THIRD PARTY FUNDING: FIEND OR FRIEND

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Absztrakt

HARMADIK FÉLTŐL SZÁRMAZÓ FINANSZÍROZÁS: ÖRDÖG VAGY BARÁT

A third party funding (TPF) a common law jogcsaládban jött létre, ami nem mást jelent, mint az eljárási költségek harmadik fél általi finanszírozásának konstrukciója, természetesen, összhangban a piacgazdaság követelményeivel megoldást ajánl a problémára. A TPF térhódítása érezhető a kontinentális jog rendszerébe tagozódó országok tekintetében is, habár, hogy a normatív szabályozása még nem alakult ki, illetve alakulóban van, így jelenleg a TPF-megállapodások Európa-szerte jogi reguláció és kontroll nélkül kerülnek megkötésre. Ez visszaélésekre, tisztességtelen feltételek alkalmazására adhatnak „esélyt" a perfinanszírozók számára.

Kulcsszavak: választott bírósági eljárás, third party funding, eljárási költségek finanszírozása, harmadik fél

Diszciplínák: jogtudomány

Abstract

The third party funding rooted in common law - which permits that a third party finances the expenditures of the litigant - offers resolution to this dilemma consistent with the requirements of the market economy. These days one can realize that TPF is gaining more and more significance, even in civil law countries; even though its normative regulation has not yet been established or at least, it is being formed. Thus, TPF agreements are concluded with no (or insignificant) regulations and control across Europe, which might give way to abuse and application of unfair/unjust terms for litigation financiers/investors.

Keywords: arbitration procedure, third party funding, financing legal costs and general legal expenses, third party

Disciplines: legal studies

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The „idea" of third party funding is not a novelty at all. Initially, it was intended to aid companies that could not have the resources to pursue claims. But later it turned out to be an element with an even broader use. Its use has extended, and many scholars, including, for example, Maya Steinitz, have described it as a novel industry (with huge financial potentials), she claims that third party litigation funding can be described as "a new industry composed of institutional investors who invest in litigation by providing finance in return for a stake in a legal claim and a contingency in the recovery." (Steinitz, 2011). Some changes have been identified by other scholars going as far as to vision the so-called "second wave" lawsuit funding (by major banks and insurance companies joined forces with smaller boutique firms – Gaukrodger and Gordon, 2012). and it has also paved the way to more publicity as well. (See, for instance: NET2). One can state that third party funding turned out to be a characteristic of the litigation in many jurisdiction. Also, funders take a look at international arbitration, mesmerized and attracted by the valuable claims, supposed finality of awards, and, of course, the enforcement regime made available by the New York Convention. It can also be observed that the last couple of years have witnessed a significant increase in funding activity, originally, with a focus on investor-state arbitration, but now it has been broadening to commercial arbitration.

Though, unlike in national proceedings where disputes are settled by court appointed judges, the use of third party funding in private arbitration, with party-appointed arbitrators, has brought up many ethical and procedural issues and concerns. Whatever the values or nuisances of the Third Party Funding in commercial and/or in civil litigation, this study does not intent to take position on, it merely highlights some crucial points to consider.

According to the International Council for Commercial Arbitration, Third-Party funding is the participation of an entity without prior interest in the legal dispute, providing financial aid to one of the parties, generally the claimant, on a non-alternative basis in the case of a failed claim. The emergence of third-party funding can be credited to the rise in the practice of international arbitration, with the users insisting on novel ways to finance arbitral matters. The scope of international commercial arbitration has swiftly expanded in the last decade, demonstrated not only in disputes among commercial parties, but also in those between states and commercial parties and in state to state disputes. Nevertheless, even with the modernization of

international arbitration and third party funding, great number of questions remain unanswered concerning potential arbitrator conflict of interest, confidentiality, and privilege and costs issues.

