

**DRAFT REPORT FOR PUBLIC DISCUSSION  
OF  
THE ICCA-QUEEN MARY TASK FORCE  
ON THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION**

**1 SEPTEMBER 2017**

## **ICCA-Queen Mary Task Force on Third-Party Funding In International Arbitration\***

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\* In addition to Task Force Members, the Report benefitted from a number of special consultants, who will be acknowledged in the final version of the Report.

## **About ICCA**

The International Council for Commercial Arbitration (ICCA) is a worldwide nongovernmental organization (NGO) devoted to promoting the use and improving the processes of arbitration, conciliation and other forms of resolving international disputes. Its activities include convening biennial international arbitration congresses; sponsoring authoritative dispute resolution publications (including the ICCA Yearbook Commercial Arbitration, International Handbook on Commercial Arbitration and ICCA Congress Series); and promoting the harmonization of arbitration and conciliation rules, laws and standards. ICCA has official status as an NGO recognized by the United Nations. See <[www.arbitration-icca.org](http://www.arbitration-icca.org)>.

## **About Queen Mary**

Queen Mary University of London is one of the UK's leading research-focused higher education institutions and one of the biggest University of London colleges. It offers teaching and produces research across a wide range of subjects in the humanities, social sciences, law, medicine and dentistry, and science and engineering, for over 130 years. The School of Law at Queen Mary University of London, where more than 2,000 students study law annually, has been consistently ranked within the top 5 law schools in the UK and the top 35 law schools in the world.

<[www.qmul.ac.uk](http://www.qmul.ac.uk)>

Any views expressed in this draft Report are those of the Task Force and not those of Queen Mary or ICCA, its Governing Board, or members. Although this draft Report is the result of the collective efforts of the Task Force, the views expressed are not attributable to any particular Member of the Task Force.

## FOREWORD

This draft Report of the ICCA-Queen Mary Task Force on Third-Party Funding is circulated for the purpose of generating discussion and in order to solicit public comments. The ICCA-Queen Mary Task Force on Third-Party Funding is a joint Task Force established by ICCA and Queen Mary, University of London in 2013.

This draft of the Report, the “Draft Report for Public Comment,” is being published from 1 September through 31 October 2017 for the purpose of obtaining public comment and feedback. After incorporation of such feedback a final version of the Report will be published as a Volume of the ICCA Reports.

The Task Force was composed of a diverse group of leading experts from a wide range of professional backgrounds, including arbitrators, in-house counsel and law firm counsels, members of arbitral institutions, academics, State parties, and a range of funders and brokers. The Task Force is co-chaired by William W. “Rusty” Park, a member of the Governing Board of ICCA, Stavros Brekoulakis, a professor at Queen Mary University of London, and Catherine A. Rogers, also a professor at Queen Mary University of London, and at Penn State Law. The work of the Task Force was coordinated by ICCA Executive Director Lise Bosman and Deputy Executive Director Lisa Bingham.

Preparation of this Draft Report for Public Comment was undertaken by designated individuals who led Sub-Committees to study specific topics. Their work was assisted by the co-chairs and other the Task Force Members. It is based on the work of the Task Force, including discussions at numerous Task Force roundtable meetings over the course of the past three years, related presentations and public discussions, and comments received by Task Force Members and special consultants.

We hope the Draft Report for Public Comment will facilitate robust discussion and submission of concrete feedback through specially organized events, and through submission of comments directly to the Task Force co-chairs at [tpftaskforce@arbitration-icca.org](mailto:tpftaskforce@arbitration-icca.org).

The final Report of the Task Force will be launched at the ICCA Congress in Sydney in April 2018.

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\* During the Public Comment period, the bibliography for the Draft Report for Public Comment will be made available at [http://www.arbitration-icca.org/projects/Third\\_Party\\_Funding.html](http://www.arbitration-icca.org/projects/Third_Party_Funding.html).

## Chapter 1

### Introduction

Modern forms of third-party funding are no longer new to international arbitration.<sup>1</sup> Recent years have seen significant increases in the number of funders, the number of funded cases, the number of law firms working with funders, and the number of reported cases involving issues relating to funding. As a result, third-party funding has increasingly drawn the attention of commentators and scholars, and even more recently of arbitral institutions, national regulatory authorities, and State trade negotiators.

Notwithstanding these trends, many questions remain about the relationship between funding and international arbitration process. To address these questions, in 2013 the International Council for Commercial Arbitration (ICCA) in collaboration with Queen Mary University of London convened a Task Force on Third-Party Funding in International Arbitration. Since its inception, the Task Force has undertaken sustained study and discussion of relevant issues, and its findings are presented in the balance of this Report. This introductory chapter provides an overview of the organization and work of the Task Force.

#### I. Composition of the Task Force

The Task Force is co-chaired by William W. “Rusty” Park, a member of the Governing Board of ICCA, Stavros Brekoulakis, a professor at Queen Mary University of London, and Catherine A. Rogers, also a professor at Queen Mary University of London, and Penn State Law. The work of the Task Force was coordinated by ICCA Executive Director Lise Bosman and Deputy Executive Director Lisa Bingham.

The Task Force included representation of stakeholders from diverse geographical and industry perspectives. It was composed of over fifty members from over twenty different jurisdictions around the world. The members included arbitrators, in-house counsel, State parties,<sup>2</sup> external counsel, representatives with experience at arbitral institutions, academics, and a range of third-party funders and brokers. The Task Force first met as a group on 12-13 February 2017, and then on several occasions since then, to engage in substantive roundtable discussions.

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<sup>1</sup> In some sectors, such as maritime, forms of third-party funding have long-existed. In this respect, many of the types of funding addressed in this Report may be regarded as “modern” forms of funding.

<sup>2</sup> All individuals on the Task Force who are employed by States served on the Task Force in their individual capacity.

These discussions were generally organized around reports on specific topics prepared and presented by individual Task Force Members. Report topics included arbitrator conflicts of interest, costs and security for costs, privilege, and implicated a range of other definitional, policy, and practical issues. The work of the Task Force and this Report also benefitted from extensive consultations with various groups and organizations during this time, and it is hoped will also receive feedback received during a public comment period from 1 September through 31 October 2017, both through individual comments and through the numerous roundtable discussions and public symposia that are organized during that period.<sup>3</sup>

## II. Task Force Objectives

The Task Force's objectives emerged out of its work. No specific work product was initially envisaged and no specific mandate explicated. Its starting objective was to identify and study the issues that arise in relation to third-party funding in international arbitration, and to determine what outputs, if any, would be appropriate to address them.

Initially, views of Task Force members largely reflected the range of perspectives that had been publicly expressed. Some were generally disinclined to produce any form of prescriptive guidance, both for substantive reasons (examined in greater detail below) and in light of what some regard as an excess of "para-regulatory" or soft law instruments in international arbitration.<sup>4</sup> Others believed that the Task Force should aim to produce for international arbitration a code of conduct for third-party funders, similar to the Litigation Funders Code in England and Wales, or other form of regulation.

Despite these initial differences, the Task Force quickly identified two questions on which members of the Task Force agreed. First, members agreed that all stakeholders would benefit from greater understanding about what third-party funding is and from multi-lateral dialogue about the issues it raises in international arbitration. From this observation, one of the Task Force's primary objectives emerged: to facilitate education and informed dialogue.

Second, members agreed that stakeholders would benefit from greater consistency and more informed decision-making in addressing issues relating to third-party funding.<sup>5</sup> The

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<sup>3</sup> A list of events at which the Task Force's work and drafts have been or will be presented can be found at [http://www.arbitration-icca.org/projects/Third\\_Party\\_Funding.html](http://www.arbitration-icca.org/projects/Third_Party_Funding.html).

<sup>4</sup> See generally Daniele Favalli (ed.), *The Sense and Non-sense of Guidelines, Rules, and other Para-regulatory Texts*, International Arbitration, ASA Special Series NO. 37 (Juris 2015); but see Queen Mary Survey, (finding an overall positive perception of guidelines and soft law instruments, with only 31% responding either that they were too numerous or not useful) Queen Mary University of London and White & Case, "2015 International Arbitration Survey: Improvements and Innovations in International Arbitration" (2015) available at <http://www.arbitration.qmul.ac.uk/docs/164761.pdf> (last accessed 21 August 2017).

<sup>5</sup> Norton Rose Fulbright, International Arbitration Report (September 2016), available at <http://www.nortonrosefulbright.com/files/international-arbitration-report-issue-7-142408.pdf> , last visited 29 August 2017 (In the words of one funder, "What we seek in relation to the twin issues of adverse costs and security

challenge, of course, is that however desirable consistency may be in the abstract, disagreement remains—both on the Task Force and beyond—about how and on what terms such consistency should be achieved.

In both public debates and on the Task Force, debate has largely moved beyond questions about whether third-party funding should be permitted, to evaluation of more specific issues that are implicated by third-party funding.<sup>6</sup> Divergent perspectives on these issues remain, however, and in turn affect how differently situated stakeholders view the appropriate means and standards for achieving consistency. The Task Force began its work cognizant of the tensions among a need for consistency, the continued and evolving debate about third-party funding, and (as discussed in greater detail below) the rapid pace of evolution both in international arbitration practice and the funding market. Against the backdrop of these tensions, the Task Force began its work by identifying the most frequently occurring issues that arise in relation to third-party funding in international arbitration.

Since the Task Force was initially constituted in 2013, there have been several important developments relating to third-party funding. The funding market has expanded in several respects. The number of cases funded has increased significantly. The number and geographic diversity of funders has also increased, with new entities continuing to enter the market and consequently increase the aggregate amounts available for funding. Perhaps most importantly, the forms of dispute financing have expanded significantly, raising challenging questions about how “third-party funding” should be defined.

Other developments involve changes in the regulation of third-party funding. Just in the year prior to publication of this Report, prohibitions against funding international arbitrations have been relaxed or eliminated in some important jurisdictions, most notably Hong Kong and Singapore. In conjunction with relaxing prohibitions against funding in international arbitration, these jurisdictions also introduced new regulations, most importantly with respect to disclosure for

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for costs is certainty. We simply want to know when and on what bases we will be liable to pay these amounts.”); Van Boom (“In investment arbitration, the parties do not have certainty at the beginning of proceedings if, and to what extent, the English or American rule will be applied concerning cost-shifting. This probably renders it unappealing for TPF funders to voluntarily disclose their involvement.”); *see also* William H. VAN BOOM, “Third Party Financing in International Investment Arbitration”, (21 December 2011) p. 50, available at: <http://poseidon01.ssrn.com/delivery.php?ID=427100007071003098024124025083107086060033061010095011108114103076068007111081120120049058116059030048032000068124093071025097050083035032000084076067101091115100027052023101090100089027068021072067103072109082097092106073088066081107104125023098092&EXT=pdf> (last accessed 27 October 2016).

<sup>6</sup> As one commentator explains:

“Whether in favor or against TPF, the industry is increasingly requiring a clear, uniform and binding regulatory framework within the field of international arbitration. This is confirmed by the results of the [2015 Queen Mary School of International Arbitration survey](#) where a clear majority of practitioners (71%) expressed a desire for regulating the industry, and approximately half of respondents (49%) with practical experience in TPF agreed with the findings.”

Francisco BLAVI, “It’s About Time to Regulate Third Party Finding” Kluwer Arbitration Blog (17 December 2015) available at <http://kluwerarbitrationblog.com/2015/12/17/its-about-time-to-regulate-third-party-funding/?print=pdf> (last accessed 20 August 2017).



the purpose of assessing arbitrator conflicts of interest. At the same time, other international bodies also introduced new obligations, particularly with relation to disclosure.<sup>7</sup>

Another, more amorphous development is that in recent years the poles of the debate over third-party funding appear to have moderated somewhat.<sup>8</sup> When the Task Force started, it was more common to hear, at least among some funders, that funding is essentially just a form of corporate finance, which should not be subject to any regulation other than what already exists within financial markets.<sup>9</sup> By contrast, particularly in the international investment context, there were arguments to eliminate third-party funding because of its asserted consequences for the real and perceived legitimacy of investment arbitration.<sup>10</sup>

A number of reasons explain why some of the more extreme positions are not asserted as often or with as much vigour. First, third-party funding has also become available to and has been used by State parties in investment arbitration, and in some cases it has provided access to justice that a legitimately aggrieved party would not have been able to bring. These developments have made it more difficult to fundamentally reject the practice altogether. It is also now more generally recognized by both supporters and detractors that, in a globalized market for legal services and among arbitration providers, third-party funding is here to stay.

Modern forms of funding are also now recognized as resembling in essential ways certain alternative types of funding that have long-existed and are more widely accepted, such as contingency and conditional fee arrangements and insurance.<sup>11</sup> These similarities can make it difficult to draw distinctions that would be a basis for limiting or precluding third-party funding, and these difficulties are in turn complicated by the challenges in regulating the legal

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<sup>7</sup> For a discussion of international investment treaties and agreements that address third-party funding, see Chapter 4, at p. 48.

<sup>8</sup> As one article described, at one end of the spectrum third-party funding was regarded as the “arbitration antichrist,” while at the other end it was regarded as “the best thing since sliced bread.” Sebastian PERRY, “Third-Party Funding: The Best Thing Since Sliced Bread?”, GAR (28 November 2012) (reporting on GAR Live London debate) available at <<http://globalarbitrationreview.com/news/article/31006/third-party-funding-best-thing-sliced-bread>> (last accessed 27 August 2017).

<sup>9</sup> See, e.g., Bogart (“To look to the *identity* of the capital provider and treat specialist firms like Burford differently from other providers of financial support in litigation and arbitration is unfair and discriminatory.”) Christopher P. BOGART, “Third-party financing of international arbitration”, *The European Arbitration Review* 2017 (14 October 2016) available at <<http://globalarbitrationreview.com/insight/the-european-arbitration-review-2017/1069316/third-party-financing-of-international-arbitration>> (last accessed 19 August 2016).

<sup>10</sup> See Eric DE BRABANDERE and Julia LEPELTAK, “Third-Party Funding in International Investment Arbitration”, 27 (2) *ICSID Review* (2012) pp. 379-398 available at <<https://doi.org/10.1093/icsidreview/sis017>> (last accessed 22 August 2017); Marco DE MORPURGO, “A Comparative Legal and Economic Approach to Third-Party Litigation Funding” 19 *Cardozo Journal of International and Comparative Law* (2011) p. 343 at p. 384; See Munir MANIRUZZAMAN, “Third-Party Funding in International Arbitration—A Menace or Panacea?” *Kluwer Arbitration Blog* (29 December 2011) available at <[http://kluwerarbitrationblog.com/2012/12/29/third-party-funding-in-international-arbitration-a-menace-or-panacea/?doing\\_wp\\_cron=1503332583.8441140651702880859375](http://kluwerarbitrationblog.com/2012/12/29/third-party-funding-in-international-arbitration-a-menace-or-panacea/?doing_wp_cron=1503332583.8441140651702880859375)> (last accessed 20 August 2017); For coverage of this issue in the popular press, see BuzzFeed News, “Let’s make then poorer and we’ll get rich” (31 August 2016) available at <[https://www.buzzfeed.com/chrishamby/not-just-a-court-system-its-a-gold-mine?utm\\_term=.mrD3wzYQZ#.ovZwDejmL](https://www.buzzfeed.com/chrishamby/not-just-a-court-system-its-a-gold-mine?utm_term=.mrD3wzYQZ#.ovZwDejmL)> (last accessed 27 August 2017).

<sup>11</sup> See Chapter 2, at p. 15, and Chapter 3, at p. 55.

representation of parties in international proceedings. For proponents and opponents of funding, therefore, it is now generally accepted that funding will be part of the modern reality in international arbitration.

Finally, the international arbitration community has focused on finding solutions to the high cost of arbitration. Funding is increasingly regarded as a potential solution to this problem, both in investment arbitration and beyond.

As a consequence of these developments, both the public attention and the Task Force inquiries have largely focused on more nuanced questions: 1) what issues does funding raise in international arbitration?, and 2) how should those issues be addressed? The premise for the Task Force was that answers to these questions would best be developed through active dialogue that involves a full range of perspectives and takes account of all stakeholder interests.

### **III. The Scope of the Task Force's Work**

Third-party funding raises a number of potential issues. The Task Force, however, limited its work to those issues that: (1) directly affect international arbitration proceedings; and, (2) are capable of being addressed at an international level. This focus leaves many important issues outside the scope of the Task Force's work and this Report.

For example, the Task Force did not address several more technical issues relating to financial markets and issues that are generally addressed through lawyer ethics and regulation at the national level. For this reason, the Report does not address specifically lawyers' obligations to clients with respect to third-party funding arrangements. Many systems impose, through professional regulation or otherwise, obligations or prohibitions on attorney conduct that apply when a client is funded.<sup>12</sup>

Those rules and regulations are not generally implicated in arbitral proceedings, and there is no international consensus about the reasons for and against them. Moreover, some efforts to regulate third-party funding relate to issues such as whether a funder is adequately capitalized,<sup>13</sup> an issue not directly implicated in international arbitral proceedings. For these reasons, the Task Force and the Report do not directly address these issues.<sup>14</sup>

In addition, for some, questions remain about how third-party funding affects larger policy issues like the extent to which it actually affects access to justice and whether it may impact the

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<sup>12</sup> For example, in the United States, attorney codes of ethics have express rules regarding an attorney's duty of loyalty when a third-party is paying the client's fees. Meanwhile, many jurisdictions still prohibit contingency fee arrangements, which are often part of a third-party funding agreement.

<sup>13</sup> See, e.g., Code of Conduct, Litigation Funders Association, available at <http://associationoflitigationfunders.com/code-of-conduct/>, last visited 30 August 2017.

<sup>14</sup> For these reasons, this Report does not seek to propose "regulation" of third-party funding, as that term is generally understood. Instead, it seeks to provide limited guidance on select key issues.

number of cases brought or be used for strategic purposes. These are important questions, and it is hoped that this Report may facilitate discussion and debate about these larger policy issues. To that end, the Report often articulates competing policy arguments that were raised in or implicated by Task Force discussions.

Notably, the inclusion of references to such policy issues drew concern during the drafting process. Policy debates over funding have sometimes included harsh characterizations of funding that are regarded as unfair. On the other hand, economic and market-based analysis of issues regarding funding are sometimes regarded as improperly diminishing issues about legitimacy. In the drafting process, reference to either side of these policy debates sometimes drew concern that the Report was endorsing or legitimating a particular side of the debate. These concerns were especially acute in discussions regarding investment arbitration cases and in Chapter Eight, which provides an overview of policy debates in investment arbitration.

Given its narrow focus on issues that directly affect international arbitral proceedings, and particularly the absence of relevant empirical research, the Report does not aim to resolve these larger policy issues, but only to include reference to them where relevant for context. In this respect, Chapter Eight provides an independent outline of the policy issues, but again mostly to amplify the policy issues raised in earlier chapters and provide a basis for future discussion.

Another important limitation on the work of the Task Force is that it explicitly carves out maritime arbitration from the scope of the recommendations in this Report. At least according to some definitions, third-party funding has long existed in maritime arbitration through membership clubs that provide Protection and Indemnity (“P&I”) insurance and Freight, Demurrage and Defence (“FD&D”). The existence of membership clubs, and the fact that maritime arbitration is a distinct field that has distinctive internal rules, specialized arbitral institutions, a specialized body of practitioners, and a well-established history of funding maritime disputes, put the topic of funding in maritime cases beyond the scope of the Task Force’s inquiry and outside of its recommendations.<sup>15</sup>

To date, most efforts to regulate third-party funding, which focus on more modern forms of funding, do not appear to have contemplated specifically their effect on maritime arbitration and the funding regime that has long existed in that field. For these reasons, even though funding in maritime arbitration might presumptively fit within the Working Definition of third-party funding in this Report, it is expressly carved out from the definitions used in this Report. To the extent it is occasionally mentioned, the reference is only as a point of comparison.

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<sup>15</sup> See Chapter 1, at p. 6. The term “maritime arbitration” refers to the range of arbitration disputes that arise out of circumstances between parties engaged in maritime affairs, and/or to arbitrations brought pursuant to maritime arbitration rules, such as those of the London Maritime Arbitration Association. P&I and FD&D are referred to in Chapters 2, 3, and 6 simply as a point of historical reference. Although maritime arbitration is specifically identified in this carve out, the recommendations of this Report may also be inapposite for other forms of ad hoc and trade association arbitration, where more traditional forms of funding is the norm.

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#### **IV. Organization and Structure of the Report**

In terms of the format, each of the main substantive chapters of this Report begins by articulating specific Principles for each of the topics it covers. The Principles from these substantive chapters are collected in a comprehensive whole as an Annex to the Report, and may be referred to collectively as ICCA-Queen Mary Principles on Third-Party Funding (the “ICCA-Queen Mary Principles” or “Principles”).

The body of each of these chapters provides a detailed analysis of the sources and competing viewpoints the Task Force considered in reaching these Principles, as well as the reasons why particular viewpoints were eventually incorporated into the Principles instead of others. Beyond the guidance provided by the Principles, the substantive analysis will be useful for future consideration of the relevant issues, particularly in light of future developments that may prompt reconsideration of the Principles themselves.

In terms of the structure of the Report, after this Introduction, Chapter Two provides an overview of the market and mechanics of third-party funding. It begins with an examination of the reasons parties seek funding, and the process funders use to evaluate whether to fund a dispute. It then provides a descriptive overview of the range of means for financing disputes, including both modern case-specific non-recourse funding and a range of other sources that serve similar functions.

Building on Chapter Two’s overview of the forms of funding, Chapter Three then examines the definition of third-party funding. Specifically, Chapter Three provides a broad working definition and examines different possible definitions, surveys the range of definitions that have been adopted by various other sources, and concludes by examining how different definitions affect analysis of different issues addressed in subsequent chapters.

Importantly, as elaborated in Chapter Three, this Report and its recommendations do not extend to maritime arbitration and the forms funding that exist in that field. Many definitions of third-party funding, including the Working Definition in this Report, would ostensibly apply to traditional modes of funding in maritime arbitration. However, funding in the maritime context exists within a historical tradition and subject to a set of existing practices and internal norms that were beyond the scope of the Task Force’s work.

Each of the substantive chapters of this Report begins by articulating specific Principles for each of the following topics: Disclosure and Conflicts of Interest (Chapter 4), Privilege (Chapter 5), and Costs and Security for Costs (Chapter 6). The Principles from these substantive chapters are collected in a comprehensive whole in Chapter Seven, and may be referred to collectively as ICCA-Queen Mary Principles on Third-Party Funding (the “ICCA-Queen Mary Principles” or “Principles”).

The body of each of these chapters provides the sources and competing viewpoints the Task Force considered in reaching these Principles, as well as the reasons why particular viewpoints were eventually incorporated into the Principles instead of others.

Chapter Four addresses the issue of disclosure and potential arbitrator conflicts of interest. Consistent with other recent sources, the principle it articulates requires disclosure of the existence and identity of third-party funders to facilitate analysis of potential conflicts. In its current form, this Report includes proposed alternative versions of the Principles regarding disclosure in order to facilitate specific input regarding those issues for which there was disagreement on the Task Force.

Chapter Five addresses privilege. It provides a survey of national differences regarding privilege, which is supported by an Annex that collects national reports indicating how different jurisdictions treat it articulates an international principle regarding waiver of information that is otherwise determined to be subject to privilege. Specifically, it recommends that tribunals do not treat privilege as waived by virtue of information being shared with a third-party funder.

Chapter Six takes up the issue of costs and security for costs. It analyzes existing standards for granting costs and security for costs, concluding that the existence of funding is not generally relevant to such determinations.

Chapter Seven summarizes best practices for funding agreements. Task Force members generally agreed that a statement of existing best practices would be useful to new parties seeking funding, new funders entering the market, and the increasing number of arbitrators and counsel that are encountering funding for the first time.

Finally, Chapter Eight examines third-party funding in investment arbitration. The analysis in each of the foregoing chapters also analyzes the relevant issues in the context of investment arbitration. This Chapter, however, seeks to provide additional analysis of both the policy issues that affect how the Principles of this Report are applied in investment arbitration, and a limited range of specialized issues that arise with respect to funding in investment arbitration.

## **V. Conclusion**

At least in theory, parties could adopt the ICCA-Queen Mary Principles to govern their proceedings. More likely, and more consistent with the intent of the Task Force, parties, counsel, and arbitrators may reference or invoke the Principles to address issues that arise in the course of an arbitration, in entering into a funding agreement, and in continued discussions and debates regarding third-party funding.<sup>16</sup> The Report may also be useful for national courts in reviewing

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<sup>16</sup> The Principles have been drafted to reflect existing norms and emerging trends. To that end, it is not anticipated that they would be applied retroactively, though they may provide guidance for cases that have already been commenced.

international arbitral awards or in satellite litigation, and for regulatory bodies and arbitral institutions that seek to address issues relating to third-party funding in international arbitration.

Particularly in light of how rapidly international arbitration practice and funding models are evolving, this Report does not aim to be either definitive or permanent. Changes in the field and considerations that arise within in particular regulatory contexts may require reconsideration of, or readjustment to, the Report's Principles and amplification of its analysis. While this Report will not be the last word on issues relating to third-party funding, it develops an important set of conceptual frameworks and detailed analysis that the Task Force hopes will provide a foundation for future work in the area.

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## Chapter 2<sup>†</sup>

### Overview of Dispute Funding

#### I. Dispute Funding: An Introductory Overview

As international arbitration continues to grow in prominence and complexity, so do the attendant costs and demands from users of the process to find innovative ways to finance their matters.<sup>17</sup> “Whether in favour or against, third-party funding of litigation and, more recently, arbitration, is an undeniable and important reality.”<sup>18</sup> Anecdotal reports suggest that the global market for dispute funding is in the billions, likely currently exceeding USD \$4 Billion and is growing.<sup>19</sup>

The business of law is changing and dispute funding is very much an integral part of the future of the global arbitration and litigation markets. It is amidst this backdrop that an exploration of the interplay between dispute funding and international arbitration is not only increasingly timely, but of the utmost importance. The arbitration community must find a way to balance the increasing business need for innovative approaches to the financing of legal matters while protecting the integrity of the arbitral process and the ultimate enforceability of awards. The aim of this chapter is to provide a general overview of dispute funding as it relates to international commercial and investment arbitration.

#### A. What is Dispute Funding?

In less than a decade, dispute funding has moved from the fringes of a handful of common law jurisdictions to centre stage in the global commercial litigation and arbitration market. Dispute funding first started in Australia and then migrated to the United Kingdom in the beginning of the

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<sup>†</sup> This Chapter was authored by James Blick and Erika Levin, with input from other Members of the Task Force.

<sup>17</sup> See Jonas VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure*, International Arbitration Law Library, Volume 35 (Kluwer Law International 2016) pp. 1-2.

<sup>18</sup> Bernardo M. CREMADES Sanz-Pastor, 'Chapter 12. Concluding remarks', in Bernardo M. Cremades Sanz-Pastor and Antonias Dimolitsa (eds), *Third-Party Funding in International Arbitration (ICC Dossier)*, Dossiers of the ICC Institute of World Business Law, Volume 10 (Kluwer Law International; International Chamber of Commerce (ICC) 2013) p. 153.

<sup>19</sup> See Burford Capital's Quarterly Summer 2017 Overview, available at <http://www.burfordcapital.com/wp-content/uploads/2017/07/Burford-Quarterly-Summer-2017.pdf> (last visited, 14 August 2017). (“As of Summer 2017, Burford Capital reports that it itself has “over \$2 billion invested in and available to invest in the legal market”). See also CREMADES, at p. 153. (“The New York City Bar Association estimated in 2011 that the aggregate amount of litigation financing outstanding exceeds US \$1 billion. Fulbrook management estimated [in 2013] that there is a potential market for claimants in the United States needing financial support in the combined amount of US \$8-10 billion.”)



twenty-first century. While Australia, the United Kingdom, and the United States are now known to have established and thriving legal dispute funding markets, the practice continues to emerge and grow in new jurisdictions around the world (e.g., Singapore, Hong Kong, Latin America, and Europe).<sup>20</sup>

In its simplest form, third-party funding involves an entity, with no prior interest in the legal dispute providing financing to one of the parties (usually the claimant). Typically, this financing is offered on a ‘non-recourse’ basis, meaning that the funder has no recourse against the funded party if the case is unsuccessful. The funder’s recourse for repayment of the capital advanced and return on the capital invested is limited only to the claim proceeds recovered, if any.

### **i. Rising Demand for Funding**

It has been suggested that the rapid expansion of this type of funding was fuelled by the economic downturn in 2008. Many corporations and investors experienced economic instability and were unable to proceed with meritorious claims due to reduced cash flow. At the same time, investors were seeking alternative capital outlets, where returns would not be correlated to traditional markets. It remains to be shown, however, that there is any real as opposed to coincidental correlation between the 2008 crisis and the expansion of third-party funding in international arbitration.

In recent years, with the rising costs of international arbitrations<sup>21</sup> and the additional number of constraints being placed upon corporate legal budgets, it is not surprising that the demand for dispute funding has continued to increase. According to Professors Sahani and Nieuwveld, the “three main forces driving the sharp increase in the demand ... [are: (1)] increasing access to justice ... [; (2)] companies seeking a means to pursue a meritorious claim while also maintaining enough cash flow to continue conducting business as usual ... [; and (3)] worldwide

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<sup>20</sup> See Chiann BAO, “Third Party Funding in Singapore and Hong Kong: The Next Chapter”, *Journal of International Arbitration*, (Kluwer Law International 2017, Volume 34 Issue 3) pp. 387 – 400; Matthew SECOMB, Phillip Tan, et al., “Third Party funding for Arbitration: An Opportunity for Singapore to Lead the Way in Regulation”, *Asian Dispute Review* (Hong Kong International Arbitration Centre (HKIAC)); 2016, Volume 2016 Issue 4, pp. 182-188; Napoleão CASADO FILHO, *Arbitragem e Acesso á Justiça: O Novo Paradigma do Third Party Funding* (Saraiva 2017) pp. 1-272.

<sup>21</sup> See VON GOELER, *supra* at 2, p. 1, n. 1 (citing CIArb Costs of International Arbitration Survey 2011, 13 (survey of 254 international commercial arbitrations conducted between 1991 and 2010 finding that claimants on average spend GBP 1,580,000 in total, while respondents spend GBP 1,413,000); UNCTAD, *Investor–State Disputes*, 16-18 (‘[c]ontrary to the expectations, it turns out that costs involved in investor–state arbitration have skyrocketed in recent years ... costs for conducting arbitration procedures are extremely high’) (emphasis original); OECD, *Government Perspectives on Investor-State Dispute Settlement*, 8 (‘legal and arbitration costs for the parties in recent ISDS [investor-state dispute settlement] cases have averaged over USD 8 million’)).

market turmoil and uncertainty ... which has inspired .. investors to seek investments that are not directly tied to or affected by the volatile and unpredictable financial markets.”<sup>22</sup>

“The global economic slowdown has also inspired companies facing bankruptcy or insolvency to seek funding to pursue claims that may generate cash flow for their businesses or mitigate the risk of losing a ‘bet-the-company’ dispute.”<sup>23</sup> Additionally, and not surprisingly, the aforementioned economic situation has increased client pressures upon law firms to deliver innovative solutions, some of which require the use of funding directly by the law firms in conjunction with the offering of alternative fee arrangements, in order to attract legal work.<sup>24</sup>

Rising demand for third-party funding has now led to a boom in supply. The last few years have seen numerous new entrants into the global dispute financing market, in addition to which many of the larger, established players are continually raising new capital and the growth of the industry shows no signs of slowing.

## ii. Why is Funding Sought and by Whom?

The key participants in the dispute funding process are the claim holders, funders, lawyers and, potentially, funding brokers. Funding may be sought to cover legal fees, out-of-pocket costs (e.g., expert fees, arbitrator fees, arbitral institution fees, discovery-related fees, etc...), or costs associated with subsequent enforcement actions or appeals and may be structured around a single claim or a portfolio of claims. Dispute finance is also increasingly being used by claim holders for other purposes, such as for example raising working capital for the claimant entity, discharging other financial liabilities or financing other litigation (unrelated to the claim against which the finance is secured).

Historically third-party funding was often considered as being primarily relevant to financially distressed claimants as a way of obtaining access to justice. However, much of the focus of the litigation finance market today is on the growing corporate utilization of funding by large, well-resourced entities, who are looking for ways to manage risk, reduce legal budgets or take the cost of pursuing arbitration off-balance sheet, or other business reasons for not wanting to

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<sup>22</sup> Victoria SHANNON SAHANI and Lisa Bench NIEUWVELD, *Third-Party Funding in International Arbitration*, (Kluwer Law International 2012) p. 12. See also, Christopher P. BOGART, Chapter 4. Overview of Arbitration Finance, in Bernardo M. CREMADES SANZ-PASTOR and Antonias DIMOLITSA (eds), *Third-Party Funding in International Arbitration (ICC Dossier)*, Dossiers of the ICC Institute of World Business Law, Volume 10 (Kluwer Law International; International Chamber of Commerce (ICC) 2013) p. 51 (“Litigation and arbitration, particularly investor-state arbitration, are unduly expensive and frequently inefficient, and those deficiencies interfere with their ability to deliver justice.”).

<sup>23</sup> SAHANI, at p. 12.

<sup>24</sup> See Nick ROWLES-DAVIES, *Third Party Litigation Funding* (Oxford: Oxford University Press 2014), p. 61 [3.08] (Lawyers “are having to be innovative to survive .... The economic climate since the ‘Great Recession’ which began in around 2008 has caused many, even traditional institutional clients, to look for ways to reduce their legal fees, along with their business costs.”)

allocate resources to financing an arbitration matter.<sup>25</sup> Put simply, funding is not only for those that are impecunious. “The use of funding offers the client the ability to minimize risk, does not have any negative effect on their cash flow, and ensures payment of lawyers.”<sup>26</sup>

## 1. Claimants

As noted above, the vast majority of recipients of third-party funding are claimants. At one end of the spectrum, there may be a party that has invested all of its resources into a failed project and funding provides this investor with the only mechanism by which the investor can seek redress from the parties that caused its losses.

Somewhere in the middle, exists a claimant, who may be adequately capitalized, but nonetheless is a smaller entity than the corporation it wishes to pursue an action against. In his book, Nick Rowles-Davies provides an example that captures this scenario well.<sup>27</sup> The example involves a mid-size company that has been wronged by a much larger competitor and is faced with the decision of whether to spend its capital on vindicating its rights (and unlocking a potential recovery) or allocating those resources to its core business operations.<sup>28</sup> In addition, even if it does decide to self-fund the matter, it is likely that it will be outmatched in resources by its opponent. But for funding, the claimant would be in an untenable position. Funding allows the claimant to grow its business while pursuing the action in a manner that poses no cash flow burden or risk.<sup>29</sup>

At the other end of the spectrum, large corporations with strong balance sheets are increasingly employing dispute funding as a corporate finance tool that allows them to effectively manage their disputes without negatively impacting their balance sheets.<sup>30</sup> Dispute funding for corporate clients can take on a variety of forms including traditional capital outlay by funders as well as insurance/hedge offerings, which enable clients with good liquidity to mitigate litigation risk without paying substantial returns to a third-party funder.<sup>31</sup> As an alternative to tying up their

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<sup>25</sup> See BOGART, at p. 51 (Dispute funding “has developed quickly because it allows corporations to unlock the often substantial value they have tied up on unresolved claims and because it allows them to proceed with arbitrations while retaining control of their exposure to loss.”)

<sup>26</sup> See ROWLES-DAVIES, at p. 62.

<sup>27</sup> See ROWLES-DAVIES, pp. 63-64 (highlighting a “real life practical example of a mid-sized company deciding whether to embark on a piece of litigation ... [against] a much larger competitor.”)

<sup>28</sup> *Id.*

<sup>29</sup> *Id.* at 63.

<sup>30</sup> “Litigation can be financed – just like any other corporate expense. Yet most corporations still pay for legal costs out of pocket, and that has a profoundly negative financial impact: reducing operating profits, impacting publicly reported earnings, and thus valuation. Litigation finance removes this problem by shifting the cost and risk of pursuing high-value litigation off corporate balance sheets.” <http://www.burfordcapital.com/what-we-do/for-businesses/> (last visited, 14 August 2017).

<sup>31</sup> “*Litigation Finance, Sure. Litigation Insurance? UK Broker Seeks US Sales*” Roy STROM, *The Am Law Daily*; June 14, 2017

own capital in litigation or arbitration, corporations can use dispute funding to pursue arbitrations that can help transition their in-house legal departments from cost centres to profit centres.

## **2. Law Firms**

The role played by law firms in the third-party funding market is a multi-faceted and evolving one. In some instances, law firms, themselves, may be the users of dispute finance. For example, a law firm could seek the use of third-party funding as a way to support contingency fee opportunities, as discussed more fully below. In this context, the law firm would approach the funding market directly in order to seek financing options for its own fee risk exposure and enhance its ability to offer alternative billing offerings relative to its competitors.

As discussed more fully below, in some instances a law firm may effectively act as the provider of dispute finance, for example when offering to act on a contingency fee basis.

Even where not directly a party to the funding agreement, the law firm's role is often pivotal in a claimant's decision as to whether it should explore the possibility of third-party funding and the approach taken if funding is sought. Although awareness of litigation finance is rising amongst corporate counsel,<sup>32</sup> most claimants rely heavily on their legal advisors for advice relating to third-party funding, the costs and practicalities involved, and which funder(s) or broker should be approached. Funders therefore cultivate relationships with law firms in order to encourage future referrals. In some instances, even where a law firm is not a direct party to the eventual funding agreement, the firm may still be highly invested in the outcome of the approach to funders. It is not uncommon for a law firm acting for a financially distressed client to invest significant time on a speculative basis in preparing a case for presentation to funders, understanding that it will only be able to recoup that time investment if funding is successfully obtained.

While the majority of opportunities presented to the funding market come via law firms, a growing awareness of third-party funding amongst clients has led to an increased percentage of claimants seeking funding directly, often prior to selecting a law firm (*e.g.*, while still engaging in a law firm tender process).

## **3. Brokers and other intermediaries**

As an alternative to approaching the funding market directly, some lawyers and claimants opt to use the services of a specialist third-party funding broker to advise on potential financing options, access a broader range of funders and manage the process. With the ever-growing number of funds operating worldwide, as well as the range of alternative insurance structures available,

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<sup>32</sup> See Burford Capital article, at p.15.

brokers play an increasingly prominent role in the process of sourcing and structuring dispute finance arrangements.

