund Managers Directive 2011/61/UE (the "AIFMD") implemented in Luxembourg by the law of 12 July 2013 on AIFM (the "AIFM Law").

Luxembourg's strategic position

Offshore companies are most often not able to comply with regulations regarding AML procedures (which we anticipate to grow increasingly rigorous in the future) and are not part of European regional organisations. This makes it more difficult for them to adapt to the evolution of the European financial sector legislation which is often seen worldwide as state of the art.

---

[5] For a more detailed analysis of the due diligence process, please see O. Marquais & A. Grec, *Do's and Don'ts of Regulating Third-Party Litigation Funding: Singapore vs. France*, 16(1) Asian Int'l Arb. J. (2020).

[6] A distinction however is that a TPF acquires future beneficiary rights as a result of litigation proceedings whereas PE acquire stakes in operating companies.

The Grand Duchy of Luxembourg, while adopting a more conservative and compliant approach, positioned itself early on as the first EU jurisdiction to adapt to the evolution of EU legislation in a business-friendly manner, while successfully competing with offshore jurisdictions' efficiency. For example, Luxembourg created a highly successful and favourable regulatory environment, including investment vehicles and legal system, for PERE investments. This includes maintaining a toolbox for PERE fund managers combining the adaptability and flexibility of offshore jurisdictions with compliance of investment protection regulations as well as distribution strategies. PERE fund managers thus naturally favor Luxembourg for fund management.

As a member state of the European Union, Luxembourg adheres to all European regulations and thus benefits from a global access to the European market. Taking EU legislative developments as growth opportunities, Luxembourg modernized and refined its legal system to offer a unique variety of tools for investors to set up their (regulated or unregulated) structures, with or without a distinct legal personality, allowing managers to set up the vehicle which best fits their needs. Two examples immediately come to mind.

First, the launch in 2011 of the AIFMD framework and mechanisms in Europe[7] allowed Luxembourg to implement a regulatory and legal environment suited for all investment funds addressing alternative asset classes (such as international disputes funding), which were previously ineligible for regulated structures. When managers want to successfully market such alternative strategies, offering funds to investors under the AIFMD rules, especially by reason of the annual reporting and mandatory investor disclosure obligations, has become – in our opinion – an excellent solution.

Second, driven by some international initiatives, and sometimes even preceding them, Luxembourg introduced a number of measures aiming at preventing the financing of terrorist activities and the use of the financial system for money laundering purposes. Financial sector actors which are subject to the law of 12 November 2004 on the fight against money laundering and terrorist financing (the "12 November 2004 Law")[8] shall

---

7 The AIFMD framework is made up of a number of EU legislation including the Directive 2011/61/EU and amending Directives and Regulations, and the Commission Regulations No 231/2013, No 447/2013, No 448/2013 and 694/2014.

8 Pursuant to Article 2(1) of the 12 November 2004 Law, these include in particular credit institutions and professionals of the financial sector licensed or authorised to exercise their activities in Luxembourg, undertakings for collective investment and investment

comply with three types of obligations: (i) customer due diligence which relates to identifying the client or the persons for whom they act and which may require seeking documentation justifying one's professional activity, address and source of funds,[9] (ii) adequate internal management requirements and (iii) requirements to cooperate with and inform the authorities of any suspicion of money laundering activities in particular in consideration of the origin of the funds or the purpose, nature and procedure of an operation.[10] Luxembourg legislation was further completed by a number of CSSF Circulars including the CSSF Circulars 12-02 of 14 December 2012 and of 18/698 of 23 August 2018 clarifying anti-money laundering and terrorist financing expectations as applicable to investment managers and registrar agents. In an attempt to align with the European regulatory framework, Luxembourg also introduced the Law of 13 February 2018 amending the 12 November 2004 Law and transposing the EU Directive 2015/849, and the law of 25 March 2020 further amending the 12 November 2004 Law and implementing the EU Directive 2018/843 (the "5th AML Directive"). The Luxembourg law of 25 March 2020 expands the reach of the 12 November 2004 Law and, in a number of respects, goes further than the 5th AML Directive, for example by requiring obliged entities to take into account recommendations expressed by the Financial Action Task Force ("FATF").

Third-Party Funders obviously benefit from a similar mix of flexibility and compliance in the conduct of their activities. Their underlying assets require a particularly flexible regime and tailored management because of the number of case specific risks involved (e.g. jurisdiction, merits, damage valuation, monetization, recovery, ethics/reputational considerations, etc.), and an increasing degree of compliance with the requirements of institutions and judicial systems (in particular in Singapore, Hong Kong or as may be anticipated of the Australian regulatory framework to be implemented), or even arbitral tribunals.

