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ADVANTAGES AND DISADVANTAGES OF THIRD PARTY FUNDING OF JUDICIAL PROCEEDINGS

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Abstract
In international arbitration, parties autonomy is a vital principle, allowing them to determine how the proceedings are to be conducted, subject to the application of the mandatory regulations of the state where the proceedings are held and, where applicable, the rules of the arbitral institution. In other words, being a technique that is mainly based on the application of the principle of freedom of contract, third party financing (TPF) is often allowed in principle in arbitration cases that are also contractual in nature.
The research focuses on the attention paid to financing by third parties in judicial cases, which can be explained by some of the fundamental advantages it entails (respect for the fundamental nature of the right to defense and unrestricted access to justice, patrimonial advantages, etc.). Both plaintiffs and defendants can take advantage of the TPF throughout the procedure, but also afterwards (ie during the execution of the resolution). The analysis of the law in force and the jurisprudence are used to explain one of the key issues fueling suspicion and skepticism about the use of TPF, i.e the method introducing an outsider into the lawyer-client relationship (the third-party funder) whose sole interest and only connection to the dispute is the pursuit of the capitalist objective of making a profit. The papers point out the advantages and the lack of the procedure, in the context of the EU law proposal for a regulation on the topic.
Keywords : *litigation financing; third party; fundamental rights.*
JEL Classification: K34, K40.

1. INTRODUCTION

In the current social and political context, dominated by globalization, at all levels of life, the legislative harmonization and borrowing, at the level of evolution and development of the regulatory framework, is a common practice. Institutions from different states use legal instruments regulated on various scale in other states, possibly at different intensities or frequencies of use and on other level of development of their legal framework.

Surprisingly, therefore, the hypothesis of litigation financing and the identification of solutions in the hypothesis of a lack of financial resources to support the right to defence is, at least from the perspective of Romanian law, an almost exclusive concern of those who decide to use the judicial way to restore justice. Only in isolated situations are financial aid mechanisms created by law for those involved in the management of processes before the courts, exemptions from stamp duties, help to cover expenses, etc. (Ungureanu, 2018).

The financing of litigation is, in the Romanian legal system, a concern of the one directly involved in the respective litigious situation, the existing regulations being very discreet and strict regarding how the state provides support to those in objective need of financial support to be able to exercise the right to defence (Martin, 2009). This reality is in deep dissonance with international regulations and jurisprudential practice in other states. Litigation financing by third parties in international trade is more commonly known by the abbreviation TPF, derived from the English name of the concept, i.e. tertiary party financing (Radin, 1936).

In the US, the courts, despite the maintenance and champerty doctrines, have over time been increasingly disinterested in validating agreements between litigants and financiers. By the second half of the 20th century, contingency fee agreements became the de facto exception to self-funding by litigants, third parties interested in funding litigation using their relationship with the parties' lawyers to provide financial support to maintain the litigation (Faure and De Mot, 2012). Thus, in most state jurisdictions in the US, the funding of litigation by third parties, for profit, is allowed, except when such agreements are based on an illegal or immoral cause or when they promote "frivolous litigation (Glickman, 2016).

The paper analyses the evolution of the regulatory framework to support third party financing of litigation, pointing out the positive and the controversy dimension of this relatively recent legal instrument to support the wide scale access to justice.

2. METHODOLOGY

From the methodological perspective, the work was carried out considering appropriate scientific research methods, the main purpose of the research being an exhaustive analysis of the proposed investigation area. The research used the documentation method from the specialized literature, from the adopted normative acts, but also from the relevant judicial practice at the national level, at the level of the European Union and at the level of the courts of other countries. The documentation on the case law also covered the solutions relevant to the field of study that were pronounced by the courts of different states. We used the comparative method to identify and present the existing similarities and differences between different regulatory systems regarding the financing of disputes by third parties and the resulting material was subjected to logical, systemic and historical analysis.