#### 4. Respondents

While far from commonplace, the current availability of financing for respondents is evolving. Putting aside scenarios where a party may be defending a claim, but either via a counterclaim or a successful defence of the arbitration could unlock a significant financial upside,<sup>33</sup> the funding of respondents is still quite rare. Outside of the above scenario, the challenge is how to remunerate the funder for the provision of capital in the event of successful defence, while avoiding potential moral hazards created by the existence of the funding. A theoretical option for respondents in situations where they can value their exposure may be to identify a realistic exit point, which if met, will trigger a payment of some amount to their funders or law firms. Essentially, this would translate into a payment by the respondent to the funder for some amalgamation of “the amount by which its liability has been reduced, comparing the amount originally claimed with the amount awarded”.<sup>34</sup> While this structure is from time to time described in theory, in reality there appear to have been few such arrangements successfully negotiated between funders and respondents. A rare example is to be found for instance in *RSM Production Corporation v Grenada*, where the Respondent State was funded by a third party.<sup>35</sup>

Occasionally, cause-based funding of a defendant has occurred (*e.g.*, *Philip Morris v. Uruguay*, ICSID case no. ARB/10/7). As noted in following sections, the defence of a claim could also potentially be included in a portfolio arrangement.

#### B. The Dispute Funding Process

##### i. Fundamentals

The nature, structure, and features of third-party funding arrangements can vary significantly from case to case, as can the process involved in putting the arrangement in place. It

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<sup>33</sup> In scenarios like this, a funder could agree to defend the respondent in exchange for a percentage of the proceeds and/or market share that are unlocked as a result of winning the case.

<sup>34</sup> VON GOELER, *supra* at 2, pp. 48-49.

<sup>35</sup> Jean-Christophe HONLET, *Recent decisions on third-party funding in investment arbitration*, ICSID Review (Fall 2015) 30 (3): 699-712, at fn 30 doi: 10.1093/icsidreview/siv035. It appears from a separate decision in a subsequent case that such third party was a company called ‘Global Petroleum’. See, *Rachel S. Grynberg, Stephen M. Grynberg, Miriam. S. Grynberg and RSM Production Corporation v. Grenada*, ICSID Case No. ARB 10/6, Tribunal’s Decision on Respondent’s Application for Security for Costs (14 October 2010) para. 4.5. Global Petroleum had been awarded the oil exploration rights lost by RSM Production Corporation in Grenada and saw an interest in having the State prevail in the arbitration. See also *Investment Treaty News* (28 April 2010).

may surprise some that the vast majority of cases presented to any given funder are rejected by the funder for one reason or another. There are few published statistics available, however anecdotal reports, as well as statements made by some funders, suggest rejection rates of 90% or higher, although this may change with the growing number of funders entering the market, coupled with the increasing familiarity amongst lawyers and their clients with the basic requirements of most funders.

The decision as to whether or not to support a claim will be taken following detailed due diligence by the funder, (often using external counsel, and potentially damages or technical experts) and approval by the funder's board or investment committee. Funders are primarily concerned with the case merits, the economics of the proposed investment (*i.e.*, the ratio of the legal costs budget to the realistic claim value, which will dictate the level of return the funder may be able to achieve), and the enforceability of any award.

In order for a funder to seriously consider a potential opportunity, there must be an adequate demonstration of a solid claim with a healthy, recoverable margin between the anticipated damages recovery and budget expected for legal fees and costs. The facts, the merits, the parties, and their representatives will all play a crucial role in this calculus. "In addition, the analysis will consider other factors such as: 1) value of the law suits; 2) amount to be advanced; 3) jurisdictional obstacles; 4) defences; 5) nature and length of the proceeding (including whether arbitration or litigation; venue and applicable rules); 6) possibilities of settlement; 7) creditworthiness of client and the opposing party (particularly with a view to collection prospects); 8) counsel chosen and compensation structure (whether there is a contingency fee agreement in place) or 9) additional obligations of the party to be funded linked to the potential risk of recovery (such as previous funding agreements or any other alliance).<sup>36</sup>

## **1. Economics**

By far the most common reason for a potential opportunity being turned down by a funder is not concerns over the legal merits of the case, but rather concerns that the quantum of the claim (or at least the realistic recovery or likely settlement value) will not be sufficient to justify the level of investment required in order to finance the arbitration budget.

Few funders will wish to embark upon a case where the most likely outcome will see the combined funding costs (reimbursement of funder's capital and success fee, any contingent litigation insurance premium payable and any contingent fee payment to the legal team) leaving the claim holder with a minority share in the recovery. While funders' approaches to this issue

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<sup>36</sup> Bernardo M. CREMADES SANZ-PASTOR, Chapter 12. Concluding remarks, in Bernardo M. CREMADES SANZ-PASTOR and Antonias DIMOLITSA (eds), *Third-Party Funding in International Arbitration (ICC Dossier)*, Dossiers of the ICC Institute of World Business Law, Volume 10 (Kluwer Law International; International Chamber of Commerce (ICC) 2013) p. 154.

vary, many will include a fairly crude economics test in their investment criteria, requiring a minimum ratio between the funding request and a realistic claim value of 1:10. It may be assumed that these numbers will leave a sufficient margin to allow for the claim holder to retain more than half of the claim proceeds, after deducting the cost of the funding arrangement.

Most funders tend to be highly conservative when valuing claims and will concentrate on the realistic or likely “floor” value of the claim - - as opposed to the maximum potential (but inherently more speculative) claim value.

Funders will also carefully scrutinize the arbitration budget (assuming that the financing is being provided primarily or solely for this purpose). A light or overly optimistic budget may be a cause for concern. While the funding commitment will be limited to a fixed or staged sum, a case which exceeds the budget where there is no pre-agreed mechanism in place to deal with the overrun can be problematic for all parties, potentially necessitating renegotiation of the funding agreement mid-way through the case. Funders increasingly will address this issue upfront, potentially requesting a fee cap or an overrun agreement from the claimant’s legal team in order to secure budget certainty.

Ultimately, the most desirable cases are those that have a very high (realistic) claim value as well as a high ratio between the arbitration budget and the quantum of the claim.

## 2. Return Structures

A dispute funder providing “non-recourse” litigation finance will generally expect to make a multiple return on the capital invested. This reflects both the high-risk nature of the investment as well as the Internal Rate of Return (“IRR”) expectations of those that invest in litigation funds. From the claimant’s perspective, the funder’s return (or success fee) may be structured in a number of different ways. It may be structured as a multiple of the capital invested or as a percentage of the ‘claim proceeds’ (the amount recovered by way of damages or settlement). Some arrangements will involve a combination of these, for example the greater of 3x the capital invested or 35% of the claimant’s recovery. By way of illustration, this was the structure and pricing of the funder’s return in the *Norscott v Essar* case, in which the arbitrator heard and accepted evidence from James Blick of The Judge Limited that the cost of the funding was reasonable in the circumstances of the specific case in question.<sup>37</sup>

It is also common for the funding agreement to link the funder’s return to the duration of the case (or to the amount of capital drawn down), meaning that the funder’s return is lower if the case settles early, but rises throughout the proceedings. Such a structure will facilitate early

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<sup>37</sup> Sir Philip Otton sitting as a sole arbitrator in an arbitration subject to the International Chamber of Commerce (ICC) rules made the unusual award that the Respondent should be liable for the cost of the claimant’s funding arrangement, in addition to the damages awarded. Essar applied to the English Court to have the award set aside under s. 68(1) of the Act on the ground of serious irregularity, but was unsuccessful in its application.

settlement for the claimant, while ensuring that the return to the funder is more proportionate to the actual capital risk taken if the case settles early.

While many funders target broadly similar returns, the differences from a claimant's perspective between different funding offers on a specific matter can be huge, especially where the claim value is high. Fully understanding the commercial terms of any funding arrangement requires, at a minimum, some basic financial modelling in order to calculate the amount that the funder will be entitled to in a range of theoretical settlement outcomes at different stages of the case with different levels of capital deployed. With the growing number of funders competing for business, claimants are well-advised to obtain and compare (either via brokers or directly) multiple funding offers before entering into a funding agreement.

### **3. Waterfall**

Closely related to the funder's return structure is the waterfall agreement or priority agreement. This will either be contained in the funding agreement or in a separate document and will usually require execution by all "stakeholders", *i.e.*, those entitled to a share or contingent payment from any recovery, typically including the claim holder, the funder, the law firm and any insurer providing coverage for fees, costs or an adverse costs award. The waterfall will set out how the claim proceeds are to be divided between the stakeholders and can be as important as the return structure when considering the cost of a potential financing arrangement.

### **4. Risk Alignment**

Risk alignment (or "skin in the game" as it is more colloquially referred to) is an important consideration to many funders when considering a potential opportunity. Some funders have a strict requirement that the law firm should assume some element of risk in relation to its fee budget, either by offering a partial contingency fee and/or fee cap or overrun agreement. Even for those funders that do not require this as a matter of course, a law firm's (and/or client's) willingness to share in the risk and reward will be seen as a positive feature when assessing a potential funding opportunity.

### **5. Control**

The extent to which the funder will take over control of the arbitration and the claimant's decision-making process (*e.g.*, whether, when and at what level to settle the claim) is often a concern expressed by claimants, lawyers and regulators, as well as an important issue in



considering the legality of the financing arrangement in common law jurisdictions where doctrines of maintenance and champerty still exist.

In reality, the vast majority of third-party funding arrangements are structured carefully to ensure that the funder does not have control over the case or the claimant. In many jurisdictions, this is essential in order to avoid or minimize the risk of a challenge to the lawfulness of the funding agreement. Even in civil law jurisdictions which permit the sale or assignment of claims, many funders still adopt this common law model, although there are also many examples of funds in such jurisdictions seeking to purchase and aggregate (and thus take over control of) claims. This is prevalent, for example, in cartel damages claims in jurisdictions such as Germany and the Netherlands, but less common in international arbitration.

However, even where the funding arrangement does not seek control, there are nevertheless certain safeguards built in to protect the funder's investment. A third-party funding arrangement is not an unconditional agreement to fund the case to conclusion. Provision of ongoing funding will be subject to the merits of the case and compliance with the terms of the funding arrangement. Breach of the agreement or a fundamental change in the likelihood of success may entitle the funder to terminate the agreement (and, in some instances of serious breach, may allow the funder to seek recourse for the amount invested). While this does not amount to direct control, if the claimant is financially reliant upon the funder in order to pursue the claim to conclusion, the possibility of the withdrawal of funding may still amount to powerful indirect control.

Related to the issue of control is the question of how actively the funder wishes to monitor its investment. This varies from funder to funder, but it should be assumed that at a minimum, the funder will require reports about the progress of the case, notification of any significant developments (*e.g.*, settlement offers or new information which changes the case outlook) and direct access to the claimant's legal team. In some instances, the funder may play a highly active role, attending client meetings and/or hearings, being copied on correspondence and having input on strategic issues. Some clients may see this active involvement by the funder as an additional 'value add' in terms of legal, strategic or technical expertise, beyond the mere provision of capital.

## **6. Confidentiality / Privilege**

Securing funding necessarily requires the sharing of confidential, privileged and on occasion highly sensitive information with prospective funders. Ensuring that the confidentiality of such information is protected (to the same standards) and that the privilege is not lost is an important issue that claim holders and their advisors must consider before seeking funding.

Anyone navigating the process must balance the disclosure of information required for assessment/due diligence and minimizing the risk of waiving privilege. Certain basic steps, such as entering into non-disclosure agreements before sharing any information and limiting the information shared early on, are fairly standard practice, however the concerns and protocols will

necessarily vary depending on the jurisdiction involved. In some jurisdictions, the law is fairly well-established, whereas in others it is still evolving (although generally in the direction of accepting that parties should be able to share information with funders without waiving privilege).<sup>38</sup>

Attempts to address the calls for greater transparency with respect to the disclosure of the existence of funding arrangements must take note of what will occur post-disclosure. Depending on the jurisdiction involved, the disclosure of the existence of a funding relationship could have very different results. On the one hand, in a civil jurisdiction where discovery is not readily available, the disclosure of the existence of the funding arrangement might signal the strength of the case to the opposing party and encourage a settlement. On the other hand, in some common law jurisdictions where discovery may be more readily available, it may subject a claimant to a costly and time-consuming fishing expedition by the respondent. Needless to say, a balance has to be achieved between the mitigation of any conflicts of interest and the preservation of a party's privileged and protected information.

## **7. Conflicts of Interest**

The third-party funding market necessarily has to grapple with the issue of conflicts of interest (whether actual, potential or perceived) which arise as a result of the funder's participation in a particular case. The issue of arbitrator conflicts of interest is addressed more fully in subsequent chapters.

A related issue is that of how the claimant's legal team can mitigate or manage potential conflicts of interest arising between its duties to the claimant and its relationship with the funder. While the majority of funded cases proceed smoothly with an aligned interest between the funder and claimant (and legal team), there is always the potential for issues to arise. For example, a funding structure where the funder is entitled to a multiple of the capital invested as a priority over the claimant, means that there is a theoretical case outcome where the funder receives a healthy return (of say repayment of its investment plus a return of 3x the invested capital), but the claimant receives nothing. Such a structure (while not uncommon) can clearly give rise to tensions when it comes to considering an offer of settlement pitched by the respondent somewhere in around that level. Similarly, issues such as budget overrun, a change in legal representation during the proceedings, or a deterioration in the merits of the case can create situations where the interests of the claimant diverge from those of the funder.

The most common structure of a third-party funding arrangement is one which allows the law firm to maintain a fairly clear demarcation between the duties owed to the claimant and those (if any) owed to the funder. The claimant and the funder enter into an arrangement under which

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<sup>38</sup> See *Viamedia, Inc. v. Comcast Corp.*, No. 16-cv-5486, 2017 WL 2834535 (N.D. Ill. June 30, 2017); *Miller UK Ltd. V. Caterpillar, Inc.*, 17 F. Supp. 3d 711 (N.D. Ill. 2014).

the funder provides the claimant with capital in order to finance the legal fees and costs associated with the arbitration. Under this structure, the claimant's lawyer advises and owes duties only to the claimant (the funder typically having taken separate advice from its own external counsel).

However in reality, the relationships between funders and law firms often go much deeper. It may be for example that the client entered into the funding arrangement as a result of the law firm's introduction or relationship. It may even be that the law firm relies upon the funder for financing across a portfolio of matters, which can make it more difficult to avoid or manage perceived conflicts of interest where a disagreement arises between the funder and one of the funded clients in the portfolio.

Some law firms utilize or recommend the services of independent brokers in order to maintain distance from the funder selection process and mitigate any perceived conflict issues.

## **ii. The Process**

### **1. The Approach**

The dispute funding market is changing rapidly, with a continued influx of new capital providers, greater competition amongst funders, and the increasing availability of alternative insurance-based structures. Since most clients are not repeat users of dispute funding, they often rely upon a specialist broker or lawyer with expertise in this area for advice and guidance and to manage the process throughout.

Regardless of whether or not a broker is used, any party considering third-party funding for a claim will be well-advised to simultaneously approach multiple prospective funders. This increases the chances of securing funding (as noted above, individual funds reject the vast majority of opportunities presented to them), while creating a competitive process to enable the terms of any funding offer received to be weighed up in the context of any competing offers available.

Once a decision has been made to approach prospective funds with a particular matter, careful funder selection based upon the case profile and specifics (taking into account each funder's investment criteria), as well as the types of structure and commercial terms sought, will have a significant bearing on the eventual outcome.

Case presentation is also important. As noted above, funders' investment decisions will be based upon a range of factors and a well-prepared and comprehensive case presentation will enable prospective funders to form a preliminary view on the case and move quickly to a decision on whether or not to offer terms.

## 2. Case Assessment

Each funder's approach and decision-making process is different, as is the speed with which each can move from initial case presentation to execution of a funding agreement. The most common approach is a two-stage process. The first stage involves an initial (usually internal) evaluation of the opportunity by the funder. This will encompass the items discussed above, such as the case merits, amount of the funding request, claim value, legal landscape, enforcement, etc.<sup>39</sup> If satisfied that the case meets the funder's investment criteria, the funder will make an offer (usually in the form of a term sheet or conditional funding agreement). The offer will usually be subject to the funder completing a second more detailed due diligence process, often using external counsel. Given the time and expense incurred during the second phase, many funders request a period of exclusivity in order to complete this.

The requirement for exclusivity is not universal, but it is a relatively common practice amongst funders. While it should generally be accepted as a legitimate requirement by a funder about to embark upon an intensive and potentially costly due diligence process, it should also be approached with caution by claimants. Agreeing to a lengthy exclusivity period in a time-sensitive case can be highly damaging if the funding agreement is not executed at the end of the process.

Some funders also employ a third level of review, which requires submission of the claim and the proposed funding terms to an investment committee for a final decision.

## 3. The Litigation Funding Agreement<sup>40</sup>

The Litigation Funding Agreement ("LFA") sets forth the terms upon which the funding is provided to the claimant, including the extent of funding commitment, return structure, rights and obligations of the parties and termination rights.

For purposes of providing an overview, the sample Therium LFA contained within Nick Rowles-Davies' book is useful, as is his explanation and those of other authors.<sup>41</sup> However, each funder's standard LFA is different and most LFAs eventually executed by a claimant are individually negotiated and therefore depart from the funder's standard form to some extent. As

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<sup>39</sup> See Mick Smith, in Shannon and Nieuwveld, *Third-Party Funding in International Arbitration*, pp. 28-33, for a discussion of the valuation of a claim from a funder's perspective, including an overview of a matrix approach employed by Calunius Capital.

<sup>40</sup> For a more thorough discussion, please see Goeler, *supra* at 2, pp. 11-72; Smith, *supra* at 20, pp.19-38; and Rowles-Davies, *supra* at 9, pp. 120- 125, 221-247 (Appendix 1, which provides a copy of a sample Therium Litigation Funding Agreement).

<sup>41</sup> See Goeler, *supra* at 2, pp. 11-72; Smith, *supra* at 23, pp.19-38; and Rowles-Davies, *supra* at 9, pp. 120-125, 221-247 (Appendix 1, which provides a copy of a sample Therium Litigation Funding Agreement). See also Maya Steinitz, *A Model Litigation Funding Contract*, 99 Iowa Law Review 711 (2014).

such, it is beyond the scope of this chapter to attempt to comment in detail upon the commonalities and differences between various agreements.

However, there are some provisions which are worthy of particular consideration. For example, the circumstances in which the funder may suspend or terminate the funding or potentially seek recourse against the claimant for the amount invested are especially important. The Association of Litigation Funders of England & Wales (“ALF”) Code of Conduct envisages the following grounds for the funder seeking termination of the LFA (the last of which potentially entitling the funder to recourse for the capital invested to that point):

“11.2.1 reasonably ceases to be satisfied about the merits of the dispute;

11.2.2 reasonably believes that the dispute is no longer commercially viable; or

11.2.3 reasonably believes that there has been a material breach of the LFA by the Funded Party.”<sup>42</sup>

While on the face of it, these are reasonable grounds for the withdrawal of funding, the manner in which the merits and commercial viability of the claim are to be judged and by whom are significant.

The ALF Code of Conduct requires that any dispute about settlement or termination should be resolved by independent counsel. A dispute resolution clause along these lines is a common feature in many LFAs (including produced by funders who are not members of the ALF) to enable a funder to exercise reasonable termination rights, while protecting the client from a unilateral and unreasonable decision by the funder to cease funding.

It should also be noted that in addition to the LFA, various ancillary agreements may also be entered into as a part of formalizing the overall funding arrangement, such as the Priorities Agreement or waterfall agreement,<sup>43</sup> Retention/Engagement Agreement with the Law Firm, and/or Insurance Policies. As noted above, the Waterfall Agreement is a particularly important document (or section within the LFA) and sometimes one of the more challenging items to negotiate, given that multiple parties, potentially with competing interests, need to agree to the framework.

## II. Other Dispute Funding Models

Although third-party funding or dispute funding has only relatively recently emerged as a distinct industry, it should be viewed in context as one of a number of the alternative ways of financing arbitrations. This Section provides some examples of the other models that exist.

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<sup>42</sup> Code of Conduct for Litigation Funders (November 2016), Association of Litigation Funders of England & Wales, available at <http://associationoflitigationfunders.com/code-of-conduct/> (last accessed on 30 August 2017).

<sup>43</sup> See Goeler, *supra* at 2, p.33 (The priorities “agreement involves all relevant stakeholders in the claim and stipulates who will receive what in case of successful recovery.”); Smith, *supra* at 20, pp. 23-24 (describing and providing an example of a typical priority of payments structure).

## A. Insurance

Insurance is one of the oldest alternative sources of funding for disputes.<sup>44</sup> Liability insurance generally involves funding the “legal representation in any action to defend against liability or recover damages, or to pay any award, order, or judgment against the insured, or both.”<sup>45</sup>

There are also specialized forms of legal expenses insurance, sometimes referred to as “before-the-event” (BTE) and “after-the-event” (ATE) insurance. Both forms of insurance are specifically intended to cover the insured’s liability for legal fees and costs incurred in relation to litigation or arbitration. Depending on the structure, coverage may be provided for the insured’s own legal fees and costs and/or the insured’s potential liability for the opponent’s legal fees and costs if the claim is unsuccessful.<sup>46</sup>

BTE is taken out to cover the risk of possible future litigation arising. It is sometimes sold as an add-on to other kinds of insurance and is usually limited in the types of dispute covered and the level of coverage provided. It will provide funding for bringing a claim falling within the scope of cover, paying lawyers’, arbitrators’ and experts’ fees during the course of the arbitration. It may also cover an insured’s liability for a costs award in its opponent’s favour. A BTE insurer is remunerated through premiums paid in advance (usually annually). It has no interest in the proceeds of an arbitration which it supports, other than potentially for reimbursement of the amount funded. For that reason, being keen to minimize its expenditure, it will control the conduct of the claim as closely as it can.

ATE insurance (increasingly known as litigation/arbitration insurance) is taken out after a legal dispute has arisen and covers the risk that the insured party will be unsuccessful in the litigation/arbitration. The industry flourished in the UK in the early 2000’s and was historically aimed primarily at insuring the fee shifting (adverse costs) risk, as well as the claimant’s own ‘disbursements’, such as expert fees, barrister fees, court fees etc, on the basis that the law firm would be engaged on a conditional fee basis.

Today, the litigation/arbitration insurance industry is mature and well-established, albeit niche and highly specialized. Coverage may be provided for the insured’s attorney’s fees and out of pocket costs as an alternative or complimentary option to third-party funding. In addition, in forums and jurisdictions where fee shifting applies, insurance generally remains the most cost-effective way for parties to hedge the adverse costs risk. The UK is still one of the largest markets, but the industry is growing across Europe, North America and Asia and many insurers are

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<sup>44</sup> James Clanchy, “Navigating the Waters of Third Party Funding in Arbitration” 82 *Arbitration* 222.

<sup>45</sup> NIEUWVELD & SHANNON, at p. 6.

<sup>46</sup> Bristows, *Guide to Litigation Costs Funding and Insurance*, (last accessed Oct. 31, 2011); Raconteur Media, *Raconteur on Legal Efficiency*, *The Times* (Supplement), 7-9, (Mar. 25 2010), <<http://np.netpublicator.com/netpublication/n89269938>>

experienced in underwriting large, complex international arbitration (both commercial and investor/state).

Litigation/arbitration (ATE) insurance premiums can be structured in a number of ways, but a common model, which is unique to this type of insurance, is a “contingent premium” model, meaning that the insured only pays the insurer a premium if and when they are successful in the claim (in which case the premium is usually paid out of the settlement or damages award obtained, in a similar manner to a third-party funder’s return, although usually much lower in amount).

As the litigation/arbitration insurance market expands internationally, it is increasingly competing directly with (as well as in some instances supporting) the third-party funding market. In practical terms, a claimant considering third-party funding as an option may also and in parallel consider using insurance to cover its legal fees and/or out of pocket costs (both historic and future) in exchange for which it will only pay the insurer a premium if it wins the case and collects damages or a monetary settlement. In this form, litigation / arbitration insurance is structurally very similar to third-party funding. The only material differences are that the insurer does not provide day to day financing, but instead will pay out on an indemnity basis if the case is unsuccessful and that the insurance premium is typically much lower than the typical return sought by a third-party funder.

## **B. Loans, Corporate Financing, Equity-based and Inter-Corporate Funding**

Arbitrations may also be funded through traditional loans, corporate finance, equity-based investments, or some hybrid. For example, a parent company may make a loan to a subsidiary to enable it to pursue a claim, or the shareholders, creditors or beneficial owners of an entity may provide financial support for the pursuit of a claim which will in turn provide a financial benefit which will flow back to them. Some types of funding are effectively a form of private equity.<sup>47</sup>

There have been some examples of third-party funders taking an equity position in the claimant entity and, as such, gaining control over its investment through traditional corporate governance (i.e., membership on the Board of Directors).

Corporate financing specifically to fund a party’s costs in a dispute can raise some of the same issues as third-party funding. Those issues, however, are usually resolved through traditional corporate governance mechanisms and existing rules that govern corporate relationships. For example, the potential for conflicts of interest between an arbitrator and a party extends not only to the party itself, but also to affiliates of that company.<sup>48</sup>

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<sup>47</sup> Examples include in *Churchill Mining PLC and Planet Mining Pty Ltd v. Republic Indonesia*, ICSID Case No. ARB/12/14 and 12/40 (not public), and *Crystallex International Corporation v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/11/2.

<sup>48</sup> See IBA Guidelines on Conflicts of Interest.

### C. Attorneys as Funders

Attorneys may effectively act as funders when engaged to act on a full or partial contingency fee basis.<sup>49</sup> In either instance, the attorney bears some or all of the cost of the arbitration and assumes the risk of loss. A common structure involves the client financing the out of pocket costs and expenses (either from its own resources or with external financing) with the law firm forgoing payment of some or all its fees in exchange for a share of any award or settlement obtained. However, in some instances, the law firm may also agree to cover the out of pocket expenses, including tribunal fees, in exchange for a larger contingency fee.

This type of arrangement (especially where the law firm pays the out of pocket costs) is conceptually and structurally similar to third-party funding in many ways. It may also produce comparable economics from the claim holder's perspective – the law firm's share of the proceeds for taking a case on full contingency, including covering the out of pocket costs, may reasonably be expected to be similar to the share required by a funder for financing the case in full. Where, as is not uncommon, the law firm and a third-party funder share in the risk / reward (e.g. by the firm forgoing payment of fees with the funder covering the expenses), each party should expect a share of the proceeds which is commensurate with the relative risk taken by each.

Although there are a number of law firms that have amassed significant “war chests” to support contingent fee work, many of the more conservative law firms are not able to assume significant fee risks on large claims. Such firms have historically been more likely to turn to third-party funders. However, developments in the availability of insurance options to enable law firms to hedge fee risk<sup>50</sup>, as well as the rise in law firm portfolio financing is enabling historically conservative firms to take on more contingent fee work, while mitigating fee risk and cash flow concerns.

In addition to traditional contingency fee arrangements, other alternative fee arrangements may divide the risk between clients and attorneys. Examples include a reduced hourly rate, or capped fees, but with a “success fee” added as a bonus if the claimant wins, as well as fee collars, staged fee caps, etc. Such arrangements will often bear much less resemblance to third-party funding and may in practice represent only a small departure, in risk/reward terms, from the law firm's normal hourly rate model. However, such a fee agreement is still highly relevant to the third-party funding structure. For example, a fee cap which ensures that there is no risk of budget overrun will be a positive feature from the perspective of potential funders and may in some instances be preferable to a discounted hourly rate.

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<sup>49</sup> See SAHANI, at pp. 5, 8.

<sup>50</sup> ‘Game-changer’ for UK litigators with launch of first DBA insurance, *Solicitors Journal*, 24 May 2017



With pro bono lawyering, the attorney may absorb all or most of the cost of representing a client, who is usually indigent or otherwise unable to pay, without any guarantee or reasonable expectation of reimbursement or profit. To date, pro bono representation is relatively rare in international arbitration, but certain NGOs are active as *amici* and it is plausible they could end up providing representation for certain claims that implicate causes they support. Although it has some similar markers and may raise some similar issues, pro bono representation is not usually treated as a type of “financing” because no money changes hands. But as Sahani and Niewveld point out, “the practical effect of the attorney representing the client without requiring payment could certainly be viewed as a form of ‘financing’, because the financial burden of legal representation has been shifted from the client to the attorney.”<sup>51</sup>

### III. Current Trends and Evolution of Funding Models

The rising global prominence of dispute funding has led to some jurisdictional liberalization and a re-analysis of the status of champerty and maintenance in a number of jurisdictions,<sup>52</sup> with some notable exceptions, such as Ireland, where the Supreme Court recently held that third-party funding was unlawful on the ground of champerty<sup>53</sup>.

In its modern incarnation, dispute funding has the ability to transform a legal claim into a financial asset, which can potentially be monetized or used as collateral in order to secure finance. At present, dispute funding is moving more into the realm of corporate finance, with increasingly diverse and sophisticated options becoming available.

At the same time, the global third-party funding market is growing exponentially, both in terms of the number of funds operating, and in terms of the amount of capital available. However, when it comes to individual dispute funding, many funders have similar appetites and underwriting criteria, meaning that in some jurisdictions, the market is become increasingly crowded, forcing funders to compete more aggressively for opportunities and explore alternative ways of deploying capital. What follows are some examples of the ways in which the market is evolving.

#### A. Portfolio funding

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<sup>51</sup> SAHANI, *supra* at 7, p. 6.

<sup>52</sup> For example, *Arkin v Borchard Lines Ltd and others* [2005] EWCA Civ 655; See also Hong Kong’s Legislative Council’s 2017 amendments to the Arbitration Ordinance (Cap. 609), Part 10A (ss.98E – 98W) abolishing the doctrines of champerty and maintenance for arbitration.

<sup>53</sup> *Persona Digital Telephony Ltd & ors v The Minister for Public Enterprise & ors* [2017] IESC 27

Portfolio funding is gaining prominence as an alternative to financing on a case-by-case basis<sup>54</sup> and is an approach that many funders now actively promote. A portfolio arrangement can be structured in many ways, but there are two major types of arrangements: (1) finance structured around a law firm, or department within a law firm, where the claim holders may be various clients of the firm; or (2) finance structured around a corporate claim holder or other entity, which is likely to be involved in multiple legal disputes over a relatively short period of time.

Structuring finance around multiple claims under either model usually involves some form of cross-collateralization, meaning that the funder's return is dependent upon the overall net financial performance of the portfolio as opposed to the outcome of each particular claim. This type of structure may enable the entity (*e.g.*, the law firm or corporate client) to secure third-party funding more quickly, on pre-arranged terms, and, depending on the structure, the ability to benefit from the overall success of the portfolio. Additionally, there may also be economic benefits to this approach – if the funder's risk is spread across multiple claims, this should in turn dictate a lower cost of capital for the funded party (although this does not always materialize in practice).

From a corporate claim holder's perspective, portfolio financing offer some interesting options, such as the possible inclusion of some types of cases within the portfolio that would not ordinarily be capable of being funded on an individual basis (*e.g.*, defence or non-monetary cases). This is possible because the funder's return is collateralized by the claimant cases within the portfolio. Such a model may also enable the corporate claimant to monetize the portfolio, drawing capital secured against the dispute portfolio to utilize not just for financing legal expenditure but for other business purposes and/or to declare as profits.

A law firm portfolio may be structurally similar, where the finance is provided to support a law firm's contingency fee portfolio, with the funder's return pegged to the law firm's success. Again, such a model potentially allows for the law firm to draw capital more flexibly than a single case funding scenario, as well as enabling, for example, fee overruns on one case to be offset by another case that is operating below budget. Under the above model, the funder may have no direct contractual relationship with the law firm's clients, as the portfolio funding agreement is only between the law firm and the funder.

An alternative variety of law firm portfolio (which may exist alongside the structure described above) is one where the law firm's clients enter into individual funding agreements with the funder, but the terms of those agreements and/or the process for putting finance in place is dictated by the law firm's wider arrangement with the funder. Such arrangements are arguably not portfolio arrangements as defined above, as it is unlikely that cross-collateralization would be possible amongst the funded cases. (It would be surprising for one claimant to agree that some portion of its claim proceeds should go to offset losses suffered by another unrelated client of the firm.) Such arrangements can still offer clear benefits to the law firm, if for example the funder offers an expedited due diligence process, pre-agreed funding terms, etc. However, such

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<sup>54</sup> Reference the well-publicized arrangement involving British Telecom and Burford Capital is a good example of the practice.

arrangements do create potential conflict of interest issues, which law firms need to navigate carefully.

## **B. Going Beyond Financing Legal Cost**

Another developing area with respect to the litigation finance market is the increasing willingness of funders to consider (and in some instances, actively pursue) opportunities where the funder's capital is to be used for a purpose other than solely financing legal fees and costs. For instance, funders are providing working capital to the claimant entity during the life of the proceedings, providing financing to enable the claimant to discharge pre-existing liabilities or simply providing an advance on the damages to the claimant. Such structures are substantially similar to "traditional" third-party funding, in that the funder commits to provide a certain amount of capital with the funder's return tied to the success of litigation or arbitration. Using this model, a claim holder can use the claim as an asset in order to raise capital for a variety of potential purposes.

In the early life of the market, this structure was viewed by many funders as unattractive. Where offered, it was usually only relatively modest in sum and incidental to a larger funding provision for legal costs. However, as the market has become more competitive, funders are increasingly seeking to differentiate themselves and offer alternative applications for their capital, including in some instances inviting prospective clients to consider third-party funding not only as a means of financing their litigation but simply as a way of raising capital on a non-recourse or limited recourse basis.

That said, the practical availability of such arrangements should not be overstated. Whether a deal is capable of being structured in practice depends upon a large number of factors. The dynamics of such arrangements may be unattractive. For example, if the majority or entirety of the funder's committed capital is to be drawn on day one, this may be a significant departure from the traditional litigation finance economics, where the funder expects its funding commitment to be gradually drawn down during the life of the proceedings. This may entail a greater cost of capital to the funder and therefore less favourable funding terms.

Additionally, there is the problem of the case, itself. If the claim holder wishes to use the claim to raise capital, it is likely that they may also require financing for legal costs. In such a case, the overall funding commitment will be materially larger than it would have been if the funding was limited to solely to the arbitration budget, therefore requiring a much larger claim value in order for the arrangement to work. Funders will be wary of a deal that puts too much cash into the client's pocket upfront or too heavily erodes the client's expected net recovery, because of the risk that the client may lose interest in the outcome of the case and not commit itself fully to maximizing the chances of success.

### C. **Equity Financing**

As noted above, under the traditional model of dispute funding, the funding commitment, the expected level of return, and the terms of the investment are set out within and governed by contract (*e.g.*, the litigation funding agreement (“LFA”) and/or the Priority Agreement setting out the waterfall of distribution). However, if the claim holder is a special purpose vehicle (“SPV”) or entity with no other material assets other than the claim in question, the third-party funder may be able to structure its investment and return by purchasing equity in the claimant entity. Under this model, the funder’s return is derived from distributable profits generated from the success of the arbitration, as opposed to a contractual return. Such a structure may offer a number of potential benefits. It may, for example, enable the funder to take greater or total control over the litigation without running afoul of champerty restrictions. For example, it has been expressly recognized by the Irish Supreme Court that structuring investment in this way would not be deemed to be champertous, whereas third-party funding would be.<sup>55</sup>

Furthermore, owning a stake in the claim holder may enable the funder to be brought within the circle of privilege, allowing the funder access to all privileged information without concerns about a potential discovery application for information shared with the funder.

### D. **Assignment/Sale of Claims**

There are many situations where the outright sale of the claim may be preferable for both the claim holder and the funder to the ‘traditional’ third-party funding model. A claim holder may view lengthy litigation or arbitration proceedings as a costly and time-consuming nuisance and would happily transfer the rights to another party in exchange for an immediate payment of cents on the dollar. From the funder’s perspective, having total, unfettered control of the claim (including, in particular, control of settlement decisions) may be highly desirable.

In common law jurisdictions, the outright sale or assignment of claims may not be permitted and in jurisdictions where champerty exists, funders may be prohibited from taking control of another party’s litigation in this way. The traditional definition of third-party funding in common law jurisdictions will therefore typically describe the arrangement as an investment in the claim holder’s litigation in exchange for a financial interest in the outcome,<sup>56</sup> as opposed to an outright sale.

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<sup>55</sup> *Persona Digital Telephony Ltd & ors v The Minister for Public Enterprise & ors* [2017] IESC 27

<sup>56</sup> See ALF Code of Conduct, *supra* at 26.

However, as noted above, in some civil law jurisdictions, funders may adopt a model where the claim is simply purchased outright and pursued by the purchaser, possibly aggregated to other similar claims in order to produce costs savings. The market for the purchase and aggregation of cartel damages claims in Germany and the Netherlands is a good example of this approach, although there are few examples of international arbitration claims being aggregated in this way.

In the UK, the exemption for liquidators which allows the assignment of claims to other parties has led to a rise in the practice of funders offering not to fund, but rather to buy claims arising in insolvency. The structure may involve an upfront purchase price (allowing an immediate distribution to creditors), a deferred structure where the funder pays a share of any amounts recovered to the insolvent estate, or a combined part upfront, part deferred payment structure.

## **E. Enforcement Financing**

By definition, the non-recourse litigation financing model requires the funder to accept both what may be described as “litigation risk” (*i.e.*, the risk of an adverse ruling or award) and enforcement or collection risk. In other words, in order to see a return on invested capital, the funded party must not only win the case, but must also successfully enforce the award.

Traditionally, many third-party funders have been more comfortable assessing litigation risk than enforcement risk, which is perhaps a reflection of the fact that most third-party funders are managed by former lawyers. In the early stages of the market’s development, it was common for funders to simply turn down cases where enforcement was likely to be challenging due to the lack of visibility over or location of assets. However, as the market has developed, funders have recognized that many of the largest and potentially most lucrative disputes might require an acceptance of material enforcement risk. Today, many funders have in-house asset-tracing and enforcement capability and may seek to differentiate themselves on that basis. Similarly, there are a number of funders that originally started out as award enforcement or debt recovery agencies, but have gradually embraced opportunities to get involved and finance contested claims at earlier stages in the arbitration process and now finance contested claims. Some such funders may now be known generally as third-party funders, even though their businesses may pre-date the modern third-party funding industry. Other may not describe themselves as third-party funders, but nevertheless offer similar structures.

In practice, enforcement financing may be expressly or implicitly built into an agreement to fund an arbitration claim on the basis that the funder will not see a return until the award is successfully enforced. Funders will also often consider enforcement-only opportunities, where an award has already been obtained and the claimant seeks financial support and/or expertise to secure collection. Enforcement financing is therefore a necessary component of third-party funding and something which most funders today provide, albeit with different risk appetites and levels of expertise.

