

“Third Party Funders: game-changers or business as usual?”

**A LITTLE BIT OF BOTH WORLDS. IS THERE A NEED OF MORE
TRANSPARENCY IN THIRD-PARTY FUNDING? SOME COMMENTS FROM
A LATIN AMERICAN PERSPECTIVE**

by Rodrigo Garcia da Fonseca *

The general theme of this Newsletter poses an intriguing and important question. As third-party funding grows all around the world, does it mean the international arbitration (and litigation) game is changing, or is it simply business as usual? In this short piece, I will contend it is a little bit of both, and therefore, some practices and habits will have to cautiously evolve over time so that they remain up to date and are able to preserve the efficacy and the ethics of international dispute resolution procedures.

For someone who has never thought about it, the idea of funding someone else's litigation or arbitration sounds strange at first. But it should not be so. As a matter of fact, third parties have funded litigants in various ways, for a long time, everywhere, and it has never been seen as something strange or questionable.

In the context of ordinary business, sometimes a company or a person will take an assignment of certain rights or credits that are subject to litigation/arbitration. It may be an opportunity it saw, or it may be the assignor owes money to the assignee, and settles through the assignment. However, because of civil procedure rules, or for convenience, the assignee may not substitute the assignor in the litigation/arbitration, but will instead take charge and control of the case, paying for its costs and receiving its proceeds.

Sometimes the funder may actually be unaware of what it is exactly he/she is funding, because there will be no direct link to an existing dispute. A party simply borrows money from a bank and uses it to pay lawyers, experts and other costs of litigating/arbitrating a claim. Or sometimes the bank does know where the money it lent is going and takes an interest in the claim for security. These are types of third-party

funding that have been around for quite a while, and no one has ever thought they were strange.¹

And what about insurance companies? It is a long standing practice in the insurance industry that insurance policies have clauses allowing the insurer to step in and control the litigation when a covered claim is filed against the insured. The insured will be the defendant on the record, but the insurer will choose the lawyer, the tactics and pay for the costs. It has been noted that in such circumstances, which are fairly ordinary, the position of the insurance company is much like that of professional third-party funders.²

What makes today's trend of third-party funding different, then? Why do people see it as a strange animal that needs to be tamed and subject to special regulations? The truth is that there is indeed a fundamental difference between the other kinds of third-party funding that I mentioned before and today's growing industry. And it is exactly this: that it has become an industry. It is a new line of business per se. The third-party funders that everybody is talking about these days are exactly this: funders. They are professionals of funding disputes, and they have deep pockets and a wealth of expertise in choosing which claims to go after.³

When one looks at the one-off assignee, at the bank, or at the insurance company, these entities are not in the business of funding arbitrations or litigations. They do fund them, but it is done as a by-product of another line of business, the business of lending money or of issuing insurance policies, for example.

¹ I have purposefully omitted the lawyer who works on the basis of a contingency fee only and carries the expenses of litigation for the client. This is indeed strange and even illegal in some jurisdictions, albeit accepted in others.

² Louis Degos, "Assurance, subrogation, protection juridique", in "*L'argent dans l'arbitrage*", Walid Ben Hamida, Thomas Clay (org.), Lextenso Éditions, 2013, p. 171.

³ One of the largest third-party funders in market, for example, Burford Capital, is publicly traded and recently announced overall currently outstanding commitments of US\$ 281 million, and profits of more than US\$ 16 million, after tax, in its 2014 interim report (see <http://www.burfordcapital.com/wp-content/uploads/2014/09/Burford-Capital-Interim-2014-Web.pdf>, p. 2). It is a big business, and it is undeniable that third-party funders have become very sophisticated professionals. They accept only a fraction of the cases presented to them, and make extensive and expensive analysis of the claims before jumping on board. According to one author, only about 10% of the cases end up being funded, and they go through a due diligence and vetting process that can take up to 3 months and cost US\$ 100,000 each (Clifford J. Hendel. "Third Party Funding", in *Revista del Club Español del Arbitraje*, Wolters Kluwer España, n. 9/2010, p. 77). Funders use some of the most renowned experts in the international dispute resolution community as consultants, to give opinions about the viability and the value of the claims they consider funding (see, for example, a recent piece in the internet newsletter GAR News, "Hanotiau to advise third-party funder", by Douglas Thompson, 06 October 2014).

The insurer funds a party to mitigate its loss, not to make money, and it does not choose which case to fund, the case falls upon it. Modern professional third-party funders, on the contrary, get in the game to make money in the litigation/arbitration. They study potential and existing claims to choose where and when to better allocate their resources; and, according to some, they may even instigate parties to file claims that potentially might otherwise not be filed at all.

