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Third-Party Funding: Practical Considerations and Challenges

1. Introduction

Third-party funding (“TPF”) has become a recurring element in international dispute resolution, as it enables litigation while limiting the financial risk of the parties. The importance of TPF as a tool to ensure access to justice, free up financial resources for other uses, mitigate the risks associated with litigation, or a combination of these factors, has contributed to the development of an industry of considerable magnitude.

Courts around the world have affirmed the validity of TPF agreements for international disputes, while some major arbitral centres have incorporated this tool into their rules.

This legal briefing explores what third-party funding involves, its main features and practical considerations, the relevant regulations, and the possible challenges associated with it.

2. Definition and functioning of TPF

In essence, TPF is a mechanism whereby a third party unconnected to a dispute, *i.e.*, the third-party funder, provides financial resources to a party to fund the costs of a legal dispute. This mechanism shifts the financial risk involved in the proceedings to the funder, in exchange for a fee¹. Both claimants and respondents, whether in the main proceeding or via counterclaim, can benefit from this tool.

TPF agreements usually are premised on the “no cure, no pay” principle, meaning that the funder is compensated only if the dispute is resolved in favour of the funded party. In the event of an unfavourable outcome for the funded party, the funder is not entitled to recover the amounts invested². If the funded party obtains a favourable award *e.g.*, an award ordering the payment of a sum to the claimant or, in the case of a respondent, dismissing a claim against it, the funder will be entitled to compensation. In most cases, this compensation consists of a fixed amount, or a proportion of the award (or savings) obtained.

Generally, expenses covered by TPF agreements include the fees of lawyers, experts and arbitrators; costs of the arbitral institution; expenses relating to the proceedings (*e.g.*, translations, platforms for handling and filing documents, transfers); and possible awards of costs in favour of the opposing party. In practice, TPF agreements include a budget with estimates for these items³.

Once a potential claimant submits a matter for a funder’s consideration, the funder will conduct a due diligence process which will analyse issues such as the identity of the parties; the strength of their potential claims and defences (including the availability of evidence); the potentially recoverable amounts (these should be sufficient in size to allow payment to the funder, without eliminating the claimant’s possibility of making a return); the availability of assets owned by the respondent (this is particularly important in investment arbitrations against sovereign States); the estimated duration of the litigation; and the cost of the litigation⁴.

1. E. Fernández Masiá, “La financiación por terceros en el arbitraje internacional”, Cuadernos de Derecho Transnacional vol. 8 no. 2 (October 2016), p. 208.

2. Deminor Litigation Funding, “Transform commercial litigation and arbitration claims into financial assets,” eBook (2023), p. 4.

3. J. von Goeler, “The Various Forms of Third-Party Funding in International Arbitration” in “Third-Party Funding in International Arbitration and its Impact on Procedure,” International Arbitration Law Library vol. 35 (Kluwer Law International 2016), p. 19.

4. See J. von Goeler, *op. cit.*, pp. 13 *et seq.*

TPF agreements can be entered into at any point in the course of a dispute: before or during its processing, or after its conclusion for the enforcement of the respective award.

3. Regulation of litigation funding in international arbitration

TPF agreements share elements with legal concepts recognised in various legal systems, such as the concept of *cuota litis*⁵ and the assignment of claims⁶, but do not fit directly into those categories⁷. As a result, national courts have been called upon to rule on the validity and nature of these agreements. For example, in July 2023, the Supreme Court of the United Kingdom concluded that litigation funding agreements in which the funder's compensation consists of a percentage of the amount recovered, constitute "damages-based agreements", being subject to their respective applicable rules. According to that judgment, TPF agreements with such a compensation structure not complying with these rules, are not enforceable in the United Kingdom. Meanwhile, courts in the People's Republic of China have confirmed the validity of TPF agreements in arbitration⁸.

Some leading arbitral centres have amended their rules to include TPFs, especially regarding conflicts of interest and the arbitrators' duty of disclosure. This is the case of the International Centre for Settlement of Investment Disputes ("ICSID")⁹, the International Court of Arbitration of the International Chamber of Commerce ("ICC")¹⁰, the Madrid International Arbitration Center ("MIAC")¹¹, or the Singapore International Arbitration Centre ("SIAC") (for investment arbitration)¹².