Using the logical method as a research method, we appealed to deductive and inductive analysis, using various tools to answer all the research questions caused by the realization of this scientific endeavour (Faure and De Mot, 2012). We used various methods of capitalizing the documentary material, including generalization, specification, division, classification and definition of concepts. The partial results of these analyses are presented in each chapter, the logical method of interpretation being, as a general assessment, predominantly used.

At the same time, I used the historical method of research and interpretation of the documentary material, the results of this type of investigation being presented in the content of the thesis in several chapters and sub-chapters, being presented *expressis verbis* stages of the historical evolution for certain regulations and legal institutions.

The way in which the rules relating to the financing of litigation by third parties have been included in the national law system of various contemporary states, being analysed to identify comparable elements and to retain the common regulatory directions in the plan of harmonizing the norms of European law, respectively at the global level, for the standardization of international law norms.

3. WHY USING THIRD PARTY FINANCING LITIGATION

The expression of contrary opinions regarding the beneficial nature of the operation of third-party financing of disputes are ongoing, yet we belong to the group of researchers who consider that its advantages are indisputable, both in the case of arbitration and judicial procedures (Flake, 2015).

We will highlight, next, the main advantages that are treated in the specialized literature, aspects that are certainly considered when an interested person wants to support such a procedure and which, equally, can be considered by states that do not have paid special attention to this institution up to this point.

3.1. Access to litigation proceedings

Arbitration has become a large international industry, highly competitive and prohibitively expensive, with costs continuing to rise at an unsustainable rate and creating imbalances in negotiations if one party has significantly more resources than the other (Menon, 2013). Thus, arbitration has become a type of dispute resolution with an enormous demand for funding.

Arbitrage actions are a competition between equals when the companies are roughly equal in size and the amount at stake is manageable for both parties. In this case, we would expect the dispute to be resolved only on the merits of the case and not because one party has greater bargaining power. Conversely, disparities and incidents of problem management arise if one party is much stronger than the other. The increasing expenses associated with claiming high-value claims and the need to manage the financial risks associated with pursuing these substantial values are undoubtedly reasons that can explain the growing interest and demand for TPF (Bowman *et al.,* 2011).

According to a recent study, the high upfront costs involved in arbitration have a deterrent effect and often prevent potential claimants from suing. The expense of an arbitrator can be particularly prohibitive for a party bringing claims against a larger and more powerful opponent. Funding agreements can be seen as a remedy to this problem, shifting legal costs to a third party, thereby allowing claimants with limited financial resources to pursue their claims in common law courts or arbitral tribunals (Flake, 2015, p. 115).

On the other hand, third-party funding "allows defendants with strong defences to avoid surrendering to pressure from a better-funded plaintiff to enter into an early settlement agreement" (Cremades, 2011).

It is obvious that arbitration should provide services that are available to any litigant, not only to certain categories of claimants, but to all those who have valid claims or a solid defence but cannot go to arbitration because they do not have of the necessary financial resources. Not only will this benefit smaller businesses, it could also improve public opinion of the legal system itself. Open and equal access to arbitration for all parties wishing to use it must remain a fundamental feature of any fair legal system (Bogart, 2013). Therefore, the first and perhaps the most important reason for the expansion of the TPF is the fact that, at the level of public policies, this is considered a solution for achieving the ideal of increasing access to justice. As a result of obtaining funding, the parties can have a realistic chance of asserting their rights, having the opportunity to go to arbitration without the risk of ending up in a situation of serious economic crisis due to the opening of the action.

In other words, the TPF process balances the balance between the parties in dispute resolution, if one of the parties involved has poor financial resources. Lack of access to justice could also affect perceptions of the fairness and legitimacy of international arbitration itself (Rogers, 2014). It is a considerable risk, which the international arbitration community should certainly try to avoid (De Boulle, 2014).