From an internal organization standpoint, we would suggest to funders to establish the management company (which may be responsible, for example, of AML/KYC compliance, risk management, handling of administrative tasks, communication with parties involved, coordination of investor reporting, risk management, sales coordination, etc.) in Luxembourg. The operating team with specific knowledge of the asset class

---

companies in risk capital which market their units, securities or partnership interests and subject to the laws of 17 December 2010, 13 February 2007 or 15 June 2004.

9 C. Kremer, I. Lebbe *Organismes de Placement Collectif et Véhicules d'Investissement Apparentés en Droit Luxembourgeois*, 2014, 3rd Ed., § 2114.

10 Articles 3, 4 and 5 of the 12 November 2004 Law.

may however be part of an investment advising entity located where it is most relevant. This is particularly appropriate when funders specialize in funding international arbitration cases as their underwriters may be located in the world's leading arbitration places to make contact and follow-up with law firms, benefit from the arbitration community's activities and events which they can also use for promotional purposes.

III. Choosing the Right Luxembourg Structure to Conduct TPF Activities

Specialized Investment Funds ("SIFs")

Specialized Investment Funds ("SIFs"), under the Law of 13 February 2007 (the "SIF Law"), are well-established, flexible and efficient multipurpose investment vehicles regulated by the CSSF ("*Commission de Surveillance du Secteur Financier*") and reserved to "*well-informed*" investors.[11] Such investors are expected to have the experience necessary to assess the risks associated with the investment and the information needed to form an opinion. Thus, they do not require the same level of protection as investors in Undertakings for Collective Investment in Transferable Securities ("UCITS") which may be sold to the public generally. As SIFs target an informed and sophisticated clientele, they are not subject to specific investment rules and restrictions other than that the collective investment of funds must be made "*in order to spread the investment risks*" under Article 1(1) of the SIF Law and the CSSF Circular 07/309.[12]

[11] In accordance with Article 2 of the Law of 13 February 2007 Relating to Specialised Investment Funds, these are in essence institutional investors, professional investors and investors subscribing for a minimum of 125,000 Euro in the SIF.

[12] Pursuant to the CSSF Circular 07/309 of 3 August 2007, the risk-spreading principle is complied with when the SIF adheres to the following guidelines (i) a SIF may not invest more than 30% of its assets or subscription commitments in securities of the same type issued by the same issuer (but this restriction does not apply to (a) securities issued or guaranteed by an OECD Member State or its regional or local authorities or by EU, regional or global supranational institutions and bodies, and (b) target UCIs which are already subject to comparable risk-spreading requirements), (ii) short sales may not in principle result in the SIF holding a short position in securities of the same type issued by the same issuer representing more than 30% of its assets and (iii) when using financial derivative instruments, the SIF must ensure a similar level of risk-spreading *via* appropriate diversification of the underlying assets (similarly, the counterparty risk in an OTC transaction must be limited in consideration of the relevant counterparty's quality and qualification).

The liberal regime set out by the SIF Law permits to design more demanding and incisive investment strategies requiring a higher flexibility (e.g. derivatives, capital investment and real estate)[13] and is particularly attractive to third-party funders. Also, professional and institutional investors (which are the most likely to invest in disputes financing investment vehicles) often prefer regulated funds for compliance and transparency purposes or to satisfy their internal investment restrictions.

As the SIF regime was amended by the Law of 12 July 2013 on Alternative Investment Fund Managers (the "AIFM Law" implementing the AIMD), SIFs may qualify as Alternative Investment Funds ("AIF") and must then be managed by an Alternative Investment Fund Manager ("AIFM") which performs the portfolio and risk management functions. The objective of the AIFM Law is to lay down further rules for the authorization, ongoing operations and transparency requirements of AIMFs established in Luxembourg and which manage and/or market AIF in the European Union.[14] For example, when a SIF falls within the scope of the AIMD, its manager is subject to heavy regulatory requirements dealing with transparency and communications with the investors.[15]

The fund initiator must now ensure that the SIF is authorized by the CSSF (which shall approve the constitutive documents and the choice of depository) before a SIF is incorporated and starts its activities.[16] This is however not perceived as a constraint in the industry but rather as a codification of the practice since submissions for CSSF approvals were frequently submitted, before carrying out any activities, to avoid the risks (and the related fees) of any CSSF's *ex-post* requests for modifications of documents, operations or investment policy.[17] The CSSF will also ensure that the directors of SIFs and of their depositories, as well as the persons in

---

[13] C. Kremer, I. Lebbe *Organismes de Placement Collectif et Véhicules d'Investissement Apparentés en Droit Luxembourgeois*, 2014, 3rd Ed., § 139.