In addition, *soft law* instruments such as the IBA Guidelines on Conflicts of Interest in International Arbitration¹³ and the Code of Best Practices in Arbitration of the Spanish and Iberoamerican Arbitration Club ("CEIA")¹⁴ have also sought to provide guidance on the matter.

From a supranational perspective, the European Union has taken its first steps towards the regulation of TPF agreements in the European Parliament resolution of 13 September 2022 with recommendations to the Commission on responsible private funding of litigation (2020/2130 (INL)), instructing it to "closely monitor and analyse the development of third-party litigation funding in the Member States" and then submit "a proposal for a Directive to establish common minimum standards at Union level on commercial third party litigation funding".

5. *Cuota litis* is a method of litigation funding whereby the holder of the right to initiate proceedings refrains from paying the costs of the proceedings, as well as their lawyers' fees. It generally works under the premise "no win, no fee".

6. The assignment of claims is a legal transaction that allows the sale and purchase of enforceable titles, assigned by the holder of the claim in favour of a third party, in exchange for consideration, with transfer of the title, in order to proceed with its enforcement.

7. Whereas in the *cuota litis* it is the lawyer who forgoes remuneration by financing the process in whole or in part, the TPF is a third party outside the dispute, generally highly specialised and with considerable financial resources, who finances the holder of the claim. On the other hand, whereas in the assignment of claims, there is a change of ownership of the credit, in litigation funding the holder of the claim retains their position, since the TPF merely finances without being subrogated to the legal position of the holder of the claim. See D. Agulló Agulló, "Los contratos de financiación de litigios por terceros (third-party funding) en España", *Revista de Derecho Civil* vol. IX no. 1 (January-March 2022), pp. 192-194.

8. See *Ruili Airlines Limited Company v. Yunnan Jingcheng Group Limited et al*, Wuxi Intermediate People's Court, Case No. (2022) Su 02 Zhi Yi 13, Order Civil (30 May 2022).

9. ICSID Arbitration Rules, Rules 14 (establishing the obligation to give notice of the existence of third-party funding for the tribunal to disclose any connection it may have with the funder) and 53 (establishing that in deciding whether to order a party to provide security for the costs of an arbitration, the tribunal must consider the existence of third-party funding).

10. ICC Arbitration Rules, Art. 11(7) ("In order to assist prospective arbitrators and arbitrators in complying with their duties under Articles 11(2) and 11(3), each party must promptly inform the Secretariat, the arbitral tribunal and the other parties, of the existence and identity of any non-party which has entered into an arrangement for the funding of claims or defences and under which it has an economic interest in the outcome of the arbitration").

11. MIAC Arbitration Rules, Arts. 5.2(i) (establishing the obligation of a claimant to disclose the existence of a TPF agreement) and 23 (establishing the obligation of the parties to disclose the existence of TPF agreements and the tribunal's right to request appropriate information on the funding and the funder).

12. SIAC Investment Arbitration Rules, Rule 24(1) (conferring on the tribunal the power to order disclosure of the existence and details of TPF agreements). While the SIAC Arbitration Rules (for commercial cases) do not contain a similar rule, Note PN-07/17 of 31 March 2017 sets out standards of independence and impartiality to be observed by tribunals in cases administered under the Arbitration Rules where third-party funding is involved.

13. IBA Guidelines on Conflicts of Interest in International Arbitration, Rule 6(b) (stating that "any legal or physical person having a ... direct economic interest in ... the award to be rendered in the arbitration, may be considered to bear the identity of such party").

14. CEIA Code of Best Practices in Arbitration, Recommendations 154-156 (regulating the duty to disclose the existence of TPF agreements).

4. Remaining challenges for third-party funding

Existing regulatory and policy efforts to date have not addressed critical questions for any party considering a TPF agreement, such as those relating to the role of the funder, or whether the latter can dictate the procedural actions of the funded party. Questions also remain as to whose interest should prevail when the interests of the funder and the funded party are not aligned *e.g.*, in a decision to settle a dispute on less favourable terms than could be obtained in an award. Further, there is uncertainty as to the obligations of the funded party's lawyers towards the funder.

For now, these questions must be addressed by carefully drafting the relevant TPF agreement and selecting a funder well-suited to the circumstances of the case and the parties involved. Meanwhile, the actions of States and their courts, as well as arbitral institutions, will continue to shape this evolving tool.

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