3.2. Risk transfer

Unlike state litigation, where the risks are borne by the party who made the claims or the party that loses the lawsuit, third-party funding provides a way to share the financial risks of arbitration (Khouri and Hurford, 2012). A party that would have to pay the entire bill of the arbitration action may feel compelled to drop the claim because of the high degree of risk. Process players, such as employers and corporations, typically have a higher risk tolerance, and when different levels of risk tolerance combine with different levels of available resources, the result is a level playing field unequal; the objective of fair and equitable arbitral justice is often thwarted by costs, processes and risks (Molot, 2010).

However, contracts with creditors can be structured in such a way as to allocate risks to the various parties involved, including lawyers working under conditional fee or contingency fee agreements, or other persons interested in investing in the case. In addition, financing lenders are experienced in assessing risk and are better equipped to manage it than most parties (Kirtley and Wietrzykowski, 2010).

3.3. Maintaining financial stability

The potential impact on the company's economic and financial viability and stability may also discourage a party from taking its dispute to arbitration. Third-party financing transfers the responsibility of covering the expenses to the financier, thereby giving more companies the opportunity to engage in arbitration proceedings and at the same time giving them the necessary security to maintain sufficient cash flow to avoid financial problems (Steinitz, 2011). Thus, they can continue their usual activity or even invest in new activities when pursuing a claim that meets all the conditions to be found well-founded. Companies could withdraw from arbitration proceedings if their possible continuation would endanger their liquidity.

At that time, they will balance the issues that would create the biggest problems for them: lack of liquidity, which would lead to the stagnation of the business, or giving up the claim and stopping the arbitration procedure. TPF can be a solution to this dilemma, as it allows the party using it to take the financial risk and cost of the procedures out of their financial situation, transferring them to the financier, while still being able to continue their normal business (De Boulle, 2014). In many arbitration proceedings, the main concern is the possible loss of the case, in which case the claimant would be liable not only for his own legal expenses, but also for the defendant's costs. The ability to disseminate and share these financial risks with a third party can be attractive even to clients with strong businesses and cash flows (Cremades, 2011).

3.4. Negotiation power

Third-party funding equalizes the bargaining power of plaintiffs and defendants, which gives the funded party better leverage to reach a settlement with the opposing party (Van Boom, 2011). Equalizing bargaining power can facilitate settlement of the dispute by agreement because financially stronger parties, who would otherwise have tried to take advantage of their financial power, would be more willing to engage in negotiations to reach to an agreement with the weaker (but funded) party at an early stage of the dispute (Cremades, 2011). Moreover, creditors often structure financing contracts in such a way that they favour the early settlement of the case.

3.5. The financier's specialized staff

As an indirect effect of entering into a third-party litigation funding agreement, clients can benefit from the human capital of the funders. Observations have been made in the literature that many funding firms are led by ex-lawyers with considerable litigation experience who focus on quickly, efficiently and successfully resolving funded cases to achieve maximum value achievable. By having a wide range of specialist skills and experience and being consistent with their own commercial objectives, a funder can bring real added value to the successful prosecution of arbitration claims (Khouri and Hurford, 2012). Funders can be helpful throughout the arbitration by providing advice on experts and arbitrators, providing input on strategic decisions and even helping the client hire new counsel if it becomes apparent that the current one does not have the skills or experience to successfully arbitrate the claim.

3.6. The attractive nature of the investment

The TPF industry in international arbitration is considered to be advantageous for numerous reasons, among which we mention the speed of arbitral proceedings; the high level of security related to the execution of arbitral awards, because there are several treaties that guarantee international enforcement, such as the New York Convention; prevalence of high value claims; the skills of decision makers; the fact that financiers typically seek a share of the recovered value ranging from 15% to 50%, depending on the costs and risks associated with financing the dispute (Nieuwveld and Sahani, 2017). We also mention here that the stagnation of the world economy and the associated uncertainty are determining factors for financiers, which increase the interest in third-party financing, because this is a way to make investments that are not related to unpredictable financial markets.