[14] For example, while AIFMs may delegate some of their activities, the AIFM Law strictly supervises it and stipulates their rights and obligations to safeguard investors' interests. These include CSSF approval, provisions regulating potential conflicts of interest, essential delegate characteristics, limits to delegation so that the AIFM cannot amount to a "letter-box entity" and provisions stipulating that the AIFM's liability to the AIF and its investors is not affected by any delegation of its functions, Articles 2(1) and 18 of the AIFM Law.

[15] C. Kremer, I. Lebbe *Organismes de Placement Collectif et Véhicules d'Investissement Apparentés en Droit Luxembourgeois*, 2014, 3rd Ed., § 166.

[16] Articles 42(1) and (2) of the SIF Law.

[17] C. Kremer, I. Lebbe *Organismes de Placement Collectif et Véhicules d'Investissement Apparentés en Droit Luxembourgeois*, 2014, 3rd Ed., § 159.

charge of the investment portfolio management, are of sufficiently good repute and have sufficient experience, in particular in relation to the type of the SIF concerned.[18]

Other noteworthy requirements aiming to safeguard investors' interests include the need to put in place appropriate risk management systems (to identify, measure, manage and monitor the risks arising from positions and their contribution to the general risk profile of the portfolio), and to minimize the risk of investors' interests being prejudiced by conflicts of interest.[19] Further, SIFs must have their accounting information given in their annual report audited by an approved statutory auditor ("*réviseur d'entreprises agréé*").[20] It shall promptly report to the CSSF any fact or decision of which it has become aware while carrying out the audit or any other legal task which is (i) likely to constitute a material breach of the SIF Law or the regulations adopted for its execution, (ii) affect the continuous functioning of the SIF or (iii) lead to a refusal to certify the accounts.[21]

SIFs often take the corporate form of an investment company with variable capital ("*société d'investissement à capital variable*" or "SICAV") whereby the share capital changes is always equal to its net assets as it changes (without formalities) according to investors' subscriptions and redemptions. SIFs may also be constituted in a contractual form, as common funds ("*fonds commun de placement*" or "FCP") which do not have a legal personality, must be managed by a management company and are tax transparent. Other forms, such as the investment company with fixed capital ("*société d'investissement à capital fixe*" or "SICAF") and others, while not provided for explicitly in the SIF law, are also available.[22]

Profile Investment created a Luxembourg SICAV-SIF investment structure. Its funds, "LF IC1" and "LF IC2", both qualify as AIFs benefiting from the AIFM Law and the AIFMD passport. This permits the AIFM's marketing of shares of the funds to investors in any EU Member States by submitting a notification file to the CSSF which will transmit it to the competent authorities of the Member States where the AIF is intended to be marketed.[23] Further, Profile Investment's funds benefit from a tax friendly legislation since SIFs established in Luxembourg are exempt from

18 Articles 42(3) and 42(4) of the SIF Law.

19 Articles 42a(1) and (2) of the SIF Law and as further detailed in CSSF Regulation 15-07 of 31 December 2015.

20 Article 55(1) of the SIF Law.

21 Article 55(3) of the SIF Law.

22 Articles 70 and 71 of the SIF Law.

23 Article 30 of the AIFM Law.

Luxembourg net wealth tax, corporate income tax and commercial business tax ("*impôt commercial communal*" or "ICC").[24] SIFs remain subject to an annual subscription tax ("*taxe d'abonnement*") charged at an annual rate of 0.01% based on the entire net assets of the SIF valued at the end of each calendar year.[25]

Reserved Alternative Investment Funds ("RAIFs")

In 2016, Luxembourg showed once again its ability to understand and adapt to market needs by widening its offering and making available to fund initiators a new hybrid form of AIF, the Reserved Alternative Investment Fund ("RAIF") introduced by the law of 23 July 2016 (the "RAIF Law"). At the time of writing, within four years of existence of this new fund regime, nearly 1,000 RAIFs were established in Luxembourg.[26]

Unlike SIFs, RAIFs are not regulated by the CSSF and are thus not subject to its approval regime (e.g. concerning its documents of incorporation, choice of depository, management company, etc.), its ongoing prudential supervision in the event of changes to its documents or its termination. However, controls and constraints will apply indirectly, through the AIFM.

Unlike SIFs which can be managed internally, RAIFs must be externally managed through the appointment of a separate authorized AIFM (which may be established in Luxembourg or in another Member State) within the meaning of the AIFMD[27] in order to be eligible under this regime and enjoy the corresponding EU passport for marketing. RAIFs cannot be managed by an AIFM which benefits from the exemptions of Article 3 of the AIFMD allowing to comply only partially with the AIFMD. In the event of a withdrawal, removal or insolvency of the AIFM, or that it is no longer authorized, the RAIF shall be dissolved and liquidated within three months.[28]

In accordance with the AIFMD, the AIFM must provide information at the level of the AIFM,[29] and at the level of the AIF[30] that it intends to

[24] The ICC is a tax levied on the profits of commercial companies to help communes finances their expenses and the costs engendered by business established in the commune.