Historical background and the global (legal) view on third party funding: a highlight

There is no doubt, the idea to interfere in other people's businesses and affairs, for financial or other reasons, is not a new phenomenon in legal history, neither in common law nor in civil law jurisdictions. Gian Marco Solas argues that "[m]aintenance and champerty doctrines in common law, and the prohibitions to enter into pacta de quota litis and redemptio litis in civil law, are today's symbols of the historical cultural aversion to the idea that third parties would engage in litigation, for profit or otherwise. There is evidence that litigation has been funded or otherwise maintained by non-parties at least since the ancient Greek and Roman times, although they seem to have been motivated more by sociopolitical reasons, rather than (or, at least, not only by) economic ones." (Solas, 2019). Historically, maintenance and champerty principles in common law and the prohibitions to take part in *pacta de quota litis* in civil law can be seen as symbols of the historical (legal) cultural hostility to the notion that third parties would be involved in legal actions for profit/acquisition or any other way. One can find evidence that legal actions have been funded or variously maintained by non-parties since Greek and Roman times, though we might add that they appear to have been driven by (mostly) socio-political reasons, but this does not exclude some economic reasons as well. In addition, of course, being profit oriented was central for upper (ruling) class members, too. With the dawn of Christianity, the overall picture of justice was altered, disputes were considered to be evil wholeheartedly, even though justified, or/and well-founded. All were seen as attempts to undermine equilibrium in society, therefore, these practices, as a kind of regulation, were forbidden and /or restricted. The Middle Ages brought some changes, for instance, in England interfering in lawsuits turned out to be a tool for wealthy landowner to carry war on each other. It is in this time period that hostility to the notion of funding or maintaining legal actions any other way reached its peak, but afterwards it vanished for the most part. After these periods the position of the judiciary changed, Solas Gian Marco argues that " [w]hen the judiciary became more independent and bound by the rule of law, some doubts about whether the prohibitions mentioned could not instead be a barrier to access to justice for impecunious claimants began to spread. However, it is only with the advent of the welfare state that the idea of funding other people's disputes to make them enforce legitimate rights started to gain ground. The lack of economic resources was soon recognised as a hurdle to accessing (and obtaining) justice, and legal aid became a fundamental pillar in all modern Western states' constitutions" (Solas, 2019, 17.).

Nowadays, there are many views on how to deal with this relatively novel economic situation, some countries; for instance, Hungary does not regulate it directly. However, one can state that third-party funding is not regulated in Hungary, but is legitimated through the general contractual regulations of the Hungarian Civil Code. The reason why is very simple, litigation funding does not seem widespread in Hungary. Third-party funding is theoretically probable, but in reality is not available on a commercial level, or, it is very rare. In many European civil legal systems the legal position on third party funding can be described by one word: prevention. As we have already mentioned it, other countries, where common law prevails, the third party funding was illegal and treated as a common law crime (for a long period of time). Basically, it can be divided into two cases: the torts of maintenance and champerty.

Tort of maintenance (when a person supports litigation without legitimate/lawful concern) and champerty (where the person maintaining another obtains a share of the gains from the litigation) can be reasoned historically by prevention of common exploitation, for instance, as we have summed it up, in Medieval times wealthy landowners funded legal actions to acquire land from weaker parties. Thus, in order to put a stop to this kind of abuse of the legal process, paying another person's legal costs and supporting litigation were considered to be "crimes" under common law. This preventive "strike" could prevent the funding of and trading in legal claims. Later on, most civil law countries have decide to eradicate the restrictions on third party funding, and currently several common law countries have made a decision to partly or fully repeal restrictions as well. (See, for example Huntley, Taylor, and Bradstock, 2010). (Sarkar, 2020). Contrary to the common practice of historical prohibition of third party funding nowadays the support of it is on the rise with a "message" to achieve greater "access to justice."

The concept of third party funding

The concept of a non-party to a dispute providing funding or resources/assets to a party involved in a dispute is not novel idea. Contingency fee arrangements, financial institution loans, corporate financing, before-the-event (BTE) litigation insurance (BTE litigation insurance is purchased before litigation arises, and covers the costs of that litigation. These costs often include fees of solicitors, barristers, and expert witnesses; court fines and fees; and any legal costs awarded to the other side. See Sapona, 2018), after-the-event (ATE) litigation insurance, (ATE litigation insurance protects individuals against their opponent's adverse costs and their own disbursements, should the case fail) and inter-corporate funding are all traditional methods by which a non-party provides funding or resources so that a party could pursue its claim or defence in a dispute. (Bogart, 2017a, 315. and Bogart, 2017b, see also von Goeler, 2016, 52–56.). The unique feature of "contemporary" (institutional) dispute funding is that such funding is