## F. Assignment / Sale of Awards

Related to the purchase of claims (*see discussion infra*) is the market for the purchase / assignment of awards and judgments. This practice is permitted in most jurisdictions and pre-dates modern concepts of third-party funding. Many of the funds that operate in this space would not consider themselves to be third-party funders, however many third-party funders will also consider such opportunities. Like claims sales, the sale of awards can be structured in a number of different ways, from a simple upfront purchase price to a payment which is in whole or in part based upon the amount collected.

## IV. Conclusion

In the last decade, the global litigation finance industry has grown beyond all recognition and continues to expand, both in terms of the number of funders operating and in terms of the amount of capital raised and deployed. This market growth has gone hand-in-hand with rising awareness amongst the legal community. There are few arbitration attorneys that are not at least aware of the basic premise of third-party funding and there is an ever-growing proportion that have first-hand experience of the market.

Much of the focus of the larger litigation funds today is on encouraging greater corporate use of litigation finance. While third-party funding was considered an option of last resort for financially distressed claimants, funders are increasingly encouraging corporates with strong balance sheets to use litigation finance as an alternative to tying up their own capital in litigation or arbitration. The idea and advantages of off-balance sheet litigation and turning in-house legal departments into profit centres are well-established.

While the market is becoming more diverse, the larger funders have tended to follow a relatively similar pattern. They commonly seek primarily to invest in a relatively small volume of very large commercial disputes and portfolio'. The amount of capital committed to each investment tends to be in the millions of dollars, the claim values in the tens, hundreds of millions or more and the funders are expecting to make a multiple return on the capital invested in successful cases. Investing in this profile of cases with the levels of financial risk involved tends to necessitate both high rejection rates and detailed due diligence. While many funders advertise speed of execution by comparison to their competitors, the reality is securing funding can be a lengthy and complex process. More streamlined options for financing smaller to medium-sized claims are still limited in many jurisdictions, although this is an area which is gradually attracting interest from the litigation finance market and is expected to continue to develop in the next few years.

The growing number of funders has already produced and should continue to yield positive developments for prospective users of dispute funding, requiring funders to compete on speed and cost of capital in order to win business and meet target capital deployment levels.

Third-party funding must also be seen in the context of the wider arbitration finance and risk management market. As noted above, law firms may play an increasingly prominent role in this regard. Currently, some historically conservative firms are using external finance and insurance to support developing contingency fee portfolios. As more innovative financing solutions become available to law firms, potentially with lower capital costs than traditional third-party funding, it is possible that we may see law firms and funders start to compete for opportunities.

In addition, the dispute risk insurance market is developing rapidly, growing in prominence and expanding into new markets and jurisdictions. These insurance options are now being presented by lawyers and brokers alongside third-party funding as part of a broader discussion about the potential options available to finance or de-risk arbitration.

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## **Chapter 3**

### **Definitions<sup>†</sup>**

#### **I. Introduction**

In their consideration of various substantive topics, Task Force discussions frequently returned to important and fundamental questions about the definition of third-party funding. This focus on definitions is not surprising given the need for a clear understanding of the object and the scope of the Task Force’s work and, relatedly, of any recommendations or guidance produced by the Task Force.

For these reasons, and in light of the range of definitions adopted by various entities seeking to regulate third-party funding, it was decided that the Task Force Report would benefit from a deliberative analysis of issues implicated in delineating meaningful definitions of third-party funding. This Chapter provides that analysis, including a survey of various definitions adopted in other sources, and a conceptual analysis of functional aspects of funding that may affect definitions. This Chapter is intended to be read as background to other Chapters, each of which effectively adopts a specific definition of the funding activities addressed in its analysis.

This Chapter proceeds in the following parts: Part 1 provides general background about consequences and concepts implicated in different definitions. Part 2 provides a brief definitional overview of the full range of means for funding disputes that are within the scope of the broad Working Definition that is the starting point for the Task Force. Part 3 provides a survey of the definitions that have been adopted by various institutions, legislation, treaties, policy makers, and scholars in the international arbitration context. Part 4 engages in a functional analysis of certain key features of third-party funding and briefly examines the extent to which such features raise issues that are distinct to third-party funding. Finally, Part 5 provides an overview of the more specific definitions adopted in various subsequent Chapters in order to limit the scope of their application to the specific topics taken up by those chapters.

#### **II. Background**

In recent years, courts, commentators, and policymakers have identified the rise of a new industry of non-parties that fund parties’ costs in various sectors of international arbitration. Despite their increasing presence in international arbitration, the precise definitions of “third-party funder” and “third-party funding” continue to be subject to considerable debate. Even funders

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<sup>†</sup> Primary contributors to this Chapter include Catherine Rogers, Stavros Brekoulakis, James Clanchy, and Duarte Henriques. Mr. Ahmed El Far also contributed valuable research assistance.



themselves disagree over the precise definition of third-party funding or whether it is even capable of definition.<sup>57</sup> Several reasons explain this definitional difficulty.

One reason for definitional ambiguities is that modern outside funding of a party's costs can resemble, or be co-terminous with, other forms of financing that have existed long before the current phenomenon. For example, in some jurisdictions, contingency fee arrangements are widely used to provide legal representation and in some instances cover claimants' expenses. Although rarely explicitly referenced as a form of third-party funding, the practice is inevitably subsumed in many general definitions that refer to a non-party funding for a case, unless expressly excluded.<sup>58</sup> Even if a law firm does not advance any specific amounts for costs, they are effectively contributing something of material value—legal services—in exchange for an interest in the final award.

In maritime arbitration before-the-event (BTE) insurance has funded many claims since the Nineteenth Century,<sup>59</sup> and continues to play an important role both in and apart from maritime-related disputes. Others argue that modern funding arrangements are largely indistinguishable from after-the-event (ATE) or traditional liability insurance, and from conventional forms of corporate financing through which a shareholder or related corporate entity may indirectly finance a party's costs in an international arbitration.<sup>60</sup>

Defining “third-party funding” is also difficult because a wide range of funding models exists, and that range is rapidly evolving, even since when the Task Force was constituted. For example, funding may be structured as debt instruments, equity instruments, risk-avoidance instruments, or as full transfers of the underlying claims. More recently, some funders have taken an equity position in a company or are engaged in “portfolio financing” of an identified range of

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<sup>57</sup> See Maxi SCHERER, Aren GOLDSMITH and Camille FLÉCHET, “Third-Party Funding in International Arbitration in Europe: Part 1 – Funders” Perspectives, 2 RDAI/IBLJ (2012), p. 209-10, available at: <<https://www.transnational-dispute-management.com/news/20120312.pdf>> (last accessed 27 October 2016), reporting on a roundtable, attended by various major litigation funding firms, where the participants could not agree on a definition of third-party funding. This confusion is apparent even at a terminological level. As one commentator describes, “[t]he nomenclature to describe this kind of third-party capital investment in arbitration or litigation claims is all over the map and woefully un-descriptive. It has been referred to as “third-party funding”, “third-party litigation funding or financing”, or most commonly “alternative litigation funding or financing”. Michele DESTEFANO, “Non-Lawyers Influencing Lawyers: Too Many Cooks in the Kitchen or Stone Soup”, 80 Fordham L. Rev. (2012) p. 2791 at p. 2794.

<sup>58</sup> For example, new Hong Kong legislation expressly permits third-party funding, but expressly acknowledges that contingency fee arrangements are still prohibited. This exclusion suggests that, in the absence of such an exclusion, its definition of third-party funding could include lawyer funding through contingency fees.

<sup>59</sup> James CLANCHY, “Navigating the Waters of Third Party Funding in Arbitration”, 82 Arbitration (2016) p. 222.

<sup>60</sup> Anthony J. SEBOK, “The Inauthentic Claim”, 64 Vand. L. Rev. (2011) p. 61, at p. 63-67. Given the potential overlap between modern non-recourse third-party funding and other traditional means of supporting litigation expenses, some on the Task Force argued that the Report should adopt the term “modern third-party funding” to distinguish more recent phenomena from more traditional forms of litigation support. For reasons explained in greater detail in this Chapter, however, the Task Force decided not to circumscribe its analysis to modern forms, but instead sought to locate more modern forms of funding in the constellation of existing forms.

cases involving a particular party or law firm. In the latter instance, funding is provided to the law firm, not the party, which can raise additional practical and definitional challenges.

Meanwhile, third-party funders may become involved either before a claim is filed or later in the process.<sup>61</sup> Some funders specialize only in award execution or funding for expert witness costs, while others fund all costs, including a potential adverse award of costs. Funders also separately incorporate “special purpose vehicles” to facilitate the funding arrangement.<sup>62</sup> In addition to the variety in funding models, modern funding is expanding as a result of an influx of new funders and the expansion of funding into new regions and jurisdictions.<sup>63</sup> Newer funding models increasingly also combine with equity positions, long-term relationships with parties and law firms, and various types of insurance.

The proliferation of funding models raises questions about how to define funding for the purpose of the Task Force’s study and any potential recommendations. Disagreement existed on the Task Force about whether to focus its study on the narrow, modern practice of case-specific non-recourse funding, or to adopt a broader definition that takes account not only modern non-recourse models, but other forms of financing that are conceptually or functionally similar and/or function as alternatives in the same market. As explained in greater detail below, for the purpose of study and discussion the Task Force adopted a broad definition. Meanwhile, specific recommendations in this Report are based on more targeted, narrowly tailored definitions.

Given the pace of developments in the field, this Chapter includes not only a discussion of conceptual definitions of funding, but also an analysis of the functional similarities and differences among different types of financing that may either come within a definition of funding or be considered by analogy alongside funding. Like debates about the scope of our working definitions, at least one member on the Task Force questioned the utility of including any discussion of functional aspects of third-party funding.<sup>64</sup> Given that various national, international, and scholarly debates about funding often include analogical reasoning based on functional distinctions

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<sup>61</sup> See Mark KANTOR, “Third-Party Funding in International Arbitration: An Essay About New Developments”, 24 ICSID Review (2009) p. 65, at p. 74; Jennifer A. TRUSZ, “Full Disclosure? Conflicts on Interest Arising from Third-Party Funding in International Commercial Arbitration”, 101 The Georgetown Law Journal (2013) p. 1649 at p. 1654.

<sup>62</sup> See Cento VELJANOVSKI, “Third-Party Litigation Funding in Europe”, 8 J.L. Econ.& Pol’y (2011) p. 405 at p. 430 (‘[Third-party litigation funding investors] rely on Special Purpose Vehicles, which . . . are legal entities created for . . . the acquisition, financing, or both, of a project or the setup of an investment. They are usually used because they are free from pre-existing obligations and debts, and are separate from the parties that set them up for tax and insolvency purposes.’).

<sup>63</sup> For example, third-party funding only become permissible in Hong Kong and Singapore in 2016-17 as a result of legislative changes in those jurisdictions that eliminated the doctrines of champerty and maintenance for international arbitration. Meanwhile, litigation finance has also recently arrived in Latin American with the emergence of Leste based in Brazil and Lex Finance based in Peru.

<sup>64</sup> The Task Force benefitted from the expertise of its Members and consultation with other experts on various forms of litigation support, including ATE, BTE, and liability insurance. During the public comment period, it will also co-host, together with The Law Society of England and Wales, a roundtable discussion to engage directly with members from the London insurance and maritime markets. One Member of the Task Force considered these sources and efforts inadequate for the Task Force to address issues relating to insurance.

between modern funding and other sources of litigation finance, functional aspects of third-party funding are included in this Chapter as a useful point of reference.

One challenge in analysing functional aspects of third-party funding is that funding arrangements vary significantly among different funders and funding agreements. Some funding agreements permit or require active participation of the third-party funder in key strategic decisions in the arbitration. Other agreements provide for a more limited role for funders, providing only for periodic updates and limited opportunities for intervention. One fairly conventional model for modern funding agreements provides for funders to receive a percentage of recovery, with the percentage increasing over with the passage of time since the initial investment. While most funders invest for profit, not all do, particularly if they fund responding parties. For example, in the investment arbitration case brought by Philip Morris against Uruguay, The Bloomberg Foundation and its ‘Campaign for Tobacco-Free Kids’ provided outside financial support for the Uruguayan government.<sup>65</sup> While this arrangement involves funding of a case by a third party, funding was for a respondent (not claimant) and the funder’s interest was not financial, but instead was tied to the political and policy implications of the award. Respondent States could also, as occurs in WTO proceedings, be funded by another State or, as has been reported by some funders, be funded through a model similar to after-the-event insurance.

### III. The Task Force Working Definition

Given the range of possibilities, and the likelihood that additional variations will develop and flourish, this Report has taken as a starting point a broad Working Definition of third-party funding.<sup>66</sup> While each subsequent Chapter contains its own definition applicable to the issues it

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<sup>65</sup> See Press Release by Uruguay’s Counsel, Foley HOAG LLP, “Government of Uruguay Taps Foley Hoag for Representation in International Arbitration Brought by Philip Morris to Overturn Country’s Tobacco Regulations”, p. 8 (October 2010), available at <<http://www.foleyhoag.com/news-and-events/news/2010/october/uruguay-taps-foley-hoag-for-representation>> (last accessed 19 August 2017)

<sup>66</sup> See Lisa Bench NIEUWVELD and Victoria SHANNON, *Third-Party Funding in International Arbitration*, (Kluwer 2012) p. 2. For the purposes of this Report, “international arbitration” refers to both commercial and investment arbitration, but generally excludes maritime arbitration. In all respects that are relevant to this Report, maritime arbitration is a distinct field to which analysis and recommendations of the Task Force should not be applied. For example, maritime arbitration has distinctive internal rules, specialized arbitral institutions, a specialized body of practitioners, and a well-established history of funding maritime disputes. [SB: Given the importance of maritime arbitration and the well-established tradition of funding in this industry, I would consider moving this text here up in the main text above.]

There was some disagreement on the Task Force about the viability of carving out maritime arbitration, given wide range of disputes that may fall in this category. Nevertheless, “maritime arbitration” is a term frequently used by practitioners and scholars to describe a broad range of arbitration disputes that arise out of circumstances between parties engaged in maritime affairs, and/or to arbitrations brought pursuant to maritime arbitration rules, such as those of the London Maritime Arbitration Association.

While this Report does not extend any of its recommendations to maritime arbitration, it includes references to funding arrangements that exist in the maritime field, for purposes of comparison only, because its long traditions are a helpful and important point of reference for analyzing modern funding arrangements.

addresses the Task Force's work considered all types of funding that would fit within the following definition:

**The term 'third-party funder' refers to any natural or legal person who is not a party to the dispute but who enters into an agreement either with a disputing party, an affiliate of that party, or a law firm representing that party:**

- a) in order to provide material support or to finance part or all of the cost of the proceedings, either individually or as part of a selected range of cases, and**
- b) such support or financing is provided either through a donation or grant or in return for remuneration or reimbursement wholly or partially dependent on the outcome of the dispute.**

This broad definition facilitates consideration of the full range of funding models, as well as close analogies that provide important context.

The key elements of this definition are 1) an agreement; 2) with an entity that is not a party to the dispute; 3) the provision of financing or material support; and 4) either through a grant or in return for remuneration or reimbursement dependent on the outcome of the dispute. This Working Definition not only includes respondent-side funding, which some narrower definitions exclude, but also contingency fee funding by law firms, and certain types of insurance, to name a few examples. It applies not only to funding models that are premised on an expectation of a return on investment, but also to pro-bono representation and funding for non-profit purposes.

This definition is also intended to apply not only to individually funded cases, in which a funder's support is directed specifically at individual cases, but also to newer models of funding. For example, this definition comprehends funding of a portfolio of claims held by business or represented by a law firm, or in financing provided to a law firm and collateralized by funds anticipated to be received from cases represented by that firm.

The purpose in adopting such a broad Working Definition is to ensure that the Task Force considers the full range of funding models and engages in careful analysis of the nature of the issues under consideration. Using a broad definition as an analytical starting point also facilitates examination of the extent to which issues under consideration are identical to, similar to, or different from those that arise or do not arise with respect to other more long-standing forms of funding.

For example, definitions that are too narrow may either exclude certain types of funding or preclude clear application of specific rules or guidelines that are intended to apply to third-party funders. For example, a special purpose vehicle created to fund one case might avoid easy application of the IBA Guidelines on Conflicts of Interest in International Arbitration (IBA

Guidelines on Conflicts) that require disclosure and possible disqualification of an arbitrator who has been reappointed several times in a case involving the same funder.<sup>67</sup>

In another example, many existing definitions that require financial interest in the award would exclude respondent- or defence-side funding (where no counter-claim has been filed). Respondent- or defence-side such funding undertaken, for example, to generate favourable precedent or advance policies implicated in the award, can raise concerns identical to those in modern claimant-side third-party funding. For example, an arbitrator may represent or sit on the Board of Directors of a non-governmental organization that is funding an arbitration or otherwise conflicted with a non-party that is providing funds for the dispute.<sup>68</sup>

Narrower definitions that do not consider functional similarities between modern third-party funding and other forms of dispute funding also may raise questions about coherence and fairness. For example, in some cases insurance companies or pro bono supporters may exert influence in selecting an arbitrator or making case management decisions that are functionally identical to modern third-party funders. If these sources of funding are definitionally excluded from consideration, resulting conclusions and recommendations for new regulation or guidance might draw lines that seem arbitrary. Conclusions and recommendations based on narrow definitions might also inadvertently preference one form of funding over another, even though they function as equivalents or alternatives, compete in the same market, or implicate identical issues.

Debate existed on the Task Force about whether this Working Definition would extend also to BTE insurance. The argument against inclusion is that premiums for BTE insurance are paid before any claim is initiated, and BTE insurer's remuneration or reimbursement for its services is paid exclusively through these premiums and is not "dependent on the outcome of an arbitration."

By contrast, others regarded BTE insurance<sup>69</sup> as coming within the Task Force's Working Definition because a BTE insurer will be able to recover costs only in the event a claimant prevails, even if not by directly enforcing the costs award. In this way, the financial interests of a BTE insurer may be considered "dependent on the outcome of the dispute."<sup>70</sup> As described in Chapter

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<sup>67</sup> See "Standard 6" of the IBA Guidelines on Conflicts of Interest in International Arbitration, and Explanation to Standard 6 (b), available at <[https://www.ibanet.org/ENews\\_Archive/IBA\\_July\\_2008\\_ENews\\_ArbitrationMultipleLang.aspx](https://www.ibanet.org/ENews_Archive/IBA_July_2008_ENews_ArbitrationMultipleLang.aspx)> (last accessed 15 July 2017) (henceforth IBA Guidelines).

<sup>68</sup> This situation arose in *Quasar de Valores SICAV S.A. et al. v The Russian Federation*, (SCC Arbitration No. 24/2007) Award (20 July 2012), para. 223. In that case, the funder, Group Menatep Limited, was a former majority shareholder in the Russian oil company Yukos (rather than a commercial third-party funding entity) and there was no formal written funding agreement that required claimant to reimburse Menatep. Speculation is that Menatep was funding the case in an effort to create a favorable "precedent" that would be helpful in its future, much larger, shareholder dispute against Russia under the Energy Charter Treaty. See Victoria SHANNON, "Revealing Not-for-Profit Third-Party Funders in Investment Arbitration", available at <<http://oxia.ouplaw.com/page/third-party-funders>> (last accessed 19 August 2017).

<sup>69</sup> For a description of BTE insurance, see Chapter 2, at p. 24.

<sup>70</sup> There was further debate on the Task Force about whether BTE insurance would come under the IBA Guidelines' definition. That issue is discussed below.

Two, like modern third-party funding, BTE insurance “will provide funding for bringing a claim falling within the scope of cover, paying lawyers’, arbitrators’ and experts’ fees during the course of the arbitration.”<sup>71</sup> Unlike modern third-party funding, a BTE insurer “has no interest in the proceeds of an arbitration which it supports,” but because it can potentially be reimbursed as a result of the award, a BTE funder will, like a modern third-party funder, “control the conduct of the claim as closely as it can.”<sup>72</sup>

Similarly, there was debate about whether ATE insurance<sup>73</sup> would come within the Working Definition because ATE insurance does not involve financing. Like other types of third-party funding, however, premiums under most ATE policies are only payable in the event of success. As one scholar explains, “This means that the insured claimant ... is only liable to pay the premium if the claim is won [and]...if the insured loses the case, no ATE premium is due.”<sup>74</sup> Under such policies, because the ATE insurer will recover payment for policies only in the event of an award in favour of the insured, most on the Task Force regarded ATE insurance as being tied to the outcome of a dispute in a manner that brings it within the Working Definition. In addition, some ATE policies provide for reimbursement not only of an adverse cost award, but also for coverage of a party’s own legal fees and costs,<sup>75</sup> which makes it direct competition for and more closely resemble modern forms of third-party funding such that separating it out from the definition was regarded as an artificial curtailment.

In addition, as discussed in greater detail below, in various respects, ATE, BTE, and liability insurance providers also functionally resemble third-party funders because their financing or support is predicated on a substantive assessment of claims to determine their likelihood of success. Insurers may also (depending on the policy and market) either select counsel or, in those jurisdictions where lawyers do not have a monopoly on legal services, BTE insurers may directly take on legal representation of the claim.<sup>76</sup>

Narrower definitions that do not consider functional similarities between modern third-party funding and other forms of dispute funding may raise questions about coherence and fairness. Notably, prior to recent reforms introduced by the IBA, the ICC and SIAC, insurance was not

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<sup>71</sup> See Chapter 2, at p. 24.

<sup>72</sup> *Ibid.*

<sup>73</sup> For a description of ATE insurance, *see* Chapter 2, p. 25.

<sup>74</sup> Cento VELJANOVSKI, “Third-Party Litigation Funding in Europe”, 8 J.L. Econ.& Pol’y (2011) p. 405; *see also* Marco DE MORPURGO, A COMPARATIVE LEGAL AND ECONOMIC APPROACH TO THIRD-PARTY LITIGATION FUNDING, 19 Cardozo J. Int’l & Comp. L. 343, p. 353 (2011) (“From the viewpoint of third parties, ATE insurance is another way to invest in the outcome of litigation. ATE insurance is a particular type of insurance that can be taken out after an event, such as an accident that has caused an injury, to insure the policyholder for disbursements, as well as any costs should he lose his case.”). In addition, under some policies, premiums for the policy are only due dependent on particular outcomes, such as if the insured wins the case. See also overview of ATE and BTE insurance in Chapter 2, at pp. 24-25.

<sup>75</sup> Vicki WAYE, *Trading in Legal Claims: Law, Policy & Future Directions in Australia, UK & US* p. 87 (2008); *see also* <<https://www.thejudgglobal.com/litigation-and-arbitration-insurance/>> (last accessed 30 August 2017).

<sup>76</sup> *See* Mark TUIL and Louis VISSCHER, “New Trends in Financing Civil Litigation in Europe, A Legal, Empirical, and Economic Analysis” pp. 96-98 (2010).

generally required to be disclosed in international arbitration. The revised IBA Guidelines, however, recognize that similar types of conflicts of interest may arise with respect to various types of insurance (for example, if an arbitrator sits on the board of directors of an insurance company, or owns substantial stock in it) in the same manner they arise with modern third-party funding. A narrow definition inadvertently preferences one form of financing over another, even though they function as alternatives, compete in the same market, and implicate identical issues.

Despite adopting this broad definition for the purposes of the Task Force's analysis and discussions, later Chapters generally adopt narrower definitions so any recommendations or guidance is specifically targeted to particular issues. For example, insurance markets and the participation of insurers in adjudicatory proceedings are already generally regulated in various legal regimes through national procedural rules (in the litigation context) and professional ethical regulations.<sup>77</sup> Prior to recent reforms introduced by the IBA, the ICC and SIAC, insurance was not regulated or required to be disclosed in international arbitration.

Meanwhile, in a similar vein, P&I and FD&D clubs have membership agreements and internal professional norms and traditions regarding representation of members, which appear to work well for their members.<sup>78</sup> Finally, contingency fee arrangements are generally regulated through national attorney regulation, and potential conflicts with law firms providing contingency fee funding are governed by other sources aimed at the conduct of lawyers, such as the IBA Guidelines on Conflicts' provisions regarding conflicts with attorneys and law firms,<sup>79</sup> and the IBA Guidelines on Party Representatives in International Arbitration.<sup>80</sup>

Given these definitional complexities, each topic considered in the subsequent Chapters required independent reconsideration of the broad Working Definition of third-party funding to determine the scope consideration, the nature of any potential recommendations, and the conduct and entities to which such recommendations might apply. This Chapter provides general background regarding definitional aspects of third-party funding that informed the Task Force's discussions. It also attempts to locate more specific definitional decisions regarding recommendations in subsequent chapters within a broader analysis of the complexities involved in defining third-party funding.

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<sup>77</sup> [Insert references here to specific examples of regulation of insurance markets and of insurers, which relate to issues covered in other chapters of the report.]

<sup>78</sup> Club rules require members' conduct of proceedings to be reasonable and cost effective. See, for example, Rule 5 of the UK Defence Club Rules, Available at <[https://www.ukdefence.com/fileadmin/uploads/uk-defence/Documents/Club\\_Rules/UKDC\\_Rule\\_Book\\_2017.pdf#page=24](https://www.ukdefence.com/fileadmin/uploads/uk-defence/Documents/Club_Rules/UKDC_Rule_Book_2017.pdf#page=24)> (last accessed 18 August 2017).

<sup>79</sup> See IBA Guidelines on Conflicts of Interest, 3.1.3.

<sup>80</sup> Notably, Article 4 of the IBA Guidelines on Party Representatives requires "A Party should promptly inform the Arbitral Tribunal and the other Party or Parties of any change in such representation." This provision, along with general procedures and practices that require disclosure of representation at the commencement of an arbitration, ensure that arbitrators are aware of the participation and identity of any attorneys or law firms in an arbitration.

## IV. Survey of Existing Definitions

### A. Legislation and Codes of Conduct

Debate exists in some domestic contexts about whether and to what extent third-party funding should be permitted or regulated. As a result, national laws regarding third-party funding in domestic litigation vary considerably.

To date, however, only two States appear to have taken any action to regulate, and therefore define, third-party funding in international arbitration. These legislative efforts have been undertaken as part of an effort to legalize the use of funding in international arbitration, which had previously been prohibited under the doctrines of champerty and maintenance.

Singapore has recently amended its law and permit modern third-party funding.<sup>81</sup> For that reform, the definition of third-party funding is found in the recent Civil Law Amendment Bill and in the Civil Law Regulations.

The Civil Law (Amendment) Act 2017 defines third-party funding as “a person who carries on the business of funding all or part of the costs of dispute resolution proceedings to which the person is not a party.”<sup>82</sup> A “third-party funding contract” is defined as:

“a contract or agreement by a party or potential party to dispute resolution proceedings with a Third-Party Funder for the funding of all or part of the costs of the proceedings in return for a share or other interest in the proceeds or potential proceeds of the proceedings to which the party or potential party may become entitled.”<sup>83</sup>

Under these provisions, the definition of a “third-party funder” appears to be considerably broader than the definition of a “third-party funding contract.” It is uncertain whether this distinction was intentional, and if so, what the intent was behind the drawing of this distinction. Notably, the definition of third-party funding contracts for the purposes of the Act does not appear to extend to non-commercial funders (such as individual persons), because they do not “carry on business” as a funder. Meanwhile, the provision that the funding contract provide for “a share or other interest in the proceeds or potential proceeds of the proceeding” would seem to preclude pro-bono or

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<sup>81</sup> Civil Law (Amendment) Bill 2016 and Mediation Bill 2016 were introduced for First Reading in Parliament on 7 November 2016. See Alastair HENDERSON and Daniel WALDEK, “Singapore Arbitration Update: Third Party Funding and New SIAC Rules 2016”, Herbert Smith Freehills Arbitration Notes (1 July 2016).

<sup>82</sup> Article 5B(1) of the Act to amend the Civil Law Act (Chapter 43 of the 1999 Revised Edition) and to make a related amendment to the Legal Profession Act (Chapter 161 of the 2009 Revised Edition), passed 10 January 2017 and assented by the President on 3 February 2017 (“Civil Law (Amendment) Act 2017”).

<sup>83</sup> *Ibid.*



respondent-side funding,<sup>84</sup> as well as BTE and ATE insurance that is not offered through a third-party funding agreement.<sup>85</sup>

The relatively narrow scope of the Singapore definition of a third-party funding contract appears to be confirmed in the explanation in the draft version of the Bill regarding funder obligations required for enforcement of their rights under the funding contract.<sup>86</sup> In its final version, Article 4 of the Civil Law (Third-Party Funding) Regulations of 2017 defines a third-party funder as an entity that “carries on the principal business, in Singapore or elsewhere, of the funding of the costs of dispute resolution proceedings to which the Third Party Funder is not a party.”<sup>87</sup> (emphasis added)

In a similar vein, Hong Kong recently enacted legislative reforms to permit third-party funding arrangements that were previously prohibited under the doctrines of champerty and maintenance. Under the Hong Kong Ordinance, like the Singapore legislation, “third-party funding” and the “funding agreement” are defined terms, but the Hong Kong legislation also defines separately “third-party funding.” Specifically, in defining funding, Section 98I of the Hong Kong Ordinance provides:

Third-party funding of arbitration is the provision of arbitration funding for an arbitration—

- (a) under a funding agreement;
- (b) to a funded party;
- (c) by a third-party funder; and
- (d) in return for the third-party funder receiving a financial benefit only if the arbitration is successful within the meaning of the funding agreement.

(2) However, third-party funding of arbitration does not include the provision of arbitration funding directly or indirectly by a person practising law, or providing legal services, whether in Hong Kong or elsewhere.

Notably, the definition precludes funding by attorneys in the same case in which they are acting as legal representatives, meaning that Hong Kong legislators intentionally excluded contingency fee arrangements from their definition of third-party funding. Hong Kong regulatory authorities are separately considering whether and how to enact reforms that would permit contingency fee representation.

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<sup>84</sup> This limitation is confirmed in the Law Society of Singapore, Guidance Note 10.1.1, which describes “Third-party funding” as involving “a commercial funder agreeing to pay some or all of the claimant’s legal fees and expenses.”

<sup>85</sup> The exclusion in the Singapore Act definition of BTE and ATE insurance is likely related to the fact that the starting point for the legislative effort was to abolish the tort of maintenance and champerty, and these types of funding historically have not been regarded as implicating that tort.

<sup>86</sup> See Article (4) the Civil Law (Amendment) Bill of 2016, and see Explanatory Statement of the Civil Law (Amendment) Bill of 2016.

<sup>87</sup> See Article (4) of the Civil Law (Third-Party Funding) Regulations 2017.

Under the Hong Kong legislation, a “third-party funder” is defined in 98J as follows:

- (1) A third-party funder is a person—
  - (a) who is a party to a funding agreement for the provision of arbitration funding for an arbitration to a funded party by the person; and
  - (b) who does not have an interest recognized by law in the arbitration other than under the funding agreement.
- (2) In subsection (1)(b), the reference to a person who does not have an interest in an arbitration includes—
  - (a) a person who does not have an interest in the matter about which an arbitration is yet to commence; and
  - (b) a person who did not have an interest in an arbitration that has ended.

Under this definition, key aspects of the definition of a third-party funder is someone who enters into a funding agreement and does not have “an interest” either in “the matter” of an arbitration yet to be commenced or in “an arbitration that has ended.” The reference to an interest in “an arbitration” presumably means an interest in the substance of the underlying dispute. This definitional approach contrasts with the approach of the International Bar Association, which rests on a “direct interest” in the award.

In a separate Section 98H, the Hong Kong Ordinance defines the “funding agreement,” as follows:

- A funding agreement is an agreement for third-party funding of arbitration that is—
- (a) in writing;
  - (b) made between a funded party and a third-party funder; and
  - (c) made on or after the commencement date of Division 3.

To date, the legislative efforts by Singapore and Hong Kong to regulate third-party funding is unique in their effort to regulate third-party funding in international arbitration. One reason is that these jurisdictions were later than many others in relaxing their prohibitions against maintenance and champerty. Only a few other jurisdictions have expressly regulated litigation funding in domestic contexts.

In England and Wales, in January 2014, a voluntary Code of Conduct for Litigation Funders (Code) was published by the Association of Litigation Funders.<sup>88</sup> Because it pertains

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<sup>88</sup> See Victoria SHANNON and Lisa Bench NIEUWVELD, *Third-Funding in International Arbitration* (Kluwer 2012) p. 114.

primarily to domestic litigation, it refers to “litigation funding,” even if that definition includes arbitration.<sup>89</sup> Specifically, the Code provides:

“Litigation funding is where a third party provides the financial resources to enable costly litigation or arbitration cases to proceed. The litigant obtains all or part of the financing to cover its legal costs from a private commercial litigation funder, who has no direct interest in the proceedings. In return, if the case is won, the funder receives an agreed share of the proceeds of the claim. If the case is unsuccessful, the funder loses its money and nothing is owed by the litigant”.<sup>90</sup>

This definition is similar to the older version of the Code published in 2011.<sup>91</sup> Notably, like the Singapore definition, it is limited to commercial funders. This focus is not surprising given the composition of the group that drafted it. This definition notably refers only to non-recourse funding of individual cases, and thus excludes many forms of funding that have been introduced since 2011.

As various institutions and entities have undertaken to assess issues that may arise with the participation of funders, and/or develop guidance or regulations relating to those issues, each institution or entity will have to base its analysis and final outputs on a definition. For this reason, it anticipated that the range of definitions presented in this Part will continue to expand.

## **B. Bi-Lateral Investment Treaties and Free Trade Agreements**

In contrast to national legislation focused on commercial funders and claim-side non-recourse funding, definitions developed by international bodies have tended to adopt broader definitions. For example, certain several investment treaties and free trade agreements have introduced provisions addressing third-party funding, which adopt significantly broader definitions.

The draft European Union-Vietnam Free Trade Agreement was the first investment agreement to include a reference to, and purport to regulate, third-party funding.

Specifically, Article 2 of the draft EU-Vietnam Free Trade Agreement provides that:

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<sup>89</sup> See Article (2.4) of the Code of Conduct for Litigation Funders (January 2014), available at: <<http://associationoflitigationfunders.com/wp-content/uploads/2014/02/Code-of-conduct-Jan-2014-Final-PDFv2-2.pdf>> (last accessed 29 October 2016); Burcu OSMANOGLU, “Third-Party Funding in International Commercial Arbitration and Arbitrator Conflict of Interest”, 32 *Journal of International Arbitration* (2015), p. 325 at p. 338.

<sup>90</sup> See Association of Litigation Funders, definition available at: <<http://associationoflitigationfunders.com/litigation-finance/>> (last accessed on 29 October 2016).

<sup>91</sup> See Article (2) of the Code of Conduct for Litigation Funders (November 2011), available at: <<http://associationoflitigationfunders.com/wp-content/uploads/2014/02/CodeofConductforLitigationFundersNovember2011.pdf>> (last accessed 29 October 2016).

“Third Party funding” means any funding provided by a natural or juridical person who is not a party to the dispute but who enters into an agreement with a disputing party in order to finance part or all of the cost of the proceedings in return for a remuneration dependent on the outcome of the dispute or in the form of a donation or grant.”<sup>92</sup>

The above definition is similar to the definition included in the European Union’s proposal for Investment Protection and Resolution of Investment Disputes under the Transatlantic Trade and Investment Partnership (TTIP). To that effect, Article 1 of Section 3 provides that:

“Third Party funding” means any funding provided by a natural or legal person who is not a party to the dispute but who enters into an agreement with a disputing party in order to finance part or all of the cost of the proceedings in return for a remuneration dependent on the outcome of the dispute or in the form of a donation or grant”.<sup>93</sup>

Similarly, the revised version of the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union adopted an explicit definition of third-party funding. Article 8.1 provides that:

“third party funding means any funding provided by a natural or legal person who is not a party to the dispute but who enters into an agreement with a disputing party in order to finance part or all of the cost of the proceedings either through a donation or grant, or in return for remuneration dependent on the outcome of the dispute”.<sup>94</sup>

As one commentator notes, the CETA define “a not-for-profit funder by focusing on whether the funder expects repayment for the capital it advances to the funded party rather than focusing on what other motivations the funder might have besides profit.”<sup>95</sup> In drawing this distinction, the CETA definition extends only to pro bono funding arrangements that contemplate reimbursement. In that author’s view, “[t]his definition is an appropriate catch-all, since the variety of motivations a funder could have may be endless.” According to one Member on the Task Force, the CETA definition would not extend to BTE insurers because their remuneration, in that Member’s perspective, is not dependent on the outcome of the dispute and the definition does not include the word “premium” in addition to “grant or donation.”

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<sup>92</sup> See Article (2) of Chapter 8 of the [draft] EU-Vietnam Free Trade Agreement, January 2016.

<sup>93</sup> See Article (1) of Section (3) of the European Union’s proposal for Investment Protection and Resolution of Investment Disputes under the Transatlantic Trade and Investment Partnership, dated 12 November 2015.

<sup>94</sup> See Article (8.1) of the revised version of the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union, (29 February 2016), available at: <[http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc\\_152806.pdf](http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf)> (last accessed on 26 October 2016).

<sup>95</sup> Victoria SHANNON, “Revealing Not-for-Profit Third-Party Funders in Investment Arbitration”, available at <<http://oxia.ouplaw.com/page/third-party-funders>> (last accessed 19 August 2017).

During its work, the Task Force benefitted from previews of draft bi-lateral investment treaty provisions regarding third-party funding, which included definitions of third-party funders. For example, a draft French Model BIT provides that:

“third party funder means any natural or legal person other than the disputing party who supports part or all of the costs of the arbitration in return for remuneration as a percentage of the compensation awarded by the tribunal entrusted to settle a dispute between an investor and the recipient host state of the investment of this investor.”<sup>96</sup>

Meanwhile, a Draft Slovak Model BIT provides:

“A request for consultations must contain identification of any government, person or organization that has provided or agreed to provide any financial or other assistance to the investor in connection with the claim, or has an interest in the outcome of the claim.”

The final versions of these Model BITs are not publicly available and research has not identified other BITs that include specific language regarding third-party funding.

## **C. Arbitral Institution Rules and the IBA Guidelines**

### **1. The IBA Guidelines on Conflicts of Interest**

Before any arbitral institution took up the issue of third-party funding, the Task Force revising the 2014 IBA Guidelines on Conflicts of Interest sought to address the issue and adopted an expansive definition of funders. Specifically, General Standard 6(b) includes a requirement that arbitrators disclose the following relationships:

“[...] direct or indirect, between the arbitrator and the party (or another company of the same group of companies, or an individual having a controlling influence on the party in the arbitration), or between the arbitrator and any person or entity with a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration.”