[25] Articles 66, 68(1) and 68(4) of the SIF Law.

[26] Luxembourg Trade and Company Register, access on 16 March 2020, available at: https://www.lbr.lu/mjrcs/jsp/webapp/static/mjrcs/en/mjrcs/pdf/listeFIAR.pdf

[27] Articles 4(1) and 4(2) of the RAIF Law.

[28] Article 4(3) of the RAIF Law.

[29] This include information concerning persons effectively conducting the business of the AIFM, on the identities of the AIFM's shareholders or members, programme of activity

manage, to the competent authorities of its home Member State. Thus, despite the absence of direct CSSF oversight, a RAIF remain subject to transparency requirements and shall make available an annual report to investors (upon request), to the competent authorities of its home Member State and to the competent authorities of the home Member State of the RAIF.[31] By reason of these regular reporting requirements, the CSSF is kept informed of a RAIF's financial information and activities when these are established in Luxembourg.

Except for the references to the CSSF which were naturally excluded, the RAIF Law was heavily influenced by the drafting of the SIF Law since the Luxembourg legislator evidently sought to provide unregulated funds with a range of benefits otherwise reserved for regulated funds (e.g. umbrella structure, variable capital and specific tax regime). RAIFs thus naturally share many similarities with SIFs. For example, RAIFs offer the same investment possibilities and as little investment restrictions as SIFs while enjoying their benefits and structuring flexibility. RAIFs are also reserved to well-informed investors,[32] subject to similar risk spreading requirements,[33] can take the corporate form of a SICAV (which is not available to other unregulated funds),[34] FCP[35] or other[36] (e.g. SICAF), must have their accounting information given in their annual report audited by an approved statutory auditor[37] and enjoy a very similar (default) fiscal regime.

While the risk spreading requirements applicable to SIFs also govern investments in RAIFs,[38] RAIFs may derogate from these rules by providing in their constitutive documents that their exclusive object is the investment in assets representing risk capital.[39] The approved statutory auditor will confirm,

---

setting out the organizational structure of the AIFM, remuneration policies and practices and arrangements made for delegation of functions, Article 7(2) of the AIFMD 2011/61/EU.

30 This include information concerning the investment strategies (including the types of underlying funds if the AIF is a fund of funds, the AIFM's policy, the risk profiles and other characteristics of the AIFs), the location of the master AIF if the AIF is a feeder AIF, rules or instruments of incorporation of the AIF and the arrangements made for the appointment of the depository, Article 7(3) of the AIFMD 2011/61/EU.

31 Article 22 of the AIFMD 2011/61/EU.

32 Article 2(1) of the RAIF Law.

33 Article 1(1) of the RAIF Law.

34 Article 23 et seq of the RAIF Law.

35 Article 6 et seq of the RAIF Law.

36 Article 31 et seq of the RAIF Law.

37 Article 43 of the RAIF Law.

38 Article 1(1) of the RAIF Law.

39 Article 48(1)(a) of the RAIF Law.

at the end of the relevant financial year, that the investments comply with the policy of investing in risk capital.[40] When targeting exclusively such investments, RAIFs may opt for the tax regime applicable to SICARs[41] and benefit from a tax exemption for income arising from funds reserved for investment and having been invested within twelve months.[42] The decision to opt for the optional SICAR fiscal regime shall be made at the umbrella level of the structure.[43]

By including unregulated RAIFs in its offering, the Luxembourg legislator builds on the characteristics of Luxembourg's most successful CSSF approved and supervised products while providing a substantial time-to-market advantage,[44] contractual freedom, the protection of the AIFMD framework and of the RAIF Law, and the marketability of an investment vehicle which – once approved in one EU Member State – can be distributed in all others through the much sought-after EU marketing passport.

