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Third-Party Funding in International Arbitration – A Menace or Panacea?

By

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As its Council Member I attended the ICC Institute of World Business Law's 32nd annual meeting on 'Third-Party Funding in International Arbitration' held in Paris on 26 November 2012. It was a grand success as it drew many professionals, arbitrators, experts, academic specialists and, above all, representatives from some major third-party funding bodies such as Burford Group Ltd., Calunius Capital LLP, Fulbrook Management LLC and others, and the discussion and debates generated a great deal of interest among the participants. The presented topics ranged from the concepts of litigation and arbitration financing to more complicated issues such as ethical issues of third-party funding (TPF), due diligence and decision making process in investing in claims by third parties, conflict of interests for arbitrators / counsel, arbitrator's independence and impartiality, confidentiality and disclosure of TPF and the problems of TPF in investor-State arbitration. The purpose of this blog is to highlight some of the burning issues passionately debated in the meeting. Following the Chatham House Rule the views express herein will not be specifically attributed to any individual or organization.

One of the issues debated was the concept and nature of TPF itself. As the concept is ever evolving in recent years in the field of arbitration, the participants' views did not seem to point to a consensus on a fixed definition of TPF. However, certain existing models in practice were articulated in the discussion. The notion of third-party litigation financing (in a broad sense) is not new as it has been in practice in the USA for more than a century now (*i.e.* contingency fee arrangement), though in Europe it is relatively a new phenomenon and fragmented in practice (*e.g.* conditional fee arrangement is permitted in England; pure contingency fee arrangement is permitted in Italy while it being prohibited in England and in many other countries in Europe such as France, Switzerland, Sweden and Spain). In the field of arbitration TPF is recently emerging as an attractive option facilitating access to justice to an impecunious party who may have a credible / meritorious claim. Arbitration finance is a specialty corporate finance focused on arbitration claims (*i.e.* the award proceeds) as assets being used as collateral to obtain such finance which is a non-recourse one. The reward or return of the third-party funder is said to be determined on a case-by-case basis. Normally, a percentage of the damages ranging from 20 percent to 40 percent or a cost multiple, usually running from two to four, or a combination of these is applied to determine the third-party

funder's return. Some participants expressed various ideas around the concept of TPF such as third-party funder's buying equity interest in the claim or a share in the proceeds of a prospective arbitral award, or a joint venture (in the sense of equity joint venture, *i.e.* by monetizing the claim) arrangement between the client and the third-party funder. As opposed to the aforementioned narrow connotation to TPF, others tended to suggest a broad one encompassing also other contracts as "derivatives" such as contingency fees arrangements between a client and counsel and insurance contracts (*e.g.* for adverse costs), etc. Some third-party funders indicated that TPF, in time, might evolve into complex financial engineering (*e.g.* credit default swaps) involving other related financial products, but it remains to be seen as the market develops and demand grows in the years ahead. The third-party financing is an investment *per se* in arbitration (albeit a high-risk investment) to be described as a portfolio investment rather than direct. Both claimants and respondents can take the advantage of TPF at any stage during the arbitration proceedings and beyond, *i.e.* at the stage of the enforcement of the arbitral award.

A significant amount of time was dedicated to the debate of ethics of TPF and thereby conflict of interests that might arise in that respect. The involvement of a third-party funder may raise the issue of impartiality or independence of an arbitrator in certain circumstances. For example, a situation could arise where a person acts as an arbitrator in a case in which the claimant is financed by the same third-party funder who had also financed a claimant in another case in which the same person (*i.e.* the arbitrator) acted as that claimant's Counsel. So, the same third-party funder's involvement in two cases with the same person acting in two different capacities, *i.e.* arbitrator and counsel, could raise issues of impartiality or / and independence of the latter, *i.e.* conflict of interests. Apart from that, the third-party funder's influence or involvement, if any, in the choice of an arbitrator could also beg the question whether that might bring to bear on the determination of the eventual amount of damages in the prospective arbitral award. Among the other concerns expressed was the probability of a third-party funder's abuse of its stronger bargaining leverage against a vulnerable impecunious party in any way. Furthermore, the involvement of a third-party funder could deter the prospect of a settlement of the dispute by the parties if it does not satisfy the funder's requirements, though acceptable to the client, whilst, on the other hand, it was argued by some funders to the contrary that TPF could rather be used as a weapon for a satisfactory settlement, after all, for all the parties involved.