3.7. Equalization of the negotiation capacity of the parties

One of the main concerns in arbitration actions where the opposing parties are unequal in size is that the weaker party might be tempted to accept a less than reasonable settlement offer on the grounds that the offer would release it but of the burden of the dispute resolution process, regardless of how solid the claim it raises may be. Without the credible threat to the stronger party that the dispute could go to arbitration and possible enforcement proceedings, the weaker party would usually be forced to accept an agreement, drawn up unilaterally by the stronger party (Rodak, 2006). This is the sense in which the TPF is said to have a "bargaining power equalization" function.

Supporters of the TPF also point out that this will have a positive impact on the parties' agreements through which they reach an agreement (settlement) and may lead to early settlements mainly for two reasons: on the one hand, the financially stronger party will lose the power to impose unilateral settlement agreements; on the other hand, the presence of a funder is an indication to the opposing party that the plaintiff has a strong case, and this increased influence of the funded party will give the opposing party a greater incentive to negotiate a more favourable settlement. In addition, the fact that financing agreements are often worded and structured in such a way as to encourage the adoption of a solution in the shortest possible time, for example by including a provision that the funder will be charged a lower amount if the dispute is settled in one stage to begin with, it also contributes to the positive effect that TPF has on arbitration settlements (De Boulle, 2014).

On the other hand, critics of the TPF claim that it could have a negative impact on settlement, as a rational claimant would be reluctant to settle for any amount that is less than that advanced by the funder. As a result, the use of third-party financing would discourage plaintiffs from settling. In the same vein, it is assumed that financiers will be reluctant to accept settlement offers that would not recoup their investment in full (Nieuwveld and Sahani, 2017). Arguing this idea, the literature emphasizes the fact that there is no evidence to suggest that plaintiffs stay in the game to obtain more profitable settlements simply because they have to pay something to the financier, just as there is no evidence that plaintiffs, they want more profitable deals to cover the interest they had to pay to borrow money to cover their expenses (Bogart, 2013).

To support this view, the following analogy is made: plaintiffs in the US initiate lawsuits using the support of lawyers who grant them legal assistance based on a conditional fee agreement; based on it, they are aware that they are giving up part of the amount they would get from the deal. However, he accepts this from the outset and there is no reason to suggest that he would not agree to such an arrangement, which he considers reasonable due to the possibility that the payment of the fee may be made conditional on winning the case. TPF in arbitration is not much different from this situation.

We appreciate that both types of arguments are legitimate, but we tend to give more weight to the point of view of TPF supporters, because that this process has or could have on imbalances in bargaining power. This preponderance of arguments supporting TPF is also supported by the development of the third-party litigation finance industry, even if the pace of development is faster in some states and slower in others.

4. THE OPOSITE VIEW ON THE TOPIC

4.1. Public policy concerns

Third-party funding opens the door to claims based on less robust or interpretable legal grounds, as funded parties assume little or no financial risk and are therefore not always dissuaded from pursuing such claims. If the potential recovery is large enough, the lawsuit will be an attractive investment, even if the likelihood of getting that amount is low (Bogart, 2013). Third-party funding also unfairly raises the bar on out-of-court settlement negotiations, while inflating costs for unfunded opponents, potentially even increasing the client's costs.

Because they will often have little or no leverage when negotiating the terms of the financing agreement with their financiers, clients must be willing to give up substantial portions of their potential earnings to secure financing (Khouri and Hurford, 2012).

4.2. Conflicts of interest

Third-party funding can also lead to several ethical issues in arbitration, perhaps the most obvious of which is conflicts of interest. Funders need to obtain information to assess the viability of a claim, which can be problematic for lawyers, who have a duty of loyalty to their clients (Van Boom, 2011).

