# THE THIRD PARTY LITIGATION FUNDING LAW REVIEW

Fourth Edition

**Editor**
Simon Latham

THE LAWREVIEWS

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FOURTH EDITION

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This article was first published in November 2020
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Published in the United Kingdom
by Law Business Research Ltd, London
Meridian House, 34–35 Farringdon Street, London, EC4A 4HL, UK

www.TheLawReviews.co.uk



ISBN 978-1-83862-509-2

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

# ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

ADINA THORN LAWYERS

ARNTZEN DE BESCHE ADVOKATFIRMA AS

AUGUSTA VENTURES

BORDEN LADNER GERVAIS LLP

BUDIDJAJA INTERNATIONAL LAWYERS

INCE

LINKLATERS C WIŚNIEWSKI I WSPÓLNICY SPÓŁKA KOMANDYTOWA

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# CONTENTS

# PREFACE

As a law graduate whose first steps in the legal profession were encumbered by the impact of the previous global financial crisis, I faced a fairly bleak outlook. By happenstance (sheer bloody-mindedness), I found myself at the doors of the London branch of a US plaintiffs' firm, little known on these shores at the time (I still recall the firm's name was spelled incorrectly by the court on most documents in those days). The firm's proactive, and innovative, culture naturally meant it was an early adopter of third party funding (TPF). As such, I had the great fortune to be inducted into the world of TPF from my very first day as a trainee solicitor. I witnessed, first-hand, how TPF catalysed both the firm's growth and its clients' paths to a healthier balance sheet, notwithstanding the burdens that the financial crisis had left in its wake. A spark was lit.

As an investment manager, now immersed within the TPF sector in the face of what has been described as the worst global economic crisis since the Great Depression, I face the challenge of translating my experience into reasons for optimism. Like many of my industry peers, I understand and appreciate the role that TPF plays in providing access to justice for those who could otherwise not afford to pursue their claims. Similarly, in a time when cash is king, TPF has a role to play in enabling corporates to resolve their disputes without depleting resources that could be invested profitably elsewhere within the business. With ever increasing funds under management both by members of the Association of Litigation Funders (ALF) and by the broader TPF fraternity, there are significant resources available for litigants and law firms to utilise. Yet despite the sector's expansion since the previous global financial crisis, TPF still remains a little-known, or little-understood, solution for businesses. Even among lawyers, there are few who are fully aware of the TPF options available to their own businesses, let alone to their clients.

So what exactly is there for law firms and litigants to know about TPF? Well, just as the list of legal remedies available to litigants varies between jurisdictions, so too does the menu of TPF options. The past year alone has seen both shifts in and endorsements of the various regulatory frameworks that underpin the sector across the globe. In Australia, the industry found itself on the receiving end of stringent new regulations, notably without industry consultation. Partly in response to those developments, a number of funders and finance firms have sought to create a global lobbying voice for the TPF sector, by establishing the International Legal Finance Association, chaired by my editorial predecessor, Leslie Perrin. By contrast, there have been notable judicial endorsements of TPF in other jurisdictions over the past 12 months. The English courts, for example, have endorsed not only TPF, but also the ALF itself.

With government support for businesses during the current crisis coming to an end and legal developments such as the forthcoming EU directive on representative actions on the horizon, could 2021 become a milestone year for TPF? I hope this publication provides a useful guide for litigants, lawyers and investors alike as we take on the challenges the new year brings.

**Simon Latham**
Augusta Ventures
London
November 2020

**Chapter 14**

# PORTUGAL

*Fernando Aguilar de Carvalho and Constança Borges Sacoto*[1]

## I MARKET OVERVIEW

Portugal continues to be a peripheral market for third party funding, especially when compared to other countries in Europe and across the globe. However, there is potential and Portugal is starting to feature on the agenda of international funders, who are regular visitors to the country's main law firms to showcase their portfolios and look for new opportunities.

The rise in recent years both in foreign investment in the country and of cross-border disputes submitted to arbitration creates the right atmosphere for the third party funding market to develop.

It is therefore not surprising that third party funding has caught the attention of the local arbitration community and has become a hot topic of debate, not only at arbitration conferences and webinars, but also in several recently published articles on the subject.[2]

Portugal is also a greenfield market when it comes to the specific regulation of third party funding (as described in more detail below), although it remains to be seen whether this is something that favours or hinders its development in the country.