The Explanation to General Standard 6(b) defines “third-party funder” or “insurer” as:

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<sup>96</sup> Draft French Model BIT (2006), available at <<https://www.italaw.com/documents/ModelTreatyFrance2006.pdf>> (last accessed 19 August 2017).

“[...] any person or entity that is contributing funds, or other material support, to the prosecution or defence of the case and that has a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration.”

Reading the two provisions together, although General Standard 6(b) does not include the requirement that the entity “is contributing funds, or other material support, to the prosecution or defence of the case,” it would appear the two are meant to be read together. Under this reading, the definition in General Standard 6(b) is limited by the additional language in the definition in the Explanation to 6(b).

To date, no reported cases have adopted or provided clarification of the definition of third-party funding including in the IBA Guidelines. Debate existed on the Task Force, similar to debates noted above, about the extent to which the IBA definition extends to ATE and BTE insurance. In addition to the arguments raised above, some Task Force members were of the view that the requirement that there be a “direct economic interest” precluded this definition from applying to ATE or BTE insurance. This view hinges on the observation that ATE and BTE insurers do not have a direct claim to proceeds from an award. Instead, for example, BTE insurers were said not to be entitled to “remuneration” since any amounts they receive would be in the form of premiums paid. Consequently, it was argued, BTE insurers cannot be said to have a “direct economic interest” in the award.

Others were of the view that this analysis was unduly formalistic and elevated form over substance. Under this latter view, BTE insurers have the potential to receive recompense only in the event of a favourable costs award, which would satisfy the requirement that they have a “direct economic interest” in the award.

## **2. Arbitral Institutions**

Mostly institutional rules do not include any provisions explicitly defining or addressing third-party funding, with only a few exceptions.<sup>97</sup>

The first exception is the Brazilian CAM-CCBC, which in Administrative Resolution No. 18 of 20 July 2016 provides in Article 1:

“It is considered third-party funding when a natural or legal person who is not party to the arbitration proceedings provides full or partial resources to one party so as to enable or assist the

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<sup>97</sup> See Aren GOLDSMITH and Lorenzo MELCHIONDA, “The ICC’s Guidance Note on Disclosure and Third-Party Funding: A Step in the Right Direction”, Kluwer Arbitration Blog, (14 March 2016) available at <http://kluwerarbitrationblog.com/2016/03/14/the-iccs-guidance-note-on-disclosure-and-third-party-funding-a-step-in-the-right-direction/> (last accessed 18 August 2017).

payment of the arbitration costs, receiving in return a portion or percentage of any profits earned from the award or from the agreement.”<sup>98</sup>

The second exception, apparently adopted in response to the new legislation in Singapore, is a practice note adopted by the Singapore International Arbitration Centre in 31 March 2017.<sup>99</sup> The note addresses arbitrator conduct in cases involving “External Funding.”<sup>100</sup> The note includes the following relevant definitions:

“‘External Funder’ means any person, either legal or natural, who has a Direct Economic Interest in the outcome of the arbitration proceedings”

“‘Direct Economic Interest’ means an interest in the arbitration proceedings resulting from the provision by a non-Disputant Party to a Disputant Party of funding for or indemnity against the award to be rendered in the arbitration proceedings”

These definitions appear broad enough to include both liability, and BTE and ATE insurance, though for reasons discuss above, there was some debate on the Task Force about whether the requirement that there be a “direct economic interest” might exclude ATE insurance from this definition. Notably, this SIAC practice note appears to be broader than the definition in Singapore legislation, discussed above.

Also in Singapore, the new SIAC Investment Arbitration Rules of 2017 provide in Article 24 that the arbitral tribunal have the power to

“order the disclosure of the existence of a Party’s third party funding arrangement and/or the identity of the third-party funder and, where appropriate, details of the third-party funder’s interest in the outcome of the proceedings, and/or whether or not the third-party funder has committed to undertake adverse costs liability”.<sup>101</sup>

Notably, the SIAC Investment Arbitration Rules do not include a specific definition of third-party funding.

Also recently, the Singapore Institute of Arbitrators released its “Guidelines for Third Party Funders,” which describe third-party funding as follows:

“Third party funding arises when a third party (the Funder) provides financial support to enable a party (the Funded Party) to pursue or defend an arbitration or related court or mediation proceedings. Such financial support is provided in

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<sup>98</sup> Article 1 of Brazilian CAM-CCBC Administrative Resolution No. 18 (20 July 2016), available at <<http://www.ccbc.org.br/Materia/2890/resolucao-administrativa-182016/en-US>> (last accessed 19 August 2017).

<sup>99</sup> See Practice Note of 31 March 2017, available at <<http://www.siac.org.sg/images/stories/articles/rules/Third%20Party%20Funding%20Practice%20Note%2031%20March%202017.pdf>> (last accessed on 31 May 2017).

<sup>100</sup> *Ibid.*

<sup>101</sup> Singapore International Arbitration Centre investment arbitration rules, available at <<http://www.siac.org.sg/our-rules/rules/siac-ia-rules-2017>> (last accessed 19 August 2017).

exchange for an economic interest in any favourable award or outcome that may ensue.”<sup>102</sup>

The SIArb Guidelines are presumed to be based on the London Association of Litigation Funders’ Code of Conduct. Under this view ATE insurers have an economic interest in a favourable award, but as described above, they do not provide financial support, only protection against a financial risk. For this reason, it appears that the SIArb Guidelines do not extend to ATE insurers, though it may apply to funders who also provide ATE insurance as part of a larger funding arrangement.

The ICC Guidance Note for the disclosure of conflicts by arbitrators endorsed a similar description of third-party funding, alongside ATE and liability insurers. The Note provides that arbitrators should consider, when evaluating whether to make disclosures, “Relationships between arbitrators, as well as relationships with any entity having a direct economic interest in the dispute or an obligation to indemnify a party for the award, should also be considered in the circumstances of each case.”<sup>103</sup>

Finally, the China International Economic and Trade Arbitration Commission Hong Kong Arbitration Center (CIETAC) issued for public consultations guidelines for third-party funding in arbitration.<sup>104</sup>

For the purposes of the guidelines, third-party funding was defined as:

“third party funding (“Funding”) arises when a professional third person or entity (“Funder”) contributes funds, or other material support to a party in arbitration (“Funded party”) and has a direct economic interest in the award to be rendered in the arbitration”.<sup>105</sup>

While these are the first institutions to directly address the participation of third-party funders, other institutions—most notably ICSID—are working to follow suit.

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<sup>102</sup> See the “Guidelines for Third Party Funders” of the Singapore Institute of Arbitrators available at <[http://siarb.org.sg/images/SIarb-TPF-Guidelines-2017\\_final18-May-2017.pdf](http://siarb.org.sg/images/SIarb-TPF-Guidelines-2017_final18-May-2017.pdf),> (last accessed on 31 May 2017).

<sup>103</sup> See ICC Note to Parties and Arbitral Tribunals on the Conduct of the Arbitration under the ICC Rules of Arbitration, (22 September 2016), p. 5, at para. 24; Aren GOLDSMITH and Lorenzo MELCHIONDA, “The ICC’s Guidance Note on Disclosure and Third-Party Funding: A Step in the Right Direction”, Kluwer Arbitration Blog, (14 March 2016) available at <<http://kluwerarbitrationblog.com/2016/03/14/the-iccs-guidance-note-on-disclosure-and-third-party-funding-a-step-in-the-right-direction/>> (last accessed 18 August 2017).

<sup>104</sup> See James ROGERS and Matthew TOWNSEND, “CIETAC Hong Kong Consults on Draft Guidelines on Third Party Funding”, Kluwer Arbitration Blog, (14 August 2016), available at: <http://kluwerarbitrationblog.com/2016/08/13/cietac-hong-kong-consults-on-draft-guidelines-on-third-party-funding/> (accessed 28 October 2016).

<sup>105</sup> See China International Economic and Trade Arbitration Commission Hong Kong Center, “Guidelines for Third Party Funding in Arbitration”, (23 May 2016), para. 1.2.



#### D. Arbitration literature

Several scholars have also attempted to define third-party funding. As is discussed below, some commentators adopt a narrow definition of the concept, while others adopt a broader definition.

Generally, those who adopt a narrow definition of third-party funding often generally limit their definition to the funding of arbitration cases by specialized funders who are not connected to the dispute and who provide funding in return for a potential profit.<sup>106</sup>

Yves Derains defined third-party funding as:

“a scheme where a party unconnected to a claim finances all or part of one of the parties’ arbitration costs, in most cases the claimant. The funder is then remunerated by an agreed percentage of the proceeds of the award, a success fee, or a combination of the two or through more sophisticated devices. In the case of an unfavourable award, the funder’s investment is lost”.<sup>107</sup>

Another scholar noted that:

“Third-party funding can be defined as the financing of an arbitration by a party who has no pre-existing interest in the dispute, usually on the basis that, if the funded party is successful in the dispute, the funder will be paid out of the proceeds of any amounts recovered as a consequence of the dispute, often as a percentage of the recovered amount”.<sup>108</sup>

Third-party funding in the context of investment arbitration has been defined as follows:

“a contract between a claimant in an investment arbitration procedure and a party who has no pre-existing interest in the arbitration. The TPF funder will bear specific parts of the claimants’ out-of-pocket expenses concerning arbitration. The claimant will share a portion of the proceeds of the award or settlement with the funder. However, the funder is not

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<sup>106</sup> See Endicott Natalia GIRALDO-CARILLO and Jean KALICKI, “Third-Party Funding in Arbitration: Innovation and Limits in Self-Regulation (Part 1 of 2)”, Kluwer Arbitration Blog, (13 March 2012), available at <<http://kluwerarbitrationblog.com/2012/03/13/third-party-funding-in-arbitration-innovation-and-limits-in-self-regulation-part-1-of-2/>> (last accessed 27 October 2016); Roula HARFOUCHE and James SEARBY, “Third Party Funding: Incentives and Outcomes”, Global Arbitration Review (2013) p.10, available at <<http://globalarbitrationreview.com/chapter/103673T7/third-party-funding-incentives-and-outcomes>> (last accessed on 27 October 2016); Laurent LEVY and Regis BONNAN, “Third-Party Funding: Disclosure, Joinder and Impact on Arbitral Proceedings” in Bernardo M. CREMADES and Antonias DIMOLITSA (eds.), *Third Party Funding in International Arbitration* (ICC Publishing 2013), p. 78; Georges AFFAKI, “A Financing is a Financing ...”, in Bernardo M. CREMADES and Antonias DIMOLITSA (eds.), *Third Party Funding in International Arbitration* (ICC Publishing 2013), at 11.

<sup>107</sup> See Yves DERAIS, “Foreword to Third-Party in International Arbitration”, in Bernardo M. CREMADES and Antonias DIMOLITSA (eds), *Third-Party Funding in International Arbitration*, (ICC Dossier 2013), p. 5.

<sup>108</sup> See Catherine A. ROGERS, *Ethics in International Arbitration*, (OUP 2014) p. 182.

entitled to remuneration should the claim fail. Additionally, the TPF funder may agree to (in whole or part) indemnify the claimant for adverse cost orders”.<sup>109</sup>

In her monograph, Victoria Sahani Shannon defines third-party funding as:

“a financing method in which an entity that is not a party to a particular dispute funds another party's legal fees or pays an order, award, or judgment rendered against that party, or both. The agreement between the funder and the funded party may also include paying another party's attorney fees if the funded party loses the case or the decision-maker (i.e., an arbitrator or panel of arbitrators, a judge or panel of judges, or a jury) orders the funded party to pay the attorney fees of another party.”<sup>110</sup>

The inclusion of payment of an order or award may suggest that this definition includes insurance but, if so, it is not clear, from this wording, what type(s) of insurance the authors had in mind.

Another commentator has defined third-party funding:

“in general terms, third party funding involves a commercial funder agreeing to pay some or all of the claimant’s legal fees and expenses associated with a dispute in return for reimbursement of the funder’s direct outlays and a share of any sum recovered from the resolution of the claim (whether following settlement, judgment or award)”.<sup>111</sup>

A similar definition was used in another note:

“third party funding, also known as ‘litigation finance’, represents an alternative means to fund your claim. In simple terms, a commercial fund with no prior connection to the case – the ‘third party’ – finances the costs of the proceedings in return for a share of any damages awarded”.<sup>112</sup>

Similarly, in the context of litigation, scholars note that third-party funding is:

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<sup>109</sup> See William H. VAN BOOM, “Third Party Financing in International Investment Arbitration”, (21 December 2011), p. 25, available at: <<http://poseidon01.ssrn.com/delivery.php?ID=427100007071003098024124025083107086060033061010095011108114103076068007111081120120049058116059030048032000068124093071025097050083035032000084076067101091115100027052023101090100089027068021072067103072109082097092106073088066081107104125023098092&EXT=pdf>> (last accessed 27 October 2016).

<sup>110</sup> See Victoria SHANNON and Lisa B. NIEUWVELD, “Third Party Funding in International Arbitration”, (Kluwer 2012), p. 3; also see Maya STEINITZ, “Whose Claim is This Anyway? Third-Party Litigation Funding”, 95 *Minnesota Law Review* (2011) p. 1268 at p. 1275-1276.

<sup>111</sup> See Susanna KHOURI, Kate HURFORD and Clive BOWMAN, “Third Party Funding in International Commercial and Treaty Arbitration – a Panacea or a plague? A Discussion of the Risks and Benefits of Third Party Funding”, 8 *Transnational Dispute Management*, Issue 4 (2011), p. 3, available at: <[https://www.benthamimf.com/docs/default-source/default-document-library/573330\\_1.pdf?sfvrsn=2](https://www.benthamimf.com/docs/default-source/default-document-library/573330_1.pdf?sfvrsn=2)> (last accessed 29 October 2016).

<sup>112</sup> See Matthew SECOMB, Melody CHAN, Thomas WINGFIELD and Philip TAN, “Third Party Funding: A New Chapter in Hong Kong & Singapore”, White & Case Client Alert Note, (July 2016).

“The funding of litigation by a party who has no pre-existing interest in the litigation, usually on the basis that (i) the funder will be paid out of the proceeds of any amounts recovered as a consequence of the litigation, often as a percentage of the recovery sum; and (ii) the funder is not entitled to payment should the claim fail.”<sup>113</sup>

Other commentators have defined third-party funding as follows:

“[...] an arrangement where a party involved in a dispute seeks funding from an outside entity for its legal representation. The outside entity—a third-party funder—finances the party's legal representation in anticipation of making a profit. The third-party funder could be a bank, hedge fund, insurance company, or some other entity or individual. If the funded party is the plaintiff, then the funder contracts to receive a percentage or fraction of the proceeds if the plaintiff wins the case. Unlike a loan, the funded plaintiff does not have to repay the funder if it loses the case or does not recover any money. If the funded party is the defendant, then the funder contracts to receive a predetermined payment from the defendant, similar to an insurance premium, and the agreement may include an extra payment to the funder if the defendant wins the case”.<sup>114</sup>

Third-party funding has also been defined as:

“A system by which one of the parties’ arbitration costs is being financed by a third-party to the arbitration proceedings, partially or in totality. In case of a favourable award, the third-party funder is generally paid by a previously agreed percentage of the proceeds of the award; however, in this context, third-party funding is a non-recourse loan, and in case of an unsuccessful claim, the claim-holder does not have to repay the funder”.<sup>115</sup>

As noted by Jennifer Trusz:

“The third-party funding relationship involves a contract between the third party funding corporation and the claimholder. The funder provides money to allow the claimholder to pursue the claim in exchange for a share of a successful claim, whether by settlement, a court’s judgment, or an arbitrator’s award. After being reimbursed for its costs, the funding corporation generally receives between one-third and two-thirds of the claim. As a nonrecourse loan, however, the claimholder does not have to repay the third-party funder for its investment if the claim is unsuccessful.”<sup>116</sup>

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<sup>113</sup> Rupert JACKSON, “Review of Civil Litigation Costs – Final Report”, (December 2009).

<sup>114</sup> See Victoria Shannon SAHANI, “Judging Third-Party Funding”, 63 *UCLA Law Review* (2016) p. 388 at p. 392-393.

<sup>115</sup> See Burcu OSMANOGLU, “Third-Party Funding in International Commercial Arbitration and Arbitrator Conflict of Interest”, 32 *Journal of International Arbitration* (2015) p. 325 at p. 329-330.

<sup>116</sup> See Jennifer A. TRUSZ, “Full Disclosure? Conflicts on Interest Arising from Third-Party Funding in International Commercial Arbitration”, 101 *The Georgetown Law Journal* (2013) p.1649 at p. 1654; Stuart L. PARADAU, “Alternative Litigation Financing: Perils and Opportunities”, 12 *U.C. Davis Law Journal* (2011) p. 65 at p. 66.

On the other hand, other scholars have endorsed a rather broad definition of third-party funding; a definition that includes other financing agreements as well. Thus, some described it as “every possible contract where the pay-out under that contract is linked to the proceeds of litigation”.<sup>117</sup> While this definition necessarily includes third-party funding, it also includes lawyers’ contingency fee arrangements and insurance contracts, even though they are held by different stakeholders. The purposes of such a broad definition are numerous, but primarily to facilitate systematic study of funding alternatives that are functionally similar and to arrive at insights and recommendations that are fair and rational.

A similarly broad definition of third-party funding has been suggested by other commentators to the effect that:

“In its broadest definition, TPF is the funding of the costs of bringing or defending a claim by a party which is not itself a party to the arbitration. This would include funding by insurers, such as ‘before the event’ and liability insurers, who regularly stand behind parties in commercial arbitrations[.]”<sup>118</sup>

In this regard, others have suggested that third-party funding should be distinguished from other related financial agreements. Proponents of this position argue that BTE and liability insurers differ from non-recourse third-party funding both in the level of control exercised over the dispute and in the applicable industry and ethical rules applicable to each.<sup>119</sup>

Notably, many of the above definitions adopted by scholars are limited to funding of individual cases on a non-recourse basis. In this respect, it is worth noting that even the passing of a few years, in which the market for funding has become much more complex and the forms of funding more diverse, scholarly definitions will likely expand to address these changes.

## **V. Functional considerations related to the definitional task**

Given difficulties in defining third-party funding in conceptual terms, this Part examines functional and comparative aspects of funding that may be helpful in assessing alternative definitions. This functional approach aims to move beyond formal definitions to determine the key functions of different forms of funding in order to focus on those functions that are unique or

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<sup>117</sup> See Maxi SCHERER, Aren GOLDSMITH and Camille FLÉCHET, “Third-Party Funding in International Arbitration in Europe: Part 1 – Funders’ Perspectives”, RDAI/IBLJ (2012), p. 209, available at: <<https://www.transnational-dispute-management.com/news/20120312.pdf>> (last accessed on 27 October 2016).

<sup>118</sup> James CLANCHY “Third Party Funding in Arbitration: breaking down barriers and building bridges” Croatian Arbitration Yearbook (2016).

<sup>119</sup> See Victoria SHANNON and Lisa B. NIEUWVELD, “Third Party Funding in International Arbitration”, (Kluwer 2012), p. 8; Burcu OSMANOGLU, “Third-Party Funding in International Commercial Arbitration and Arbitrator Conflict of Interest”, 32 Journal of International Arbitration (2015) p. 325 at p. 329.

not unique to third-party funding.

By identifying specific types of conduct, rather than categories of actors, a functional or conduct-based approach may help focus definitional questions and avoid development of overbroad standards, guidelines or rules, and facilitate more nuanced analysis to distinguish between conduct in which funders' activities do not raise issues that are the target of such rules and guidance. Alternatively, functional similarities between third-party funding and other types of finance may provide a basis for extending existing rules or doctrines that apply to other actors, such as the extension of the common interest privilege from the insurance industry to third-party funding.

#### **A. Assessment and Risk-Assumption**

One important benefit third-party funders bring to dispute settlement is an ability to engage in a disinterested, dispassionate and highly detailed assessment of claims. This function differentiates them from both the client and its attorney. A client, no matter how sophisticated, may be influenced by business incentives and perceptions about the facts underlying the claim. Meanwhile, a party's lawyers may, intentionally or unintentionally, be influenced both by an effort to please a client interested in bringing a claim as well as their own potential to earn hourly fees. By contrast, funders and traditional insurers have both structural detachment and financial incentives to engage in a uniquely independent incentive to assess cases, and by many reports that leads to extensive, fine-tuned assessment of the case.

Leading funders report an average review-acceptance rate of 10-1, meaning that for every 10 cases reviewed, they only agree to fund one case.<sup>120</sup> In deciding whether to accept a case, they assess its legal, factual, practical, temporal, and (sometimes) political variables to determine risks, likelihood of success, and potential rate of return. With the exception of the rate of return, BTE insurers undertake a very similar process. In making this assessment, funders are free from many of the pressures that can cloud a party's or law firm's assessment of the same claim. They are also subject to pressures from shareholders to pick claims that are likely to deliver high rates of return.

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<sup>120</sup> Cento VELJANOVSKI, "Third-Party Litigation Funding in Europe" 420, available at <[https://www.researchgate.net/publication/228120796\\_Third\\_Party\\_Litigation\\_Funding\\_in\\_Europe](https://www.researchgate.net/publication/228120796_Third_Party_Litigation_Funding_in_Europe)> (last accessed 19 August 2017).

In assessing claims, some argue that funders bring a level of sophistication and precision unique even among large, sophisticated multi-national companies and law firms,<sup>121</sup> though there have also been anecdotal reports of inadequate due diligence or inaccurate case assessments.<sup>122</sup>

As described in Chapter 1,<sup>123</sup> third-party funders generally create a risk-assessment model or matrix that takes into account the percentage likelihood of different outcomes in light of specific factors. These factors include, among others, the jurisdiction of the claim, strength of the claimant's legal arguments, strength of facts supporting the arguments, extent of loss flowing directly from the respondent's conduct, a claimant's motivation, commitment and honesty, the experience of the claimant's legal team, the respondent's ability/likelihood to pay, reasonable duration to obtain an award, and costs of bringing the claim.<sup>124</sup>

Data for the matrix is obtained through due diligence by the funder, its legal team, and accountants (and other experts, such as intelligence and data recollection). The analysis entails inquiries of the claimant's lawyers regarding timing and evidentiary issues, legal strategy, and compilation and assessment of material documents. Importantly, conducting this kind of due diligence often requires assessment of confidential information. Based on this matrix, the funder determines the likelihood of estimated returns on investment over a period of years, which will be weighed against other investments in the funder's overall portfolio.

The extent of funders' due diligence in comparison insurance with is ultimately an empirical question and may vary among funders (or insurers), and from case to date.<sup>125</sup> For the purposes of assessing definitions, however, the fact that most insurers (most notably BTE insurers) undertake similar due diligence confirms that case assessment is not new or unique to modern third-party funders, and indeed may be considered an essential predicate for any entity contemplating assuming risk tied to the outcome of a particular case. In the insurance context, the need for case assessment is in part what has led to development of the so-called "Common Interest Privilege." The similarities in case assessment by funders and insurers is part of the basis for arguments that the same privilege that applies to confidential communications with insurers should

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<sup>121</sup> See Mick SMITH, "Mechanics of Third-Party Funding Agreements: A Funder's Perspective" p. 28–35 available at < [http://www.calunius.com/media/7098/mechanics%20of%20third-party%20funding%20agreements%20\(mick%20smith%20-%202012\).pdf](http://www.calunius.com/media/7098/mechanics%20of%20third-party%20funding%20agreements%20(mick%20smith%20-%202012).pdf)> (last accessed 10 August 2017); Veljanovski, 'Third-Party Litigation Funding in Europe' p. 418–20 available at <[https://www.researchgate.net/publication/228120796\\_Third\\_Party\\_Litigation\\_Funding\\_in\\_Europe](https://www.researchgate.net/publication/228120796_Third_Party_Litigation_Funding_in_Europe)> (last accessed 19 August 2017).

<sup>122</sup> See, e.g., Robert BLACKETT, "Still Stuck in the Stone: Third Party Funding in the Excalibur Case", <https://www.andrewskurth.com/insights-1491.html> (last accessed 3 August 2017).

<sup>123</sup> In the Task Force's final report, this Report on Definitions will be preceded by a chapter/report that provides an overview of the mechanics of third-party funding.

<sup>124</sup> See Maxi SCHERER, Aren GOLDSMITH and Camille FLÉCHET, "Third-Party Funding in International Arbitration in Europe: Part 1 – Funders" Perspectives, 2 RDAI/IBLJ (2012), p. 212-13, available at: <<https://www.transnational-dispute-management.com/news/20120312.pdf>> (last accessed 27 October 2016); Mick SMITH, "Mechanics of Third-Party Funding Agreements: A Funder's Perspective" p. 30–32 available at < [http://www.calunius.com/media/7098/mechanics%20of%20third-party%20funding%20agreements%20\(mick%20smith%20-%202012\).pdf](http://www.calunius.com/media/7098/mechanics%20of%20third-party%20funding%20agreements%20(mick%20smith%20-%202012).pdf)> (last accessed 10 August 2017).

<sup>125</sup> The Task Force did not pursue empirical research on this topic, but future empirical research on this issue may be useful.

extend to third-party funding, a topic taken up in Chapter 5.

It is uncertain the extent to which these case assessment procedures are as rigorous when cases are financed as part of a portfolio. “Portfolio financing” is a relatively new model that may challenge some of these basic features of conventional third-party funding. As one funder describes, “the portfolio approach is inherently flexible and ideally suited for defensive matters as well as claims, and for matters that would otherwise be less attractive for funding. Pricing is generally lower because risk is diversified.”<sup>126</sup>

Diversifying risk may make initial assessment of risk less essential. As a consequence, it is at least plausible that the assessment criteria are diluted when investment is made in numerous cases contained in a portfolio, which are designed to spread the risk of higher risk investments.

In portfolio financing, the rationale seems to be similar to contracting risks in the insurance industry. Indeed, in the words of one author, the “practice has shown that the losses can be offset by the wins across the board and as long as the value of the winning cases is greater than the amount expended on a losing case, the funder will make a profit.”<sup>127</sup>

Similarly, spreading the risk in terms of volume and quantity reduces the negative consequences of an unsuccessful portfolio. In this sense, a funder may well provide funds for twenty or more cases at a time, each of them with different chances of success and different amounts at stake. The funder may anticipate that it will likely lose some of those cases, but considers the overall investment will likely be worthwhile if the success taken in a sufficient number of cases to render the overall portfolio profitable. At the same time, a loss incurred in a case will be unlikely to affect the performance of the portfolio as a whole.

With portfolio funding, because the rationale of the risk underlying this investment becomes statistically spread across the portfolio, funders’ assessment of cases may in practice be less rigorous than in individually selected cases for one-off funding. Similarly, funders may exert a lesser degree of control over individual cases when funding on a portfolio model.

Burford Capital appears to be the pioneer in this business model, though it is unclear the extent to which its portfolio funding involves international arbitrations, as opposed to domestic litigation.<sup>128</sup> No evidence has come to the attention of the Task Force, as of the date of this publication, of other funders actively engaging in portfolio funding in international arbitration, apart from anecdotal evidence of defence side portfolio funding of States in investment arbitration.

To the extent portfolio funding becomes more prevalent, it may require reconsideration of issues relating to how cases are assessed for funding. If assessment (and control) are minimized in

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<sup>126</sup> Burford Capital, “Beyond Litigation Finance” available at <[http://www.burfordcapital.com/wp-content/uploads/2016/09/Burford-Beyond\\_Litigation\\_Finance-US\\_Web.pdf](http://www.burfordcapital.com/wp-content/uploads/2016/09/Burford-Beyond_Litigation_Finance-US_Web.pdf)> (last accessed 19 August 2016).

<sup>127</sup> See Nick ROWLES-DAVIES, *Third-Party Litigation Funding* (OUP 2014) p. 72.

<sup>128</sup> See Sam REISMAN, “Burford Clinches Portfolio Funding Deal With UK Firm”, available at <<https://www.law360.com/articles/949613/burford-clinches-portfolio-funding-deal-with-uk-firm>> (last accessed 15 August 2017).

certain types of portfolio funding, it may be that that funding model more resembles other forms of passive corporate financing that do not implicate certain issues implicated in third-party funding of individual cases.

## **B. Control & Cost-Containment**

Another functional consideration that may affect whether or how to regulate third-party funding is the level of control that a funder may exercise over case strategy, particularly in its efforts to control costs. Control over case management is not viewed by the Task Force as either an inherently good or bad feature of funding, but it may be relevant in evaluating certain issues how similar modern third-party funding is to other means of dispute financing, which may in turn affect analysis of certain issues, such as disclosure and conflicts.

In some jurisdictions, the exercise of control by a funder—particularly over a case’s larger objectives like settlement—can also raise ethical issues for counsel. As national ethical rules vary considerably both on whether and how they regulate these issues, the Task Force did not consider or endeavour to articulate any guidance about attorney obligations in light of funder control. As examined in Chapter Seven on Best Practices, the extent, nature, and conditions of control are largely a function of the funding agreement negotiated by the party and funder, applicable law, and, in some jurisdictions, applicable ethical or industry rules.

Although the Task Force does not make any recommendations regarding the appropriateness of funder control, an understanding of the functional aspects of a funder’s control can be an important touchstone in assessing the degree to which third-party funding is similar to or different from other types of dispute financing. Unfortunately, there are inconsistent reports and no empirical evidence regarding the actual degree of control that funders exercise over management of a case. Some funders report that, after careful initial assessment, they function only as distant and detached monitors who are entitled to receive regular updates.<sup>129</sup> Other anecdotal reports indicate that, on more than one occasion, a third-party funder has directly appointed an arbitrator or physically appeared at an arbitral hearing.

Meanwhile, some argue that a relatively high degree of control would be important for funders to be able to protect their investment and ensure that a case is prosecuted consistent with the assumptions and analysis that facilitated the funding in the first place. This view has effectively been endorsed by the Court of Appeal in England, which reasoned that a third-party funder’s “‘rigorous analysis of law, facts and witnesses, consideration of proportionality and review at appropriate intervals’ is what is to be expected of a responsible funder.”<sup>130</sup>

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<sup>129</sup> Jonathon MOLOT, “Theory and Practice in Litigation Risk”, “Burford has no control over litigation or settlement decisions and it does not interfere with the attorney client relationship.”, available at <<http://rippmedia.com/Molot-TheoryandPractice.pdf>> (last accessed 15 August 2017)

<sup>130</sup> *Excalibur Ventures v Texas Keystone and others* [2016] EWCA Civ 1144.



Consistent with this view, third-party funders may control or exercise detailed oversight over numerous strategic decisions in a case, including arbitrator selection, expenditure of significant funds (such as retention of experts), changes in legal teams, drafting of memoranda, oral pleadings, and settlement. The extent to which any particular funder in any particular case exercises all or some of these controls will depend on internal practices and protocols of the funder, the nature of the case, the professional relationship the funder has with the funded party and legal team, the financial terms in the funding agreement (which may include financial incentives that reduce the need for monitoring), as well as specific provisions in the funding arrangement that either expressly authorize or limit certain forms of control.

Termination rights also factor into concepts of control. As von Goeler explains:

“when some major litigation funders emphasise in their webpages that they do not control cases, perhaps what they mean is that such express contractual rights to veto specific decisions tend to be absent. However, to what degree a litigation funder will be able to exercise control over the conduct of a claim is not only determined by the existence or not of express veto rights over key decisions. This will also depend on the funder’s termination rights and, not least, on the configuration of the litigation funder’s case monitoring.”<sup>131</sup>

In some respects, the control exercised by third-party funders similar to the control exercised by insurance companies. As Charles Silver describes:

“Liability insurers manage quality and cost ruthlessly and creatively. They make defense-related decisions directly, thereby obtaining complete freedom to use their vast experience dealing with lawyers to minimize litigation costs. They decide which lawyers to hire, obtain volume discounts by concentrating work in a small number of firms, maintain staff counsel operations in areas where the volume of work is sufficient to justify the expense, subject lawyers to litigation management guidelines and audits, and use innovative fee arrangements to motivate outstanding performance. Insurers also control settlement negotiations and decision making. This enables them to act on their incentive to minimize costs by deploying their knowledge of claim values with maximum effect.”<sup>132</sup>

The similarities between the control exercised by third-party funders and insurers are often treated as relevant to various questions regarding whether and how to regulate third-party funders. For example, the “common interest privilege” that applies to insurers in some common law jurisdictions is often pointed to as a basis for extending attorney-client privilege to third-party funders.

The comparison between funders and insurers is also raised with respect to issues of disclosure. For example, in many jurisdictions, such as the United States, the presence of an insurer in a case is required to be disclosed, but the fact that a party is insured may not be

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<sup>131</sup> Jonas VON GOELER, “*Third Party Funding*”, (Kluwer 2016) p. 35.

<sup>132</sup> SILVER, p. 621-22.

considered in assessing the damages to be awarded. Although legislative reforms have not yet extended the disclosure rules to third-party funders in the United States, the similarity in their function may be the reason why disclosure of third-party funding is required in some contexts in Australia, England, and New Zealand.

Shipowners' and Defence Clubs are excluded from any recommendations or guidance provided by the Task Force as part of the carve-out of maritime arbitration, identified above.<sup>133</sup> They are, however, an interesting point of reference in discussions of control over funded cases.

Shipowners' and Defence Clubs exercise discretion over whether to provide their members with funding for litigation or arbitration, leaving the decision to club managers or boards.<sup>134</sup> For example, usually Shipowners' Club rules allow the club's managers to appoint lawyers on behalf of their ship-owner members. For example, Rule 6 of the UK Shipowners' Club Rules 2015 provides:

“All persons appointed by the Association on behalf of the Member or appointed by the Member with the approval of the Association shall be or be deemed to be appointed on the terms that they have been instructed by the Member at all times (both while so acting and after they have ceased so to act): (a) to give advice and to report to the Association in connection with the claim, dispute or Proceedings; (b) to seek and act on the instructions of the Association; and (c) to produce to the Association any documents or information in their possession or power relating to the claim, dispute or Proceedings, as if such persons had been appointed to act and had at all times been acting on behalf of the Association.”<sup>135</sup>

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<sup>133</sup> See Chapter 1, p. 6.

<sup>134</sup> James CLANCY, “Third Party Funding in Arbitration: the First 125 Years”, LexisNexis Dispute Resolution Blog (17 May 2016), available at <<http://blogs.lexisnexis.co.uk/dr/third-party-funding-in-arbitration-the-first-125-years/>> (last accessed on 19 August 2016); see also Britannia, “FD&D: Scope of Cover”, available at <<https://www.britanniapandi.com/services/fd-and-d/>> (last accessed 19 August 2017); The Standard, “Defence”, available at <<http://www.standard-club.com/what-we-do/tailored-covers/defence/>> (last accessed 3 August 2017); The Swedish Club, “Rules for P&I Insurance, Rules for FD&D Insurance, Articles of Association” (2016/17), p. 71, Rule 5 available at <[http://www.swedishclub.com/media\\_upload/files/Publications/TSC%20PI%20and%20FDD%20Rules%202016\\_17.pdf](http://www.swedishclub.com/media_upload/files/Publications/TSC%20PI%20and%20FDD%20Rules%202016_17.pdf)> (last accessed 10 August 2017); UK Shipowners' Club, Rules 2016, page 4, Section 2, Rule 3(1) <<http://ukdefence.com/images/assets/documents/555-UKDC-A5-TC-2016-VFW.pdf#page=12>> (last accessed 14 November 2016).

<sup>135</sup>UK Shipowners' Club Rules, (2016) Rule 6 available at <[http://www.ukdefence.com/section/209/6/Club\\_Rules\\_2015](http://www.ukdefence.com/section/209/6/Club_Rules_2015)> (last accessed 14 November 2016).

Shipowners' Clubs may also provide a cap for maximum recovery amounts,<sup>136</sup> and can further require members to contribute to the costs of all legal expenses should they pass beyond a specified threshold.<sup>137</sup>

Clubs exercise decision-making control throughout arbitral proceedings they fund, typically requiring either that members' lawyers follow the club's instructions or that members to use lawyers chosen by the club.<sup>138</sup> "Unlike other forms of legal expenses insurance (which FD&D cover largely predated), the Club's managers (who are often qualified lawyers) remain involved with the day-to-day handling of the case, with the assistance of external lawyers where necessary."<sup>139</sup>

Regarding the insured's right to select their own lawyers, an exemption in the English Insurance Companies (Legal Expenses Insurance) Regulations 1990 provides that its provisions ensuring the insured's right to select its own lawyers do not "apply to legal expenses insurance contracts concerning disputes or risks arising out of, or in connection with, the use of sea-going vessels."<sup>140</sup>

In contrast to both third-party funding and insurance, with attorney financing (most typically through contingency-fee arrangements), control in theory remains with the client. This assumption exists despite the fact that the attorney is assuming most or all of the risk of the client losing the case and despite the fact that in class action cases, the clients may have little at stake in the case in comparison to the attorneys.<sup>141</sup>

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<sup>136</sup> Britannica, "FD&D: Deductibles and Limits" available at <<https://www.britanniapandi.com/services/fd-and-d/>> (last accessed 19 August 2017); The Standard, "Defence", available at <<http://www.standard-club.com/what-we-do/tailored-covers/defence/>> (last accessed 3 August 2017); UK Shipowners' Club Rules (2016) p. 4 Section 2, Rule 2(6), available at <<http://ukdefence.com/images/assets/documents/555-UKDC-A5-TC-2016-VFW.pdf#page=12>,> (last accessed 14 November 2016).

<sup>137</sup> Britannica, "FD&D: Deductibles and Limits", available at <<https://www.britanniapandi.com/services/fd-and-d/>> (last accessed 19 August 2017).

<sup>138</sup> The Standard, "P&I and Defence Rules and Correspondents" (2016/17), page 28, Rules 8.1-8.4, available at <<http://www.standard-club.com/media/1992587/pi-and-defence-rules-and-correspondents-2016-17.pdf>> (last accessed 19 August 2017); The Swedish Club, "Rules for P&I Insurance, Rules for FD&D Insurance, Articles of Association" (2016/17) p. 72-73, Rules 7-8, available at <[http://www.swedishclub.com/media\\_upload/files/Publications/TSC%20PI-%20and%20FDD%20Rules%202016\\_17.pdf](http://www.swedishclub.com/media_upload/files/Publications/TSC%20PI-%20and%20FDD%20Rules%202016_17.pdf)> (last accessed 10 August 2017); UK Shipowners' Club Rules, (2016), page 14, Section 3, Rule 6(1)-(2) available at <<http://ukdefence.com/images/assets/documents/555-UKDC-A5-TC-2016-VFW.pdf#page=12>> (last accessed 14 November 2016).