There are also suspicions indicating that, if TPF were to be used, lawyers might misdirect their loyalty towards financing creditors rather than clients, particularly in settlement negotiations, negotiations in which between clients and financiers there is no consensus. There may also be conflicts of interest between financiers and arbitrators because of multiple appointments of arbitrators, made indirectly by the same third-party financier, because of a pre-existing relationship between the financier and the arbitrator, or the shares held by the arbitrators in corporations specialized in financing (Trusz, 2013). Thus, litigation financiers are aware of the ethical issues that TPF entails, which is why they analyse not only the legal aspects, but also the ethical ones, before concluding the financing contract, hiring consultants of top, with recognized experience in their field of competence, who are aware of the evolution of TPF and the new ethical issues that stand out in practice (Pierce and Burnett, 2013).

4.3. Confidentiality

Another deontological issue regarding third-party financing in arbitration is the violation of the confidentiality of information obtained from the relationship with clients. Confidentiality is a fundamental right in the attorney-client relationship and is becoming increasingly important in arbitration, but it is threatened whenever a disinterested third party is introduced into this relationship. This is especially true when lenders perform an invasive screening process that includes confidential information before deciding whether to invest. Moreover, attorney-client privilege generally does not protect communications made in the presence of third parties that are not objectively necessary for attorney-client contact (Sebok, 2013).

4.4. The financier's control over the claims

Third-party financing tends to undermine the customer's control over the claim. Party autonomy is one of the cornerstones of arbitration, but financiers may seek to usurp control and influence strategic decisions to protect their investments (Sebok, 2013). Customer control could also be jeopardized by breaches of confidentiality or potential conflicts of interest, and some customers may even be required to delegate the handling of all claims during the litigation to the funder by way of power of attorney (Trusz, 2013).

Concerns about the ethical implications of third-party funding are not unfounded. However, there are numerous safeguards in place to address potential ethical issues should they arise. For example, conflicts of interest are governed by the general principle that lawyers have ethical obligations only to their clients, not to third parties (Flake, 2015). Any possible tendency of them to favor the interests of financiers at the expense of clients is strictly regulated by the code of ethics of the profession - including disciplinary sanctions and liability in case of malpractice - and by the clauses of the financing contract (Khouri and Hurford, 2012).

Codes of ethics in most countries that apply TPF prohibit lawyers from accepting compensation from a third party in any situation that involves interference with independence in the exercise of the profession or the lawyer-client relationship. In addition, financing agreements may expressly provide that in the event of a conflict of interest between the claimant and the funder, the lawyer may continue to act exclusively for the claimant, even if the interests of the funder would be adversely affected by this measure. Conflicts of interest that may arise between creditors and arbitrators can be neutralized by establishing the obligation to declare them (Brabandere and Lepeltak, 2012). For example, under the arbitration rules established by the American Bar Association (ABA), arbitrators are required to disclose any circumstances that might raise reasonable doubts as to the impartiality or independence of the arbitrator.

Equally, under the Revised Uniform Arbitration Act (RUAA) arbitrators are required to disclose any known facts that a reasonable person might consider affecting their impartiality, including financial or personal interests and relationships with any part of the arbitration action (Flake, 2015). Privacy issues arising from third-party funding are also solvable. Nondisclosure agreements are increasingly common in arbitration and can be extended to include funders (Menkel-Meadow, 2002). It is true that the due diligence process sometimes requires access to confidential information to fully assess the merits of a claim, and clients who provide such information to funders may indeed waive attorney-client privilege (Giesel, 2012). However, the lawyer must obtain the client's informed consent before releasing information to a third party, and communications with funders may still be protected by the professional secrecy rule, provided that they have been conducted in preparation for a actions.

Finally, critics exaggerate the extent to which undermining customer control is a problem (Sebok, 2013). Common law allows parties to waive control over legal claims by contract, in various contexts, and in third-party financing, the financing contract dictates the level of control granted to the financier.

In our view, the fact that funders can be given a certain degree of control is not necessarily problematic, since "the competence of the funder in a certain type of case could lead to the proposal of better tested strategies and the making of better-informed decisions than would be possible in the case of an inexperienced claimant". In most cases, financiers do not need to usurp control from the client because their interests are aligned (Khouri and Hurford, 2012).

