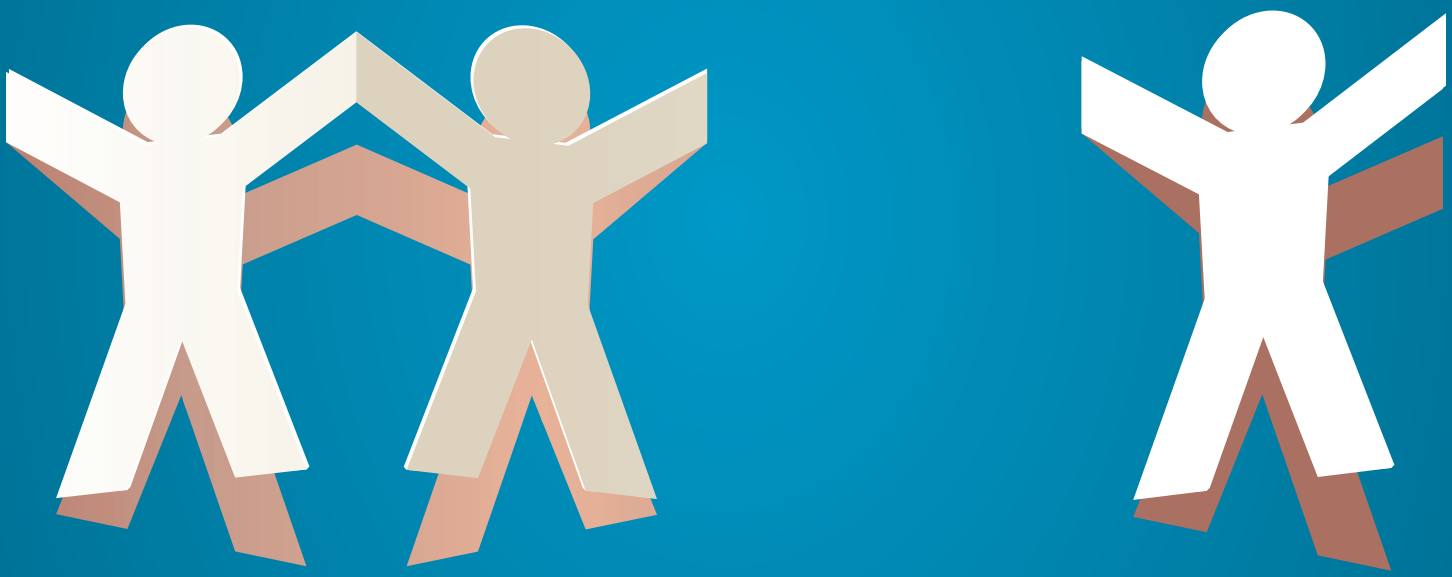
Interested third party



The growth of arbitration as a means to settle disputes in Latin America presents an opportunity for third-party funding to thrive, resulting in greater access to justice, particularly for cash-strapped claimants. But teaming up with a third-party financier can also raise novel concerns that must be considered at the outset. Zachary Krug, senior investment officer at Woodsford Litigation Funding in London, and Leonardo Viveiros, chief legal officer at Brazil's Leste Litigation Finance, present the pros and cons

Once only found in the US, the UK and Australia, litigation and arbitration funding is becoming more commonplace across the world, including in Latin America. Within the past few years there has been a rapid expansion in its use, particularly in connection with international disputes. There are few rules related to third-party funding in Latin America, but the region's civil law codes permit the alienation of litigation rights.

The rapid growth of international arbitration across the region provides third-party funders with a growing market. There are several advantages for both lawyer and claimant too. Rather than an individual or corporation paying the costs out-of-pocket (which can be substantial) or a lawyer proceeding on contingency (which many firms cannot accommodate), a commercial litigation funder finances the cost of the proceedings in return for a share of the award. Because this funding is typically non-recourse, if the claim is lost, the claimant is not liable to repay the financier's investment.

Fundamentally, third-party funding (commonly called litigation funding) facilitates access to justice. Capital-constrained claimants who might not otherwise have the resources to prosecute their claims (often as a direct result of the defendant's wrongful conduct) are given the opportunity to have their day in court.

Even if a claimant does have the resources to fund a dispute, litigation funding offers the advantage of allowing it to hedge some of its risks, while maintaining a healthy share of an award. As such, litigation funding may be the only capital source available to allow a meritorious claim to be heard or to help a business maintain its operations during the pendency of a legal dispute.

For in-house counsel, litigation finance can be particularly attractive, as it allows them to manage their legal budget, while unlocking the value of potential litigation claims. Some litigation funders are even staffed with experienced litigators, so can provide a valuable resource to claimants and their lawyers.

Litigation funding can sometimes lead to better settlement outcomes. A claimant who knows they have the resources to fully prosecute a dispute will be in a more advantageous position for settlement and will not be forced to accept lowball offers. The very fact that a litigation funder has backed a claimant's position sends a powerful signal to the defendant and the court that a third-party believes strongly enough in the merits of the underlying claim to put their own capital at risk.