The current economic conditions, shaped the covid-19 pandemic, could also be a catalyst for the growth of the third party funding market in Portugal. The increasing number of both businesses in distress and those that are compelled (or simply prefer) to allocate funds to their businesses rather than to fund litigation, opens the door to third party funding as a suitable alternative means for these companies to pursue cases while reducing their financial exposure.

However, not everything favours third party funding in Portugal. The relatively small size of claims together with the local business mentality may be considered negative factors.

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1 Fernando Aguilar de Carvalho is a partner and Constança Borges Sacoto is an associate at Uría Menéndez – Proença de Carvalho.

2 See, for example, José Miguel Júdice, 'Notes About Third-Party Funding: A Work in Progress', *Estudos em Homenagem* a *Agostinho Pereira de Miranda*, Almedina 2019, pp. 205–218; and Tito Arantes Fontes, Sara Rebordão Topa and Inês Dias Lopes, 'O Financimento de Litígios por Terceiros: os novos desafios à independência e imparcialidade dos árbitros', *Estudos Comemorativos dos 30 anos do Centro de Arbitragem Comercial da Câmara de Comércio e Indústria Portuguesa*, Almedina 2019, pp. 1053–1088.

## II LEGAL AND REGULATORY FRAMEWORK

Like many other European countries, Portugal has not enacted a specific national statutory or regulatory framework for third party funding.

There are also no known judgments from the Portuguese courts regarding third party funding, self-regulation for operators in this market or soft law that is specific to third party funding.

However, the lack of specific regulation does not mean an absence of rules applicable to third party funding. It simply means less certainty and clarity for parties who want to avail of third party funding, because they will need to seek guidance from and take into account a number of general rules and principles.

The main points of concern are not exclusive to the Portuguese market and include matters such as (1) licensing of the activity itself, (2) the independence and impartiality of arbitrators, (3) conflicts of interest, (4) the national courts' perception of third party funding; (5) the legal and ethical issues that third party funding poses for lawyers in Portugal; and (6) possible interference with control and strategy in the proceedings.

### i Authorisation to fund a third party dispute

To operate legally in Portugal, banking and financial institutions are subject to specific authorisation and regulation pursuant to Portuguese Decree-Law No. 298/92 of 31 December (as amended). However, it is difficult to categorise the activity of a third party funder among the activities of banks and financial institutions permitted under this legislation.

A third party funder not only lends an amount of money, but also expects to receive a portion (usually a percentage) of the proceeds arising from a favourable ruling (whether from a judicial court or an arbitral tribunal). This type of risk factor and the division of the profits from a potential win are not envisaged as a type of activity in which banks or financial institutions can engage. A bank financing a plaintiff to initiate litigation (or a defendant to enable it to present its defence) would be a different matter, but that can be achieved through a standard commercial loan from a bank, which is granted regardless of the outcome of the litigation; the bank would be financing the borrower itself, rather than the borrower's litigation.

Similarly, it is not possible to classify third party funding as an insurance activity, even though there is a risk factor involved. Insurance and reinsurance activities are regulated in Portugal pursuant to Law No. 147/2015 of 9 September. However, once again, in our view third party funders' activity cannot be qualified as an insurance activity, as it lacks one of its fundamental elements: the payment of a premium as consideration for the insurance policy, for which there is no equivalent in third party funding.

In summary, the current Portuguese legal framework does not require any specific authorisation or licence to act as a third party funder of legal disputes in Portugal, as this area is completely unregulated.

### ii Third party funding and arbitration

As mentioned above, there is an ongoing debate in Portugal among arbitration practitioners and scholars on the topic of third party funding, with a general consensus that one of the main concerns it raises is the independence and impartiality of arbitrators and the resulting potential for conflicts of interest. It is important to point out that in Portugal, as in many

other jurisdictions, it is common for arbitrators to be experienced lawyers, many of whom are partners in large law firms that may have dealt not only with the third party funders themselves, but also with the funded party or the counterparty in the dispute.

In other words, arbitration's already fertile terrain for conflicts of interest becomes even more prone to problems of this kind when you add a third party funder to the equation.