provided by an entity whose sole business is the financing of disputes. Thus, ultimately, traditional and modern funding represents different types of third-party funding (TPF) available to disputants. As we have already stated it, basically, it can be said that third party funding is where somebody who is not involved in arbitration grants funds to a party to that arbitration in exchange for a contracted return. Characteristically, the funding will cover the funded party's legal fees and expenses gained in the arbitration. The funder might also consent to pay the other side's costs and provide security for the opponent's costs if the funded party is so ordered. Since the use of third-party funding has got greater than before, so have the number and range of institutions that are ready to be involved in financing lawsuit and arbitration. There are a great number of "players" can be identified, besides specialised third party funders, for example, insurance companies, banks, especially investment banks, hedge funds and law firms have entered. As the market (and the demand) has grown, the range and sophistication of funding products and structures available has become wider and this tendency has not stopped yet.

Still, there are some difficulties identified by scholars, such as, Maxi C Scherer states that "[t]he exact definition of third party funding, however, remains elusive and its legal and ethical implications in international arbitration, mostly unexplored." (Scherer, 2013, 95.). Thus, it seems that no consensus has been reached so far on how this novel economic activity is supposed to be valued or understood.

There is no doubt, third party funding, or "litigation finance" has developed, and its "evolution" seems unstoppable. In addition to this, funding one-off cases, litigation finance is being used for a wider range of purposes, with the proceeds of the litigation or arbitration being used as collateral. One can also see another tendency, the current trend is the increase of portfolio funding, and where funders provide a funding package that covers a portfolio of cases. Put it differently, "third-party funding is an arrangement where an entity with no prior interest in the merits of a dispute provides funding to a party involved in the dispute. Traditionally, this funding was specifically to assist the party to the dispute by financing its legal fees and costs and could be obtained in a number of ways, such as through insurance or loans from financial institutions" (Howie and Moysa, 2019). There are simplified though more critical versions of definition of third party funding, for instance, Victoria Shannon Shani states that "third-party funding is a controversial business arrangement whereby an outside entity—called a third-party funder—finances the legal representation of a party involved in litigation or arbitration or finances a law firm's portfolio of cases in return for a profit." (Sahani, 2017, 405.). Also, Catherine A. Rogers argue that "[c]onventional definitions are limited to agreements entered into after a dispute has arisen, but they can be entered into either before or after the case is filed. Moreover, many funding arrangements are not

necessarily entered into between the principal funder and the party" (Rogers, 2014a, 184.). There is also a tendency when "[...]funders frequently create separate corporate structures from the funders themselves to facilitate the funding arrangement. In some situations, funders may provide financing directly to law firms. In addition to variations in structure, the conditions for funding and for recovery by a third-party funder also vary significantly. A typical agreement provides for funders to receive a percentage of recovery, and the percentage increases with the passage of time since the initial investment." (Rogers, 2014a, 184.). If one considers the nature of this "relationship", it cannot be easily simplified as a bilateral one. Though, it might be seen as a "symbiotic relationship" between a client, the funder and the party's law firm. (Nieuwveld and Sahani, 2017, 13.). Other scholars, such as, Anthony J. Sebok and W. Bradley Wendel, view this issue merely as a relationship between the investor and the funded client. (Sebok, and Wendel, 2013, 1831.). One of the obvious reasons why it is challenging to define third party funding is that it is a (relatively) new emerging economic activity facing diverse views/judgements and critics. Also, Omar Puertas Álvarez, Carlos Ara Triadú, Oriol Valentí i Vidal and Ana Fernández Araluce argue that „[t]he relationship in third-party funding arbitration has traditionally been depicted as being an equilateral triangle. When the funder steps in, it breaks the linear client-counsel relationship, creating a tri-angular funder-client-lawyer dynamic. As discussed in most literature, this triangular paradigm mainly focuses on the relationship client-counsel and client-funder, whereas the relationship funder-counsel remains blurred (for it has comparatively received less attention). The client-counsel and client-funder boundaries are clear and the realm in which counsel and funder move and exist is conditioned by the terms of their respective agreements with the client. In contrast, there is no legal relationship between counsel and funder, but for their mutual client and their common interest in winning the case". (Álvarez, [et. al.], 2021, 27-28.). We might add that the leniency towards third party funding seems to have increased by becoming a vital source, but this does not mean that the debate surrounding the definition and the concept of third party has been erased; on the contrary, it looks to have paved the way to bring up more and more issues, advantages and dis-advantages (see: Veljanovski, 2012 or Shahdadpuri, 2016).