Since there is a possibility of conflict of interests or ethical issues arising in the presence of a third-party funder in an arbitration, it was felt by many participants that such presence should be disclosed. On this point various issues were raised as to the nature (*i.e.* whether mandatory or voluntary disclosure) and the extent of disclosure (*i.e.* whether of the mere existence of a third-party funding arrangement or of the actual funding agreement), to whom to disclose (whether to the arbitral tribunal and / or to all the parties and stakeholders involved) and the time to disclose (before or at the beginning of the arbitration, or at some point in the arbitral proceedings)[See on the issue of timing of TPF impacting ICSID jurisdiction in a most recent case: *Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanos del Sur S.A. v. The Argentine Republic*, ICSID Case No. ARB/09/1(Decision on Jurisdiction, December 21, 2012), including *Dr Kamal Hossain's Separate Opinion*, http://italaw.com/chronological_list.htm] It was felt that the representatives of the third-party funding companies present were not in favour of an extensive disclosure of the terms and conditions whatever might have been agreed between the third-party funder and its client as in many respects confidentiality rules apply for various reasons (including the sensitive nature of information, or matters involved may be concerned with the economics of the deal, *etc.*) and in their view no question of mandatory disclosure should arise, let alone the fact that there does not exist so far on the international level any established rules requiring such disclosure. Some participants felt that in some situations there may be a need for disclosure in good faith, otherwise it would lead to the breach of procedural good faith. When some participant questioned as to why third-party funders are 'secretive about disclosure' to which a funder representative retorted by saying that it is

preferable to use the expression 'cautious about disclosure' to better reflect the state of affairs. According to third-party funders, if for any reason the conflict of interests, transparency, adverse costs, or security for costs is in issue, or a settlement is being discussed, only limited disclosure of third-party funding is tolerable.

One of the important issues discussed concerned TPF in the context of investor-State arbitration. Thus, as a recipient of TPF a State party may have its sovereign authority issues or political implications as a third-party funder may exercise control over the dispute strategy and management whilst the former may have little or no control as it may have to submit to the whims and considerations of the third-party, often contrary to the State's public policy. There could also be the possibility of the state's regulatory or nationalization measures being attributed to the interest of the third-party funder which might not be unusual though in the case of some corrupt governments. Thus, there could be issues of public policy, transparency and the State's accountability to the public when the relationship between the State and the third-party funder may not be perceived as level playing because of the overbearing control exercised by the third-party funder. It has been warned by some participants that the disclosure of the presence of a third-party funder on the other side is essential to the State party in the public interest.

Last but not least, the serious question whether TPF should be regulated or not was debated passionately. If it is to be regulated, then how - by hard law or soft law? The issues such as the extent of regulation and its *modus operandi* were also discussed. The overall question of regulation of TPF centred on dealing with some ethical issues, *i.e.* to prevent the: (i) abuse of TPF arrangement for excessive and unreasonable profiteering (*e.g.* 90% of the award proceeds) in some cases, (ii) unreasonable exertion of influence in arbitration strategy including selection of arbitrators defying the requirement of impartiality and independence of arbitrators, (iii) possible exploitation of attorney-client privilege and confidentiality and (iv) funding of frivolous cases intended to inflate the value of funders' portfolios, and, above all, to avoid a subprime-mortgage-induced financial disaster like situation of the recent past in the field of arbitration that might cause irreparable reputational damage to arbitration as an institution itself. The soft-law, *i.e.* non-binding, instrument such as the Code of Conduct for Litigation Funders (November 2011) issued by the Association of Litigation Funders of England and Wales was not considered robust enough to deal with the concerns expressed, let alone the question of its applicability to international arbitration. One participant reminded the International Chamber of Commerce of its duty to serve the international business community in this respect by taking timely measures to develop principles and rules to regulate TPF. Some other participants also called for initiatives by other international professional bodies such as IBA and ICCA, etc., in this respect.

These were just some of the concerns expressed in respect of TPF. It was, however, felt by the majority of the participants that whilst TPF is a welcome option and not a bad idea at all as it allows a financially distressed party, either claimant or respondent, to have access to justice otherwise denied, it needs to be regulated for the welfare of the arbitrating parties (and not in the least for the protection of the reputation of third-party arbitration funders) and the stability and the longevity of arbitration as an institution itself (perhaps a reminder in the wake of some states' renouncing of investment treaty arbitration lately!).

One thus needs hardly reminding:

'Fire can burn down the earth, but if its use is regulated it can contribute to the welfare of all on the planet'.