<sup>139</sup> Stephen J. HAZELWOOD and David SEMARK, *P&I Clubs Law and Practice*, 4<sup>th</sup> edn (Lloyds of London Press 2010) para 26.2. Notably, Clubs "strive to do as much work in-house as is possible," FD&D: Claims Handling, available at <<https://www.britanniapandi.com/services/fd-and-d/>> (last accessed 13 August 2017).

<sup>140</sup> Insurance Companies (Legal Expenses Insurance) Regulations 1990 (SI 1990/1160), implementing Council Directive 87/344/EEC of 22 June 1987 on the Coordination of Laws, Regulations and Administrative Provisions relating to Legal Expenses Insurance, cited in Stephen J. HAZELWOOD and David SEMARK, *P&I Clubs Law and Practice*, 4<sup>th</sup> edn (Lloyds of London Press 2010) fn. 81 para 26.2.

<sup>141</sup> Natalie C. SCOTT, "Don't Forget Me! The Client in a Class Action Lawsuit", 15 Geo J. Legal Ethics (2002) p. 561 at p. 573-83; David L. SHAPIRO, "Class Actions: The Class as Party and Client", 73 Notre Dame Law Rev. (1998) p. 913, at p. 924, 929, 939-40; Jasminka KALAJDZIC, "Self-Interest, Public Interest, and the Interests of the Absent Client: Legal Ethics and Class Action Praxis", (2011) 49 Osgoode Hall L.J. p. 1 at p. 13-24 (discussing a similar issue under Canadian law).

Attorney financing, usually through a contingency fee arrangement, is another context in which an entity that is not an original party to the underlying lawsuit may nevertheless exercise a degree of control over certain aspects of the proceedings as a means of protecting. When they lawyers or law firms represent parties on a contingency fee basis, they are also in a position to exert control over aspects of the dispute.

In those jurisdictions that permit contingency fee arrangements, applicable codes of conduct and professional ethical rules generally require attorneys to be loyal to their clients, even in the face of their own competing interests. In the United States, courts also operate as a check on attorneys in contingency fee, class action cases. Notably, some third-party funding agreements include contingency fee arrangements with law firms providing representation. For those agreements, the funding arrangement may be subject to attorneys' ethical rules, in addition to contractual provisions between the parties or other applicable legal rules.

## **VI. Overview of Definitions Used in Subsequent Chapters**

As noted above, the Working Definition of the Task Force is intentionally broad to facilitate consideration of all types of third-party funding. For the purposes of discussion and study, this broad Working Definition facilitated analysis of functional similarities among different financing options, and their increasing overlap and integration in the market for litigation finance.

While comprehensive consideration of the range of options was important for discussion, such a broad definition is not necessarily helpful for assessing certain technical issues. For example, the insurance industry, insurance markets, and the participation of insurers in national court proceedings are already generally regulated through national insurance and financial regulations, through national procedural rules (in the litigation context), and through professional ethical regulations. Until recent revisions to the IBA Guidelines, and related reforms in Singapore and Hong Kong, insurers were not subject to disclosure and analysis with respect to conflicts of interest with arbitrators. For reasons examined in greater detail in Chapter Four, insurance is included in the Task Force definition regarding arbitrator conflicts of interest, but it is not included in definitions in other chapters.

Notably, it would be superfluous for Chapter Five, which addresses privilege, to include insurance as part of the definition of third-party funding. Chapter Five instead examines the so-called "common interest privilege" that exists for insurers in many jurisdictions and whether that privilege or the justifications for it should also extend to third-party funders.

Meanwhile, in Chapter Six, which addresses costs and security for costs, insurance is in some respects relevant to the analysis. For example, the existence of ATE insurance has, in at least one case, been the reason a tribunal denied a request for security for costs. Meanwhile, to the extent third-party funding may be considered in assessing whether to order security for costs, such

funding does not raise any questions different from those implicated by contingency fee arrangements.

Chapter Seven, which provides a compendium of best practices, addresses only modern third-party funding. As noted above, insurers' relationships with their customers are already regulated through national legislation and attorney funding through contingency fees are regulated through domestic regulation of the legal profession.

For Chapter Eight, which addresses issues in investment arbitration, once again it is important to use a broad definition of third-party funding, which comprehends not only modern non-recourse funding, but also respondent-side funding, including by non-governmental organizations, but also those types of insurance that operate as functionally equivalents to modern funding and arguably raise similar issues.

## **VII. Conclusion**

One of the challenges in recent debates about third-party funding, and related efforts to introduce related reforms, is that they often start with implicit assumptions about third-party funding, but without clear definitions of the phenomena that is the focus of their attention. As demonstrated in the analysis of this Chapter, certain definitions either include or exclude certain forms of financing that may or may not be intended for inclusion or exclusion. Accidental inclusion or exclusion of related phenomenon may raise questions about coherence and fairness.

It is hoped that the analysis in this Chapter, read together with Chapter Two, will illuminate aspects of the practice and market of third-party funding and facilitate deeper understanding, particularly in understanding the analysis in the Chapters that follow.

## Chapter 4

### DISCLOSURE AND CONFLICTS OF INTEREST<sup>†</sup>

#### PRINCIPLES

**[ALTERNATIVE A]:\***

1. A party should, on its own initiative, disclose the existence of a third-party funding arrangement and the identity of the funder to the arbitrators and an arbitral institution or appointing authority (if any), either as part of its first appearance or submission, or as soon as practicable after funding is provided or an arrangement to provide funding for the arbitration is entered into.

**[ALTERNATIVE B]:**

1. Arbitrators and arbitral institutions have the authority to, during the selection and appointment process, expressly request that the parties disclose whether they are receiving support from a third-party funder and, if so, the identity of the funder.

**[ALTERNATIVE A]:**

2. For the purposes of the Principles in Chapter 3, the term “third-party funder” is defined as follows:

*For the purposes of assessing potential conflicts of interest, the terms ‘third-party funder’ and ‘insurer’ refer to any natural or legal person who is not a party to the dispute but who enters into an agreement either with a disputing party, an affiliate of that party, or a law firm representing that party, in order to finance part or all of the cost of the proceedings, either individually or as part of a selected range of cases, and such financing is provided either through a donation or grant or in return for remuneration dependent on the outcome of the dispute.*

**[ALTERNATIVE B]:**

2. For the purposes of the Principles in Chapter 3, the term “third-party funder” is defined as follows:

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<sup>†</sup> Primary contributors of this Chapter include Victoria Shannon Sahani, Mick Smith, Stavros Brekoulakis, and Catherine Rogers.

\* This Chapter presents alternative options for the Principles it articulates. These alternatives are based on continued differences that existed among Members of the Task Force and on which input during the public comment period is specifically sought.

*For the purposes of assessing potential conflicts of interest, the terms ‘third-party funder’ refers to any natural or legal person who is not a party to the dispute but who enters into an agreement either with a disputing party, an affiliate of that party, or a law firm representing that party, in order to finance part or all of the cost of the proceedings, either individually or as part of a selected range of cases, and such financing is provided either through a donation or grant or in return for remuneration dependent on the outcome of the dispute. This definition does not extend to agreements that provide insurance or to persons who provide insurance.*

- 3. In light of any disclosures made pursuant to Principle 1, above, arbitrators and arbitral institutions should assess whether any potential conflicts of interest exist between an arbitrator and a third-party funder, and the need to make appropriate disclosures or take other appropriate actions that may be required under applicable laws, rules, or Guidelines.**

## I. ANALYSIS

Potential conflicts of interest between third-party funders and arbitrators were among the first and most prominent issues that attracted attention with respect to their participation in international arbitrations. More specifically, questions have arisen as to the extent and nature of disclosures to be made to allow arbitrators, parties, and institutions to assess potential conflicts of interest involving funders. The Chapter proceeds in the following parts. Part 1 provides a general overview and delineates relevant background considerations. Part 2 considers the scope of the definition of third-party funding appropriate for the purpose of analyzing conflicts. In explaining the definition adopted by the Task Force, the analysis in Part 3 compares and contrasts other existing definitions, including those adopted by the International Bar Association (IBA) Guidelines on Conflicts of Interest in International Arbitration (IBA Guidelines), and other national and international sources. Finally, Parts 4 and 5 analyze, respectively, when disclosures need to be made and by whom, and the effect of unknown conflicts.<sup>142</sup>

### 1. Background

The potential for arbitrator conflicts of interest due to the involvement of third-party funders has garnered increasing attention for a number of reasons in recent years: the increase in the number of cases involving third-party funding, the highly concentrated segment of the funding industry that invests in international arbitration cases, the symbiotic relationship between funders and a small group of law firms, and relatedly, the often close relations among elite law firms and leading arbitrators.<sup>143</sup> In addition, a number of leading arbitrators have taken positions within, or ad hoc consultant roles with, some funders.<sup>144</sup> Against this backdrop, the potential for conflicts of interest for arbitrators in funded cases can materialize out of several possible scenarios.

The Principles and analysis in this Chapter are premised on the following background considerations:

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<sup>142</sup> These principles are subject to revision and have not yet been finally endorsed by the Task Force.

<sup>143</sup> See Marc GOLDSTEIN, “Should the Real Parties in Interest Have to Stand Up?” 4 *Transnational Dispute Management* (2011) p. 7. See also Maxi SCHERER, Aren GOLDSMITH and Camille FLÉCHET, “Third Party Funding of International Arbitration Proceedings—A View From Europe: Part II”, *International Business Law Journal* (2012) p. 649 at pp. 651–3 (discussing third-party funder disclosure obligations in the context of potential arbitrator impartiality issues).

<sup>144</sup> It was pointed out in Task Force discussions that arbitrators do not tend to take on such roles with traditional insurers.



1. The participation of a third-party funder in an international arbitral dispute can create the potential for a conflict of interest that should be disclosed by an arbitrator;
2. Knowledge of the participation of a third-party funder in international arbitral disputes is an essential predicate for arbitrators to make necessary disclosures;
3. Third-party funding may be provided through a variety of structures such that it is difficult to isolate a single definition of third-party funding;
4. Avoiding conflicts of interest is in the best interest of all parties and arbitrators, and is important for the legitimacy of international arbitration; and
5. Disclosure should strike an appropriate balance between providing adequate information for arbitrators, parties, institutions, and appointing authorities to assess potential conflicts of interest, but avoid excessive disclosure that may lead to unnecessary delay and significant expense from frivolous challenges to arbitrators, or unfounded applications for disclosure of financial information and funding agreements.

In light of these starting considerations, and based on analysis provided in greater detail below, broad agreement existed on the Task Force that disclosure by the funded party of the existence and identity of funders is necessary so that arbitrators could make appropriate disclosures and decisions regarding potential conflicts of interest. This view was regarded as keeping with global trends in regulation of third-party funding, which increasingly requires disclosure of the existence and identity of the entity providing funding. There was also general agreement on the Task Force that, absent exceptional circumstances, no other information except the existence and identity of funders was required for the purposes of analyzing conflicts of interest.

There was disagreement about whether that disclosure should be as a matter of course in every case [Principle 1, Alternative A], or based on a request for disclosure by the arbitrators [Principle 1, Alternative B]. The arguments for and against each of these positions are presented below.

The Task Force does not propose any new or special rules or guidelines regarding how potential conflicts between funders and arbitrators should be analyzed or when such potential conflicts should lead to recusal or disqualification. Instead, the Principles in this Chapter address only the issue of how and when disclosures should be made to enable arbitrators to make relevant assessments about potential conflicts of interest based on existing applicable standards and guidelines. It leaves to other sources—the IBA Guidelines, arbitral rules, and national legislation—the substantive analysis of potential conflicts.

## **2. Definition of Third-Party Funding for Conflicts Analysis**

Until relatively recently, there was debate about whether it was possible for funders, or at least certain types of funding, to create conflicts of interest for arbitrators.<sup>145</sup> Third-party funding, it has been argued, could not raise potential conflicts of interest because it is simply one among many possible forms of financial support for pursuing or defending a dispute. The source of financing for a dispute is irrelevant to the merits of the dispute, the argument goes, and there is no reason to treat third-party funding as subject to any special treatment that would not apply, for example, to a corporate loan taken out for the purpose of pursuing a claim.<sup>146</sup>

Most opposition to disclosure is not so much a desire to keep secret the presence of funding or identity of the funder, but rather a reaction to the procedural and strategic consequences of disclosure, such as challenges to arbitrators and requests for security for costs. Some report a problem with frivolous arbitrator challenges based on alleged conflicts, and requests for security for costs that are based solely on the existence of funding, not a genuine risk that a potential cost award could not be satisfied<sup>147</sup>. It was also suggested by some that these responses to disclosure may not simply be a matter of case strategy, but an intentional effort to drive up the cost of the case to make the funding model untenable.

Another argument against disclosure of funding arrangements for the purposes of assessing arbitrators' potential conflicts of interest is that unknown conflicts of interest cannot be a basis for an effective challenge to an arbitrator or an award. Some arbitrators and courts have in fact found that unknown conflicts cannot be a basis for refusing enforcement of awards. Even though a resulting award may not always be subject to set aside or refused enforcement, however, there are other potential costs to undisclosed conflicts.

If an unknown conflict of interest relating to a third-party funder later comes to light, the result can be messy and expensive for the parties. Regardless of whether an arbitrator is removed or an award set aside or refused enforcement, the parties and the funder waste time and fees. Even a truly unknowing arbitrator may suffer the embarrassment of having his or her integrity questioned publicly, and potential harm to reputation even if vindicated on the merits. Finally, challenges based on undisclosed conflicts can undermine the integrity and legitimacy of international arbitration generally.

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<sup>145</sup> See, e.g., Christopher BOGART, (taking as a “given that “there is no legal, logical, or equitable basis for requiring disclosure of funding without also requiring the disclosure of other parties with economic interests in the outcome of a matter”). Arguably, this language could be interpreted to that no test for disclosure regarding funders could be valid unless it applied equally to all forms of economic interests, not only equity investors. This interpretation is consistent with his earlier assertions that ‘arbitration finance is really just specialty corporate finance’. See Mark KANTOR, “Third-Party Funding in International Arbitration” 24(1) ICSID Review - Foreign Investment Law Journal (2009) p. 65; Maya STEINITZ, “Whose Claim Is This Anyway?” 11-13 University of Iowa Legal Studies Research Paper (2011) p. 1268 at p. 1292.

<sup>146</sup> See Munir MANIRUZZAMAN, “Third-Party Funding in International Arbitration—A Menace or Panacea?” Kluwer Arbitration Blog (29 December 2011) available at <[http://kluwerarbitrationblog.com/2012/12/29/third-party-funding-in-international-arbitration-a-menace-or-panacea/?doing\\_wp\\_cron=1503332583.8441140651702880859375](http://kluwerarbitrationblog.com/2012/12/29/third-party-funding-in-international-arbitration-a-menace-or-panacea/?doing_wp_cron=1503332583.8441140651702880859375)> (last accessed 20 August 2017).

<sup>147</sup> For an extended discussion of standards for grating security for costs, see Chapter 2. For an extended discussion of competing views in the underlying policy debate, see Chapter 8.

Today, consensus has emerged in the international arbitration community that the existence of third-party funding can raise potential conflicts of interest for arbitrators. Most on the Task Force supported mandatory disclosure of funding by the funded party as a matter of course during the arbitrator selection process or at the initiation of funding if after constitution of the tribunal.<sup>148</sup> This view finds some support in the results of the 2015 Queen Mary School of International Arbitration survey, in which 76% of survey respondents agreed that disclosure of the existence of third-party funding should be mandatory, 63% believed that disclosure of the identity of the funders should be mandatory, and 71% that the full terms of the funding agreement should not be disclosed.<sup>149</sup>

However, the support for funding apparently expressed in the Queen Mary Survey may be subject to question since only 39% of those surveyed had experience with third-party funding in practice, and 9% were not even aware of it. The Survey also revealed support for the notion that systematic disclosure may make the use of funding a more routine part of arbitral dispute resolution.<sup>150</sup>

Others on the Task Force proposed that, instead of a general presumption of disclosure in every case, it is more prudent to confirm the authority of arbitrators and arbitral institutions to request disclosure of such information as needed. Support for this view is based on the prospect of disagreements between parties and funders about the effect of disclosure requirements in non-binding soft-law instruments, as opposed to mandatory compliance with a procedural order. These alternative approaches are explored in greater detail below. Consensus about the disclosure of funding for the purpose of assessing potential conflicts has raised related questions about what kinds of dispute financing should be included in the definition of “funding” or “funder” for the purposes of conflicts of interest analysis, and the means and process for disclosing funding.

The sources that govern potential arbitrator conflicts of interest are numerous, and include arbitral rules, national law, and international soft law instruments, such as the IBA Guidelines. Given that modern third-party funding is a relatively recent phenomenon, not many of these sources have specifically addressed the issue of potential conflicts of interest involving third-party funding.

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<sup>148</sup> Blavi mentions that “Disclosing the use of TPF and the identity of the funder from the outset of the arbitration proceeding, both to the arbitrators and to the non-funded party, is essential for the integrity and legitimacy of the arbitral system.” in Francisco BLAVI, “Its About Time to Regulate Third Party Finding” Kluwer Arbitration Blog (17 December 2015) available at <<http://kluwerarbitrationblog.com/2015/12/17/its-about-time-to-regulate-third-party-funding/?print=pdf>> (last accessed 20 August 2017).

<sup>149</sup> Queen Mary University of London and White & Case, “2015 International Arbitration Survey: Improvements and Innovations in International Arbitration” (2015) available at <<http://www.arbitration.qmul.ac.uk/docs/164761.pdf>> (last accessed 21 August 2017).

<sup>150</sup> Notably, this survey, and related discussions in international arbitration, do not generally take account of practices in ad hoc and trade association arbitration, most notably in the maritime industry, which account for large numbers of arbitrations every year. These are among the reasons why this Report does not seek to address funding in maritime arbitration. See Chapter 1, at p. 6.

The IBA was the first organization to officially take a position in the third-party funding conflicts of interest debate by implementing the 2014 IBA Guidelines on Conflicts of Interest in International Arbitration (IBA Guidelines). The IBA Guidelines define third-party funders and insurers as relevant to conflicts analysis if they have a “direct economic interest” in an award. As examined in greater detail below, this definition still leaves unresolved some questions regarding the scope and application of the IBA Guidelines to certain types of dispute financing. The IBA definition has, nevertheless, been subsequently adopted by the Singapore International Arbitration Centre in its Practice Note<sup>151</sup> and the 2 February 2016 Guidance Note on conflict disclosures by arbitrators” adopted by the ICC.<sup>152</sup> Other instruments, for example proposed Bilateral Investment Treaties and trade agreements, have adopted different, arguably broader definitions.

### A. The IBA Definition

The 2014 IBA Guidelines provide in General Guideline 6(b) the following guidance with respect to the range of entities that should be considered in assessing potential conflicts of interest, which now includes reference to third-party funders:

“If one of the parties is a legal entity, any legal or physical person having a controlling influence on the legal entity, or a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration, may be considered to bear the identity of such party.”

This Guideline provides that any entity that has “a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration” may be treated as bearing the identity of the party for the purpose of assessing conflicts of interest.

The Explanation to General Standard 6(b) provides a definition, which includes additional details:

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<sup>151</sup> Singapore International Arbitration Centre Practice Note, PN—01/17 (Mar. 31, 2017), Administered Cases under the arbitration rules of the Singapore International Arbitration Centre, On Arbitrator Conduct in Cases Involving External Funding, Mar. 31, 2017, available at <http://www.siac.org.sg/images/stories/articles/rules/Third%20Party%20Funding%20Practice%20Note%2031%20March%202017.pdf> (last accessed 29 August 2017).

<sup>152</sup> See ICC Note to Parties and Arbitral Tribunals on the Conduct of the Arbitration under the ICC Rules of Arbitration, (22 September 2016), p. 5, at para. 24; Aren GOLDSMITH and Lorenzo MELCHIONDA, “The ICC’s Guidance Note on Disclosure and Third-Party Funding: A Step in the Right Direction”, Kluwer Arbitration Blog, (14 March 2016) available at <http://kluwerarbitrationblog.com/2016/03/14/the-iccs-guidance-note-on-disclosure-and-third-party-funding-a-step-in-the-right-direction/> (last accessed 18 August 2017). itration, Note to parties and arbitral tribunals on the conduct of the arbitration under the ICC Rules of Arbitration (Mar. 1, 2017 version), para. 24, <https://iccwbo.org/publication/note-parties-arbitral-tribunals-conduct-arbitration>.

“For these purposes, the terms ‘third-party funder’ and ‘insurer’ refer to any person or entity that is contributing funds, or other material support, to the prosecution or defence of the case and that has a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration.”

Importantly, the definition in Explanation for General Standard 6(b) includes the requirement that the funder be “contributing funds, or other material support, to the prosecution or defence of the case” in addition to the requirement that the funder have “a direct economic interest in, or duty to indemnify a party for, the award.” Nevertheless, neither General Guideline 6(b), nor its Explanatory Note, define “direct economic interest.” It is uncertain, therefore, whether this term would capture, for example, an indirect obligation to reimburse a party or payments that are not taken directly out of an award, but instead simply conditioned on a particular outcome, such in some forms of After-the-Event (ATE) insurance.<sup>153</sup>

One view expressed on the Task Force was that reference to a ‘direct economic interest’ was too broad and vague because it could refer to any range of entities, including some not intended to be addressed. Under this view, it was suggested that instead the definition should be limited to an interest in proceeds or the prospect of making a profit in the event of success, and a definition should instead refer to a ‘return on investment’.

Notably, the IBA definition in the Explanation of General Standard 6 extends explicitly to “insurers.” For reasons elaborated below, for the purposes of analyzing potential conflicts of interest, insurers (whether liability insurers or before- or after-the-event insurers) can function similarly to funders and, thus, may raise some of the same issues as funders with respect to potential conflicts of interest.

As noted above in Chapter 3, the wording in the IBA Guidelines may not always extend to BTE insurers (because they arguably do not have a ‘direct economic interest’ in the outcome as their remuneration may consist in their payment of a premium paid in advance). One view on the Task Force was that this definition would likewise not extend to ATE insurers since it was doubted that their policies alone could be said to be providing ‘material support.’<sup>154</sup> On the other hand, the IBA definition does not appear to be broad enough to capture other types of funding that would seem to raise similar questions regarding potential conflicts of interest. For example, by focusing on “direct economic interests” in the award, the IBA Guidelines’ definition excludes funders that may have an interest in the award, but whose interest may not be considered a “direct economic” interest.<sup>155</sup>

For example, in investment arbitration, non-profit organizations, third States, or other parties have provided funds or material support to a party. The purpose of these funds or support

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<sup>153</sup> See Chapter 2 p. 24 (describing ATE insurance).

<sup>154</sup> See Chapter 2, p. 25.

<sup>155</sup> An argument was raised that this definition would encompass non-for-profit funding because such funding would imply a “moral obligation” to reimburse for value received, and that moral obligation would be sufficient to constitute a “direct economic interest” in the award.

is to increase the likelihood that an award will further a particular policy, or provide meaningful precedent which may, indirectly, promote their interests in the long term. For example, as Victoria Sahani explains:

“In *Quasar de Valores SICAV S.A. et al. v The Russian Federation*, SCC Arbitration No. 24/2007, Award of 20 July 2012, para. 223, the funder, Group Menatep Limited, was a former majority shareholder in the Russian oil company Yukos, rather than a separate third-party funding company, and there was no contract in place requiring the claimant to reimburse Menatep. By funding the *Quasar de Valores* case, Menatep was seeking to create a favorable ‘precedent’ in hopes that such a precedent would be applied in its future, much larger, shareholder dispute against Russia under the Energy Charter Treaty.”

Such participation even in the absence of a direct economic interest may nevertheless raise potential conflicts of interest with arbitrators in those arbitrations, but the existence of such funding would not be required to be disclosed under the IBA Guidelines’ definition because it is limited to a “direct economic” interest in the award.

In addition to ambiguities about whether the definition of “direct economic interest” in the IBA Guidelines extends to non-commercial funders or BTE insurers, it is also uncertain whether or to what extent the definition would address portfolio financing or law firm funding, where a loan is made to a law firm collateralized by anticipated income from identified cases.<sup>156</sup> In law firm financing a funder provides financing directly to a law firm (not a party). The funding is provided usually based on a range of cases on which the law firm is counsel and in which the law firm may have a contingent or conditional fee arrangement. Portfolio financing may also be provided when a party has multiple arbitrations.

Portfolio funding for law firms allows funders to spread risk. It also means, however, that their compensation is not necessarily tied to the outcome of any individual arbitral award, but instead on the performance of the portfolio. Such funding is usually on a non-recourse basis, meaning that the funder’s recovery is still tied to the outcome of the arbitrations. As such, portfolio financing may be regarded as providing funders with an economic interest in the awards in the portfolio, but it is not certain that interest would be considered a “direct” or “indirect” economic interest in the award, such that portfolio funding would fall within the IBA Guidelines’ definition.

Nevertheless, even acknowledging the limitations of the definition in the IBA Guidelines, it seems inescapable that an arbitrator might have a potential conflict of interest as a result of portfolio financing. For example, if an arbitrator provided consultative advice to the funder in selecting a particular case, serving as an arbitrator in that case would seem to raise a conflict of interest for the arbitrator whether that case was funded as part of a portfolio or funded as an

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<sup>156</sup> For a description of “portfolio funding” or “law firm financing,” see Chapter 2, p. 28.

individual case. The same might be true if the arbitrator sat on the Board of Directors of that funder, or had been re-appointed in numerous cases in the same portfolio of funded cases.<sup>157</sup>

As portfolio financing, and other forms of third-party funding, were not well known when the IBA undertook its 2014 revisions, the drafters were likely unable to fully consider the implications of their relatively narrow definition. The Task Force anticipates that with any future revisions to the Guidelines, the IBA may reconsider its definition. In the meantime, the Task Force's broader definition can be used for determining the scope of disclosures, which may then be analyzed under existing IBA Guidelines.

## **B. The Task Force Definition**

The disclosure recommendations of this Chapter are applicable to funders who fall within following definition:

**For the purposes of assessing potential conflicts of interest, the terms ‘third-party funder’ and ‘insurer’ refer to any natural or legal person who is not a party to the dispute but who enters into an agreement either with a disputing party, an affiliate of that party, or a law firm representing that party, in order to finance part or all of the cost of the proceedings, either individually or as part of a selected range of cases, and such financing is provided either through a donation or grant, or in return for remuneration dependent on the outcome of the dispute.**

This definition is intended to be broad, but also does not apply to certain types of funding for which alternative rules regarding disclosure and conflicts of interest exist, as discussed below.

### *i. Scope of Definition*

This definition applies not only to traditional claimant-side funding, in which funding is provided in expectation of a return on investment, but also to defense-side funding and pro-bono representation. For example, in the investment arbitration case brought by Philip Morris against Uruguay, The Bloomberg Foundation and its “Campaign for Tobacco-Free Kids” provided outside financial support for the Uruguayan government.<sup>158</sup>

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<sup>157</sup> See Victoria Shannon SAHANI, “Reshaping Third-Party Funding”, 91 Tulane L. Rev (2017) p. 405 (analysing in detail the conflicts of interest that may arise if the funder combines with a party or if the funder combines with a law firm).

<sup>158</sup> See Press Release by Uruguay's Counsel, Foley HOAG LLP, “Government of Uruguay Taps Foley Hoag for Representation in International Arbitration Brought by Philip Morris to Overturn Country's Tobacco Regulations”

This definition is also intended to apply not only to individually funded cases, in which a funder's support is directed specifically at individual cases, but also to other models of funding, in which the investment is in a portfolio of cases represented by a particular law firm.

There was considerable debate on the Task Force about whether this definition should include insurers, including liability insurers, after-the-event, and before-the-event insurers. On the one hand, liability insurers have interests in and, depending on the type of insurance and the jurisdiction, may exercise control over key aspects of a party's case that are largely similar to the kinds of control exercised by modern third-party funders.<sup>159</sup> For some on the Task Force, these similarities raised questions of fairness in treating similarly situated entities in similar manner for the purposes of disclosure. [Principle 2, Alternative A].

On the other hand, it was noted that various forms of insurance are ubiquitous in international arbitration, have existed for many years, and have not historically been considered subject to assessment with respect to potential arbitrator conflicts. For some, the exclusion of insurers from conflicts of interest assessment was an historical anomaly that should be corrected in conjunction with taking up the issue of third-party funding since insurers may be considered to be a form of funding by a third-party. Meanwhile, others expressed the view that exclusion of insurers was a structural feature of dispute settlement that should not be tampered with and could be maintained as separate from the issue of third-party funding. Under this view, [Principle 2, Alternative B], disclosure and conflicts of interest with respect to insurers should not be considered, much less recommended, in the absence of special consideration of the special market and regulatory issues that prevail in the insurance industry.

On the merits, some types of relationships with insurers would raise obvious conflicts. For example, an arbitrator may serve on a Board of Directors of an insurance company or hold significant stock in an insurance company that held as one of its major assets a sizable policy indemnifying a party. An arbitrator's law firm might have an insurance company as a client, or may have an agreement by which it is retained to represent the company's insureds. These examples undeniably raise potential conflicts that should be disclosed.

Similarly, it would be difficult to articulate a rationale for why a conflict may exist if a third-party funder was involved in multiple cases in which the same arbitrator was appointed, but the same activity by an insurer would not similarly constitute a conflict. For these reasons, most Members of the Task Force were of the view, consistent with the IBA Guidelines that the definition of third-party funding in this Chapter should extend to insurance (outside of maritime arbitration). One member of the Task Force disagreed with this view, and the notion that insurers can necessarily raise similar potential conflicts of interest as other types of funders.

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(8 October 2010) available at <<http://www.foleyhoag.com/news-and-events/news/2010/october/uruguay-taps-foley-hoag-for-representation>> (last accessed 22 August 2017).

<sup>159</sup> See Chapter 2, at p. 24.



Unlike the IBA definition, the definition adopted in this Chapter clearly extends to portfolio funding and law firm financing. Specifically, it applies when funds are extended to finance an arbitration “**either individually or as part of a selected range of cases.**” The definition adopted also avoids the ambiguity in the IBA Guidelines’ definition between direct and indirect economic interests by referring to funding that is provided “**in return for remuneration dependent on the outcome of the dispute.**” Thus, the definition would apply to law firm portfolio financing models in which a funder finances one portfolio of cases (portfolio A), but the funders’ returns are linked only to the outcomes in portfolio B, which may be a subset of portfolio A.

*ii. Exclusions from Definition*

The definition in this Chapter is broad, but it does not extend to certain types of dispute financing that are required to be disclosed by other rules. For example, for some purposes, contingency fee arrangements or conditional fee arrangements may also be within the definition of third-party funding.<sup>160</sup> However, separate rules exist that require disclosure of lawyers and law firms involved in international arbitration.<sup>161</sup> Based on these existing disclosure requirements, arbitrators already consider the potential for conflicts of interest with lawyers and law firms, and that analysis would not change if the law firm were providing representation on a contingent or conditional fee basis.

The definition in this Chapter also does not necessarily extend to certain types of funding that are structured as equity investments that are being reported in some investment arbitration cases, or debt instruments, for example a loan provided by a parent company. For dispute funding that is facilitated through equity and debt-based arrangements, disclosure may be required for other reasons.

For example, General Standard 7(a) of the IBA Guidelines provides that disclosure for the purpose of assessing conflicts applies not only to a party, but also to “another company of the same group of companies [as the party], or an individual having a controlling influence on the party in the arbitration.” A funder that acquires sufficient shareholdings to influence decisions about how to manage the dispute would qualify as having a “controlling influence,” and should therefore be disclosed. In addition, the individual IBA Guidelines also apply not only to parties, but also to

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<sup>160</sup> See Chapter 2, p.15.

<sup>161</sup> See International Bar Association, “IBA Guidelines on Party Representation in International Arbitration”, (2013), available at < <https://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0ahUKEwjqZCL4ejVAhUBKcAKHbS4CTsQFggmMAA&url=https%3A%2F%2Fwww.ibanet.org%2FDocument%2FDefault.aspx%3FDocumentUid%3D6F0C57D7-E7A0-43AF-B76E-714D9FE74D7F&usg=AFQjCNEh59hDXSao8TZVV7K5j4FnegIy7w>> (last accessed 20 August 2017); see also [sample arbitral rules].

“affiliates” of the parties.<sup>162</sup> A related company that provides funding, for example through inter-corporate loans, would be disclosable under this requirement.

Unfortunately, these provisions in the IBA Guidelines could be more clear and precise. For example, greater specificity would be useful for determining when an influence is “controlling,” or how “group of companies” is defined. Future revisions to the IBA Guidelines may address these issues, for example, by specifying specific percentage holdings, such as provided in some domestic procedural and disclosure rules.<sup>163</sup>

In addition, as explained in Chapter 1 (Introduction) and Chapter 2 (Definitions), the recommendations of this Report do not extend to maritime arbitration. It was recognized that funding provided through Shipowners’ and Defence Clubs are similar to modern third-party funding,<sup>164</sup> and hence raises some of the same concerns about potential arbitrator conflicts of interest. The Task Force did not study the existing practices in maritime arbitration, however, and, therefore, as noted in Chapter One, expressly excludes maritime arbitration from any recommendations in this Report.

Finally, although the Task Force concluded that the presence and identity of a funder should be disclosed or disclosable to permit arbitrators to assess conflicts of interest, the potential for arbitrator conflicts should generally not be considered a basis for requiring disclosure of any additional details about the funding relationship or funding agreement. Such details are generally irrelevant to questions of arbitrator conflicts of interest.

This recommendation is made, however, in recognition that the need for transparency and avoidance of conflicts must be counterbalanced by meaningful responses by opposing parties to exploit the participation of a funder to gain an unfair strategic advantage.<sup>165</sup> Tribunals should remain mindful of potential dilatory requests or arguments to the tribunal based on unfounded assertions about the consequences of a funder’s participation.<sup>166</sup>

### iii. Standards for Disclosure

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<sup>162</sup> Footnote 6 of the IBA Guidelines provides: “Throughout the Application Lists, the term ‘affiliate’ encompasses all companies in a group of companies, including the parent company [...]”. International Bar Association, “IBA Guidelines on Party Representation in International Arbitration”, (2013), available at <<https://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0ahUKEwiiqZCL4ejVAhUBKcAKHbS4CTsQFggmMAA&url=https%3A%2F%2Fwww.ibanet.org%2FDocument%2FDefault.aspx%3FDocumentUid%3D6F0C57D7-E7A0-43AF-B76E-714D9FE74D7F&usg=AFQjCNEh59hDXSao8TZVV7K5j4Fnegly7w>> (last accessed 20 August 2017).

<sup>163</sup> For example, Rule 29.6 of the Rules of Court of the U.S. Supreme Court requires disclosure of an ownership interest only when it exceeds 10%.

<sup>164</sup> See Chapter 2 (Overview of Funding Market); Chapter 3 (Definitions).

<sup>165</sup> *Ibid.*

<sup>166</sup> *Ibid.*

There is general agreement that disclosure of the identity of a funder is necessary for an arbitrator to undertake analysis of potential conflicts of interest. There is less consensus about how and when such disclosure should occur.

Some sources that have attempted to address the issue of disclosure and potential conflicts of interests nevertheless do not address precisely when and how disclosure about a third-party funder should be made. Nevertheless, these sources generally all suggest that potential conflicts of interest arising from the involvement of third-party funders should be considered by arbitrators.

#### **a. Guidance from Institutions**

As examined in detail above, the first entity to promulgate guidelines regarding third-party funding was the International Bar Association (IBA) in its Guidelines on Conflicts of Interest in International Arbitration, last revised in 2014.<sup>167</sup> Since that time, only a few institutions have specifically addressed the issue. Of those that have, none appear to require expressly the systematic disclosure of third-party funding as a matter of course, but instead leave the issue to the discretion of arbitrators.

In December 2015, the ICC Commission on Arbitration issued a Report entitled “Decisions on Costs in International Arbitration” that provided some guidance to arbitrators regarding third-party funding.<sup>168</sup> Notably, the Commission provides a different definition of a third-party funder in Footnote 44 of its report:

“A third-party funder is an independent party that provides some or all of the funding for the costs of a party to the proceedings (usually the claimant), most commonly in return for an uplift or success fee if successful.”

The Report does not suggest that the existence and identity of the funder must be disclosed as a matter of course, but instead provides as follows:

“The tribunal might also consider discussing with the parties, at the outset of the arbitration or during the proceedings (typically at the first case management meeting), other aspects of cost management, including... sensitive matters, such as whether there is third-party funding and ...whether the identity of the third-party funder (which could be relevant to possible conflicts of interest) should be disclosed.”

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<sup>167</sup> International Bar Association, “IBA Guidelines on Conflicts of Interest in International Arbitration” (2014) available at <[http://www.ibanet.org/Publications/publications\\_IBA\\_guides\\_and\\_free\\_materials.aspx](http://www.ibanet.org/Publications/publications_IBA_guides_and_free_materials.aspx)> (last accessed 19 August 2017).

<sup>168</sup> See ICC Commission, “Arbitration report on Costs from December 2015, available at <<http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2015/Decisions-on-Costs-in-International-Arbitration---ICC-Arbitration-and-ADR-Commission-Report/>> (last accessed 10 August 2017).

The report also provides a worldwide survey of laws regarding disclosure of third-party funding (beginning on page 45) and a worldwide survey of cost provisions in all international arbitration rules (beginning on page 49).

SIAC's newly released Investment Arbitration Rules (IARs) specifically authorize arbitral tribunals to order disclosure of the existence of third-party funding and/or the identity of such funder (IAR 24(1)) and to take account of third-party funding when apportioning costs (IAR 33.1).<sup>169</sup> This complements Singapore's legislative amendment (discussed below) to its Civil Law Act to allow for third-party funding,

The ICC Court of Arbitration adopted a definition of third-party funding that appears to more closely resemble the IBA Guidelines than the ICC Commission's Report. In its *Note to parties and arbitral tribunals on the conduct of the arbitration under the ICC Rules of Arbitration* (22 Sep 2016 version), the ICC Court gives arbitrators the following guidance in Paragraph 24:

“Relationships between arbitrators, as well as relationships with any entity having a direct economic interest in the dispute or an obligation to indemnify a party for the award, should also be considered in the circumstances of each case.”<sup>170</sup>

This instruction for arbitrators to consider relationships with third-party funders would seem to imply arbitrators have a duty to investigate the existence of a funder in an arbitration.<sup>171</sup>

## **b. National Legislation**

Few jurisdictions have specifically sought to regulate disclosure of third-party funding in international arbitration. The two exceptions are Hong Kong and Singapore, which recently enacted reforms to remove prohibitions that were regarded as previously prohibiting such funding in locally seated arbitrations. Notably, both these reforms mandate disclosure of the existence of funding and identity of the funder.