The RAIF Law provides for a procedure allowing existing Luxembourg (regulated and unregulated) investment structures – as well as non-Luxembourg entities – to be converted into RAIFs.[45] Existing regulated funds (i.e. Part II UCI, SIF or SICAR) may want to do so to enjoy lighter supervision (and save the related CSSF costs) and benefit from the speedy launching of new sub-funds. Existing unregulated funds may wish to convert into RAIFs to enjoy the numerous advantages discussed *supra* and the option to create sub-funds with distinct investment policies within an umbrella structure. Interestingly, the conversion procedure also allows a RAIF to be transformed into a regulated entity.[46] Thus, fund initiators may be tempted to adopt a "phased approach" by first setting up an RAIF (to benefit from the time-to-market advantage and have a first rapid closing for investors which do not require a regulated product), before converting it into a regulated AIF, for example, SIF or SICAR, to accommodate the needs of additional investors which are obligated to invest in directly regulated products. Such conversions are subject to a resolution of a general meeting of shareholders, passed with a majority of two thirds of the votes cast, regardless of the

---

40 Article 48(1) (b) of the RAIF Law.

41 This includes being treated as a normally taxable entity for corporate and municipal business tax purposes, and enjoy double tax treaties.

42 Article 48(3) of the RAIF Law.

43 Thus, within an umbrella structure, some sub-funds may not be subject to the default tax regime while others are subject to the SICAR-mirroring tax rules.

44 Simplifying the regulatory burden on fund managers and the absence of direct CSSF supervision allows for a quick setup and launch.

45 Article 49 of the RAIF Law.

46 Article 49(10) of the RAIF Law.

portion of the capital represented. The Luxembourg legislator aims to facilitate such conversions as no specific quorum is required to approve them.

The authors welcome the addition of this latest tool in Luxembourg's investment fund toolbox as it is perfectly suited to the needs of third-party funders which may be required to react quickly to market trends and dedicate substantial resources to specific types of disputes. For example, Profile Investment created a Luxembourg SICAV-RAIF investment structure composed of a main generalist compartment dedicated to international commercial arbitrations, investor-state arbitrations and litigations, and a number of specialized compartments (within which the general compartment may acquire a minority stake). Profile Investment dedicated a compartment specifically to arbitration disputes resolved in Singapore and another compartment to construction and infrastructure claims.

Special Limited Partnerships

SIF, RAIF, SICAR and other acronyms do not refer to the legal form an investment vehicle can take, but to a specific set of legal, regulatory and tax provisions. [47] SIFs qualifying as AIFs and RAIFs created under the form of an investment company (as opposed to a common fund) are often set up as limited partnership structures. These include the Anglo-Saxon based Common Limited Partnership ("*Société en Commandite Simple*" or "SCS") and a continental type of partnership, the Partnership Limited by Shares ("*Société en Commandite par actions"* or "SCA").[48]

In the middle ages, similar forms were used in maritime commerce where an investor (who often remained anonymous) provided a ship, commodities or funds to a seafarer to carry out a specific commercial undertaking in exchange for a share of the profits. Once the required means were secured, all decision-making and risks associated with conducting the commercial enterprise lied solely with the seafarer while the investor, which did not participate in the undertaking, only risked losing its invested capital. This allowed to seek funding from the 'bourgeoisie' or 'Nobility of the Robe' which did not otherwise partake in commercial activities.[49]

Under Luxembourg law, the underlying principle is that the partnership is formed by agreement between one or more limited partners ("*associés*

[47] M. Meyers, J. Mullmaier, M. Royer, *Private Equity*, Luxembourg Chapter, 3rd Ed., Sweet & Maxwell, 2018, p. 151.

[48] Elvinger Hoss, *Luxembourg Partnerships in the Asset Management Industry*, September 2019, p. 5.

[49] A. Steichen, *Précis de Droit des Sociétés*, 6 Ed, 2018 pp. 538-539.

commanditaires") who enjoy a passive role and contribute assets but do not participate in the management of the company, and one or more unlimited or general partners ("*associés commandités*") with general management powers.[50] Limited partners participate in the profits and losses, generally *pro rata* with their participation in the partnership and up to the amount of their commitment.[51] Thus, limited partners' liability is generally limited to the assets contributed in accordance with the provisions of the Limited Partnership Agreement ("LPA") or "*contrat social*", so they may not be held liable for the losses of the company. General partners, however, bear unlimited joint and several liability for all obligations of the partnership.

Such legal forms allow fund initiators to structure the acquisition vehicle by using common-law partnership concepts which they are familiar with.[52] However, while Anglo-Saxon partnerships models were most favored in the asset management industry for the structuring of a number of international transactions in the fields of private equity, real estate and venture capital,[53] their Luxembourg equivalents, introduced by the Law of 10 August 1915 on commercial companies (the "Company Law"), were rarely used. The uncertainty resulting from the lack of regulations harmed the robustness of the structures put in place despite the strong degree of contractual freedom characterizing these legal forms.[54]