Issues, concerns, pros and contras

It is not far-fetching to state that third party funding has turned out to be a key source used globally in commerce and dispute resolution. Thus, it does not come as a surprise to realize that since 2012, the market related to third party funding has been greater than before, estimations claim over five hundred percent, considering active funding agreements and potential cases for investments as well. (Delaney, 2014). The rise in complex international arbitration cases has further encouraged a demand for third-party funding

arrangements since the disputes involve large amounts of money in addition to high legal costs. (Knull and Rubins, 2000, 531., 543-44.). Vienna Messina argues that "[i]n the last several years, the sentiment toward using third party funding to finance international arbitration proceedings has shifted from reluctance to acceptance." (Messina, 2019, 433.). Globally, the debate over the validity of third-party funding arrangements in international arbitration centres on what law governs; particularly, whether third-party funding is supposed to be regulated by domestic law, the seat of arbitration, or the place of enforcement. (Nieuwveld and Sahani, 2017, 13.). (See, for instance: Bertrand, 2011). Also, Vienna Messina adds that "[t]he heart of recent debate, however, concerns the lack of a standard framework to address third-party funding in international arbitration proceedings. There is no question that parties in international arbitration will continue to use third-party funding. It is time, therefore, to tailor the processes for addressing issues that arise when third-party funders are involved in cross-border disputes and investor-state claims." (Messina, 2019, 434.). There is no doubt, an international debate, concerning third party funding, has already started, reports have been pouring in. One of the global law firms, Norton Rose Fulbright, has published its views focusing on third party funding. (Norton Rose Fulbright is a global law firm that provides full business law services for the world's top corporations and financial institutions, with having about 3800, plus other legal staff based in more than 50 cities throughout Europe, the USA, Latin America, Canada, Africa, Australia, Central Asia, and the Middle East.). Two of the most frequently mentioned benefits of third party funding are (better) access to justice and levelling the playing field, though there era more less obvious one as well. Christopher Bogart states that "Litigation finance isn't just used when claimants can't pay, as a matter of necessity; it is increasingly used proactively, as a tool of choice. It can be far more efficient for corporations to pay for legal fees and expenses by moving them off their own balance sheets. Another common misconception is that funding can be used only for the prosecuting of claims. In actuality, litigation financing is appropriate for defendants and law firms themselves." (Petit, Rogers and Dowling, 2016, 3.). Sherina Petit, Cara Dowling and Andrew Sheftel take a look at the concerns and issues that are brought up in general and they attempt to give some (practical) suggestions on how parties can best minimise risks connected to funding. They argue that "[t]he benefits of third-party funding are well known. Funding can provide access to justice for under-resourced parties (as is often the case in investor–state disputes) enabling them to pursue proceedings which a lack of financing would otherwise have prevented. For parties that are adequately resourced, funding can offer a more convenient financing structure, allowing capital which would otherwise be spent on legal fees to be allocated to other areas of their business during the proceedings. Against those benefits, however, there are concerns ex-