With respect to statutes, Singapore has recently introduced new legislation that allows third-party funding in international arbitration.<sup>172</sup> Amendments to the Legal Profession

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<sup>169</sup> Investment Arbitration Rules of the Singapore International Arbitration Centre SIAC IA Rules (1<sup>st</sup> Edition, 1 January 2017) available at <<http://www.siac.org.sg/our-rules/rules/siac-ia-rules-2017>> (last visited 28 August 2017).

<sup>170</sup> See ICC Commission, “Note to parties and arbitral tribunals on the conduct of the arbitration under the ICC Rules of Arbitration”, (2016) available at <<http://www.iccwbo.org/Products-and-Services/Arbitration-and-ADR/Arbitration/Practice-notes,-forms,-checklists/>> (last accessed 10 August 2017).

<sup>171</sup> One commentator has elaborated specific guidelines about how such disclosures should be made. See Jennifer TRUSZ, *Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration*, 101 GEO. L.J. 1649, 1673 (2013).

<sup>172</sup> Civil Law (Amendment) Act 2017, §5(b)(2) “A contract under which a qualifying Third-Party Funder provides funds to any party for the purpose of funding all or part of the costs of that party in prescribed dispute resolution proceedings is not contrary to public policy or otherwise illegal by reason that it is a contract for

(Professional Conduct) Rules 2015 require that a legal practitioner must disclose “to the court or tribunal, and to every other party to those proceedings”<sup>173</sup> the “existence of any third-party funding contract”<sup>174</sup> along with “the identity and address of any third-party funder involved in funding the costs of those proceedings.”<sup>175</sup> Disclosure must be made “at the date of commencement of the dispute resolution proceedings where the third-party funding contract is entered into before the date of commencement of those proceedings”<sup>176</sup> or “as soon as practicable”<sup>177</sup> after the third-party funding contract is entered into.<sup>178</sup>

Hong Kong has adopted legislation that is similar to that of Singapore with respect to its requirements for disclosure of third-party funding in international arbitration.<sup>179</sup> Under the new Hong Kong law, a funded party must disclose “the fact that a funding agreement has been made” and the “name of the third party funder.”<sup>180</sup> Notice of the funding agreement must be given “before the commencement of the arbitration” or for a funding agreement made after commencement of the arbitration “within 15 days after” the funding agreement is made.<sup>181</sup> Notice must be given to “each other party to the arbitration” and to the “arbitration body.”<sup>182</sup> Similarly, a funded party must give notice to the other party and the arbitration body of the termination of a funding agreement within 15 days after the funding agreement ends.<sup>183</sup>

### c. Trade and Investment Treaties

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maintenance or champerty.” <http://statutes.agc.gov.sg/aol/search/display/view.w3p;orderBy=date-rev.loadTime;page=0;query=Id%3Aae379db0-c3da-4abe-ad09-1d1518181ee9;rec=0#legis>

<sup>173</sup> Legal Profession (Professional Conduct) Rules 2015, Part 5A Rules Applicable to Third-Party Funding, at §49(A)(1) <<http://statutes.agc.gov.sg/aol/search/display/view.w3p;ident=dc37692e-e97b-4751-81bd-de82cd9bfd02;page=0;query=DocId%3Ae61bfe00-bda6-4ed2-8978535bf9ef5f27%20Depth%3A0%20Status%3Ainforce;rec=0#pr49A-he->>> (last accessed 30 August 2017).

<sup>174</sup> Ibid at §49(A)(1)(a)

<sup>175</sup> Ibid at §49(A)(1)(b)

<sup>176</sup> Ibid at §49(A)(2)(a)

<sup>177</sup> Ibid at §49(A)(2)(b)

<sup>178</sup> See Melody CHAN, Matthew SECOMB and Philip TAN, “Third Party Funding: a New Chapter in Hong Kong & Singapore”, (29 July 2016) available at <<http://www.jdsupra.com/legalnews/third-party-funding-a-new-chapter-in-40360/>> (last accessed 22 August 2017).

<sup>179</sup> See Sapna JHANGIANI and Rupert COLDWELL, “Third-Party Funding for International Arbitration in Singapore and Hong Kong – A Race to the Top?”, Kluwer Arbitration Blog (30 Nov. 2016) available at <<http://kluwerarbitrationblog.com/2016/11/30/third-party-funding-for-international-arbitration-in-singapore-and-hong-kong-a-race-to-the-top/>> (last accessed 20 August 2017); Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016.

<sup>180</sup> Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016 at §98T (1)(a)-(b). <http://www.legco.gov.hk/yr16-17/english/bills/b201612301.pdf>

<sup>181</sup> Ibid at §98T (2)(a)-(b)

<sup>182</sup> Ibid at §98T (3)(a)-(b)

<sup>183</sup> Ibid at §98U (1)-(3).

A few trade and investment treaties, and some proposed treaty provisions, have also recently sought to introduce disclosure obligations with respect to third-party funding. These instruments expressly require disclosure of funding arrangements.

The Comprehensive Economic and Trade Agreement (CETA), recently ratified by Canada and the European Union, contains the following provisions relating to third-party funding:

“Article 8.1: Definitions

third-party funding means any funding provided by a natural or legal person who is not a disputing party but who enters into an agreement with a disputing party in order to finance part or all of the cost of the proceedings either through a donation or grant, or in return for remuneration dependent on the outcome of the dispute.

Article 8.26: Third party funding

1. Where there is third party funding, the disputing party benefiting from it shall disclose to the other disputing party and to the Tribunal the name and address of the third party funder.
2. The disclosure shall be made at the time of the submission of a claim, or, if the financing agreement is concluded or the donation or grant is made after the submission of a claim, without delay as soon as the agreement is concluded or the donation or grant is made.”<sup>184</sup>

The EU has proposed including provisions regarding third-party funding in the Transatlantic Trade and Investment Partnership, negotiation of which is on hold at the time of writing. The EU’s proposed language is as follows:

“Article 1, Scope and Definitions:

2. For the purposes of this Section: ‘Third Party funding’ means any funding provided by a natural or legal person who is not a party to the dispute but who enters into an agreement with a disputing party in order to finance part or all of the cost of the proceedings in return for a remuneration dependent on the outcome of the dispute or in the form of a donation or grant.

Article 8, Third party funding

1. Where there is a third party funding, the disputing party benefiting from it shall notify to the other disputing party and to the Tribunal, or where the division of the

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<sup>184</sup> See Full text of “Comprehensive Economic and Trade Agreement” (CETA), available at <http://data.consilium.europa.eu/doc/document/ST-10973-2016-INIT/en/pdf> (last accessed 22 August 2017).

Tribunal is not established, to the President of the Tribunal, the name and address of the third party funder.

2. Such notification shall be made at the time of submission of a claim, or, where the financing agreement is concluded or the donation or grant is made after the submission of a claim, without delay as soon as the agreement is concluded or the donation or grant is made.”<sup>185</sup>

Some draft or model Bilateral Investment Treaties apparently include similar disclosure obligations. As of the date of publication of this Report, those drafts were not publicly available.

Several international investment arbitration cases, as well as a few international commercial arbitration cases and domestic court cases, have addressed the issue of disclosure of third-party funding.

Apparently the first, and most controversial, investment arbitration involving disclosure of third-party funding was *RSM Production Corporation v Saint Lucia*, where disclosure was sought in relation to costs, not in relation to potential conflicts of interest. It resulted, however, in a challenge to one arbitrator as a result of strong language used to describe regarding third-party funding in an Assenting Opinion.<sup>186</sup> The claimant’s principal grounds for the challenge were as follows:

“The description of third-party funders as ‘mercantile adventurers’ and the association with ‘gambling’ and the ‘gambler’s Nirvana: Heads I win and Tails I do not lose’ are, in Claimant’s view, radical in tone and negative and prejudice the question whether a funded claimant will comply with a costs award. Additionally, Claimant derives from [the arbitrator’s] determinations that his alleged bias against the funders extends to Claimant as the funded party as well. Claimant contends that the language used by [the arbitrator] cannot be qualified as a neutral discussion of the issues or a mere rhetorical emphasis.”<sup>187</sup>

The other two arbitrators rejected the challenge and articulated the following reasoning:

“The expressions used by [the challenged arbitrator] in his Assenting Reasons, such as ‘gambling,’ ‘adventurers’ and the reference to the ‘gambler’s Nirvana’ are strong and figurative metaphors. However, in our view, these expressions primarily serve the purpose

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<sup>185</sup> See Chapter II – Investment, EU Draft, available at [http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc\\_153807.pdf](http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc_153807.pdf) (last accessed 20 August 2017).

<sup>186</sup> See *RSM Production Corporation v Saint Lucia*, (ICSID Case No ARB/12/10), Decision on claimant’s proposal for the disqualification of Dr Gavan Griffith QC, IIC 662, (23 October 2014).

<sup>187</sup> See *RSM Production Corporation v Saint Lucia*, (ICSID Case No ARB/12/10), Decision on claimant’s proposal for the disqualification of Dr Gavan Griffith QC, IIC 662, (23 October 2014) para. 42.

of clarifying and emphasizing the point [the challenged arbitrator] purports to make, namely the paramount importance, in his opinion, of third-party funding of a party in connection with a request for security for costs. We do not regard it to be established that these terms reveal any underlying bias against third-party funders in general or Claimant in particular. The means of expressing a point of view or articulating an argument may vary from one arbitrator to another, and different arbitrators possess varied characteristics, including their habits of drafting decisions and the wording used. As long as such wording does not clearly reveal any preference for either party, it cannot serve as a ground for a challenge.... As we require an objective standard to be met, Claimant needs to establish facts indicating [the challenged arbitrator]'s lack of impartiality. However, in this case, the facts presented are that [the challenged arbitrator] issued his Assenting Reasons with the contents as described by Claimant. These facts, however, are as such not sufficient to constitute a lack of impartiality. The underlying arguments, as presented by [the challenged arbitrator] and the wording, in our view, do not cast reasonable doubt upon [the challenged arbitrator]'s capacity to issue an independent and impartial judgment in the present arbitration.”<sup>188</sup>

This case has been the subject of substantial discussion, in large part because of the strong language in the assenting opinion and the subsequent challenge to its author, as well as subsequent efforts to annul the award on the merits.<sup>189</sup>

In most cases when disclosure has been ordered, the arbitral tribunal orders disclosure of the identity of the third-party funder, but only rarely disclosure of the terms of the funding arrangement, and usually not for reasons related to arbitrator conflicts. For example, a dispute regarding termination of the funding arrangement in the ICSID case *S&T Oil Equipment & Machinery Ltd v Romania* was litigated in the U.S. courts, which required disclosure of the terms of the funding arrangement in dispute.<sup>190</sup> As a result of this dispute over the funding arrangement, the funder, Juridica, ceased paying the S&T Oil's fees and costs in the ICSID case, and the ICSID tribunal ultimately terminated the proceedings due to this non-payment. In this case, the funding agreement was in dispute, so disclosure of its terms was appropriate.

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<sup>188</sup> See *RSM Production Corporation v Saint Lucia*, (ICSID Case No ARB/12/10), Decision on claimant's proposal for the disqualification of Dr Gavan Griffith QC, IIC 662 (2014), (23 October 2014), paras. 87, 90.

<sup>189</sup> See procedural history of *RSM Production Corporation v. Saint Lucia*, (ICSID Case No. ARB/12/10), available at <<http://www.italaw.com/cases/2706>> (last accessed 3 August 2017).

<sup>190</sup> See *S&T Oil Equipment & Machinery, Ltd, et al v Juridica Investments Limited, et al*, 456 Fed. Appx. 481, 2012 WL (5 Jan. 2012) p. 2842, (requiring disclosure of funding arrangement to resolve a dispute between S&T and Juridica regarding termination of the third-party funding provided for the ICSID case *S&T Oil Equipment & Machinery Ltd v Romania*, (ICSID Case No ARB/07/13) Order to Discontinue Proceedings (16 July 2010); Bernardo M CREMADES JR, “Third Party Litigation Funding: Investing in Arbitration” (2011) 8 *Transnational Dispute Management* pp. 12–15 (discussing these two S&T cases); Nate RAYMOND, “Litigation Funding Gone Wrong”, *The American Lawyer* (25 April 2011) available at <<http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202492845664&slreturn=1law.com>> (last accessed 13 August 2017) (discussing the U.S. Fifth Circuit case, *S&T v. Juridica*).



In most cases, however, the funding agreement is not in dispute, so disclosure of its terms is not appropriate for the purposes of assessing potential conflicts of interest. For example, in the ICSID case *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic*, the tribunal ordered the claimant to reveal the identity of its third-party funder for the purposes of checking for arbitrator conflicts of interest, but did not require the claimant to disclose any of the terms of the funding arrangement.<sup>191</sup> In that case, the claimant had previously voluntarily disclosed that it was funded by a Luxembourg-based funder, but the claimant did not disclose the identity of that funder until ordered to do so by the tribunal.

*Muhammet Çap & Sehil İnşaat Endustri ve Ticaret Ltd Sti v Turkmenistan*, an ICSID case, provides an example of a tribunal ordering a claimant to disclose both the identity of the funder and the terms of the funding arrangement.<sup>192</sup> In doing so, the tribunal invoked its “inherent powers to make orders of the nature requested where necessary to preserve the rights of the parties and the integrity of the process.” In April 2014, Turkmenistan had requested the tribunal to order the claimant to disclose whether it had engaged the services of a third-party funder as well as the terms of that arrangement.<sup>193</sup> In Procedural Order No. 2, the tribunal refused the request and listed several reasons why a tribunal could justifiably order disclosure of third-party funding.

“It seems to the Tribunal that the following factors may be relevant to justify an order for disclosure, and also depending upon the circumstances of the case:

- a. To avoid a conflict of interest for the arbitrator as a result of the third party funder;
- b. For transparency and to identify the true party to the case;
- c. For the Tribunal to fairly decide how costs should be allocated at the end of any arbitration;
- d. If there is an application for security for costs if requested; and
- e. To ensure that confidential information which may come out during the arbitral proceedings is not disclosed to parties with ulterior motives.”<sup>194</sup>

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<sup>191</sup> See *EuroGas Inc and Belmont Resources Inc v Slovak Republic*, (ICSID Case No ARB/14/14), *Transcript of the First Session and Hearing on Provisional Measures* (17 March 2015), p. 145 (“We think that the Claimants should disclose the identity of the third-party funder, and that third-party funder will have the normal obligations of confidentiality.”).

<sup>192</sup> See *Muhammet Çap & Sehil İnşaat Endustri ve Ticaret Ltd Sti v Turkmenistan*, (ICSID Case No ARB/12/6), Procedural Order No 3 (12 June 2015).

<sup>193</sup> *Ibid.* at para. 1.

<sup>194</sup> *Muhammet Cap & Sehil Insaat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan*, (ICSID Case No. ARB/12/6), Decision on Jurisdiction, (13 February 2015), para. 50 (quoting Procedural Order No. 2).

One year later, Turkmenistan renewed its request for such disclosure to ensure that there were no conflicts of interests with the arbitrators or counsel in the case and to check whether the claimants were “still the actual owners of the claims in this arbitration.”<sup>195</sup> To bolster its renewed request, Turkmenistan also cited the newly enacted General Standard 7(a) and the Explanation to General Standard 7(a) of the International Bar Association (IBA) Guidelines on Conflicts of Interest in International Arbitration, which took effect in October 2014.<sup>196</sup> Turkmenistan also stated that it was considering applying for security for costs in the case due to the presence of the third-party funder.<sup>197</sup> In Procedural Order No. 3, the tribunal decided to grant Turkmenistan’s renewed request for the following reasons:

“First, the importance of ensuring the integrity of the proceedings and to determine whether any of the arbitrators are affected by the existence of a third-party funder. In this respect the Tribunal considers that transparency as to the existence of a third-party funder is important in cases like this. Second, although it has not yet done so, Respondent has indicated that it will be making an application for security for costs. It is unclear on what basis such application will be made, e.g. Claimants’ inability to pay Respondent’s costs and/or the existence of a third-party funder. There are two additional factors which the Tribunal considers support the conclusion it has reached. Claimants have not denied that there is a third-party funder for the claims in this arbitration. It would have been straight forward to do so, just as they denied having assigned any of their rights to another party. Furthermore, and this was not denied by Claimants, Respondent has alleged that the order for costs in favour of Respondent made by the Kılıç Tribunal<sup>198</sup> has not been paid even though the claimant (Kılıç İnşaat İthalat İhracat Sanayi ve Ticaret Anonim Şirketi) has funded the annulment proceedings.”<sup>199</sup>

It is important to note that the tribunal did not specify in its procedural order which of the terms of the funding arrangement were required to be disclosed and which could stay confidential.<sup>200</sup> This creates uncertainty regarding whether such disclosure may unfairly disadvantage the disclosing party or unfairly advantage the party receiving the information.

Similarly, in the PCA case *South American Silver v. Bolivia*, Bolivia “request[ed] the Tribunal to order the Claimant to ‘disclose the identity of the funder of this arbitration, as well as

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<sup>195</sup> See *Procedural Order No. 3*, *supra* note 192, at para. 2.

<sup>196</sup> *Ibid.* at para. 2.

<sup>197</sup> *Ibid.* at para. 2.

<sup>198</sup> *Kılıç İnşaat İthalat İhracat Sanayi ve Ticaret Anonim Şirketi v Turkmenistan*, (ICSID Case No ARB/10/1) Award (3 July 2013).

<sup>199</sup> *Ibid.* at paras. 9-12.

<sup>200</sup> See Jean-Christophe HONLET, “Recent decisions on third-party funding in investment arbitration”, 30 (3) ICSID Review (2015) pp. 699-712, available at < <https://doi.org/10.1093/icsidreview/siv035>> (last accessed 22 August 2017).

the terms of the funding agreement signed with him.”<sup>201</sup> Like in the *Muhammet Cap* case, it would appear that the parent company of the claimant had earlier voluntarily disclosed the existence of the third-party funding, but not the identity of the funder or the terms of the agreement.<sup>202</sup> Like Turkmenistan, Bolivia argued that it was seeking this disclosure and security for costs due to the economic difficulties of the claimant coupled with the existence of third-party funding.<sup>203</sup> Bolivia also cited the 2014 IBA Guidelines provision “that third-party funders should be equated with the funded party to verify the existence of conflict of interests, and that the funded party is obliged to disclose any relationship that exists between her (including third-party funders) and the arbitrators.”<sup>204</sup>

In its reply to Bolivia’s request, South American Silver (SAS) agreed to disclose the name of its funder but noted that “the terms of SAS’s funding agreement are irrelevant to the issues in dispute in this arbitration and that the terms of that agreement are confidential, commercially sensitive, and that SAS and the funder would incur prejudice if the Tribunal ordered SAS to disclose the terms of the funding agreement.”<sup>205</sup> With respect to Bolivia’s application for security for costs, the tribunal adopted the standard articulated by the majority of the tribunal in *RSM v. Saint Lucia* and *EuroGas v. Slovak Republic* that “the mere existence of a third-party funder is not an exceptional situation justifying security for costs.”<sup>206</sup> In the end, the tribunal decided to order disclosure of the name of the funder “for purposes of transparency, and given the position of the Parties” but determined that there was no basis to order disclosure of the terms of the funding arrangement.<sup>207</sup>

The foregoing cases have all addressed cases involving for-profit third-party funding. There is another category of funders which may be termed “not-for-profit funders.”<sup>208</sup> These funders are motivated to bring about a certain outcome in the case or a change in the law, rather than motivated by making a profit. The most widely known example of a “not-for-profit” funding arrangement is the arrangement whereby the Bloomberg Foundation and its “Campaign for Tobacco-Free Kids” donated \$200,000 to Uruguay to help it fight against Philip Morris in the

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<sup>201</sup> *South American Silver Limited v. Plurinational State of Bolivia*, (PCA Case No. 2013-15), Procedural Order No. 10, (11 January 2016) para. 13.

<sup>202</sup> *Ibid.* at para. 25.

<sup>203</sup> *Ibid.* at para 25.

<sup>204</sup> *Ibid.* at para. 29.

<sup>205</sup> *South American Silver Limited v. Plurinational State of Bolivia*, (PCA Case No. 2013-15), Claimant Opposition to Respondent Request for Cautio Judicatum Solvi and Disclosure of Information, (14 December 2015) paras. 38, 40.

<sup>206</sup> *Ibid.* at para. 74 (citing *EuroGas Inc. & Belmont Resources Inc. v. Slovak Republic*, (ICSID Case No. ARB/14/14) Procedural Order No. 3 – Decision on Requests for Provisional Measures, (23 June 2015) para. 123.

<sup>207</sup> *Ibid.* at paras. 79, 80, 84.

<sup>208</sup> See e.g., Eric DE BRABANDERE and Julia LEPELTAK, “Third-Party Funding in International Investment Arbitration”, 27 (2) ICSID Review (2012) pp. 379-398 available at < <https://doi.org/10.1093/icsidreview/sis017>> (available at 22 August 2017).

ICSID case *Philip Morris v. Uruguay* in which Philip Morris challenged state regulations requiring plain packaging of tobacco products.<sup>209</sup>

Bloomberg did not expect any monetary reimbursement of its investment or have any economic interest in the award. Instead it was seeking to bring about a certain outcome in the case, namely to allowing Uruguay to successfully defend a suit challenging its laws regarding tobacco packaging.

It remains uncertain the extent to which not-for-profit funding will continue to grow. Particularly in investment arbitration, where awards are routinely relied on as a form of soft precedent, it may become more common for States that are not a party in a particular case, or non-profit entities, to support responding parties in order to affect development of the law or to protect their own rights indirectly.<sup>210</sup> To date, it would appear that many not-for-profit funders and the parties they fund are inclined to voluntarily, and even publicly, announce their involvement in the case, perhaps to sway public opinion in their favour or to attract additional funding sources for the funded party.<sup>211</sup>

#### 4. When Disclosure Should be Made and By Whom

A general principle that the presence and identity of funders should be disclosed raises separate questions about who bears the burden of such disclosure, to whom such disclosure should be made, and under what conditions.

Because third-party funders are not, by definition, usually parties to the arbitration, they cannot be directly compelled by an arbitral tribunal or rules applicable within the arbitral proceedings to disclose their participation. Instead, disclosure is ordinarily effectuated through the parties.

This obligation is delineated in IBA General Standard 7(a), which requires parties to inform arbitrators, as follows:

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<sup>209</sup> See *Philip Morris Brand Sàrl (Switzerland), Philip Morris Products SA (Switzerland) and Abal Hermanos SA (Uruguay) v Oriental Republic of Uruguay*, (ICSID Case No ARB/10/7).

<sup>210</sup> For example, Global Petroleum Group funded both Grenada and St Lucia in their efforts to defend against competing claims for access to oil reserves asserted by rival RSM. It has been alleged that Global Petroleum Group had obtained its right to access oil reserves based on “corrupt ties to the government of Grenada.” See Fernando CABRERA DIAZ, *RSM Production Corp. files second arbitration against Grenada, sues Freshfields*, <https://www.iisd.org/itn/2010/04/08/rsm-production-corp-files-second-arbitration-against-grenada-sues-freshfields/>, last accessed 30 August 2017.

<sup>211</sup> See e.g., Eric DE BRABANDERE and Julia LEPELTAK, “Third-Party Funding in International Investment Arbitration”, 27 (2) ICSID Review (2012) pp. 379-398 available at <<https://doi.org/10.1093/icsidreview/sis017>> (available at 22 August 2017).

“A party shall inform an arbitrator, the Arbitral Tribunal, the other parties and the arbitration institution or other appointing authority (if any) of any relationship, direct or indirect, between the arbitrator and the party (or another company of the same group of companies, or an individual having a controlling influence on the party in the arbitration), or between the arbitrator and any person or entity with a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration.”

At the end of General Standard 7(b), the provision clearly states that “The party shall [make required disclosures] on its own initiative at the earliest opportunity.” In addition, General Standard 7(c) further states “In order to comply with General Standard 7(a), a party shall perform reasonable enquiries and provide any relevant information available to it.”

Members of the Task Force disagreed about what relationships are required to be disclosed under General Standard 7, and how the reporting obligations in General Standard 7 relate to arbitrators’ disclosure obligations under General Standard 6. Some members interpreted General Standard 7 as requiring only that parties disclose to arbitrators information that would constitute a disclosable “relationship” under General Standard 6 or the individual Guidelines in the Red and Orange lists. Under this view, the presence and identity of a funder (or insurer) would only need to be disclosed in certain circumstances, namely if a funder might have a material relationship with an arbitrator that might give rise to a potential conflict of interest. A funder who had never had any contact or interaction with an arbitrator, or that has not funded numerous cases involving that arbitrator, would, according to this view, not need to have its presence and identity in the case disclosed.

Others on the Task Force disagreed with this interpretation. Their concern was that, as a practical matter, this narrower interpretation would effectively shift both the substance of the disclosure obligation and discretion in interpreting the IBA Guidelines not to parties, but to funders. For example, parties know whether their current case is funded, but they do not and cannot know of every relevant contact or relationship that may exist as between a funder and an arbitrator. For example, unbeknownst to a party, its funder may have funded several cases in the past few years in which the same arbitrator was appointed. In the absence of mandatory, systematic disclosure, the arbitrator would likewise be unaware and unable to know of the repeated appointments.

It is plausible that a party, as part of its duty under General Standard 7(c), could make reasonable enquiries of the funder about whether any such circumstances exist. However, not all of the IBA Guidelines are as straightforward as those that require the counting of cases and the counting of years, and in some instances, even those provisions involve nuanced assessments. If a party is only obliged to disclose the presence and identity of a funder when the funder has identified a relationship that is disclosable, then all the nuanced interpretation of what constitutes a disclosable relationship or a potential conflict of interest rests with the funder. The funder may

or may not be particularly well-versed in the IBA Guidelines and related standards that govern arbitrators' conflicts of interest.

The larger problem, for those Members who objected to the narrower reading of General Standard 7, is that it is arbitrators, not parties or funders, who are obligated to determine and disclose particular facts that may give rise to a conflict of interest. This obligation to assess potential conflicts of interest also implies a duty to investigate, which in turn obliges arbitrators to make reasonable inquiries. Those on the Task Force who supported systematic disclosure at the beginning of cases relied in large part on this duty to investigate: Arbitrators' duty to make reasonable inquiries presumably obliges them to request disclosure of the existence of funding and the identity of the funder in every case since, absent such disclosure, they may have conflicts that are not known.

## 5. Unknown Conflicts of Interest

One argument considered but ultimately rejected by the Task Force is that relationships with funders need not be disclosed to arbitrators because unknown conflicts are not generally a basis for disqualifying arbitrators or successfully challenging an award. Unlike parties and law firms, third-party funders are not readily identifiable from the pleadings. In the absence of disclosure, this argument goes, the participation of a funder would remain unknown and unknowable and an arbitrator cannot be biased by unknown information.

This view was ultimately rejected by the Task Force, and by the standards for disclosure identified above. Study of a particular example is helpful to illustrate the point.

Third-party funders can raise potentially serious conflicts that are distinct from those that arise with either law firms or parties. For example, take the case of one party (*PI*) that is funded by funder (*F*) and *X* is the presiding arbitrator in one arbitral dispute (*AI*), but *X*'s partner also serves as counsel to a claimant in another unrelated second arbitration (*A2*) and the claim is funded by the same funder *F*. The fact that the fees of *X*'s partner in *A2* are paid by *F* and that *X*'s partner is likely to have significant contacts with *F* on the basis of the funding agreement raises concerns beyond simple repeat appointments. The financial arrangement and ongoing contacts arguably raise questions about *X*'s impartiality and independence with respect to the claimant in *AI* that would make it inappropriate for *X* to sit as an arbitrator in *AI*.<sup>212</sup>

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<sup>212</sup> This hypothetical and analysis was developed by Maxi Scherer in Maxi SCHERER, "Out in the open? Third-party funding in arbitration", CDR News (26 July 2012) available at <<http://www.cdr-news.com/categories/expert-views/out-in-the-open-third-party-funding-in-arbitration>> (last accessed 3 August 2017).

The resolution to the problem illustrated in this example is self-evident, and generally should preclude the funder from taking on the case.<sup>213</sup> If a funder were somehow to undertake such funding *X* would not be aware of the conflict because *X* would not know of the existence of a funding agreement. Absent an obligation to disclose the presence and identity of a funder, the funder's participation in an international arbitration case is otherwise usually unknown or unknowable. The nature of funders' relationships with attorneys and funded parties is generally unknown.

Even if unknown at the initial stages, the existence of the funding agreement may be discovered later. A number of circumstances create the possibility of disclosure: if a dispute arises between the client or the law firm and the funder; if financing is suspended or funding caps are reached that require explanations from a party about their financial situation; or if the need arises to respond to a challenge by an opposing party that a claim of financial distress is unfounded because of a suspected funding arrangement.<sup>214</sup> Disclosure can also be accidental. For example, Jonas von Goeler reports, "[i]n the ICC case *X v. Y and Z*, for example, the claimant transferred a litigation funding agreement to the respondents without further explanation, leading counsel for the respondents to the assumption that '[t]his agreement was sent maybe by mistake.'"<sup>215</sup> Any of these scenarios can lead to disclosure about the presence of a funder.

In addition, as Jonas Von Goeler summarizes, rules governing publicly traded companies may also oblige disclosures: "Importantly, the presence of a third-party funder may need to be disclosed for reasons *not linked to the arbitration proceedings*, namely to comply with public disclosure requirements imposed upon listed companies, and following disputes between the parties to the funding agreement ending up in state courts."<sup>216</sup>

Later discovery of a third-party funder whose links with an arbitrator should have been disclosed may require that the arbitrator step down or risk rendering an award that may be set aside or refused recognition and enforcement as a result of the conflict. Even if discovered after the close of proceedings, a conflict that should have been disclosed can still be a potential ground for attacking an award, even if the arbitrator was ostensibly unaware of the funding arrangement.<sup>217</sup>

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<sup>213</sup> Calunius Capital, "IBA Guidelines on Conflicts of Interest – how should we interpret the Third Party Funding disclosure principles?" (March 2015) available at <<http://www.calunius.com/media/10902/iba%20guidelines%20on%20conflicts%20of%20interest.pdf>> (last accessed 10 August 2017).

<sup>214</sup> Marc GOLDSTEIN, "Should the Real Parties in Interest Have to Stand Up?" 4 *Transnational Dispute Management* (2011) p. 7.

<sup>215</sup> *X v. Y and Z*, (ICC Case), Procedural Order (3 August 2012), published in Philippe PINSOLLE, "Third Party Funding and Security for Costs" *Cahiers de l'arbitrage/Paris J. Int'l Arb.* (2013) pp. 399-416; Jonas VON GOELER, *Third-Party Funding in International Arbitration and Its Impact on Procedure* (Kluwer 2016) p. 127; ICCA-QM Draft Report on Costs, Fn 27.

<sup>216</sup> See Jonas VON GOELER, *Third-Party Funding in International Arbitration and Its Impact on Procedure* (Kluwer 2016), p. 128 (italics in originally).

<sup>217</sup> There is some disagreement among arbitrators and courts about the effect of an arbitrator's lack of knowledge of a conflict. As the Reporters' notes to the Restatement explain with regard to US Law:

There is some disagreement among courts about whether an arbitrator's lack of knowledge of a conflict precludes a finding of evident partiality. Some courts have taken the view that an absence of

Eventually, it might not be proven that the arbitrator knew about the participation of the funder, and the conflict be treated therefore as an “unknown conflict.” An absence of specific knowledge about a particular conflict is not, however, universally recognized as negating allegations of bias. Particularly when circumstances create inappropriate financial relationships from which an arbitrator benefitted, challenges to an award may be effective, even if the alleged financial relationship was unknown.

Another, final reason for rejecting arguments based on unknown conflicts is that arbitrators are generally understood as having a “duty to investigate” or to take reasonable steps to inform themselves of potential conflicts of interest. For example, in General Standard 7(d), the IBA Guidelines provide (d): “An arbitrator is under a duty to make reasonable enquiries to identify any conflict of interest, as well as any facts or circumstances that may reasonably give rise to doubts as to his or her impartiality or independence. Failure to disclose a conflict is not excused by lack of knowledge, if the arbitrator does not perform such reasonable enquiries.”<sup>218</sup>

Some on the Task Force view an inquiry by an arbitrator about the existence and identity of funding as part of an arbitrator’s fulfilment of this duty. Indeed, it would be difficult to argue that asking parties about whether they are funded does not fall within the duty to “make reasonable enquiries.” Under the IBA Guidelines, a failure to make a reasonable enquiry would mean that a failure to disclose is not “excused.” Under other authorities, an arbitrator’s failure to investigate a potential conflict may also be a factor to be considered in assessing the consequences of an undisclosed, unknown conflict of interest.<sup>219</sup>

As a practical matter, in an effort to protect their reputations and ensure effective handling of the dispute, most arbitrators do undertake to investigate unknown potential conflicts of interest. A request that parties disclose the existence and identify of a funder would normally be a part of that effort.

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knowledge about a conflict per se precludes a finding of evident partiality. See *Gianelli Money Purchase Plan & Trust v ADM Inv. Servs., Inc.*, 146 F.3d 1309, 1313 (11th Cir. 1998); see also Rev. Unif. Arb. Act § 12(e), 7 U.L.A. 43 (2005) (‘An arbitrator appointed as a neutral arbitrator who does not disclose a known, direct, and material interest in the outcome of the arbitration proceeding or a known, existing, and substantial relationship with a party is presumed to act with evident partiality under Section 23(a)(2).’). This approach—categorically excluding from consideration all conflicts regarding which an arbitrator has no actual knowledge—arguably discourages arbitrators from fulfilling their duty to investigate. It also imposes on the aggrieved party the unreasonable burden of having to prove actual knowledge about a conflict on the part of an arbitrator. The better view, and the one represented in the final factor of the test stated in the section, is that absence of knowledge is relevant to a court’s analysis of the facts of a case, particularly as relates to the investigation undertaken by the arbitrator. See *New Regency Prods., Inc. v Nippon Herald Films, Inc.*, 501 F.3d 1101, 1107–8 (9th Cir. 2007). If the arbitrator has taken reasonable measures to investigate potential conflicts, a lack of knowledge about a particular conflict will generally weigh significantly against a finding of evident partiality.

Restatement (Third) US Law of Int’l Comm. Arb, paras. 4-13, Reporters’ Note *f* (2013).

<sup>218</sup> IBA Guidelines on Conflicts of Interest.

<sup>219</sup> IBA, “Code of Ethics” (1988) available at < [https://www.trans-lex.org/701100/\\_iba-rules-of-ethics-for-international-arbitrators-1987/](https://www.trans-lex.org/701100/_iba-rules-of-ethics-for-international-arbitrators-1987/)> (last accessed 15 August 2017).



It is for these reasons that most standards that have emerged or have been adopted require general and systematic disclosure of the presence and identity of a funder but do not require disclosing the terms of the funding arrangement. This systematic but narrow disclosure regarding funders in turn allows arbitrators, whose ultimate duty it is to disclose potential conflicts, to engage in a thorough assessment of potential conflicts and make any necessary disclosures.

DRAFT

## Chapter 5 Privilege

### PRINCIPLES

- 1. Generally, the existence of funding and the identity of a third-party funder is not privileged information.**
- 2. Generally, the specific provisions of a funding agreement may include privileged information, and production of it should only be ordered in exceptional circumstances.**
- 3. For information that is determined to be privileged under applicable laws or rules, tribunals should not treat that privilege as waived solely because it was provided by parties or their counsel to a third-party funder for the purpose of obtaining funding or supporting the funding relationship.**
- 4. If the funding agreement or information provided to a third-party funder is deemed to be disclosable, the tribunal should generally permit appropriate redaction and limit the purposes for which such information may be used.**

### ANALYSIS

Obtaining third-party funding and the maintenance of a funding relationship generally requires disclosure of information that would otherwise be privileged, either because it involves communications between a client and its counsel, or analysis by a client's counsel in preparation for legal proceedings. However, when confidential or privileged information is shared with a third party, confidentiality and privilege are generally deemed waived. In the context of third-party funding, the tension between these two premises raises questions about whether otherwise privileged information disclosed to funders may result in a waiver of privilege. If so, that information could be susceptible to disclosure requests in the arbitration proceedings or related national court proceedings.

Related to this issue, some have expressed concern that a third-party funder, once in possession of a client's confidential information, is not legally prohibited from using such information in another funded matter for a different client, even if that matter raises a potential conflict with the interests of the original client. Funders, in their capacity as funders, are not generally regarded as bound by professional ethical rules regarding treatment of confidential information and conflicts of interest rules in the same way lawyers are.<sup>220</sup>

Despite the importance of these issues, international Conventions, and most national arbitration law and arbitral rules are silent about issues of privilege.<sup>221</sup> The rise of third-party

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<sup>220</sup> In fact, many funding agreements expressly state that the funder is not providing legal services and that the agreement does not create an attorney-client relationship.

<sup>221</sup> See Born at 2376.

funding has added new complexities to existing ambiguities about privilege in international arbitration.

An important starting point is that most national arbitration law, arbitral rules and the 2010 IBA Rules on the Taking of Evidence in International Arbitration (the IBA Evidence Rules) largely leave such issues to arbitrator discretion.<sup>222</sup> Arbitrators enjoy broad discretion to control the proceedings before them, which includes determining when to order document production, whether any privileges apply to requested documents, and whether such privileges may have been waived.

The Principles in this Chapter are predicated on arbitrators' broad authority over procedural issues, and the need to exercise that authority in light of conflicting national standards regarding privilege, and a general absence of clear standards that apply when otherwise privileged information is shared with third-party funders. This Chapter begins by outlining the scope of privileges [1.], analysing the treatment of privilege and waiver in international arbitration [2.], and summarizes the results of an international survey on privilege conducted by the Task Force [3.]. It then examines the laws that might apply to determine privilege [4.], and existing national heads of privilege and the rules that affect their applicable to funded parties [5].

## **1. Scope of Privilege Issues**

Privileged information may be provided to a third-party funder in the following situations:

- (i) during the initial due diligence phase (where funding is first requested and the third-party funder requires information in order to decide whether or not to provide financing); and
- (ii) once the third-party funder has already committed to funding a party's participation in a pending dispute and the party and/or its counsel is sharing information about developments as well as documents being submitted in those proceedings.

In addition, there are questions about whether the funding agreement itself is privileged.

In addition to information that is shared, there is a separate category of documents produced and held by the funder such as (i) the funder's own evaluation of the case; (ii) documents relating to the negotiation of the funding agreement (the terms may give away thoughts on the strength of the case); and (iii) separate legal opinions from independent counsel on the strength of the case. Since the funder is not a party to the arbitration proceedings, it is difficult to see how the funder could be obliged to disclose these documents during the course of the arbitration. There may, however, be circumstances in which these documents are sought in the context of arbitration-related litigation or, in the United States, in an action to obtain document production under 28 U.S.C. § 1782. In such instances, important questions arise regarding their privileged status.