Faced with the necessity to adjust its offering to fund initiators, the Luxembourg legislator took the opportunity of the transposition of the AIFMD into national law in 2013 to revisit and modernize certain laws governing Luxembourg investment vehicles, including the SCS regime. This resulted in the amendment of the law of 10 August 1915 on Commercial Companies (the "Company Law") and addition of the Special Limited Partnership ("SLP") ("*Société en Commandite Spéciale*" or "SCSp") to Luxembourg's arsenal of onshore legal solutions for the alternative

---

50 Articles 320-3 of the Company Law.

51 M. Meyers, J. Mullmaier, M. Royer, Private Equity, Luxembourg Chapter, 3rd Ed., Sweet & Maxwell, 2018, p. 153.

52 M. Meyers, J. Mullmaier, M. Royer, Private Equity, Luxembourg Chapter, 3rd Ed., Sweet & Maxwell, 2018, p. 153.

53 K. Panichi, L. Schummer, O. Gaston-Braud, *Les sociétés en commandite luxembourgeoises : des véhicules d'investissement adaptés aux besoins des investisseurs*, Droit Bancaire et Financier au Luxembourg, Vol. III, 2014, p. 1593.

54 K. Panichi, L. Schummer, O. Gaston-Braud, *Les sociétés en commandite luxembourgeoises : des véhicules d'investissement adaptés aux besoins des investisseurs*, Droit Bancaire et Financier au Luxembourg, Vol. III, 2014, p. 1566.

investment management industry.[55] Since 2013, SCSps have become the vehicle of choice for PERE and the vast majority of unregulated funds in Luxembourg are set up as SCSps.

Unlike most other corporate forms, they do not have a distinct legal personality.[56] This does not however prevent SCSps from having a domicile,[57] act in their own name and through their management, and be dissolved and liquidated as if they had a distinct legal personality.[58] Despite SCSps' lack of a distinct legal personality, the registration of assets pooled within the company is made in its name, rather than in the name of the limited partners or general partners.[59] Further, partners' creditors have no right over the assets pooled within the SCSps which shall only satisfy the creditors of the company.[60]

In order to submit an SCSp to Luxembourg law, it is enough for it to have its central administration (head office) in Luxembourg, even if its constitutive instrument has been executed in a foreign jurisdiction.[61] Despite portfolio management being often delegated outside Luxembourg, managers must however ensure that a sufficient number of management tasks are performed and decisions are made in Luxembourg so that the head office of the SCSp is deemed in Luxembourg.[62]

Besides the possibility to combine the financing and the know-how in the hands of distinct partners, which generally makes limited partnership structures a natural match for TPF activities, a number of attributes make Luxembourg SCSps a legal form of choice for funders looking to set up a SIF or RAIF in Luxembourg.

First, as discussed supra, establishing a budget to finance a dispute is not an exact science and naturally includes imprecisions since all developments and procedural incidents may not be anticipated. This may

55 Article 320-1(1) of the Company Law defines a SCSp as "a *company established by contract, for a limited or unlimited period, by one or more general partners with unlimited and joint and several liability for the obligations of the company and one or more limited partners who only contribute a specific share of capital which constitute their interests, whether or not represented by way of securities, as specified in the partnership agreement*."

56 Article 320-1(2) of the Company Law.

57 The domicile of the SCSp is the place of its central administration as provided by Article 320-1(7) of the Company Law.

58 A. Steichen, *Précis de Droit des Sociétés*, 6 Ed, 2018 pp. 539-540.

59 Article 320-2(1) of the Company Law.

60 Article 320-2(2) of the Company Law.

61 Articles 320-1(7) and 1300-2 of the Company Law.

62 Elvinger Hoss, *Luxembourg Partnerships in the Asset Management Industry*, September 2019, p. 12.

require the parties to the LFA to return to the drawing board and agree to more funding during the proceedings. SCSps' capital account mechanisms, pursuant to which each limited partner has an account reflecting his contribution in the partnership which it may adjust over time to reflect its participation to profits and losses of the partnership,[63] may thus fit the needs of certain forms of TPF.

Second, when introducing the SCSps, the Luxembourg legislator placed a clear emphasis on contractual freedom. This allows partners to enjoy the liberty and flexibility to structure and tailor the terms and conditions governing the partnership to their needs in the LPA, while few mandatory rules apply.[64] When providing for the organization and functioning of a SCSp dedicated to third party funding, contributors of funds appreciate the option to determine and organize, in the LPA, the conditions and timing of the distribution of profits and of the capital invested[65] – since SCSp are not required to maintain a minimum share capital.[66] This is a fundamental distinction with Anglo-Saxon partnerships models as section 4(3) of the UK Limited Partnerships Act 1907 provides that a limited partner shall not, during the continuance of the partnership, draw out or receive back any part of his contribution.[67] The partnerships laws of competing jurisdictions (e.g. Guernsey, Jersey, Delaware and Cayman Islands) do not offer such flexibility and provide a number of restrictions and limitations on the distributions and repayments of the limited partners' contributions.[68]

---

[63] M. Meyers, J. Mullmaier, M. Royer, *Private Equity*, Luxembourg Chapter, 3rd Ed., Sweet & Maxwell, 2018, p. 153.