In a world and in times where the so-called Vulture Funds can create so many problems for a country as large as Argentina, leading it to default payments of its renegotiated sovereign debt, third-party funders have suddenly become a very scary bunch, particularly in the investment arbitration scene.⁴

Funders allege that they are generally doing a good thing, because they provide access to justice, they open the doors of courts and arbitral tribunals to parties that have serious claims, but do not have the financial capacity to prosecute them. They are not in this business to be benefactors, but they do have a fair point. On the other hand, they might also stimulate the filing of some frivolous claims that should not really be filed; or make the cases more expensive, in the hope the other party blinks and settles. To make matters worse, if the funded party is financially weak, the other party may not be able to recover its costs and expenses for successfully defending a claim, whether frivolous or not.⁵

This scenario brings up the crucial issue of transparency. Do parties in litigation/arbitration need to disclose they are being funded by professional funders? If these funders are paying for the prosecution of the case and have a financial interest in the end result, should counsel and decision-makers not be aware of it? How can they

⁴ Vulture funds usually buy claims for a large discount and prosecute them in their own name. It is a different approach from that of third-party funders. George Affaki, “A financing is a financing is a financing...”, in *Third-party Funding in International Arbitration*, Bernardo Cremades, Antonias Dimolitsa (editors), International Chamber of Commerce, 2013, p. 11. However, there are obvious points of contact and similarities, as these are all professionals investing in other people’s claims. The boom in investment arbitration claims in Latin America over the last years, involving countries such as Argentina, Venezuela, Bolivia and Ecuador, plus the litigation of Vulture funds against Argentina in the courts of New York have recently raised a lot of eyebrows around Latin America and other parts of the world.

⁵ A recent ICSID case, *RSM Production Corporation v. Saint Lucia*, made many headlines a few months ago when the arbitral tribunal issued a majority decision ordering the claimant to post security for costs because it was prosecuting the case with third-party funding.

know that there may be a conflict of interest if they do not know the funder participates in the case? But if they do not know, does it really matter? Would the conflict not be simply theoretical?⁶ These questions are not easy to answer. These issues are not black and white at all, they have many more than fifty shades of grey.

What if we come to the conclusion that the presence and identity of the funder must be disclosed, but the funding agreement has a confidentiality clause? Is it enforceable against the other party, counsel and judges/arbitrators? What should be the extent of the disclosure? Does mandatory disclosure of the funding agreement give the other side an advantage?⁷

Another question that is seldom discussed relates to the confidentiality of the arbitration proceeding. If the arbitration is confidential because of the applicable institutional rules, or because the underlying agreement has a confidentiality clause, is the funding agreement in itself illegal? It is obvious that the funder will have had access to information about the case in breach of the funded party's confidentiality obligation. And if it is illegal, what is the consequence?

This is all fairly new to the international dispute resolution community. No one has undisputed answers to all these questions.

At least when it comes to international arbitration, there is a current widespread feeling that more transparency may be needed. We read articles about transparency, and we see frequent discussions on this topic in seminars and conferences everywhere. Transparency is currently a hot topic, and although confidentiality is still important, and is still seen by many as an advantage of arbitration over litigation, it clearly does not carry the same weight and prestige it had years ago.

⁶ Some authors make the point that this may be in practice a false problem; third-party funders are very cautious not to cause any conflicts of interest, because they do not want to put the awards or judgments they are investing in at risk. For example: Hamid G. Gharavi. *Le Financement par un tiers*, in "*L'argent dans l'arbitrage*", cit., p. 35.

⁷ Some authors contend full disclosure may be unfair, because the funding agreement contains sensitive financial information about the party and the claim, that could, for example, enable the other side to know or predict the funded party's settlement value. Laurent Lévy, Régis Bonnan, "Third-party funding: Disclosure, joinder and impact on arbitral proceedings", in "*Third-party Funding in International Arbitration*", cit., p. 79.

Court litigation has traditionally been more open than arbitration. There is less secrecy, and therefore transparency is much less of an issue. The rise of investment arbitration over the last decades, however, and the existence of billionaire claims that can seriously affect the financial health of whole economies, has created a need for more transparency in the system, a transparency without which it loses credibility and legitimacy, and is ultimately put at risk. If users are not satisfied with the system, they will try something different.⁸ Considering that arbitrators and counsel in investment cases tend, to a certain extent, to be the same people that act in international commercial arbitration cases, this unease with the lack of transparency has been carried over the purely commercial side of the aisle.

I believe that over the next years we will all continue to see a growing call towards more transparency in international dispute resolution mechanisms. After all, as Justice Louis Brandeis of the US Supreme Court stated many years ago, “sunlight is said to be the best of disinfectants”. It was true then, it is still true now. If people are uncomfortable with the current situation, there will be a push towards some kind of change.

In the wake of this transparency trend, we will probably see, in the years to come, more institutional rules and certain guidelines, codes of conduct or other soft law determining or suggesting the disclosure of third-party funding arrangements, or at least the fact of their existence. Whether this will make the market better, will level the playing field in a more ethical way, it is probably too early to tell. It is hard to see the future without a reliable crystal ball. But the issues that are being raised in the debate about the need of more disclosures are real and serious issues that cannot be ignored.

What one can say for sure is that third-party funding has come to stay, because the funders are finding ways to make money, and they will not give up the promising business opportunities they are seeing. International dispute resolution will have to

⁸ Bolivia, Venezuela and Ecuador have all recently pulled out of investment arbitration treaties to different degrees, and there is a lot of criticism in Latin America that the current state of affairs in investment arbitration may be unfair and biased in favor of claimants. Brazil is not part of ICSID and has not ratified any BITs. Considering that so many neighbors are complaining about the system, it is unlikely Brazil will change its position in the near future. Whether or not the critics are right is a matter of opinion, but they are undoubtedly being heard by many.

acknowledge the existence of these new kids on the block, and will have to adapt and evolve one way or another.

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