Arbitrators' independence and impartiality is regulated in Portugal. Firstly, arbitral tribunals are acknowledged by the Portuguese Constitution, which means that arbitrators are comparable to judges and must comply with similar duties of independence and impartiality. Secondly, Article 9, Paragraph 4 of the Portuguese Law on Voluntary Arbitration[3] imposes duties on arbitrators, who must remain neutral (i.e., not be biased in any way) towards the parties, their lawyers, the dispute itself and, where the dispute is decided by more than one arbitrator, the arbitrator's co-arbitrators. Thirdly, as the concepts of independence and impartiality are not legally defined, guidance should be sought from general soft law and the International Bar Association (IBA) Guidelines on Conflicts of Interest, which play a significant role together with internal rules and guidelines published by arbitral associations and institutions.[4]

Intrinsically related to arbitrators' duties of independence and impartiality is their disclosure duty, meaning that an arbitrator must be transparent, neutral, independent and impartial in the sense that he or she should disclose any relations or potential conflicts of interest between the parties involved (the parties to the dispute, their legal counsel and any co-arbitrators). However, disclosure of any relationship that an arbitrator might have with a third party funder is only possible if the arbitrator becomes aware of the involvement of the third party funder in the dispute – and this is an area that, in the absence of specific regulation, remains unclear.

The recent annulment of the award delivered in the *Eiser v. Spain* ICSID arbitration is a stark reminder of the need both for clarity and to take into account all parties, including experts and third party funders, when complying with the duty of disclosure.

The duty of disclosure incumbent on all parties is also relevant in relation to a party's ability to pay adverse costs, and may lead the arbitral tribunal to order the party concerned to pay security for costs.

### iii Third party funding and national judicial courts

It is important to highlight that the foregoing considerations regarding arbitration are not applicable in the case of third party funding of disputes heard in the national judicial courts.

For one thing, the risk of a conflict of interest is much lower. Apart from the fact that judges cannot under any circumstances work as lawyers, they are paid by the state and not by the parties to the dispute, which practically eliminates any potential conflicts of interest. Additionally, Portugal applies the constitutional principle of the 'natural judge', which means that everyone is entitled to have their case decided by a legal judge. This right means that a judge who adjudicates on a specific case must be elected to do so on the basis of objective legal and predetermined criteria and obviously not on the basis of individual and discretionary

3 Law No. 63/2011 of 14 December.

4 In Portugal, the best-known deontological code on this matter is the Portuguese Arbitration Association's Code of Conduct for the Arbitrator (2010). Similarly, Article 11 of the Rules of the Arbitration Centre of the Portuguese Chamber of Commerce and Industry establishes the duties of independence and impartiality of arbitrators.

choices. In Portugal, civil litigation disputes are assigned to judges randomly, therefore the risk of a potential conflict of interest is very low. Furthermore, judges must follow the general civil procedural rules, which prohibit a judge from hearing a case where he or she might have a particular relationship with one of the parties or an interest in the dispute, which is particularly unlikely when cases are assigned randomly (and typically there are more judges than arbitrators).

In addition, as there is no rule imposing a duty to disclose whether the parties are being funded by a third party, this is not, in principle, a relevant factor for the court. Further, the court does not have to make any assessment of the financial capability of a party to pay the court fees,[5] unless the counterparty expresses its concern and requests the court to order it to pay some sort of security (typically, a bond). Similarly, there is no concern regarding payment of adverse costs (which in Portugal are limited to payment of the court fees and a portion of the lawyers' fees), because if the losing party does not pay those costs, the counterparty can initiate enforcement proceedings to obtain payment.

Given the current circumstances, we believe that the impact of third party funding on the national judicial courts, and particularly on judges, is in fact non-existent. This is essentially because the parties are under no obligation to disclose funding by a third party, and even if such a duty were to exist, it would be most unlikely to have any impact on the judge.

### iv Lawyers' legal and ethical duties

Portuguese lawyers are bound by the Rules of the Portuguese Bar Association, established in Law No. 145/2015 of 9 September (as amended), Article 106 of which prohibits the *pactum quota litis*.[6] The purpose of this provision is to protect the integrity of the legal profession, by considering null and void any agreement whereby a lawyer is paid only according to the outcome of the case or for a successful performance.

As long as lawyers or law firms are not themselves the funders (and are only legal counsel paid by the funder to provide legal assistance to the funded party), third party funding does not seem to breach this provision.