[64] For example, partners may freely determine in the LPA whether the contributions shall be in kind, cash or services, decide on the conditions of admission of new partners and increase in capital commitment, derogate from the principle that each partner's voting rights shall be in proportion to his partnership interests, decide on the formalities and conditions for passing resolutions, how the partnership interests of limited partners may be transferred, dismembered or pledged, etc. See Articles 320-1(3), 320-6 and 320-7 of the Company Law.

[65] Article 320-5 of the Company Law.

[66] K. Panichi, L. Schummer, O. Gaston-Braud, *Les sociétés en commandite luxembourgeoises : des véhicules d'investissement adaptés aux besoins des investisseurs*, Droit Bancaire et Financier au Luxembourg, Vol. III, 2014, pp. 1565-1567.

[67] The full text of Section 4(3) of the Limited Partnerships Act 1907 (UK) provides that "*a limited partner shall not during the continuance of the partnership, either directly or indirectly, draw out or receive back any part of his contribution, and if he does so draw out or receive back any such part shall be liable for the debts and obligations of the firm up to the amount so drawn out or received back.*"

[68] See Section 21 of the Limited Partnerships (Guernsey) Law 1995, Section 17 of the Limited Partnerships (Jersey) Law 1994, Sub-Chapter 17-607 of the Delaware Revised

Third, unlike the UK Limited Partnerships Act 1907, the Luxembourg Company Law provides for a number of 'safe harbour activities' which do not constitute acts of management and which limited partners may engage in without compromising their limited liability status. This include the provision of advice to general partners and the supervision of their activities.[69] Where limited partners seeking to invest in disputes are professional and institutional investors particularly experienced in the TPF industry, SCSps offers them the option to retain an investment advisory role while enjoying a significant level of protection, as compared to UK partnerships which suffer a considerable competitive disadvantage in this regard.

IV. Conclusion

To this day, the TPF activity remains somewhat controversial as the specifics of the business remain mostly misunderstood. Further, most third-party funders' use of unregulated structures based in tax heavens or similarly accommodating jurisdictions, to avoid (seemingly unnecessary) externally-imposed constraints, exacerbates this perception and increases the chances of attacks.

For example, in 2019, a US hedge fund accused a world leading funder, Guernsey-based and listed on London Stock Exchange's AIM Market, of allegedly manipulating its return on invested capital and internal rate of return to misrepresent returns to investors in its annual reports.[70] Further to the allegations, the funder provided details of the financing structure and the evolution of its investment overtime in the case concerned. This led it to disclose information which, in the interests of the litigants, should have likely remained private.

Accusations concerning a funder's reporting to its investors raise a number of issues including whether the lenient corporate governance rules and light regulatory burden and disclosure regime of the AIM Stock Market are suitable for a multi-billion market cap fast-growing funder, concerns over the choice of corporate structures, accounting methods and the esoteric nature of the TPF business. While abiding by the strictest disclosure regime and

---

Uniform Limited Partnership Act and Section 14(1) of the Exempted Limited Partnership Law (2012 Revision).

69 Article 320-4 of the Company Law.

70 We advise caution in taking position on the merits of these allegations as the hedge fund was likely not privy to the terms of the LFA between the funder and the litigant. We also draw the reader's attention to the difficulty of determining whether a case shall be marketed as a "win" or as a "loss" in one's financial reports as the results of a dispute are rarely so black and white.

regulations may not address all of these concerns, our opinion is that avoiding offshore unregulated structures and submitting to EU regulations may dispel the opacity that characterizes many funders' activities and reduce the occurrence of such incidents.

Certain funders have it in their DNA to comply *ab initio* with heavy regulations and transparency requirements. This is the case of Profile Investment which chose to submit its (SICAV - SIF) funds to the stringent financial regulations of the Grand Duchy of Luxembourg – the second largest asset management administration centre worldwide. The impressive choice of investment vehicles made available by Luxembourg law further strengthened Luxembourg's long-established reputation for outstanding international financial services and investor protection and security. However, some of these corporate structures may pay the price of their success. For example, the unexpected success of AIFs in the post financial crisis era and the several layers of CSSF approvals may put the Luxembourg regulator's usual accessibility and responsiveness to the test, and may lead to unmanageable timeframes and, *in fine*, to jeopardizing the timely launch of some investment vehicles. Despite these challenges, Luxembourg remains ideally positioned to provide a highly suitable regulatory framework for TPF structures, adapt and respond swiftly to any upcoming concerns and requirements from governments, arbitral institutions and arbitrators.