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<sup>222</sup> Von Goeler, p. 166.

## 2. Privilege in International Arbitration

Historically, according to leading international arbitration commentators, there has been “limited authority concerning the appropriate treatment of privileges,”<sup>223</sup> in international arbitration, and international sources generally provide little guidance.<sup>224</sup>

As a practical matter, arbitrators often look to national rules and standards to determine the existence of a privilege, either as a category or as applied to particular documents. Many commentators are of the view that the weight of authority and the better view is that domestic privileges should apply, rather than international standards.<sup>225</sup> The justification for this approach is that national law provides the basis for privileges in the first instance. Under this approach, the applicable national rule is determined through conflict of laws analysis.

Arbitrators also have considerable discretion in undertaking conflict of law analysis, though some consensus is emerging regarding the factors to take account of in determining applicable national law.<sup>226</sup> In addition to traditional conflict of law factors, it is generally understood that “arbitral tribunals should do justice to the legitimate expectations of the parties”<sup>227</sup>

These basic premises are reflected in in the IBA Rules on the Taking of Evidence. Article 9(2)(b) authorises an arbitral tribunal, at the request of either party or at its own discretion, to exclude documents and other evidence that may be covered by privilege under the legal (and ethical) rules “determined by the Arbitral Tribunal to be applicable.” Meanwhile, Article 9(3) provides guidance to arbitral tribunals when considering a privilege issue under Article 9(2)(b).

Under Article 9(3)(a), a tribunal may take into account the need to protect the confidentiality of communications made in connection with and for the purpose of producing or obtaining legal advice. Article 9(3)(b) refers to similar protections for communications made in connection with settlement negotiations. Under Article 9(3)(c), arbitral tribunals are advised to consider the parties’ expectations at the time privilege is said to have arisen, and thus presumably most often the approach to privilege in the parties’ home jurisdictions.

Perhaps most notably, Article 9(3)(d) provides the considerations that an arbitral tribunal may “take into account” in determining waiver. Specifically, it provides that in ordering production of documents, an arbitral tribunal should consider “any possible waiver of any applicable legal impediment or privilege by virtue of consent, earlier disclosure, affirmative use

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<sup>223</sup> Gary B. BORN, *International Commercial Arbitration* 2375 (2<sup>nd</sup> ed. 2014).

<sup>224</sup> VON SCHLABRENDORFF & SHEPPARD, *Conflict of Legal Privileges in International Arbitration: An Attempt to Find a Holistic Solution*, in G. Aksen et al. (eds), *Global Reflection in International Law, Commerce and Dispute Resolution: Liber Amicorum in Honour of Robert Briner* 743, 763 (2005).

<sup>225</sup> BORN at 2383-2384.

<sup>226</sup> BERGER, *Evidentiary Privileges: Best Practice Standards Versus/and Arbitral Discretion*, 22 *Arb. Int'l* 501, 514-15 (2006). This pragmatic consensus is based on four key observations: (1) Privilege issues must be qualified as substantive law issues. (2) The parties’ standard choice of law clause in the contract usually does not extend to the issue of evidentiary privileges. (3) In determining the law applicable to a certain privilege issue, the tribunal shall apply the law of the jurisdiction with which the relevant communication is most closely connected, i.e., the law where the party has its place of business. (4) The tribunal may exclude evidence from both sides which is privileged under the law of one party but not under the law of the other based on compelling considerations of fairness or equality.”)

<sup>227</sup> Klaus Peter BERGER, *Evidentiary Privileges: Best Practice Standards vs./and Arbitral Discretion*, in: *Best Practices in International Arbitration* (Markus Wirth, editor) (ASA Swiss Arbitration Association Special Series No. 26, July 2006).

of the Document, statement, oral communication or advice contained therein, or otherwise.” This language is limited in the precatory language of Article 9(3) with the proviso “insofar as permitted by any mandatory legal or ethical rules that are determined by it to be applicable.”

The privilege status of documents provided to third-party funders is often described as a question of whether the privilege “extends” to the funding relationship. It is more accurate, however, to frame the question of whether the sharing of documents with a third-party funder constitutes waiver. This distinction has important consequences, particularly under the framework of the IBA Rules for Evidence, for evaluating the privilege status of documents shared with a third-party funder.

Under international standards and Article 9(2)(b), the existence of a privilege is to be determined by reference to national law that the tribunal determines to be applicable. On the other hand, Article 9(d) makes determination of waiver of “any applicable ...privilege” dependent on factual and prudential considerations. Reading these two provisions together, they suggest that the *existence of a privilege* should be made based on a conflict of laws analysis, but *findings of waiver* are not similarly predicated on conflict of laws analysis.

As examined in greater detail below and in the Annex, national laws differ significantly with respect to the “heads of privilege” they create, and the scope of such privileges. Most national laws do not clearly address, however, whether provision of privileged documents to a third-party funder would constitute a waiver. In light of these ambiguities, Article 9(3)(d) of the IBA Rules of Evidence becomes a compelling basis for concluding that tribunals should, as the Principles in this Chapter suggest, independently analyze whether a waiver has taken place.

In undertaking this analysis, another provision in the IBA Rules of Evidence is helpful. Apart from privileges established by national law, arbitral tribunals are separately authorized under Article 9(2)(e) to decline to order production on “grounds of commercial or technical confidentiality that the Arbitral Tribunal determines to be compelling.” Documents provided subject to the types of non-disclosure agreements typically entered into between funders and parties would seem to establish commercial confidentiality. Protection against disclosure would seem to be particularly compelling when disclosure would involve otherwise privileged documents.

In addition, other provisions in Article 9 instruct tribunals to consider more fairness-related issues. Under Article 9(3)(d), the arbitral tribunal is encouraged to consider whether a party’s rights to privilege have been waived. Under Article 9(3)(e), the arbitral tribunal is urged to maintain fairness and equality between the parties, particularly relevant where different rules of privilege apply to each party so that one party appears able to shield documents from disclosure while the other does not. This may involve applying the broadest standard of protection available to all parties to the arbitration.

While the IBA Rules of Evidence are not binding on arbitral tribunals, they are frequently a point of reference. To the extent they support the notion that the provision of privileged documents to a third party does not necessarily constitute waiver of privilege, the Task Force concluded they provide a firm basis for informing Principle 3 in this Chapter.

Institutional rules are generally less specific than the IBA Rules. The various institutional rules generally do not specify the criteria a tribunal may wish to consider when determining issues

of privilege and confidentiality.<sup>228</sup> Many of the main arbitral institutions simply state in their rules that the tribunal has the final say as to the admissibility of any evidence, including whether or not to apply strict rules of evidence (which will include legal privilege). For example:

(i) **The UNCITRAL Model Law (2006):**

*“Article 19. Determination of rules of procedure*

*(1) Subject to the provisions of this Law, the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings.*

*(2) Failing such agreement, the arbitral tribunal may, subject to the provisions of this Law, conduct the arbitration in such manner as it considers appropriate. The power conferred upon the arbitral tribunal includes the power to determine the admissibility, relevance, materiality and weight of any evidence.”*

(ii) **The UNCITRAL Rules (2010):**

*“Evidence*

*Article 27*

*...*

*3. At any time during the arbitral proceedings the arbitral tribunal may require the parties to produce documents, exhibits or other evidence within such a period of time as the arbitral tribunal shall determine.*

*4. The arbitral tribunal shall determine the admissibility, relevance, materiality and weight of the evidence offered.”*

(iii) **The ICC Arbitration Rules (2017):**

*“Article 22: Conduct of the Arbitration*

*2) In order to ensure effective case management, the arbitral tribunal, after consulting the parties, may adopt such procedural measures as it considers appropriate, provided that they are not contrary to any agreement of the parties.*

*3) Upon the request of any party, the arbitral tribunal may make orders concerning the confidentiality of the arbitration proceedings or of any other matters in connection with the arbitration and may take measures for protecting trade secrets and confidential information.”*

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<sup>228</sup> See Craig Tevendale & Ula Cartwright-Finch, *Privilege in International Arbitration: Is it Time to Recognize the Consensus?*, *Journal of International Arbitration* (Kluwer Law International 2009) Volume 26, Issue 6, at 825- 26.

(iv) **LCIA Rules (2014):**

*“Article 22 Additional Powers*

*22.1 The Arbitral Tribunal shall have the power ...*

*(vi) to decide whether or not to apply any strict rules of evidence (or any other rules) as to the admissibility, relevance or weight of any material tendered by a party on any issue of fact or expert opinion; and to decide the time, manner and form in which such material should be exchanged between the parties and presented to the Arbitral Tribunal...”*

Accordingly, arbitral rules generally affirm that arbitrators are afforded considerable discretion in shaping and applying rules of privilege. In this respect, they provide additional support for the power of international arbitrators to follow the relevant Articles of the IBA Rules of Evidence and Principle 3, above, to conclude that sharing documents with third-party funders does not constitute waiver.

### **3. Task Force Survey on National Practices**

To assess existing practices and governing law in various jurisdictions, the Task Force collected reports on privilege from over 20 jurisdictions.<sup>229</sup> The compiled results of this research will be made available at [http://www.arbitration-icca.org/projects/Third\\_Party\\_Funding.html](http://www.arbitration-icca.org/projects/Third_Party_Funding.html).

Each report considers the following four questions:

(i) Please describe, with brief reference to case law, legislation or legal writings, the privileges or other rules (e.g. professional secrecy) on which a party or its counsel may rely in order to resist disclosure in national court proceedings of communications between the lawyer and the client (or between lawyers) that would otherwise have to be disclosed. In each case, please identify who may claim the benefit of the privilege or other rule (e.g. the client, the lawyer).

(ii) Please describe, with brief reference to case law, legislation or legal writings, the privileges or other rules (e.g. professional secret) on which a party or its counsel may rely in order to resist disclosure in arbitral proceedings (with their seat in your jurisdiction) of communications between the lawyer and the client (or between lawyers) that would otherwise have to be disclosed. In each case, please identify who may claim the benefit of the privilege or other rule (e.g. the client, the lawyer).

(iii) Please describe the circumstances in which the benefit of the privilege or other rule may be lost in national court proceedings or arbitration. In particular, please describe the possible effect of disclosure to a third party of a communication that would

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<sup>229</sup> Jurisdictions covered are: Australia, Brazil, China, England, Germany, Hong Kong, India, Japan, Netherlands, Portugal, Russia, Scotland, Singapore, South Korea, Spain, Sweden, Switzerland, Turkey, United States (California), Ukraine, United Arab Emirates. These reports will be made available at [http://www.arbitration-icca.org/projects/Third\\_Party\\_Funding.html](http://www.arbitration-icca.org/projects/Third_Party_Funding.html).

ordinarily have been protected from disclosure to a court or arbitral tribunal by reason of the privileges or similar rules described in questions 1 and 2.

(iv) Please identify the circumstances in which disclosure of an otherwise-protected communication to a third-party funder will result in loss of the benefit of the privilege or other rule, in national court proceedings or arbitration. Please identify any circumstances where the benefit of the privilege or other rule will continue to attach to the communication, notwithstanding the disclosure. Please make brief reference to case law, legislation or legal writings relevant to this question, if such exist. Where there is little or no authority on privilege and how it applies to third-party funders, please look instead at situations analogous to the third-party funder relationship e.g. with insurers.

The following additional questions were posed to reporters for consideration:

- (i) What law applies to privilege in litigation in your jurisdiction/in arbitration with its seat in your jurisdiction?
- (ii) Are documents held by the funder protected, i.e. the funder's own evaluation of the case; separate legal opinions; negotiation of the funding agreement?
- (iii) In relation to documents transferred by the lawyer/party to the funder, does the use of a confidentiality/non-disclosure/common interest agreement work to protect privilege/secretcy in your jurisdiction?

Based on this research, the Task Force concluded that in most jurisdictions, there is no clear answer as to whether documents and information provided to a funder will be definitively protected – in a nascent industry, lawyers may be able to advise by analogy but in many (indeed most) jurisdictions, there are no well-established precedents or rules (only limited and under-developed sources) dealing with the point.

The responses from the national lawyers who responded to the Task Force's questionnaire demonstrate the need to take local advice on a case by case basis as treatment of "privileged" documents varies from jurisdiction to jurisdiction.

The main distinction in the treatment of information shared with funders appears between civil and common law systems, although many nuances exist even among jurisdictions on each side of this divide.

There can be some confidence that in common law jurisdictions where funding is allowed at all (notably it is prohibited in Ireland; recent reforms allow it for international arbitration and supporting litigation in Hong Kong and Singapore) an exchange of information with a funder will be protected, in particular where an appropriate contract is in place to manage confidentiality, limit waiver of privilege, assert a common interest and/or assert the application of an appropriate form of privilege.

However, caution must be exercised and advice taken in each case.<sup>230</sup> There has been at least one case in the US where the discovery of documents provided to a funder has been ordered.

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<sup>230</sup> See the discussion in "*The Impact of Third Party Funding on Privilege in Litigation and International Arbitration*", Alrashid, Wessel and Laird, *Dispute Resolution International* Vol 6, No2, October 2012, at p 109. *Bray & Gillespie Mgmt LLC v Lexington Ins. Co.* 2008 2008 WL 5054695 M.D. Nov 17, 2008.



We are also aware of one case before the English courts in which the disclosure of funding documents was ordered.<sup>231</sup>

The approach of civil jurisdictions is based on the concept of “professional secrecy” according to which lawyers (but often not extending to in-house lawyers) are bound by professional duties and rights not to reveal confidential information, even if – for example- ordered by a court to testify. Whether those rights and duties could be extended to a funder with whom such information is shared depends on the rules in a particular jurisdiction. In certain jurisdictions there is no protection afforded to documents not in the lawyer’s possession or control. One can take some comfort, however, from the fact that a party is not generally required to “disclose” documents at the request of an opposing party in civil law systems, so there will be limited scenarios in which disclosure of otherwise confidential case documents becomes a real issue.

Parties and funders in practice (hope to) protect against problems by entering into appropriate confidentiality agreements before sharing information.

#### **4. Applicable Laws and Rules that Determine Privilege**

Privilege may be regarded as a matter of substance or procedure, but its status as either varies from jurisdiction to jurisdiction, and is often unclear.<sup>232</sup> The existence and scope of privilege may be determined or affected by a range of sometimes overlapping domestic laws, professional ethics rules, and arbitral rules. To date, there has been in international arbitration the legal framework for determining how and

The various domestic laws that may be relevant include (i) the law of the jurisdiction where communications took place or the relevant document was created; (ii) the law of the jurisdiction where the document is physically located or held; (iii) the law of the jurisdiction where the counsel of each party is licensed and/or practises; (iv) the law of the jurisdiction where each party resides; (v) the law of the jurisdiction in which disclosure is sought; (vi) the law of the seat of the arbitration; (vii) the law governing the substance of the dispute or the law in relation to which the

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<sup>231</sup> See e.g., *Leader Technologies, Inc. v Facebook, Inc.*, 719 F.Supp.2d 373 (D.Del. 2010) (holding that common interest privilege did not exist between patentee and litigation financing companies and ordering disclosure of “limited technical documentation” that had been shared with litigation funder); *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711 (N.D. Ill. 2014) (upholding protection under the work product doctrine for documents disclosed to the funder due to a pre-existing confidentiality agreement between the client and the funder, but not upholding protection under the attorney-client privilege, because the court did not view the funder as falling within the “common interest” exception to waiver). In England, see *Excalibur Ventures LLC v Texas Leystone Inc. and others* [2012] EWHC 2175 (unreported).

<sup>232</sup> In England & Wales, legal professional privilege is usually considered a substantive common law right. However there is still some ambiguity as to whether or not it is also a procedural right. In a landmark English case, Lord Scott held that “*the debate [as to whether the right to legal advice privilege is a procedural right or a substantive right] is sterile. Legal advice privilege is both*”. *Three Rivers District Council and others v Governor and Company of the Bank of England (No 4)* [2004] UKHL 48, Lord Scott at 26. See also, for example, the Australia report for a discussion of the status of privilege as a part of substantive law rather than a procedural rule. This leads to tensions where a matter has international elements and so a tribunal may have to apply conflicts of laws principles to decide which privilege laws apply. Contrast this with the position in civil law jurisdictions, such as The Netherlands, where the concepts of professional secrecy are derived from the Code on Civil Procedure and would appear to apply by virtue of the office of the professional instructed. Where a tribunal’s analysis of conflicts of laws principles is at odds with the professional’s duties and rights with regards to secrecy this may lead to difficulty.

legal advice was provided; (viii) the law governing the arbitration agreement and/or (ix) the law of the country with the “closest connection” to the events.

International arbitral tribunals may need to conduct a conflict-of-laws analysis to determine which applicable law governs the existence and scope of any claimed legal privilege. In practice tribunals often apply a “closest connection” test to avoid this complex analysis.

In addition to the rules and laws that may be formally applicable, tribunals may also take into consideration more practical considerations, such as the materiality of the documents in question, or the equality between the parties, to ensure that the same protection is afforded to documents of both parties, or in other words that the broadest standard of protection is applied to all privileged documents concerned.

The professional/ethical obligations of a lawyer will also play a part in the way information or evidence may be protected within certain jurisdictions, particularly in civil law jurisdictions where there is no concept of “privilege”, rather the lawyer is bound by rules of “professional secrecy” which will dictate the manner in which he or she must treat information given to him by the client.

## **5. National Privileges applicable to Funded Parties**

The protections afforded to information (confidential or otherwise) passing between a lawyer and his/her client vary substantially across jurisdictions. The clearest distinction to be made is whether or not the jurisdiction concerned applies or requires a process of documentary “discovery” or “disclosure” (the sharing between opposing parties of documentary evidence) as a stage in the conduct of a dispute.

Discovery or disclosure processes most usually occur in the progress of a dispute within common law jurisdictions - England & Wales, Hong Kong, Australia and the US for example. The inevitable result of the requirement that parties share information and documentation is that the rules or laws around legal privilege – in respect of information and documents which can legitimately be withheld from that sharing process - have developed extensively. Broadly the starting point is that all relevant information and communications must be shared with opponents save for any information which is legitimately protected because it is privileged.

Many civil law jurisdictions have very limited or no process of discovery/disclosure in the course of a dispute. Nevertheless, the concept of “professional secrecy” has developed in order to protect from subsequent use or exposure confidential information which passes to a lawyer when a client seeks advice or instructs a lawyer on a dispute. The starting point is the opposite from that in common law jurisdictions: no information and communications need be or can be shared with opponents or other parties unless the prohibition is lifted (by client, lawyer, or authority, depending on the circumstances and the rules of the jurisdiction concerned).<sup>233</sup>

Despite this fundamental difference in approach, the broad policy behind protecting lawyer and client information and communications is the same across jurisdictions. A client must be able

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<sup>233</sup> The annexed reports reveal that the nature of professional secrecy, and the manner in which secrecy might be waived or lifted, varies widely. For example, it may be that the client has the right to lift the veil on secrecy and ask his lawyer to communicate secret information (Japan, Ukraine); the lawyer may have rights to lift of his own volition, for example where his/her life or honour is at threat or where imminent commission of a crime is suspected

to take advice and do business, having been candid about all of the applicable facts. Without the protection of law or legal doctrines like privilege and professional secrecy preventing the information from being released to the wider world, that process would not occur freely and openly.

### **A. Common law heads of privilege**

Across the common law jurisdictions, litigation privilege and common interest are the “heads” which are most applicable to considerations of supplying information to funders, both during a funder’s due diligence to decide whether or not to invest, as well as in ongoing communications following an investment. Of course the precise treatment and categorisation of privilege across common law jurisdictions does vary.

Many common law jurisdictions divide the concept of legal privilege into legal advice privilege and litigation privilege. The US is an exception, with no concept of litigation privilege but instead a “work product doctrine” which covers lawyers’ work done in anticipation of litigation, or may be extended still further in some US states, such as California.<sup>234</sup> Broadly, documents passing between a client and his lawyer forming part of the chain of information in order to seek and receive advice are protected by advice privilege<sup>235</sup>; documents passing between client and lawyer or involving a third party, for the dominant purpose of proceedings (which may be litigation or arbitration) are covered by litigation privilege (and may, in the US context, count as “work product”).<sup>236</sup>

#### **1. Litigation or work product privilege**

Litigation privilege protects communications with third parties, broadly where the dominant purpose of the communication is to further a litigation which is pending, reasonably

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(Brazil, Portugal, Spain, Sweden) and this may be an automatic right, or one where permission of the local bar council, the court or other authority is required (Spain, Portugal). In many jurisdictions, disclosure of otherwise secret information to a third party will result in a loss of confidentiality and waiver of the right to secrecy unless attempts have been made through a confidentiality agreement to preserve secrecy.

<sup>234</sup> In California, work product doctrine applies to any document prepared by an attorney in connection with his or her work as an attorney- there is no requirement that litigation be in contemplation. Conversely, the concept of attorney-client privilege in California is derived from statute and thus the Californian courts cannot expand upon the protection provided.

<sup>235</sup> Legal advice/ attorney-client privilege is not analysed in any more detail here as litigation privilege (or work-product privilege) is the more relevant head for communications with a funder. Indeed, whilst we understand that some US cases have held that there is no waiver of privilege when documents subject to advice privilege or attorney-client privilege are provided to a funder, this is still an area where funders themselves may exercise caution. See for example Burford Capital’s blog, *Litigation Finance and attorney work product*, of 18 September 2013 which states “we do not yet encourage disclosure to us of material that is not work product but is privileged; we’d rather be conservative in this area.” Clearly it is neither in the interest of the party, nor the proposed/ invested funder to risk loss of privilege and potential exposure of information to the party’s opponent.

<sup>236</sup> A funder currently engaged in funding a case would fall within the US version of the work product doctrine under federal Rule of Civil Procedure 26(b)(3)A for documents or tangible things created by the funder in anticipation of litigation or for litigation purposes. Federal Rule of Civil Procedure 26(b)(3)A states that “*Ordinarily, a party may not discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative (including the other party’s attorney, consultant, surety, indemnitor, insurer, or agent)*” unless there is a substantial need or undue hardship in obtaining information within the scope of discovery. A funder most likely falls within one of the categories “*consultant, surety, indemnitor, insurer, or agent.*” Thus, the documents would be protected. If a funder declines to fund a case, however, then Rule 26 does not apply to the information that the funder had already obtained about the case, which means that this information remains

contemplated or existing. Whilst largely untested in common law courts, it should be possible to argue that sharing privileged information with a potential funder in order for it to decide whether to invest in the dispute meets that dominant purpose test, if it is the case that without funding the matter may not be pursued, or would be approached differently.

In the United States, there is a growing body of federal and state case law which suggests that the court will uphold the confidentiality (and thus privilege) of information passed to a funder. Documents prepared “because of” the litigation should be protected by work product privilege, thus documents prepared for funders, may still be privileged – even though a “dominant purpose” test might not be met. This is particularly where there is a confidentiality agreement in place.<sup>237</sup>

In the United States, there have also been cases in which work product privilege was found to apply to documents created “with the intention of coordinating potential investors to aid in future possible litigation”.<sup>238</sup> That would suggest that documents created for approaches to multiple funders, most of whom will not, as a matter of logic, ultimately invest in a case, could meet the appropriate test for work-product privilege/ litigation privilege. However, one might argue that the privilege status of documents created solely for and provided to a funder who does not subsequently invest is more vulnerable to challenge;<sup>239</sup> whereas once a funder is on board and a claimant could not pursue a matter without the continued investment by that funder, arguments as to the dominant purpose or reason for creating further communications are bolstered.<sup>240</sup>

That is on the basis that a funder is unlikely to agree to continue funding proceedings without progress updates; indeed funding agreements may well include a right of termination if the funder is not kept updated in the manner and frequency agreed. Thus the continued provision of information to the funder is crucial – and thus the sole or dominant purpose – as it allows the proceedings to continue. Nevertheless, the contrary is plainly arguable,<sup>241</sup> so there must still remain a risk, particularly in jurisdictions deploying the dominant purpose test, that no privilege will apply.<sup>242</sup>

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unprotected in the US. All jurisdictions should adopt a rule protecting the information of a party seeking funding even if the funder declines to fund a case.

<sup>237</sup> *Miller v Caterpillar*, 10 C 3770, 6 January 2014, United States District Court, N.D. Ill.

<sup>238</sup> *Mondis Technology Ltd v LG Electronics Inc* No2: 07-CV-565-TJW-CE2011 WL1714304

<sup>239</sup> We are unaware of common law decisions which make a clear distinction between the privilege status of communications with a funder who does invest, and one who does not. In *Bray & Gillespie Mgmt LLC v Lexington Ins. Co.* 2008 WL 5054695 M.D. Nov 17, 2008, arguments that a deponent could withhold answers to questions about discussions held with a funder (which did not subsequently invest) by arguing both attorney-client and work product privilege, failed. However, those claims failed because of procedural mistakes during the deposition so this would appear to be an area of risk where there is no clear position.

<sup>240</sup> Federal Rule of Civil Procedure 26(b)(3)(A) explicitly protects work product once a funder is on board with funding the case.

<sup>241</sup> For the position in England & Wales, see *Winterthur Swiss Insurance Company and other v AG (Manchester) Limited and others* [2006] EWHC 839, in particular paragraphs 85 and 86 of the judgment. Counsel for the claimants argued that litigation privilege could not apply during the insurer’s due diligence period when deciding to cover or not, as obtaining insurance was a condition precedent to litigating. Thus no litigation could be contemplated until insurance was effected. On the other hand, counsel for the defendants saw the due diligence process to obtain insurance as an “intrinsic” part of the unified purpose of working towards litigation, such that litigation privilege should apply.

<sup>242</sup> The Task Force did not locate any case law in England & Wales that deals with the funder position, so again assumptions may only be drawn by examining analogous situations. In *Winterthur Swiss Insurance Company and other v AG (Manchester) Limited and others* [2006] EWHC 839 the court considered whether litigation privilege applied to preliminary claim information prepared in order to decide whether or not an ATE insurer would cover a

To our knowledge, the scope of litigation privilege has been tested in the English Courts once by virtue of an application by the defendants for funding-related documents (including those evidencing the funding terms), in the matter of *Excalibur Ventures LLC v Texas Keystone & Ors*.<sup>243</sup> [A full analysis of this case is available in the England & Wales report.] In an unreported judgment, Mr Justice Popplewell held that not all documents brought into existence for the purposes of actual or contemplated litigation will be protected by litigation privilege. The Judge refuted the wider formulation of litigation privilege advanced by Excalibur - that the funding documents were covered by litigation privilege because they were made for the dominant purpose of litigation - and said that if that were the case, “*where a litigant buys a new suit in order to appear as a witness...all documents and information in relation to that purchase [would be] privileged because its dominant purpose was the conduct of the litigation.*”

The judge agreed with previous authorities that it is the “*use of the document or its contents in the conduct of the litigation which is what attracts the privilege*” and endorsed the principle stated in *Dadourian Group*<sup>244</sup> that “*Litigation privilege...can include a communication between a client and his lawyer or between one of them and a third party which comes into existence after litigation is commenced or contemplated for the dominant purpose of obtaining information or advice in connection with such litigation or of obtaining evidence (or information which might lead to evidence) for use in the conduct of such litigation.*”

The defendants were granted copies of Excalibur’s funding agreements that were found not to be privileged, and also to be directly relevant to the claims and defences pleaded in that case. It may be that the reasoning was based on the specific facts that meant the funding arrangement was found to be directly relevant to the merits of the dispute. The Court was content, however, for certain terms (including the success fee, settlement and termination provisions) to be redacted in response to the Excalibur’s contention that knowledge of a party’s funding arrangements might provide a “*tactical advantage in relation to various aspects of the conduct of the litigation.*”

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claim: “*If the policy was not issued there would be no litigation.*” There was no conclusive result: it was found either that litigation privilege did not apply, or that if it did it was in the hands of the insurer. However, it was clear that documents prepared after the inception of the policy did have litigation privilege.

<sup>243</sup> [2013] EWHC 2767 (Comm) (the application was heard in 2012).

<sup>244</sup> *International Inc. & Ors v Paul Simms & Ors* [2008] EWHC 1784 (Ch) (which cross referred to the House of Lords decision in *Waugh v British Railways Board* [1980] AC 521) at para 86.

Two further English high court cases (*Arroyo* and *RBS*) examine whether communications with ATE insurers, and the resultant policies, could be subject to legal advice or litigation privilege, and an analogy can be drawn between the position for ATE and for professional funding.<sup>245</sup> however, as discussed in the jurisdictional report for England & Wales, those judgments are conflicting, leaving the position under English law unclear (*Arroyo* finding that an ATE policy is likely to be covered by litigation and legal advice privilege, *RBS* finding that only those parts of an ATE policy may be privileged that would allow one to work out what legal advice had been given. In the *RBS* case the court stated clearly that “*it is unlikely that privilege attaches to an ATE policy as such on either ground (litigation or advice), except to the extent... that parts of a policy (such as, possibly, the amount of premium...) may attract legal advice privilege, and require redaction on the basis that the relevant part might allow the reader to work out what legal advice has been given....*”). Thus, there are however convincing arguments to be made by parties seeking to resist disclosure of such documents both on the grounds that they are not relevant to the substantive case in issue, but also that any contents of the documents which betray legal advice (for example, premium, termination provisions and procedure over settlement offers) should be redacted prior to disclosure as those discrete aspects are likely to attract legal advice privilege.

The *Arroyo* and *RBS* judgments show an acknowledgment by the English court of the potential tactical advantage to a party who successfully obtains disclosure of an ATE policy (or by analogy, funder) documents, and thus careful consideration will be given before making any such order. It is suggested that arbitral tribunals should be mindful of the same tactical advantages, and be cautious in ordering disclosure of such documents unless there are exceptional circumstances.

## 2. Common interest

Each of England & Wales, Australia, Hong Kong, Singapore and some – but not all – US states<sup>246</sup> also recognise the concept of “common interest” as a species of privilege (or more specifically as an exception to the rule that to pass privileged material to a third-party constitutes a waiver of privilege).

Under this view, passing privileged documents to a third-party ordinarily results in a loss of privilege, but privilege is retained where it can be shown that there is a “common interest” in the subject matter of the relevant communication or the proceedings to which the document relates. As noted above, in international arbitration practice under the IBA Rules of Evidence, the existence of waiver is generally not expected to be determined by reference to national rules and law. Nevertheless, where applicable, the common interest doctrine provides additional support for Principle 3 of this Chapter.

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<sup>245</sup> See *Arroyo v BP Exploration Co (Columbia) Ltd (unreported)* approved judgment of 6 May 2010, and *RBS Rights Issue Litigation [2017] EWHC 463 (Ch)*. There is an examination of both judgments in the national report for England & Wales.

<sup>246</sup> See also the decision of *Miller v Caterpillar* (ibid) which, in the context of sharing documents with a third party funder, decided that common interest did not apply, as the interest shared between the parties must be a legal interest rather than a commercial one. Funders may wish to ensure the manner in which a common interest is drafted is not solely a commercial one, but funders should be careful not to manufacture a substantive interest in the underlying subject matter of the dispute merely to obtain shelter under the common interest privilege. A court would likely see straight through such an attempt.

Where privileged documents are disclosed to a third-party who has a common interest with the party entitled to the privilege, the document remains privileged. In England & Wales common interest privilege is not a freestanding form of privilege. It allows a party to share material that already has the protection of legal advice or litigation privilege with a third party who has a “common interest without waiving or losing that privilege.”

The common interest privilege derives from and is well established as between insureds and insurers.<sup>247</sup> For example, in the English *Winterthur* case it was found that an insurer held a common interest in the policy holder’s litigation. Mr Justice Aikens explained that:

“where a communication is produced by or at the instance of one party for the purpose of obtaining legal advice or to assist in the conduct of litigation, then a second party that has a common interest in the subject matter of the communication or the litigation can assert a right of privilege over that communication as against a third party. The basis for the right to assert this “common interest privilege” must be the common interest in the confidentiality of the communication.”<sup>248</sup>

Importantly, in the English *Winterthur* case, a distinction was made between documents created during the insurer’s due diligence (the “pre-ATE documents”) and those created after the inception of the policy (the “post-ATE documents”). The applicability of litigation privilege was unclear in respect of the pre-ATE documents but accepted for the post-ATE documents. Consequently the finding of common interest between insured and insurer was confined to the post-ATE period.

If seeking to assert that the claimant-funder relationship is analogous, then the periods of time – pre- and post- investment - may be similarly categorised. A similar analysis appears to have been applied in the Australian *Asahi* case in which common interest was found not to apply, as at the time a confidential report was provided to the insurer there was no basis to say the insurer would cover the claim.<sup>249</sup>

By analogy, where a funder has invested in a case and is provided with privileged information in order to monitor that investment, it may well follow that a common interest with the party can be asserted. Commentators have opined that the third-party funder would share a common interest in the confidentiality of a communication provided to it by a party to a litigation “as it has the common interest of pursuing litigation or arbitration in much the same way an insurer does”.<sup>250</sup> However, there is more doubt over whether a common interest can be applied during a pre-investment due diligence phase.

There is also some argument to say that a funder-counsel relationship may not have the same attributes as the relationship with an insurer. The insurer’s rights of subrogation (and indeed express contractual rights) may contribute both to securing the insurer’s rights to otherwise

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<sup>247</sup> See *Winterthur* (ibid) in which an insurer was able to assert a common interest with an insured claimant at least for the post-ATE period. The Australian courts have treated the insurer-insured relationship similarly. See section 3 of the Australian jurisdictional report which refers to *Spotless Group Ltd v Premier Building and Consulting Group Pty Ltd* [2006] VSCA 201 and *Asahi Holdings (Australia) Pty Ltd v Pacific Equity Partners Pty Limited* (No. 2) [2014]FCA 481.

<sup>248</sup> *Winterthur Swiss Insurance Company & Anor v AG (Manchester) Ltd & Ors* [2006] EWHC 839 at 78.

<sup>249</sup> See the jurisdictional report for Australia, and reference therein to *Asahi Holdings (Australia) Pty Ltd v Pacific Equity Partners Pty Limited* (No2) [2014] FCA 481.

<sup>250</sup> ALRASHID M., WESSEL J. and LAIRD J. ‘Impact of Third Party Funding on Privilege in Litigation and International Arbitration’ 6 *Dispute Resolution International* (2012) 101, p. 108.

privileged documents and to emphasising a community of interest. Thus, care should be taken when drawing an analogy. Moreover, this appears to be largely untested in the courts of common law jurisdictions as we are not aware of decisions which examine the common interest doctrine specifically in respect of the funder-counsel relationship. Nevertheless, an assertion of common interest is a standard term within confidentiality agreements made between funders and parties before information is shared.

The U.S. national court case *Miller v Caterpillar* suggests that, at least in Illinois,<sup>251</sup> the nature of the “common interest” will be relevant. Where the common interest between party and funder is commercial only, a communication will not be protected. The parties must be able to demonstrate a common interest in the legal aspects of the matter. Similarly, in *Leader Technologies v Facebook* Delaware took the same view that a funder does not fall within the common interest exception.<sup>252</sup>

### 3. Confidentiality agreements/Limited waiver

Under English law, a party is able to share privileged material with a limited number of third parties pursuant to an express agreement to keep that material confidential, thus attempting to preserve its privileged status. There is not generally an intention to waive privilege as against the world at large, but to a limited, identified third party, such that this practice is known as “limited waiver”. Whether a waiver is limited is a matter of fact and degree, so caution must be taken in terms of parties (and their number) to whom a waiver is intended.<sup>253</sup>

Parties intending to make a limited waiver should expressly state the basis on which a disclosure is being made in order to minimise the risk of a wider (unintended) loss of privilege. Nevertheless, even without clear wording, the courts of England & Wales have been prepared to impose limits and rescue a waiver after the event.<sup>254</sup>

Where a common interest is in doubt, or does not apply, a limited waiver may be another method by which privileged information may be shared with a funder. Thus confidentiality agreements typically include wording as to intended limited waiver as an alternative, or in addition to, an assertion of common interest. Where there is no common interest, the party to whom a limited waiver of privilege is made cannot for himself assert privilege. Contrast this with common interest where the privilege is one which both common parties are entitled to assert.<sup>255</sup> Similarly the US courts in the last few years appear broadly to have been accepting of the role of the third-party funder and have found that where: (i) appropriate confidentiality agreements are in place; (ii) there is an underlying privilege in the documents; and (iii) the sharing is “reasonably necessary” to advance the purpose for which the lawyer was consulted, the attorney-client

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<sup>251</sup> In *Miller v Caterpillar* (17F. Supp. 3d 711 (N.D. Ill. 2014)) the United States District Court held that common interest does not apply and thus any attorney-client privilege protection which applied to documents was lost when those documents were passed to a third party funder. This was on the basis that the interest between sender and recipient must be a legal as opposed to a purely commercial one. As treatment of privilege and indeed the doctrine of common interest varies by US state, specific local advice must be taken.

<sup>252</sup> 719 F. Supp. 2d 373 (D. Del. 2010).

<sup>253</sup> See *Privilege*, PASSMORE, 3<sup>rd</sup> edition 2013, Sweet & Maxwell at 7-043 which discussed the issue of the point at which an intended limited waiver becomes too wide to preserve confidentiality and thus privilege as against the rest of the world.

<sup>254</sup> See PASSMORE, *ibid*, at 7-038.

<sup>255</sup> See Passmore on Privilege, *ibid* at 7-038 and its footnote 76.



privilege and work product privilege will be protected. This should be the case even where a common interest cannot be found to apply. Clients must provide privileged information under a limited waiver which is clearly worded, and in circumstances which protect the confidentiality of the information. In that way whilst privilege is waived as against the funder, it remains enforceable against the rest of the world. Nevertheless, clients and funders should be forewarned that the law in this respect varies from state to state, and most states do not explicitly protect information shared with funders. There are a three states, however, that explicitly protect information shared with funders via statute - Indiana, Nebraska, and Vermont - although those statutes were enacted in the context of consumer litigation funding rather than commercial funding or international arbitration.<sup>256</sup>

### **B. Civil jurisdictions – heads of “privilege”**

“Privilege” is not a concept commonly adopted in civil jurisdictions. Instead the relationship between lawyer and client is seen as one of confidence and information passing between them is protected by a “professional secrecy” doctrine that applies with respect to both contentious and non-contentious work (and in some jurisdictions even includes pre-existing information or documents given to a lawyer in order for him to advise).