Uncharted territory

But litigation funding also raises some potential issues, which claimants and lawyers should seek to understand before entering into any transaction.

One issue to consider is that third-party funding is still developing globally and it remains a relatively unexplored practice in Latin America, meaning there may be few precedents or affirmative regulations in the region.

There are also several common concerns about litigation funding. One question lawyers frequently ask is whether sharing information with third-party funders poses a risk to claimants' privileged information. For a litigation funder to assess the merits of a case, the funder will often need access to materials containing privileged material or a lawyer's legal analysis. Because the litigation funder is an outside party, there is a concern that such communications could waive a claimant's right to keep some information privileged and undisclosed to the opposing party.

While most tribunals around the world that have considered the issue have concluded that a claimant's communications with a funder are indeed privileged, before engaging in any substantive discussions with an outside funding entity a lawyer or claimant should execute a non-disclosure agreement (NDA) with the funder. The NDA is important to ensure that communications subject to privilege remain protected and should be the first step in any transaction.

Another potential issue relates to control of the litigation and the role that a funder may have over strategy and settlement. In most cases, litigation funders play a largely passive or advisory role, and they do not control the litigation or arbitration. Decisions regarding the litigation strategy and potential settlement remain firmly in the hands of the lawyer and claimant.

Under many common law jurisdictions there are restrictions on the role third-party funders can play and as such, litigation funding agreements in those jurisdictions often contain express language that a funder does not control the litigation. These restrictions are not present in civil law jurisdictions, so in Latin America there may be some circumstances where litigation funders take a more active role and could prosecute some claims directly. For that reason, claimants, lawyers and funders should make sure that the litigation funding agreement defines their roles clearly at the outset.

Another concern is cost. Litigation finance can be expensive. Typically, a litigation funder will receive between a three to five times multiple of their investment or a share of the damages in the range of 20 to 40%. This is because, unlike most forms of traditional lending, litigation finance is non-recourse, and therefore has substantially greater risk to the litigation funder.

In the context of arbitration, another concern relates to conflicts of interest, particularly where an arbiter may have some connection with a litigation funder. For example, if the arbiter is also a practising lawyer or associated with a larger firm, the litigation funder may have funded matters being handled by the firm.

The issue of potential conflicts is not unique to funding and there are well-established ways of ameliorating such concerns. The trend in many jurisdictions is to require disclosure of a party's funded status, so that any potential conflicts may be resolved at the outset. From a funder's perspective, such disclosure can be positive, as it signals to the courts and defendants that a third-party believes in the merits of the claim.

Where there is demand

Latin America's international and domestic arbitration market looks set to continue expanding.

Zachary Krug

In response to the ever larger Latin American arbitration market, the International Chamber of Commerce (ICC) recently celebrated the opening of a branch in São Paulo (its fourth overseas station). In 2016, the ICC saw a 15% increase in the number of Latin American parties, with Brazil and Mexico among the top five nationalities globally. Before that, the number of ICC disputes involving Latin American parties increased by 131% between 2005 and 2015 and the number of arbitrations seated in Latin America increased by 230%. Latin American countries also account for a healthy share of parties in investor-state arbitration.

The logical extension of this is that the region is likely to see more third-party funding, since it has become commonplace in the international arbitration landscape.

Third-party funding in domestic arbitration will likely follow. In many Latin American countries, sophisticated parties already prefer disputes to be resolved through arbitration. A leading arbitration centre in Brazil, the CAM-CCBC, recently issued guidelines recommending parties report the existence of third-party funding and outlining a procedure for conducting potential conflicts checks to ensure an arbiter's impartiality. The provision of clear guidance makes Brazil relatively more attractive to claimants and funders as a venue for disputes.

But, for now at least, third-party funding is less of an obvious fit for domestic litigation. Funding domestic litigation often requires a deep understanding of a particular jurisdiction's legal system and of the unique characteristics of its local judicial and political structure – which a foreign funder may not have. Investments require substantial local expertise for due diligence, which foreign funders, again, might not have.

In turn, funders may be more interested in investing in arbitrations than litigations. Many of the highest value disputes are decided in arbitration, meaning domestic litigation offers funders a lower return on their investment.

Litigation funding could come to play domestically through the enforcement of domestic judgments abroad, but locally based litigation funders may still be better suited to address the domestic litigation market than their foreign counterparts.

Third-party funding can be a powerful tool for claimants, but raises some unique concerns – particularly, how much control funders can exercise over the direction of a claim and the protection of information shared under lawyer-client privilege. But if these concerns are addressed at the outset, and parties work with established and professional litigation funders, third-party funding can serve as a powerful tool for providing greater access to justice to those with meritorious claims, particularly those unable to fund a costly claim alone.