Notably, in the event of a favourable ruling, the fact that a third party funder benefits from a percentage of the proceeds obtained is not considered a form of *quota litis* because third party funders are not subject to the Rules of the Portuguese Bar Association. The Rules of the Portuguese Bar Association also prohibit sharing lawyers' fees;[7] however, once again, if the lawyers are not the funders (and only paid by the funder to advise on the dispute), this rule is not breached, because lawyers are not sharing their fees – and third party funders are not subject to these rules.

5 Where a party is unable to pay court fees, it can request financial legal aid to pay those fees (and even request a lawyer, if necessary).

6 Article 106 of Law No. 145/2015 establishes that these are agreements entered into between the lawyer and the client, before the dispute in which the client is involved ends, where the lawyer's fees depend exclusively on the outcome of the case and the client is bound to pay to the lawyer a percentage of the award obtained, be it a payment in cash or in kind.

7 Article 107 states that 'Lawyers are forbidden to share fees, even in a form of commission or any other form of compensation, except with lawyers, trainee lawyers or paralegals with whom they collaborate or have provided assistance' (loose translation).

It is another matter whether a lawyer or a law firm can be considered a third party funder when they agree to a success fee (typically a percentage of the amount at stake in the dispute) on top of the fees that they are paid regardless of the outcome of the case. Success fees are allowed under Article 106, Paragraph 3 of the Rules of the Portuguese Bar Association, so this cannot really be considered a type of funding. In addition, the fact that lawyers represent their clients before the court means that they are not considered to be a third party in relation to the client, as the lawyers do not intervene on their own behalf but, rather, exclusively on behalf of their clients.

It is also pertinent that lawyers are prohibited from (directly or indirectly) soliciting clients,[8] which means that they should be careful when exploring opportunities in the market, as they should not attract or direct a third party funder to finance a specific issue with the sole purpose of becoming the legal counsel assisting in that case – as the funder would end up paying the fees of those lawyers for advising the funded party, which could be considered to be soliciting clients.

Finally, it is important to have very clear and precise contractual provisions in place between the third party funder and the party regarding the conduct of the proceedings, to safeguard the lawyer–client relationship, which is also subject to specific provisions.[9]

### v Third party funding – advantages and opportunities in the legal market in Portugal

One of the main advantages of third party funding for the Portuguese market is that it provides companies with the opportunity to take disputes to litigation that it would not otherwise be possible to, be it because they are in financial distress, they do not have the financial muscle to get professional legal advice for larger disputes or, from a management perspective, it simply would not make sense.

In fact, pursing litigation is first and foremost a management decision as it may mean allocating significant financial resources, which might not be viable economically for a given company even if its chances of winning the case are high. Allowing a third party to fund a company's litigation means transferring the risk, as well as the 'investment', to that third party. The third party will take a percentage of the proceeds of a favourable award, but choosing this course of action might still be the smartest decision when managing a limited budget.

In our experience, companies are sometimes put off by the legal costs of high-value complex litigation, particularly in arbitration, where, in contrast to the judicial court system, costs are paid up front. Third party funding can therefore play a significant role in filling that gap and allowing companies to pursue their rights regardless of the costs involved.

The legal market in Portugal currently has many international participants and multinational companies, which makes for highly complex and sophisticated litigation. This can also be seen as an opportunity for legal counsel to assess cases in greater depth before commencing a dispute, as third party funders require a due diligence process to be undertaken to assess the risks of the case and decide whether it merits funding. This means more work for law firms but also represents a different approach to litigation, which can be beneficial, in the sense that it allows for better and more thorough preparation, mitigation of risks and fewer surprises when the case is actually taken to court.

8 Article 90, Paragraph h of the Rules of the Portuguese Bar Association.

9 Articles 97–107 of the Rules of the Portuguese Bar Association.

## III STRUCTURING THE AGREEMENT

As mentioned earlier, third party funding is not regulated in Portugal, which means that there are no rules governing agreements between third party funders and funded parties. Therefore, parties have full discretion on what to include and how to regulate their relationship, and are limited only by the general rules of public policy (prohibition of excess, and proportionality between the parties' obligations), good faith, abuse of rights and moral principles.

Although third party funding contracts are not regulated in Portugal, there has been an attempt to identify in them some of the characteristics found in regulated and standard contracts.

These include, according to some commentators, a form of joint venture, specifically an 'association in partnership', as regulated by Portuguese Decree-Law 231/81 of 21 July, while others contend that there are similarities with some forms of structured financial instruments, which constitute a form of funding to cover risks associated with company activity beyond the conventional ways that might be included in the balance sheet.

