

THE THIRD PARTY
LITIGATION
FUNDING LAW
REVIEW

FIFTH EDITION

Editor
Simon Latham

THE LAWREVIEWS

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PREFACE

This now represents my sophomore year as editor, a role I undertook during the onset of the covid-19 pandemic. As the global economy begins to creak back into motion, I'm reminded of my first steps into the legal profession as a law graduate following the last global financial crisis. Much like now, it was a challenging time for those entering the profession. 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 they were early adopters of third party funding (TPF). As such, I had the great fortune of being immersed in 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 their clients' paths to a healthier balance sheet, notwithstanding the burdens that the global financial crisis had left in its wake. A spark was lit.

Fast forward to the present and TPF is very much a mainstay across the legal landscape in the UK. It feels like every week there are press releases announcing the latest funder on the scene, the latest law firm facility, the latest representative action in the Competition Appeal Tribunal, etc. But how does it all work in practice? Well, just as the list of legal remedies available to litigants varies between jurisdictions, so too does the menu of TPF options. The past couple of years has seen both shifts and endorsements of the respective regulatory frameworks that underpin the sector across the globe. In contrast to the booming UK landscape, for example, the Australian market has found itself on the receiving end of stringent regulations, both in terms of operating structure and commercial terms (in class actions). The overwhelming bigger picture, however, is one of growth, development and innovation. Savvy investors continue to navigate the nuances of each jurisdiction to devise new ways to provide finance to the market, all of which ultimately facilitates broader access to justice. Personally, I'm excited to see how this positive force for change can progress into something even more impactful, as TPF helps facilitate the latest evolution of ESG-related disputes . . . watch this space!

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 2021

PORTUGAL

Fernando Aguilar de Carvalho and Constança Borges Sacoto¹

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 no longer a completely 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 by 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.

Although finding reliable statistics in this field is not at all easy, to the best of our knowledge, 2020/2021 has seen the first cases of third party funding in Portugal, including a number of class actions for private enforcement filed by a consumer association.

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 Financiamento 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. However, the first soft law rules on the matter have appeared within the arbitration context, at the end of 2020 and in 2021, but always concerning the duty of disclosure in order to ensure the independence and impartiality of the arbitrators (as described below in more detail).

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 Arbitration³ 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.

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.

Bearing this concern in mind, the recent Portuguese soft law clearly reflects the idea that the existence of a third party funder backing one of the parties may influence the independence and impartiality of the arbitrators. Therefore, to avoid any potential conflict of interests, a duty of disclosure is imposed on the parties regarding third party funding agreements.

On the one hand, the rules of the Arbitration Centre of the Portuguese Chamber of Commerce and Industry, dated from 1 April 2021, expressly establish that the parties have the duty to immediately inform – at all times, while the dispute is pending – of any funding agreement with a third party who may have an interest in the outcome of the case.⁴

On the other hand, the new Code of Ethics published by the Portuguese Arbitration Association (APA) at the end of 2020,⁵ also expresses the same concern. In fact, the Code of Ethics is also applicable to the parties' representatives (lawyers) and other participants in arbitration proceedings and it is binding for all APA members.⁶ This was the first time in Portuguese soft law that the matter of third party funders is regulated. Once again, the main concern of the Code of Ethics is that the parties provide enough information on the participation of any third-party funder in order to avoid potential conflicts of interest with anyone involved in handling the case. Thus, not only the parties and their representatives

3 Law No. 63/2011 of 14 December.

4 See Article 10, No. 5. See the Portuguese version of the new rules at https://centrodearbitragem.pt/images/pdfs/Legislacao_e_Regulamentos/1abr2021%20Regulamento%20de%20Arbitragem.pdf.

5 See Portuguese, English and Spanish versions of the Code of Ethics at https://www.arbitragem.pt/xms/files/PROJETOS_APA/ebook_codigos-apa_21jan2021.pdf.

6 Article 1 Code of Ethics.

have to inform of any third party funding agreement, but the arbitrators must also request this information before accepting any appointment – in order to properly weigh and verify if there is anything that may affect their independence and impartiality or justify any disclosure.⁷

In an attempt to provide clarity and certainty on its scope of application, this new Code of Ethics provides a definition of a third party funder, as follows:

*any natural or legal person who is not a party or legal representative of a party to the dispute and contributes financial support (for consideration or for free), or other economic support, for the judgement of the claims of one of the parties to the dispute and has an economic interest in the outcome of the dispute or a possible obligation to indemnify one of the parties as a consequence of such a result.*⁸

Finally, 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 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,⁹ 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

7 See Article 7, Nos. 3 and 5, al. a), Article 8, No. 1 and Article 18.^o, No. 1 Code of Ethics.

8 See Article 18, No. 2 Code of Ethics.

9 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).

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*.¹⁰ 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;¹¹ 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.

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 to mention that lawyers are prohibited from (directly or indirectly) soliciting clients,¹² 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.

10 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.

11 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).

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

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.¹³

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, pursuing 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.

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

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

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 it is 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, especially 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. The above-mentioned recently published Portuguese soft law incorporates and follows this approach.

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.¹⁴

14 See, for example, the following appeal court decisions: Supreme Court, dated 7 December 2011, proceedings No. 170751/08.7YIPRTL.L.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.OYRLSB.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.OYRLSB-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.OYRLSB-1. All of these decisions are available online at www.dgsi.pt.

From a different perspective, it should be noted that the Rules of the Portuguese Bar Association establish the rule of lawyer–client privilege,¹⁵ 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.¹⁶

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 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.

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

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

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.

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.

Curiously, as mentioned above, the first cases where it has been made public that third party funders are involved are class actions pending in the Competition Court of Santarém.

As third party funding makes its way into the Portuguese Market and gains notoriety, it is very likely that following the soft law approach on the subject described above, some form of regulation will be issued by the Portuguese Authorities.

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 private enforcement, cross-border litigation and international arbitration, as well as the financial constraints that many Portuguese companies are 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 on 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, now mainly in civil proceedings, 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.

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