

After covid-19: the next chapter for arbitration finance in Latin America

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The rise in demand for dispute resolution in Latin America has spurred the creation of a handful of local arbitration funders in recent years. Covid-19 opens the door to new opportunities – and challenges – for this breed of investor. Detlef Huber, managing director at Carpentum Capital, a Swiss litigation fund specialised in Latin America, explains why.

In Latin America it is more accurate to speak of arbitration – as opposed to litigation – finance because no one really

wants to finance never-ending legal fights in local courts. In fact, there is no need to, as court proceedings from Argentina to Mexico are relatively cheap compared to Anglo-American standards.

Therefore, the funding of legal costs in the region is shaped around arbitration (national and international). In recent years this had led to the establishment of some of the first local players – in Brazil in 2014 (Leste), Peru in 2016 (Lexfinance) and Chile in late 2019 ([Hakamana](#)). Another specialised funder is Carpentum Capital, founded in 2018, which operates out of Switzerland and has lawyers on the ground in Argentina, Brazil and Chile. Bigger international litigation funders like Burford, Woodsford or Harbour also operate in Latin American markets but mainly in the segment of pricey investor-state disputes driven by larger, international law firms.

The scene so far

You could say that arbitration finance is still in its infancy in Latin America as regards the local markets and its use by law firms and claimants. But then again there is no such thing as a “Latin American” legal market, although we keep talking about it. Just like in Europe, when it comes to arbitration or its funding you have very different markets in different states of sophistication. Argentina, for example, only passed its international arbitration law in 2018, whereas Brazil, Peru, Colombia and Chile welcomed arbitration as a dispute resolution method much earlier. Indeed, arbitration was sometimes even pushed by governments to make countries more attractive for international investors. Large companies in several jurisdictions equally realised that arbitration may be more expensive, but it is the more reliable form of dispute resolution. Hence you see more and more arbitration clauses in commercial contracts.

The trend in many (not all) Latin American jurisdictions is clear. Arbitration is on the rise. And so are the costs. Especially when it comes to international arbitration and internationally renowned arbitrators. Arbitral institutions will be more costly than local courts and law firms with expertise in that area also charge different rates. This combination – the wider use of arbitration and its higher costs – are one of the drivers of litigation finance in Latin America. But there are other reasons too.

More international law firms have started to operate directly out of Latin America and local or even regional boutique firms have been established. All staffed by highly experienced jurists with international experience in London, Washington, New York or Paris who have decided to continue practising on their home turf. Slightly lower

rates and more flexibility as regards fee arrangements used by local or regional firms also help to create more interest in arbitration and of course its funding.

Nevertheless, the awareness of arbitration funding as a financing tool is still very low if you carve international law firms out of the equation. Local claimants may never have heard of litigation funding at all. In the past, these claimants will either have avoided legal fights or worked with a lawyer willing to take a risk. But the latter does not always work for complex disputes with the necessity of larger legal teams. The capacity of a law firm to take risk may also be limited.

But what is missing to push arbitration funding in Latin America to the next level and what role could covid-19 play?

The next chapter

Spreading awareness of that litigation funding – ranging from funding the costs of a single arbitration to portfolio funding for law firms and companies, to the monetisation of awards – is an option is key. Although the concept as such is known by most law firms, there is less familiarity with the process and we are far away from law firms taking a proactive approach in informing clients about this opportunity. We are sure this will change very soon.

There is also a lack of understanding from the side of the funders. It starts with language and awareness of the legal systems and ends with expectations. Don't operate in the region if you do not speak Spanish and Portuguese. It is true that most lawyers or corporate counsel speak English, but that's not the point. You need to show dedication to the local markets and its peculiarities. You are also dealing with civil law jurisdictions in Latin America as opposed to the common law jurisdictions Anglo-American funders are used to operating in. You are facing an environment that does not rate confidentiality agreements that are 12 pages or more very highly. What works in the US, the UK or Hong Kong does not necessarily work in Bolivia, Chile or Peru. Hence, the funding market should shape its offering around local needs and not apply international standards to different jurisdictions in Latin America. As stated above, these funders do already exist and there will be more.

Another important point is the expectation as regards the capital volumes allocated by arbitration funders to Latin America. Due to lower legal fees compared to international arbitration hot spots, local arbitral institutions that may be more economic (but equally efficient) as international ones and because of missing US-style discovery proceedings that may break the bank, you will find fewer proceedings costing one or more million US dollars. This means the number of cases you will need to finance to allocate a substantial amount of any fund will be higher than elsewhere. Funders need to adapt to this situation. If they do that, the market should benefit from a potential wave of new cases driven by the upcoming covid-19 recession.

The economic crisis will lead to more bankruptcies in various sectors. We are seeing huge infrastructure projects on hold and expect a wave of claims against insurance companies, as well as breach of contract claims in general. In investor-state disputes we envisage states might be tempted to change their tax regimes, cut privileges given to certain investors or industries or favour national industries as opposed to international investors to cope with the crisis.

From the perspective of law firms, we would also expect more interest in funding of portfolios if (full or partial) contingency deals cannot be cross-financed by incoming transactional or advisory work anymore. These are areas where we believe clients may be more cautious with their spending.

In addition, companies that would easily pay their legal fees in the past might now have other issues and priorities. Fighting for survival will be more important than fighting for justice. Again, an area arbitration finance can assist, as funders can jump in at any time. We also foresee that companies may try to unwind deals already done or raise force majeure arguments to avoid payments for settlement agreements or after unfavourable awards.

All in all, covid-19 will force claimants as well as law firms to consider different ways of financing their proceedings.

But this is only one side of the coin.

The liquidity crisis does not only affect claimants, of course. It will also be harder to evaluate the creditworthiness of defendants. What may have looked like a great risk

for a funder or deep pocket for a claimant could suddenly turn out to be an empty pocket. An airline, a rental car company, a chain of hotels, a construction company or even a state that may have looked like an attractive counterpart, could now be in deep trouble and too risky.

Therefore, more lawsuits presented to an arbitration funder in Latin America do not necessarily mean more funded cases. Investors – who are already pretty conservative – will be pickier as the creditworthiness of a prima facie sound company may not be that good in the end.

But in any case, the demand for funding and its products and processes will increase (in fact it already is), which again will bring awareness levels up. Although we do not expect a dramatically changed landscape of litigation funding in Latin America in a couple of years, there will be movement. And covid-19 will accelerate what would have happened anyway. In arbitration-friendly jurisdictions, funding will become a widely used tool to the benefit of claimants, lawyers and also investors.