Despite any similarities with a partnership structure or a structured financial instrument, third party funding certainly has unique features that clearly set it apart, so not only is it not regulated under Portuguese law, but it also does not match any of the extensive list of standard contracts in our legal system, meaning that it is at the parties' discretion to define the terms of the funding agreements, within the civil law limits discussed.

Nonetheless, in Portugal, as in many other jurisdictions, our experience is that third party funders will have their own standard forms with a common law framework and the natural advantage of coming from regulated markets that have dealt with the many problems that we have briefly touched upon above for a long time. However, these factors should not be allowed to overshadow the need to factor in the particularities of the local market.

## IV DISCLOSURE

As discussed above, the duty to disclose third party funding is still a matter of much debate, not least because in Portugal, as in many other jurisdictions, there is no express statutory obligation in this regard. In any case, the majority of practitioners tend (and rightly so) to consider that, in arbitration at least, the funded party should disclose this information, because it can have a major impact on the composition of the arbitral tribunal.

Revealing the identity of the third party funder triggers the arbitrators' duty to disclose any potential conflicts of interest that the arbitrator believes might, in the eyes of the parties, raise questions or doubts as to the arbitrator's impartiality or independence. In principle, if the funded party were to disclose its funding in civil judicial litigation, it would probably not have the same kind of impact as it would in arbitration.

The arbitrators' duties of impartiality and independence cannot be waived by the parties in the dispute, even in arbitration, because these duties are imposed not only to ensure that all parties receive fair treatment regarding the observance of the principles of due process, but also to ensure a fair and transparent justice and arbitral system.

Although these duties are imposed by law (as discussed above), there is no statutory definition of the impartiality and independence required of arbitrators, and Portuguese case

law has been heavily reliant on soft law rules, in particular the IBA Guidelines on Conflicts of Interest, to bolster these concepts and ascertain whether those principles are at risk of being infringed.[10]

From a different perspective, it should be noted that the Rules of the Portuguese Bar Association establish the rule of lawyer–client privilege,[11] according to which lawyers have a duty of confidentiality regarding all the information provided about a case. Therefore, lawyers can only disclose information on a case to third party funders subject to their client's waiver of lawyer–client privilege (which is usually regulated in the third party funding agreement). Without their clients' prior written consent, no information can be provided to any third party, with the exception of those facts absolutely necessary for the defence of the lawyers' own integrity, rights and legitimate interests, or those of their clients, and subject to prior authorisation from the chair of the regional Bar Association council.[12]

Of course, this confidentiality rule does not extend to the funded party or to the third party funder, as it arises from the nature of the lawyer's professional duties, to which third party funders are not bound. However, third party funding agreements will always include confidentiality clauses or a separate non-disclosure agreement to which both parties are bound.

Finally, regardless of voluntary disclosure, it is important to bear in mind that although Portugal does not have a general discovery regime, parties can request specific categories of documents and information from the opposing side or from third parties through the judicial courts or arbitral tribunals, including third party funding agreements to the extent that these are considered relevant to the case at hand.

## V COSTS

According to Portuguese law, both judicial and arbitral courts decide how to allocate costs on the basis of the loser-pays principle (i.e., 'costs follow the event'), which means that the winning party has the right to recover the costs of the claim (or at least part of them) from the other party.

The allocation of costs is limited in the judicial courts by legal criteria. In contrast, arbitral tribunals do not usually have specific rules in this regard and therefore, in practical terms, the allocation of adverse costs is left to the arbitrators' discretion.

An arbitral tribunal may order a party to pay an order for security for costs if it has reason to believe that there is a significant risk one or both parties will not be able to pay the

10 See, for example, the following appeal court decisions: Supreme Court, dated 7 December 2011, proceedings No. 170751/08.7YIPRT.L1.S1 (in this decision the court granted interpretive relevance not only to the IBA Guidelines, but also to the Spanish Arbitration Club recommendations in this regard, among other elements of soft law); Lisbon Appeal Court, dated 24 March 2015, proceedings No. 1361/14.0YRLSB.L1-1; Lisbon Appeal Court, dated 29 September 2015, proceedings No. 827/15.9YRLSB-1; Central South Administrative Court, dated 8 October 2016, proceedings No. 13580/16; Lisbon Appeal Court, dated 19 September 2016, proceedings No. 581/16.7YRLSB.-1; Lisbon Appeal Court, dated 2 February 2018, proceedings No. 1320/17.0YRLSB-8; Lisbon Appeal Court, dated 22 January 2019, proceedings No. 1574/18.5YRLSB.L1-7; and Lisbon Appeal Court, dated 11 February 2020, proceedings No. 1577/18.0YRLSB-1. All of these decisions are available online at www.dgsi.pt.