pressed about funding and there is a level of risk involved. Clear insight into potential downsides and sufficient risk preparation are therefore essential elements of making a decision on funding." (Petit, Dowling and Sheftel, 2016, 11.). According to them, the most problematic issues can be the following: unmeritorious claims, recovery costs against funders, high costs of funding, conflict of interest, confidentiality and privilege, and improper influence over proceedings. Sherina Petit, Cara Dowling and Andrew Sheftel argue that it is more probable to see an increase in unmeritorious claims than a decrease, though, funding arrangements are supposed to act as a control on unmeritorious claims. As far as conflict of interest is concerned, they also state that [t]hird-party funding arrangements may result in undisclosed conflicts of interest – perceived or actual. This can occur, for example, where there is a prior relationship between the funder and a party or law firm involved in the proceedings or between the funder and an arbitrator. Such conflicts can result in costly satellite disputes, including challenges to the arbitrator's appointment and applications for disclosure of funding arrangement. Parties seeking third-party funding should consider whether they should disclose those arrangements (and if so, how and when). Again, the applicable law and rules of the arbitration will play a determinative role here." (Petit, Dowling and Sheftel, 2016, 11.). Another concern can be connected to confidentiality and privilege, and the issues link to them seem complicated, since the rules of privilege differ across jurisdictions as does the attitude to the confidentiality of arbitration. (The issue of confidentiality in International Commercial Arbitration alone can polarize or has already been polarized parties involved, see, for example: Simó, 2021, 14.). Sherina Petit, Cara Dowling and Andrew Sheftel advise us to be cautious, and state that "[i]n advance of entering into correspondence with third-party funders, these issues must be considered under all applicable laws. Failure to do so risks having to later disclose such communications – which often contain confidential or privileged material. Parties should enter into confidentiality or non-disclosure agreements with prospective funders. Parties should also consider what material in fact needs to be shared: a balance must be struck between limiting risk and meeting the funder's need for adequate information (both when considering whether to make an offer for funding and throughout the proceedings)" (Petit, Dowling and Sheftel, 2016, 11-12.). One of the major concerns related to third party funding is: improper influence over proceedings. Those (common law) jurisdictions where maintenance and champerty rules are applied (historically) are not concerned at all, since third party funding is forbidden. But, in those jurisdictions where these doctrines are dealt with a more positive attitude, an improper influence over proceedings can raise concerns. The reason and the possible solutions are provided by the above mentioned triad of scholars: "[...] a funder has a direct financial interest in the outcome of a dispute, there is a risk that it might seek to interfere with the conduct of the

proceedings. It is easy to see where tensions could develop – for example, if it is in a funder's interest, it might pressure a party to agree to settlement even if this is not in the party's best interest. Another concern is that, if the terms of the funding agreement allow, a funder might simply withdraw funding upon limited notice, leaving the party unable to continue the arbitration. To avoid these issues, the funding agreement should ensure that the funder does not have excessive control and may not unreasonably withdraw funding." (Petit, Dowling and Sheftel, 2016, 12.). Yet another economic concern has been brought up by other scholars, who claim that even the possibility of third party funding can push inflation of the damages demanded in an award or settlement, as the funded party is very much aware of the fact that a successful award will be shared with the third party funder in the end (Messina, 2019). A potential claimant might turn to a funder for a variety of motives: one of the reasons why a claimant might approach a funder is the mere fact that he or she does not have any other options financially, without any other alternatives, it seems reasonable for a claimant to pursue a (worthy) claim out of necessity. It sounds even more important to note that (related) costs are unpredictable inherently, thus, claimants often decide to "share" the risks, as a kind of "risk management." Therefore, claimants are ready to sacrifice a (considerable) proportion of any recoveries. One can add that "validity" as an advantage, since funders are exclusively interested in "fine" claims; they always carry out their own analysis of merits before negotiating and agreeing to fund a claim. This can be seen as an objective analysis, which might help a claimant to (re)shape and build up a case strategy, and as an additional "side effect", it may promote settlement earlier, as soon as the other party becomes aware of the fact that the claim is aided (and assisted) by a funder. There are other reasons to be considered, especially, if one considers the large scale economic impact of COVID-19, for example, in Asia, and, throughout the world. The uncertainty created by the pandemic has affected businesses in most of the sectors, and it definitely means novel challenges, for instance, troubles with liquidity, as well. Cheng-Yee Khong argues that third party funding might be of important, since „[a]midst this continuing uncertainty, many businesses will need to conserve cash and consider new ways to access liquidity. Third-party dispute finance is one potential source of liquidity. In addition to economic benefits, dispute funding also provides considerable social benefits by providing access to justice to parties who may otherwise lack the means to pursue their claims" (Khong, 2023, 204-205.). Thought, he also adds that "[d]isputes often take several year to resolve and the path to the recovery of debts is usually far from straightforward, especially for international disputes in which the losing party's assets may lie in more than one jurisdiction. Potential funded parties should take care to ensure that they select the right funder who has sufficient financial resources, strategic insights, and relevant experience and expertise to try and ensure the

best possible outcome for their claims". (Khong, 2023, 218.). As we can see, one is supposed to be aware of having some disadvantages if third party funding is used: costs can be seen an issue, even if the claimant has no other alternatives, since a winning claimant has to pay a considerable amount of damages recovered to the funder (as agreed). Yet another question is whether there is a possibility to recover the so-called funding cost. The answer is usually affirmative, it might be recovered from the respondent, though, and the decision on recoverability will remain fact dependent. Thus, expenses should stay as a crucial factor not to be neglected but to be considered.