It is also unlikely that funders will ask to take control after they have already carried out background checks on the application and the lawyer's background. A body of literature argues that courts and legislatures should allow third-party funding in domestic arbitration and asserts that the arguments against the use of this funding technique are exaggerated and inaccurate considering current public policy and ethical safeguards. Although the perspective on the possibility of financiers to guide the litigation may differ from one regulation to another, the recent proposal of the European Commission for the adoption of a Directive at the EU level regarding the regulation of third-party financing of litigation is of interest, more precisely the provision found in art. 14 par. 2, which explicitly recommends that "Member States should ensure that third-party funders are not allowed to influence the decisions of a claimant during the proceedings in a way that would benefit the litigation funder itself and the detriment of the claimant. For this purpose, any clause in the third-party funding agreements granting a litigation funder the power to make or influence decisions in relation to the proceedings shall have no legal effect".

As I mentioned in this paper, the text proposed to be included in the future provision reflects without a doubt the position of the European Union regarding the role of financiers in the evolution of the litigation and prevents situations in which the rights of the party could be prejudiced by the purely economic interests of the financier, such contractual clauses being devoid of legal effects. Moreover, the party in the process has the possibility to choose the option that it considers the safest for obtaining the expected result.

4.5. Increasing the volume of cases

Doctrinaires who express critical positions towards the use of the TPF thus express their concern in the sense that the use of funding will lead to an increase in the volume of cases subject to settlement, as it allows some baseless claims to end up in court or be subject to arbitration (De Boulle, 2014). They justify their support by arguing that the probability of success is only one component of the funding decision, another being the potential value that can be recovered. Therefore, it may be that the value at stake outweighs the likelihood that that value will be recovered. Furthermore, some commentators fear that funders will have no qualms about creating portfolios consisting of high-risk cases (i.e.

unfounded claims) and low-risk cases (i.e. claims with a high chance of success) to add to a place high-risk case and sell them to third-party speculators as financial derivatives (Kantor, 2009).

Third-party speculators would thus invest and profit from unsubstantiated claims that, sold individually, would otherwise have no market. In addition, it is assumed that financiers would be less motivated to carry out a thorough check to decide whether a claim is unfounded, since the risk of loss would be spread among many investors (Cremades, 2013).

5. CONCLUSION

TPF could thus evolve over time into a complicated financial engineering involving other related financial products such as credit default swaps. Credit default swap is a convention like insurance against certain risks (such as bankruptcy, inability to pay the debtor), in exchange for periodic payments (like an insurance premium). The one who is "insured" against this risk is considered the buyer of the credit default swap, while the one who assumes the risk of default is the seller of the credit. Its advantage is that, in case of impossibility of payment, the credit seller assumes the obligation to pay; instead, if this event does not occur, the credit seller keeps the periodic amounts paid by the buyer.

However, it remains to be seen how the market will develop and whether demand will continue to grow in the coming years. We thought it useful to mention this matter, given the possible impact it could have on the further development of the TPF industry. It can be argued, therefore, that the risk is not quite negligible in the sense of an increase in the number of unfounded claims financed in court or in arbitration by third parties. This risk is increased when portfolios of high-risk cases are created, which are then sold as derivatives. We are thus in a different scenario from the case-by-case financing situation, where there is, as a rule, very little reason for financiers to get involved in claims that do not meet the legal requirements to be considered well-founded.

In the first scenario, however, financiers could cover some of their risks by also accepting some low-risk cases. Consequently, financiers will have a higher appetite for risk when financing a portfolio of cases, in which case there is also a higher probability of financing frivolous claims. Although numerous points of view are expressed in the doctrine that express the concern analysed above, there are also authors who state that until now there is no conclusive evidence that the TPF would promote unfounded causes. Moreover, the number of cases that are resolved because of benefiting from TPF has not increased so much as to justify this type of concern, i.e. the unjustified increase in the prosecution of numerous, mostly unjustified, claims.

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