Profile Investment's decision to have its investment vehicle and management company regulated by the CSSF in Luxembourg may have burdensome implications but is well-thought out and strategically beneficial. It also provides all stakeholders involved in disputes financed by Profile Investment with a high degree of security concerning the availability, origin and transparency of the capitals and the efficiency of the gatekeeping supervisory process.[71] We cannot sufficiently stress the importance of these factors which *must* govern any injection of capitals in one's dispute for the benefit of third-party. Indeed, contributing instruments of soft law, establishing best practices to the dispute resolution ecosystem and promoting sophisticated (Singapore-like) legal and regulatory landscape are only one side of the coin which funders often unfortunately satisfy themselves with. Litigants, investors, the public at large but also funders themselves will remain at risk until they fully embrace the need to submit their corporate structure to a strict and unforgiving regulator.

---

71 Entering 2020, Luxembourg had over EUR 4.7 trillion of net assets under management in investment funds, ALFI, available at https://www.alfi.lu/Alfi/media/Statistics/Luxembourg/ouverture_section_statistique_chiffres_du_mois.pdf, accessed on 19 March 2020.

Olivier MARQUAIS, Alain GREC, *Investment Management and Corporate Structuring Considerations for Third-Party Litigation Funders in Luxembourg*

Summary

In the context of investing in Third-Party Funding structures, providing adequate investor protection, transparency as to the origin of the funds and addressing anti-money laundering and terrorism financing considerations, require submitting a funder's investment strategy, processes, risk management and policies to appropriate regulations. Such concerns may only be addressed if the right choices are made at the moment of determining the funder's investment management strategy and of setting up its corporate structure.

The Grand Duchy of Luxembourg positioned itself early on as the first EU jurisdiction to adapt to the evolution of EU legislation in a business-friendly manner, while successfully competing with offshore jurisdictions' efficiency. Following the 2007-2011 global financial crisis, the regulatory wave aiming at protecting investors gave Luxembourg further opportunities to widen its offering to fund initiators. This includes creating a highly successful and favourable regulatory environment, including investment vehicles and legal system, for Private Equity/Real Estate investments.

From a financial and asset management point of view, the assessment of litigation/arbitration cases, the selection process, the asset's behaviour during its lifetime and the risk management process of financing disputes bear many fundamental similarities with traditional Private Equity investments.

Depending on the corporate form and investment vehicle chosen, Specialized Investment Funds and Reserved Alternative Investment Funds can offer the mix of flexibility and compliance required by funders and their investors. Further, Luxembourg's most recent limited partnership structure, the Special Limited Partnership, provides significant competitive advantages as compared to offshore structures, offers a number of attributes addressing specifically funders' and investors' concerns and may become the vehicle of choice to conduct Third-Party Funding activities globally.

Submission of Manuscripts

Manuscripts and related correspondence should be sent to the Editor. At the time the manuscript is submitted, written assurance must be given that the article has not been published, submitted, or accepted elsewhere. The author will be notified of acceptance, rejection or need for revision within eight to twelve weeks. Manuscripts may be drafted in German, French, Italian or English. They should be submitted by e-mail to the Editor **(mscherer@lalive.ch)** and may range from 3,000 to 8,000 words, together with a summary of the contents in English language (max. ½ page). The author should submit biographical data, including his or her current affiliation.

Aims & Scope

Switzerland is generally regarded as one of the World's leading place for arbitration proceedings. The membership of the Swiss Arbitration Association (ASA) is graced by many of the world's best-known arbitration practitioners. The Statistical Report of the International Chamber of Commerce (ICC) has repeatedly ranked Switzerland first for place of arbitration, origin of arbitrators and applicable law.

The ASA Bulletin is the official quarterly journal of this prestigious association. Since its inception in 1983 the Bulletin has carved a unique niche with its focus on arbitration case law and practice worldwide as well as its judicious selection of scholarly and practical writing in the field. Its regular contents include:

– Articles
– Leading cases of the Swiss Federal Supreme Court
– Leading cases of other Swiss Courts
– Selected landmark cases from foreign jurisdictions worldwide
– Arbitral awards and orders under various auspices including the ICC and the Swiss Chambers of Commerce ("Swiss Rules")
– Notices of publications and reviews

Each case and article is usually published in its original language with a comprehensive head note in English, French and German.

Books and Journals for Review

Books related to the topics discussed in the Bulletin may be sent for review to the Editor in Chief **(Matthias SCHERER, LALIVE, P.O.Box 6569, 1211 Geneva 6, Switzerland).**