Regulation of third party funding in a nutshell

International arbitration is an outstandingly flexible institution, but numerous unsolved and largely unacknowledged ethical dilemmas lurk below the surface. Globalization of commercial trade has amplified the number and diversity of parties, counsel, experts and arbitrators which have in turn can lead to more frequent ethical conflicts just as procedures have become more formal and transparent. The unsurprising result is that ethical transgressions are more and more manifest and less tolerable. In spite of these expansions, regulation of a variety of actors in the system arbitrators, lawyers, experts, third-party funders and arbitral institutions stays vague and often feeble. Can the regulation be the desired answer? One can easily see that the situation is recently modest or no obligatory/binding regulation on third party funding, whether in domestic laws, international conventions or the rules of the major institutions of arbitration. Though, for example, in England a voluntary Code of Conduct for Litigation Funders has come to exist since 2012. It is a self-regulatory attempt with the intention of covering capital adequacy requirements for funders and the rights to terminate and to control proceedings as well. The regulatory body to watch over and supervise this self-regulation is the Association of Litigation Funders. (To get to know more, visit for instance: NET1). Although it sounds promising most of the funders have not joined to this self-regulating "project", which leaves us no other choice but to pose serious questions to the viability of self-regulation itself. Though we can find other "voices" of scholars who vote for ethical self-regulation, for instance, Catherine Rogers in her work *Ethics in* her work, *International Arbitration,* methodically evaluates the causes and effects of the progresses as they link to the professional conduct of arbitrators, counsel, experts, and third-party funders in international commercial and investment arbitration. Ultimately, she suggests a model for effective ethical self-regulation, meaning regulation of professional conduct at an international level and within existing arbitral procedures and structures.

We can easily find suggestions for regulations and reforms related to third party funding, for instance, Maya Stinitz states that "[t]he elements of the suggested regulatory

framework are as follows: (1) eliminate the champerty prohibition, at least as it relates to litigation funding; (2) reform the attorney clientfunder relationship, including by extending some of the protections and duties of the attorney-client relationship to the funder-client relationship, by limiting the prohibition on fee sharing to allow attorneys to contract directly with the funders, and allowing and encouraging fee structures that align the three parties' interests; (3) apply consumer-protection and contract design principles to funding agreements; (4) require court supervision over the attorney-client-funder arrangements; and (5) tailor securities regulation to legal-claims-backed securities" (Steinitz, 2011, 1326.). It can be observed that the last couple of years have see a major increase in financing activity, originally, with an emphasis on investor-state arbitration, but now it has been expanded to commercial arbitration, thus, the need and demand for a more apparent and complex regulatory system regulating third party funding demand has emerged.

Conclusion

As we have seen it, the term, third party funding is an umbrella term that coves a number of situations, and some scholars focus on it as a binary notion, but many consider it as a triangle. It is important to note that a third party funder when decides to invest in a claim needs to consider several factors such as the status of the claim (meritorious or not), the amount of the claim and investment, the risks (including collection risk), the time aspects of recovery, the legal merits and, of course, the contextual part of the business itself. As we can see, the attitude towards third party funding has moved from prohibition to its regulation that can be beneficial both to parties in litigation and to the society in its entirety. It allows the enhancement of the access to justice and private enforcement of the law with paying attention to the minimizations of the relating side effects of legitimizing a third party to fund legal action. It can be stated that the last couple of years have experienced a major enlargement in funding activity, initially, with an emphasis on investor-state arbitration, but now it has been extended to commercial arbitration, as a result, the necessity and demand for a more transparent and complex regulatory system regulating third party funding demand has surfaced. Though, one must bear in mind that this study does not intend to idolize litigation finance, it sole purpose has been to show funding litigation has become an industry, a force in the economy, and an element with which one is supposed to count on.

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