11 Article 92 of the Rules of the Portuguese Bar Association.

12 Article 92, Paragraph 4 of the Rules of the Portuguese Bar Association.

adverse costs in the event of losing the case. As mentioned earlier, this would only happen in judicial courts with a well-grounded request from the counterparty. In both cases, the courts would only order a party to pay security for costs based on the *fumus boni iuris* and *periculum in mora* criteria, and they would usually resist making a decision on a case in advance. Therefore, security for costs is only required in very specific and limited situations and, in relation to arbitration, probably when the court is not aware that one of the parties is being funded by a third party.

## VI THE YEAR IN REVIEW

As we have mentioned already, third party funding is now established on the agenda in Portugal, particularly within the arbitration community, following the trends and in the footsteps of the international arbitration community, where the concept has emerged and developed.

However, for now at least, although everyone knows it exists, that it is available and that it works and has benefits, there are little or no indications that it has been used extensively in Portugal.

As with many other innovations originating in the international arbitration arena that have found their way into local arbitration practice, the debate around third party funding will open the door to what looks like a promising activity, and one that can bring benefits to companies seeking to diversify risk and obtain funding for litigation otherwise unavailable to them from traditional sources.

If this proves to be the case, regulation is likely to follow, which makes sense given the particularities of third party funding and the challenges it brings.

## VII CONCLUSIONS AND OUTLOOK

The currently unregulated area of third party funding in Portugal offers funders and potential funded parties a wide array of opportunities that deserve to be explored to provide benefits both for the parties and for the justice system.

In view of the increasing costs of litigation, particularly in complex cross-border litigation and international arbitration, as well as the financial constraints that many Portuguese companies will be experiencing because of the financial crisis resulting from the covid-19 pandemic, third party funding is a valuable and alternative means of funding that has potential to develop in Portugal.

As the discussions of the benefits and obstacles around third party funding evolve in the international arena, the arbitration community in Portugal will follow suit. Therefore, any major regulatory developments abroad, particularly in Europe, will probably be reflected immediately in the practice in Portugal and, in due course, in the national legal framework.

In our view, the most controversial topics regarding third party funding that require attention, further debate and clarification in the context of the Portuguese market are (1) the parties' duty of disclosure to reveal funding by a third party, and (2) the balance between the rights and duties of the parties in the funding agreement and the lawyer's statutory role in advising the client independently.

**Appendix 1**

# ABOUT THE AUTHORS

## FERNANDO AGUILAR DE CARVALHO

*Uría Menéndez – Proença de Carvalho*

Fernando Aguilar de Carvalho began his career as a lawyer at Proença de Carvalho Advogados in 1992 and joined Uría Menéndez – Proença de Carvalho in 2010 when the firms merged.

Fernando heads the litigation practice area in Portugal and focuses on various areas of litigation, arbitration, white-collar crime and corporate law. He advises both national and foreign companies.

Having completed part of his studies in South Africa, he has an important foreign client base and he is also responsible for the firm's Africa desk.

Between 1995 and 1996, Fernando combined his practice at Proença de Carvalho Advogados with the post of in-house legal advisor at Hewlett Packard Portugal.

Fernando obtained his law degree from the Classical University of Lisbon in 1992. He is a member of the Portuguese Bar Association, the Portuguese Arbitration Association and the Spanish Arbitration Club.

## CONSTANÇA BORGES SACOTO

*Uría Menéndez – Proença de Carvalho*

Constança Borges Sacoto is a senior associate in the litigation practice at Uría Menéndez – Proença de Carvalho's Lisbon office. Constança joined the firm in 2012 and worked in several areas, namely the commercial area and the labour department.

In September 2014, Constança joined the litigation team as a junior associate. She works mainly in civil and commercial litigation, insolvency, companies' recovery and arbitration. She is also a member of the Portuguese Arbitration Association.

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ISBN 978-1-83862-509-2