The secrecy concept, set out in professional rules, statutes, and civil procedure rules or otherwise, means that information relayed between lawyer and client cannot be revealed to the court, authorities or the wider world. In some civil law jurisdictions, such as South Korea, Turkey and the Netherlands, this doctrine forms part of counsel’s ethical obligations and in general cannot be waived by the client. In other jurisdictions, client consent or permission from a regulator/bar association may allow the lawyer to reveal information, for example in order to defend himself, or to make disclosures to a regulator or authority. In other jurisdictions (such as Russia, Ukraine and Brazil), a client may expressly or impliedly consent to his lawyer passing information on to a third-party (an insurer or funder for example) but otherwise the information retains its “secret” status.<sup>257</sup>

The release, with or without client consent, of information to funders may pose a risk to the inherent secrecy of the information, however. In some jurisdictions (such as Turkey, Portugal and Sweden) the information in the hands of a funder (as opposed to a lawyer) will not be subject to professional secrecy, so a funder may be obliged, for example by court order, to reveal that information. Alternatively, passing information to a funder will be seen as a waiver of the secrecy

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<sup>256</sup> See 2016 Ind. Acts 1557 (providing an exception to waiver of the attorney-client privilege and work product doctrine for communications between parties and funders in Indiana); VT. STAT. ANN. tit. 8, § 2255 (2016) (providing that “communication between a consumer’s attorney and the [funding] company shall not be discoverable” and providing an exception to waiver of the attorney-client privilege and work product doctrine for communications with funders in Vermont); NEB. REV. STAT. § 25-3306 (2010) (providing an exception to waiver of the attorney-client privilege and work product doctrine for communications with funders in Nebraska).

<sup>257</sup> As noted above, in many civil jurisdictions a lawyer’s right and obligation to keep secret matters communicated by his client is derived from procedural rules but also professional obligations or the constitution of his/her jurisdiction, and is thus inviolable, save for limited policy exceptions and in some instances the ability of a client to lift such a restriction. Tribunals may need to allow for the assertion by a civil lawyer of his professional obligations with regards to secrecy of information, and ensure that decisions on the parameters of discovery do not violate that assertion. Moreover, civil lawyers must be careful to consider the mechanics of releasing secret information to a funder to ensure that the lawyer is not inadvertently breaching his obligations to keep client matters secret. See for example the reports in relation to The Netherlands, Germany, Turkey, Ukraine, Russia.

otherwise afforded to the information, and it may therefore be admissible as evidence or susceptible to disclosure to authorities on request. That risk may be alleviated by use of an appropriately worded confidentiality agreement.<sup>258</sup>

In advance of sharing information, then, funders and potential funded parties should take considered advice on whether and how some level of protection over the information may be maintained. As in common law jurisdictions, the role of the funder and the protections that may be afforded information passing to them is largely untested.

Likewise, some civil law jurisdictions are developing methods for extending privilege protections to third-party funders. Principally this includes the use of confidentiality agreements when releasing information to third-party funders in order to retain maximum control over the use of the information<sup>259</sup>. Consideration may also be given to whether it is the lawyer or client who passes on the information and/or whether the funder is simply copied into communications between lawyer and client in order to preserve secrecy. In some jurisdictions whilst the lawyer's duty and right to assert professional secrecy may protect the communication with a third-party, the same will not apply to the client.<sup>260</sup>

It should nevertheless be noted that in certain civil jurisdictions information transferred by the lawyer to a third party will lose its confidential status regardless of the existence of a confidentiality agreement: once in the funder's hands, the secrecy in the information itself is considered waived.<sup>261</sup> This may depend on whether or not the client has expressly waived the secrecy.

## **C. To whom does any privilege belong?**

### **1. Common law jurisdictions**

In common law jurisdictions any privilege belongs to the client and is for the client alone to waive. No adverse inference can be drawn (for example by a court) from a client's refusal to waive his right to assert privilege. Even where it may be in professional interests of an adviser to be able to waive privilege, it is for the client alone to waive. For example if the adviser is facing criticism or legal action by a third-party and would wish to deploy the privileged information in order to defend himself/herself, without permission of the client (or former client, as the privilege is permanent even after a case or matter is closed) the lawyer may take no steps to deploy or disclose the privileged information. Where the client himself/herself brings a claim against his/her

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<sup>258</sup> The effectiveness of a confidentiality agreement may vary across jurisdictions, and between litigation and arbitration. In Russia, for example, whilst a confidentiality agreement may protect secrecy from third parties, this may be irrelevant if a court makes an order that documents should be disclosed and used in evidence in court proceedings. Within arbitration, the sensible approach in order to ensure that secrecy remains intact is that the advocate retains custody over relevant documents; alternatively that the funder instructs its own advocate who holds the documents.

<sup>259</sup> The use of confidentiality agreements appears to offer effective protection for secret information in the hands of the funder in jurisdictions such as the Netherlands, Russia, Germany and Japan.

<sup>260</sup> In Germany for example, whilst a communication (with a client's permission) between a lawyer and a funder would be protected as long as an appropriate confidentiality agreement was made, a direct communication from the client to the funder could not be protected in any way. Contrast with Japan, Sweden and Spain where it would appear that either a lawyer or client could communicate with a funder without risk of waiver or loss of the confidential status of information. Interestingly, in the Ukraine, a communication by lawyer to funder without express permission from a client would be inadmissible evidence and thus it is preferable for communications to come at all times from lawyers.

<sup>261</sup> See for example the jurisdictional reports for Turkey and Portugal.

lawyer, then he/she is regarded as having waived the privilege and confidence to the extent required for the lawyer to defend himself/herself.

### Civil law jurisdictions

The balance between the rights and duties of lawyers and their clients is different in civil jurisdictions from that in common law jurisdictions where the client is in complete control; in addition there are differences of approach according to jurisdiction.

Where professional secrecy applies, it may be regarded both as a duty of the lawyer to keep matters secret, but also a right to be exerted, for example in order to resist giving testimony on the matters which are subject to the secrecy for example. Generally, unless the secrecy is waived by the client, or there is permission from the lawyer's regulating body (such as a local bar council) the lawyer is able to resist all requests for disclosure.

#### **2. Documents held by the funder**

There is a further concern that documents created and/or held by the funder are protected. Again, the problem must be analysed both in the context of common law jurisdictions and civil law jurisdictions.

Common law: Where a funder, in order to decide to invest or not, consults its own external lawyers, then it should naturally follow that the flow of information seeking and obtaining that advice is covered by advice privilege or its equivalent across common law jurisdictions such as attorney-client privilege in the US. The situation where a funder consults its own employees who are lawyers for that same advice requires additional consideration. If properly consulted in his or her capacity qua lawyer (rather than as a commercial adviser) then most common law jurisdictions would recognise that the resultant documentation was equally covered by advice privilege or its equivalent. This does highlight, however, the need for funders themselves to consider privilege issues carefully in the structure of their business and the way they deploy employees with a legal qualification.

Any other documents generated by a funder – but not by lawyers – would be unlikely to attract the protection of advice privilege, but would likely be covered by litigation privilege/work-product privilege<sup>262</sup>, if its production can be argued to meet the dominant purpose test (or the less onerous “because of” test for the US) discussed above.<sup>263</sup> However, this may be susceptible to challenge, for example in situations where a funder does not ultimately make an investment in the proposed litigation or where it is asserted that the information was passing for a commercial rather than a legal purpose, as may well be the case with a funder.<sup>264</sup> Civil law: the position is much less

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<sup>262</sup> For example, in the US under Federal Rule of Civil Procedure 26(b)(3)(A).

<sup>263</sup> See the analysis by Grace M. Giesel in *Alternative Litigation Finance and the Work-Product Doctrine*, Wake Forest Law Review, Vol 47, 2012, 1083-1140, in particular at 1124-1125 in which there is an examination of analogous cases of evaluation of ongoing litigation by an independent company auditor. Where those evaluations included and recorded the thoughts and impressions of lawyers advising the company, the court was prepared to find that work-product privilege applied. (*United States v Deloitte LLP*, 610 F 3d 129 (D.C. Cir 2010). The court in that case was able to apply the less stringent “because of” test and found that the documents recorded information “... prepared by the company and its lawyers because of the prospect of the litigation.” This may be seen as a judgment at the limits of the because of test, and such protection may not be forthcoming in other courts of common law jurisdictions, but nevertheless the case highlights the policy motivations of courts to protect the confidentiality of the adversarial litigation or arbitration process, even if that is to go as far as to protect documents created by a funder.

<sup>264</sup> Professional ethics rules would usually currently prohibit a lawyer from using or revealing any information gleaned from a prospective client even if that lawyer does not take the client's case. See e.g. the American Bar

clear in civil jurisdictions as the precise structure of the professional secrecy rules vary across jurisdictions and depends on: the professional status of the person to whom information is given; the rights of the client to circulate information; and the ability of either professional or client to lift the secrecy obligation/ right in certain circumstances. Many civil jurisdictions will not view a funder as belonging to a profession which of itself attracts the status which confers professional secrecy rights and obligations, so this may mean that the only chance of asserting secrecy is for the funder to appoint its own lawyers to consider the case and proposed investment and thus take advantage of the secrecy status of those lawyers. Other jurisdictions, for example Brazil, recognise certain financial institutions as structures which may attract professional secrecy, so it may be that a funder could incorporate itself as a particular type of financial entity in order to take advantage of the additional status this would confer on communications.

There is a further concern that the funder itself keep the information confidential and does not share information it has from one party/client with another party/client without consent. In England & Wales, where many of the major funders are self-regulated under the Association of Litigation Funders, comfort can be taken from Article 7 of the ALF Code of Conduct which provides that “A funder will observe the confidentiality of all information and documentation relating to the dispute to the extent the law permits, and subject to the terms of any confidentiality or non-disclosure agreement agreed between the funder and the funded party. For the avoidance of doubt, the funder is responsible for the purposes of this code for preserving confidentiality on behalf of any Funder’s Subsidiary or Associated Entity.” Equivalent provisions can be added to the confidentiality agreement entered into with the funder.

A related question is whether a funder can refer to otherwise confidential information in its possession to defend itself in a suit by the funded party. The answer is presumably yes in most circumstances.<sup>265</sup>

Again, English insurance cases can provide a helpful analogy. In *Formica*<sup>266</sup> ECGD had guaranteed 90% of the loss arising out of a contract between Formica and a Swedish company. The latter went into liquidation and Formica called on the guarantee. ECGD resisted on the basis that it was not kept apprised of the litigation developments which they had initiated overseas to try and recover some of the debt in breach of a condition of the guarantee. The court held that Formica could not claim legal professional privilege in relation to those documents in the litigation since ECGD was contractually entitled to see them at the time the guarantee was active.<sup>267</sup> Their

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Association’s Model Rules of Professional Conduct, Rule 1.18(b). A similar rule would be useful with respect to funders.

<sup>265</sup> But see, for example, the most recent Court of Appeal authority, *Berezovsky v Hine & Ors* [2011] EWCA Civ 1089, the Court held that Mr Berezovsky could assert privilege in his draft witness statement in the context of later, separate proceedings despite having given it to the Defendant in earlier unrelated proceedings. Importantly, when the document was initially disclosed, there was no express restriction as to the purpose for which the privileged document could be used and the court inferred this restriction from the “*obvious intentions of the parties.*” The Court held that privilege could be retained by the claimant in respect of a different set of (unrelated) proceedings if: (i) the court is satisfied that the disclosure to the third party was limited to a particular purpose and that party is now seeking to use them for another purpose without the consent of the holder of privilege or (ii) where such use will damage the privilege holder or (iii) where it will involve the documents being disclosed to a third party.

<sup>266</sup> *Formica Ltd v Secretary of State* (acting by the Export Credits Guarantee Department) [1995] 1 Lloyd’s Rep. 692

<sup>267</sup> The court held that “*where such documents never were transferred, but, if they had been, would have been transferred for such a joint interest purpose, the applicant for discovery can show that had he been supplied with the documents at the time, he would have held them subject to the mutual obligations of confidence attributable to legal*

contractual relationship meant that both parties had a common interest in recovering the outstanding debt from the Swedish company.<sup>268</sup>

### 3. Risk that privileged documents are sought in litigation proceedings

There is a risk that a party to an arbitration may turn to the courts to try to seek disclosure of confidential information in the hands of a funder. For example, Article 17J of the UNCITRAL Model Law provides that a court “shall have the same power of issuing an interim measure in relation to arbitration proceedings, irrespective of whether their place is in the territory of this State, as it has in relation to proceedings in Court.”

The Model Law provision clearly envisages that a court in the relevant jurisdiction has the power to order discovery as an interim measure. There has, for example, in recent years been a proliferation of attempts to use the 1782 procedure in the US court to seek US-style disclosure of documents held by a third party in aid of arbitration. Section 1782(a) provides in relevant part:

“The district court of the district in which a person resides or is found may order him to give his testimony or statement or to produce a document or other thing for use in a proceeding or a foreign or international tribunal, including criminal investigations conducted before formal accusation. The order may be made pursuant to a letter rogatory issued, or request made, by a foreign or international tribunal or upon the application of any interested person and may direct that the testimony or statement be given, or the document or other thing be produced, before a person appointed by the court.... The order may prescribe the practice and procedure, which may be in whole or part the practice and procedure of the foreign country or the international tribunal, for taking testimony or statement or producing the document or other thing. To the extent that the order does not prescribe otherwise, the testimony or statement shall be taken, and the document or other thing produced, in accordance with the Federal Rules of Civil Procedure.”

There is a divergence of authority as to whether this section can be used in support of arbitration proceedings.<sup>269</sup> Nevertheless, there is a risk that an opponent in a dispute could attempt to use such mechanisms to obtain documents by seeking them directly from a funder. For these reasons, extra caution should be exercised to minimise the risk that such applications could be successful. It is

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*professional advice. He is thus entitled to say that he would then have been within the ambit of confidentiality protected by the law and that therefore privilege does not attach to the documents which he now seeks on discovery.”*

<sup>268</sup> Similarly, in other insurance cases like *Commercial Union Assurance Co v Mander and Winterthur*, [1996] 2 Lloyd's Rep 640, the Courts have shown that the insured cannot use privilege to prevent his insurer from accessing privileged documents (given its contractual entitlement to them) and neither can an insurer withhold such documents from a reinsurer on the grounds of privilege. *Cia Barca de Panama SA v George Wimpey & Co Ltd* [1980] 1 Lloyd's Rep 598, 615, involved the scenario where privileged material existed in connection with a case in which A and B were both involved in at the same time. Lord Bridge said that if “A and B have a common interest in litigation against C and if at that point there is no dispute between A and B then if subsequently A and B fall out and litigate between themselves and the litigation against C is relevant to the disputes between A and B then in litigation between A and B neither A nor B can claim legal professional privilege for documents which came into existence in relation to the earlier litigation against C.”

<sup>269</sup> See the discussion by Jonathan Blackman and Peter Fox in *Global Arbitration Review*, 16 August 2016, “Discovery in Aid of Arbitration under 28 USC 1782, in particular the discussion on the cases of *NBC v Bear Stearns & Co* 165 F.3d 184, 191 (2<sup>nd</sup> Cir. 1999); *Republic of Kazakhstan v Biedermann International* 168F 3d 880 (5<sup>th</sup> Cir 1999) against such use, and *Intel* 542 U.S. 198 (2004) in support. In the First, Third, Eighth and DC Circuits, district courts have held that at least some types of private arbitral tribunal are within the ambit of the statute, while their counterparts in the Fifth, Seventh, Ninth and Tenth Circuits have held that at least some types of private arbitral tribunal are not covered. In one instance, the same arbitration proceeding has produced conflicting decisions in different district courts.

imperative to take steps to consider possible avenues of privilege protection, make clear assertions of such protection, and put in place clear contractual provisions to keep information confidential.

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## Chapter 6<sup>†</sup>

### COSTS AND SECURITY FOR COSTS

#### PRINCIPLES

##### Final award (allocation) of costs:

1. Generally, at the end of an arbitration recovery for costs should not be denied on the basis that a party seeking costs is funded by a third-party funder.
2. When recovery for costs is limited to costs have been “incurred” or “directly incurred,” the obligation of a party to reimburse the funder in the event of successful recovery is generally sufficient for a tribunal to find that a funded party comes within that limitation.
3. In the absence of exceptional circumstances, the cost of funding, including a third-party funder’s return, is ordinarily not recoverable as costs.
4. Generally, a tribunal lacks jurisdiction to issue a costs order against a third-party funder.

##### Security for costs:

1. Applications for security for costs should be determined irrespective of any funding arrangement and on the basis of impecuniousness.
2. In the first instance, the burden is on the moving party; no party should have to defend a motion for security unless and until the moving party makes a *prima facie* showing of impecuniousness.
3. If a party is found to be impecunious, that party should be given the opportunity to present additional evidence of funding or have a security for costs award imposed.
4. At that stage, a request for disclosure of third-party funding agreements should normally be accepted as the moving party and the tribunal should be able to examine the relevant parts of the third-party funding agreement (in particular provisions on the funder’s termination of funding rights and funder’s obligation to cover adverse costs) in the context of the security for costs application against an impecunious party. However, tribunals should limit disclosure orders to the provisions that are strictly

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<sup>†</sup> Primary contributors to this Chapter included: Stavros Brekoulakis, Audley Sheppard, Susan Dunn, Mick Smith and Jonas von Göler.

**necessary to assess the extent to which the funder may cover (or not) an adverse costs order.**

- 5. If a tribunal decides that a security for costs order is warranted, it can order security for costs by way of a bank guarantee. Payment into a bank account may be ordered for security for costs in exceptional circumstances, and where there is no ATE or any other form of evidence of indemnification arrangements already in place.**
- 6. In addition, an arbitral tribunal should consider indicating to the requesting party that, should the defence fail, it will be held liable for the costs reasonably incurred by the funded party in posting security. It should be for the funded party to substantiate the amount of costs it reasonably incurred in posting security.**

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## ANALYSIS

### I. INTRODUCTION

The purpose of this Chapter is to provide guidelines in respect of the impact of TPF on allocation of costs and security for costs applications. The report focuses on non-recourse funding arrangements. When relevant, ATE, BTE and contingency fee arrangements are discussed for purposes of comparison. The Chapter first examines issues on awarding of costs, and then issues on security for costs applications. Unless a tribunal establishes the likelihood that costs could in principle be awarded against an unsuccessful claimant, it cannot make a decision on a security for costs application.

#### 1. Awarding of Costs

When awarding costs at the end of the proceedings, an arbitral tribunal has to address a number of issues. First, it must decide whether to award costs... Second, if costs will be awarded, how they should be allocated. Third, where costs are allocated based on the outcome of the case, the tribunal must determine which of the prevailing party's costs are recoverable (type and amount of recoverable costs). An arbitral tribunal's decisions on these issues will be framed by the applicable arbitral laws and rules [A]. A number of arbitral tribunals (and state courts) have already dealt with the awarding of costs in the presence of a third-party funding agreement. These decisions shall be looked at [B] before presenting the recommendations of the sub-committee on how Tribunals should award costs in claims funded by third-party funders [C].

The Report addresses the following issues:

- 1. Should a funded party that has prevailed in the arbitration be able to recover party costs at all where these costs have been funded by a third party?*
- 2. Where costs are allocated based on the outcome of the case and the funded party prevails, what type of costs can it recover from the opponent?*
- 3. Where costs are allocated based on the outcome of the case and the non-funded party prevails, could an arbitral tribunal render a costs order directly against a third-party funder?*

#### [A] Arbitral Laws and Rules

##### i. Arbitral Laws

English arbitration law contains comparatively detailed provisions on costs allocation. Section 61 English Arbitration Act 1996 provides that:

- (1) The tribunal may make an award allocating the costs of the arbitration as between the parties, subject to any agreement of the parties.
- (2) Unless the parties otherwise agree, the tribunal shall award costs on the general principle that costs should follow the event except where it appears to the tribunal that in the circumstances this is not appropriate in relation to the whole or part of the costs.

As regards the amount of recoverable costs, Section 63 English Arbitration Act 1996 states:

- (3) The tribunal may determine by award the recoverable costs of the arbitration on such basis as it thinks fit.

If it does so, it shall specify—

- (a) the basis on which it has acted, and
  - (b) the items of recoverable costs and the amount referable to each.
- (4) If the tribunal does not determine the recoverable costs of the arbitration, any party to the arbitral proceedings may apply to the court (upon notice to the other parties) which may—
- (a) determine the recoverable costs of the arbitration on such basis as it thinks fit, or
  - (b) order that they shall be determined by such means and upon such terms as it may specify.
- (5) Unless the tribunal or the court determines otherwise—
- (a) the recoverable costs of the arbitration shall be determined on the basis that there shall be allowed a reasonable amount in respect of all costs reasonably incurred, and
  - (b) any doubt as to whether costs were reasonably incurred or were reasonable in amount shall be resolved in favour of the paying party.

Default rules on costs shifting can also be found in the arbitration laws of Hong Kong, Germany, Spain, Brazil and Portugal.<sup>270</sup> While the arbitration laws of the UNCITRAL Model Law, France, Switzerland, and the United States are silent on the issue of costs allocation, it is clear that tribunals sitting in these jurisdictions have the power to render awards on costs.

## ii. **Arbitral Rules**

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<sup>270</sup> Hong Kong Arbitration Ordinance (2011), s. 72(4) (written offer to settle as a particularly relevant factor); German Code of Civil Procedure (2013), s. 1057(1) (outcome of the case as a particularly relevant factor); Spain: Law 60/2003, Art. 37; Portugal: Law 63/2011, Art.42; Brazil: Law 13.129 (26 May 2015) Art.27.

Many widely used arbitral rules set a presumption that costs should follow the event, or should be allocated based on the degree of success, unless particular circumstances call for a different approach.<sup>271</sup> Other rules simply provide for wide arbitrator discretion.<sup>272</sup>

As regards the type and amount of recoverable party costs, Article 40(2)(e) UNCITRAL Rules is representative, limiting recoverable costs to ‘[t]he legal and other costs incurred by the parties in relation to the arbitration to the extent that the arbitral tribunal determines that the amount of such costs is reasonable’. Similar formulations can be found, for instance, in the ICC Rules,<sup>273</sup> the LCIA Rules,<sup>274</sup> and the CIETAC Rules<sup>275</sup>

### iii. Arbitral Practice

Since the procedural matrix established by the arbitration law and rules typically allow tribunals wide discretion as regards costs allocation, it is not always easy to predict how an arbitral tribunal will ultimately approach the issue in a given case. The award of substantial costs based on the case’s outcome – notably of legal costs based on counsel’s hourly fees – constitutes an approach that is especially prevalent in court litigation in the United Kingdom and other common law jurisdictions. Nevertheless, it is one that appears to be increasingly applied in international arbitration as well, not least since, as discussed above, many widely used arbitral rules provide that the prevailing party is presumptively entitled to its costs, while authorizing the tribunal to adopt a different standard if appropriate in the particular case.<sup>276</sup>

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<sup>271</sup> UNCITRAL Rules (2010), Art. 42 (‘costs of the arbitration shall in principle be borne by the unsuccessful party’); LCIA Rules (2014), Art. 28(4) (‘costs should reflect the parties’ relative success and failure in the award or arbitration or under different issues, except where it appears to the Arbitral Tribunal that in the circumstances the application of such a general principle would be inappropriate under the Arbitration Agreement or otherwise’); DIS Rules (1998), s. 35(2) (‘[i]n principle, the unsuccessful party shall bear the costs of the arbitral proceedings’, but the tribunal may order each party to bear its own costs or apportion the costs between the parties, in particular, where each party is partly successful and partly unsuccessful); WIPO Rules (2014) Art. 74.

<sup>272</sup> ICSID Convention, Art. 61(2) (‘the Tribunal shall, except as the parties otherwise agree, assess the expenses incurred by the parties in connection with the proceedings, and shall decide how and by whom those expenses, the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the Centre shall be paid’); SIAC Rules (2016), Art. 35(1) (‘[u]nless the parties have agreed otherwise, the Tribunal shall determine in the award the apportionment of the costs of the arbitration among the parties’); ICC Rules (2017), Art. 38(5) (‘[i]n making decisions as to costs, the arbitral tribunal may take into account such circumstances as it considers relevant, including the extent to which each party has conducted the arbitration in an expeditious and cost-effective manner’).

<sup>273</sup> ICC Rules, Art. 38(1) (‘reasonable legal and other costs incurred by the parties for the arbitration’).

<sup>274</sup> LCIA Rules (2014), s. 28(3) (‘legal or other expenses incurred by a party ... The Arbitral Tribunal shall decide the amount of such Legal Costs on such reasonable basis as it thinks appropriate’).

<sup>275</sup> CIETAC Rules, Art. 52(2) (winner entitled to ‘the expenses reasonably incurred by it in pursuing the case’).

<sup>276</sup> ICC Commission on Arbitration and ADR Report, “Decisions on Costs in International Arbitration” (2015) paras 12-19, available at: <<http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2015/Decisions-on-Costs-in-International-Arbitration---ICC-Arbitration-and-ADR-Commission-Report/>> (last accessed 18 August 2016).

## [B] Costs Decisions in Third-Party Funding Scenarios

This section looks at the body of arbitral case law dealing with the awarding of costs in the context of third-party funding.

### i. **Kardassopoulos v. Georgia**

In *Ioannis Kardassopoulos & Ron Fuchs v. Georgia*<sup>277</sup> the investors were successful in an arbitration funded by German company Allianz Litigation Funding for a claim against Georgia for compensation for the unlawful termination of a concession to build and maintain a pipeline. Claimants requested that they be awarded costs of proceedings including legal costs, arguing that there is a trend of outcome-based recovery in investment-treaty arbitration. Respondent argued, *inter alia*, that claimants' legal costs were excessive. Respondent also argued that it appears that the claimants' legal costs might have been born (at least in part) by a third-party investor and therefore not properly recoverable. The Tribunal held that:

The Tribunal knows of no principle why any such third party financing arrangement should be taken into consideration in determining the amount of recovery by the Claimants of their costs.<sup>278</sup>

This passage has been adopted by the ICSID annulment committees in *RSM v. Grenada*<sup>279</sup> and *ATA v. Jordan*<sup>280</sup>.

### ii. **Siag and Vecchi v. Egypt**

In *Siag and Vecchi v. Egypt*<sup>281</sup> the claimants' law firm (King & Spalding) had acted on a contingency fee basis. Despite this, the claimants requested recovery of a specified amount of normal (hourly) fees, without the corresponding invoices or other details. The tribunal accepted this. Orrego Vicuna dissented, albeit not on the issue of substantiation of costs, but more generally on the allocation of costs:

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<sup>277</sup> *Kardassopoulos and Fuchs v. The Republic of Georgia* (ICSID Case Nos. ARB/05/18 and ARB/07/15), Award (3 March 2010).

<sup>278</sup> *Ibid.*, para. 691.

<sup>279</sup> *RSM Production Corporation v. Grenada* (ICSID Case No. ARB/05/14), Annulment Proceeding, Order of the Committee Discontinuing the Proceeding and Decision on Costs (28 April 2011) para. 68.

<sup>280</sup> *ATA Construction, Industrial and Trading Company v. The Hashemite Kingdom of Jordan* (ICSID Case No. ARB/08/2), Annulment Proceeding, Order Taking Note of the Discontinuance of the Proceeding (11 July 2011) para. 34.

<sup>281</sup> *Siag and Vecchi v. The Arab Republic of Egypt* (ICSID Case No. ARB/05/15) Award (1 June 2009).

In respect of the costs of this arbitration I believe that a more adequate approach would be to require each party to pay one half of such costs, particularly taking into account the fact that the Claimant agreed to pay attorney's fees only on a successful recovery. While there is nothing unusual in such arrangement, it entails the acceptance of the Claimant of a degree of risk that should not entirely be shifted to the Respondent, particularly in view of the amounts involved.<sup>282</sup>

**iii. Quasar de Valores v. Russia**

In *Quasar de Valores v. Russia* the tribunal denied the prevailing Spanish portfolio investors in Yukos recovery of their costs because the funder (Menatep, ex-majority shareholder in Yukos) had funded the entirety the costs of the proceedings and had no contractual right vis-à-vis the claimants for reimbursement of these costs. The tribunal explained that:

The usual arguments about the recoverability of costs where a party's representation in a case has been financed by a third party are inapposite here, because such third-party financing is typically part of a legally enforceable bargain under which the prevailing party in the arbitration has given up something in return for that support. Here, it is conceded that there is no legal duty on the part of the Claimants to hand over any recovery on account of costs to Menatep.<sup>283</sup>

As flagged in the extract from the ruling of the tribunal, above, the factual circumstances in *Quasar de Valores* were highly unusual in that the funded party had no obligation whatsoever to reimburse the funder for the costs advanced, effectively giving the funded party a "total free ride".<sup>284</sup>

**iv. ICC Case No. 7006**

By contrast to *Quasar de Valores v. Russia*, an ICC tribunal noted (obiter) that the legal costs of a respondent that had been paid by a third party (insurer) would have been recoverable had the respondent succeeded:

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<sup>282</sup> *Siag and Vecchi v. The Arab Republic of Egypt* (ICSID Case No. ARB/05/15) Dissenting Opinion of Francisco Orrego Vicuña, (11 May 2009) para. 6.

<sup>283</sup> *Quasar de Valores SICAV S.A. et al. v. The Russian Federation* (SCC Arbitration No. 24/2007), Award (20 July 2012) para. 223.

<sup>284</sup> *Quasar de Valores SICAV S.A. et al. v. The Russian Federation* (SCC Arbitration No. 24/2007) Award (20 July 2012) para. 223. The funder, Group Menatep Limited, a former majority shareholder in the Russian oil company Yukos, had a strategic, indirect financial interest in the outcome of the case, namely to create a favourable "arbitral precedent" for its own, much larger majority shareholder claims filed against Russia under the Energy Charter Treaty.

I believe that they are [recoverable], at least from the point that Defendants rather than the [indemnifier], mandated counsel to represent them in the arbitration. By so doing, they incurred the primary obligation to pay such counsel's fees and expenses-one not negated by the fact that someone else, through prior arrangement, paid them on their behalf. The counterpart to this determination is that Defendants would be obliged to reimburse their indemnifier any costs they recovered from the arbitration.<sup>285</sup>

#### v. Overview of Recoverability of funding Costs in Litigation

For comparative purposes, this section provides a brief overview of the status of recoverability of funding costs in litigation in some of the most popular jurisdictions for international litigation.

As regards the question of whether a third-party funder may be ordered to pay adverse costs should the funded claim fail, there is case law from the UK<sup>286</sup> and the US<sup>287</sup> to the effect that costs can be awarded against third-party funders if they have obtained a sufficient degree of economic interest and control in relation to the claim. It is doubtful whether the reasoning of these litigation cases can readily apply to arbitration, which is consensual in nature; this is addressed further below.

In England and Wales conditional fees and the premium for after-the-event insurance were made recoverable under the English and Wales Courts and Legal Services Act as amended by the Access to Justice Act 1999. Section 58A(6) Access to Justice Act 1999 stated that costs orders made in any proceedings might include success fees. Section 58A(4) made it clear that the term 'proceedings' included arbitration proceedings. Section 29 Access to Justice Act 1999 provided that '[w]here in any proceedings a costs order is made in favour of any party who has taken out an insurance policy against the risk of incurring a liability in those proceedings, the costs payable to him may, subject in the case of court proceedings to rules of court, include costs in respect of the premium of the policy.' This was subsequently changed with the Legal Aid, Sentencing and Punishment of Offenders Act 2012, which abolished the recoverability of after-the-event insurance

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<sup>285</sup> *Supplier v First distributor, Second distributor* (ICC Case No. 7006), Final Award (1992) 4 *ICC Bull.* (May 1993) 49.

<sup>286</sup> *Excalibur Ventures LLC v. Texas Keystone Inc. & Ors v. Psari Holdings Limited & Ors*, English High Court (Queen's Bench, Commercial Court), (Case No. 2010 Folio 1517), Order of 23 October 2014, [2014] EWHC 3436, paras 4, 161 confirmed by the Court of Appeal in *Excalibur Ventures LLC v Texas Keystone Inc & Ors* [2016] EWCA Civ 1144; *Arkin v. Borchard Lines Ltd. & Ors*, English Court of Appeal, Judgement of 16 May 2005, [2005] EWCA Civ. 655 ('[w]here ... the non-party not merely funds the proceedings but substantially also controls or at any rate is to benefit from them, justice will ordinarily require that, if the proceedings fail, he will pay the successful party's costs'). Further, the *Arkin* case is also considered authority to the effect that the funder's maximum liability for the respondent's costs is capped at twice the amount loaned.

<sup>287</sup> *Abu-Ghazaleh v. Chaul*, Florida Third District Court of Appeal, (Nos. 3D07-3128, 3D07-3130) Decision of 2 December 2009, 36 So. 3d 691. Whereas parties litigating in front of US courts typically have to bear their own costs, *Abu-Ghazaleh v. Chaul* presents special circumstances in that a fee shifting statute applied.

premiums and conditional fees for agreements entered into after 1 April 2013 on the ground that such premiums and fees were key drivers behind the escalating costs of civil litigation. In the United States – where parties typically bear their own costs – the Supreme Court has clarified that if a federal fee shifting statute applies and the prevailing party seeks to recover its contingency fees, only reasonable hourly fees (lodestar-method) are recoverable.<sup>288</sup> In Germany, interest charged on a loan used to pay litigation expenses is not recoverable under section 91 German Code of Civil Procedure, since the interest cost is not directly related to the conduct of the proceedings.<sup>289</sup> Accordingly, recovery of other funding costs (such as an after-the-event insurance premium) would likely be impossible from the perspective of German procedural law.

### C. Key Observations and Suggestions of the Sub-Committee

For the purposes of this report it is assumed that, as is typically the case, a third-party funder assumes an obligation to reimburse the funder for the costs advanced, in case of successful recovery. It is also assumed that the tribunal is generally willing to allocate costs based on the outcome of the case.

[1] Should a funded party that has prevailed in the arbitration be able to recover party costs at all where these costs have been funded by a third party?

[a] Amount of costs: did a funded party ‘incur’ costs?

Although the answer to this question will depend on the billing structures adopted by third-party funders for each case, when a party is funded by a third-party funder it typically assumes an obligation to reimburse the funder for the costs advanced. The obligation to reimburse a funder should be sufficient for tribunals to accept that a funded party has incurred costs.

Specifically, the usual practice in funded arbitration claims is that the invoices by lawyers are issued in the funded party’s name and become payable by the funder as a result of the funding agreement. The funded party’s lawyers would usually send the invoice to the funder (along with a monthly report). If the funded party and funder are satisfied that the invoice is consistent with the pre-agreed budget, the funder will pay the invoice directly to the lawyer. Thus, the involvement of a funder does not change the funded party’s primary liability to discharge the bill. The funded party incurs the obligation to reimburse the funder for the costs so advanced in case of successful recovery (plus a return to the funder as per the funding agreement). For these reasons, the fact that the funder pays the bills is not practically speaking giving the opposing party a ‘free ride’ on not having to repay any costs if it ultimately fails to defend the claim against it.

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<sup>288</sup> *City of Burlington v. Dague*, Supreme Court of the United States, Judgement of 24 April 1992, 505 U.S. 557.

<sup>289</sup> *Schulz*, in *MüKo ZPO*, § 91 para. 205 (with further references); *Herget*, in *Zöller*, § 91 para. 13.



Equally important, if we accept, on a policy level, that third-party funding has an important role to play in supporting the system of international arbitration and providing access to justice for meritorious claims,<sup>290</sup> it would be unwarranted to increase the costs of obtaining third-party funding. Claimants could potentially be discouraged from seeking funding if they know that they might not be able to recover potentially substantial legal costs, even in case of success.

It is therefore suggested that legal costs that the funded party is contractually obliged to repay to the funder should be considered as legal costs incurred by the funded party.<sup>291</sup> Equally, and for illustrative purposes, other types of third-party funding, including traditional funding on a recourse basis, may not be considered a basis for denying an award on costs for the successful funded party.

For example, a P&I and FD&D Club will be responsible for paying the party's legal expenses albeit they will not appear on the record. P&I and FD&D are a form of liability insurance.<sup>292</sup> It operates on a "pay to be paid" principle, i.e. the member must incur a liability first and then the club will reimburse such expenses. In both cases the funded party pays the invoices to the legal representatives and then the club reimburses. Therefore, again the party on the record incurs the costs, and P&I and FD&D arrangements should not be considered a basis for refusing a costs award in favour of the successful party.

The same applies for conditional (or contingency) fee arrangements. CFAs<sup>293</sup> typically provide that the successful party will have to pay the law firm the amount of time spent in the arbitration on the basis of its normal hourly rates and an uplift (i.e. a success fee). While recoverability of the uplift may be dependent on the circumstances of the case (see below under b), recoverability of the amount of the fees for the time spent in the arbitration by the legal firm should be possible as part of the legal costs incurred the successful funded party.

On the other hand, obtaining an ATE<sup>294</sup> policy will not include any funding of the arbitration, and therefore the question of whether an ATE insurer pays the insured party its

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<sup>290</sup> As has been suggested, for example, the UK's Civil Justice Council report endorsing the potential of litigation funding to increase access to justice, Civil Justice Council Report, "Improved Access to Justice—Funding Option & Proportionate Costs" (2007) <<https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/CJC/Publications/CJC+papers/CJC+Improved+access+to+Justice+Funding+options+and+proportionate+costs.pdf>> (last accessed 18 August 2017); Cf also the UK Court of Appeal's decision in the well-known *Excalibur Ventures LLC v Texas Keystone Inc and others* [2016] EWCA Civ 1144, stating that litigation funding is "an accepted and judicially sanctioned activity perceived to be in the public interest" (per LJ Tomlinson). Cf also Lord's Jackson's Review of Civil Litigation Costs (in the UK) which allowed third party funding after it expressed concerns that "in some areas of civil litigation costs are disproportionate and impede access to justice", Lord Rupert JACKSON, "Review of Civil Litigation Costs" (2009) Foreword, available at <<https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf>> (last accessed 19 August 2016).

<sup>291</sup> ICC Commission on Arbitration and ADR Report, "Decisions on Costs in International Arbitration" (2015) paras 87-89, available at: <<http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2015/Decisions-on-Costs-in-International-Arbitration---ICC-Arbitration-and-ADR-Commission-Report/>> (last accessed 18 August 2016).

<sup>292</sup> See Chapter 3 for definitions of P&I and FD&D.

<sup>293</sup> See Chapter 3 for definition of CFAs.

<sup>294</sup> See Chapter 3 for definition of ATE.

arbitration costs does not arise in the first place. ATE policies typically meet adverse costs awards only, and therefore the claimant will have to obtain funding from elsewhere or fund the arbitration itself. If it is successful, a party with ATE policy will have incurred legal costs, which should be recoverable.

[b] Allocation of costs: should a tribunal deviate from otherwise applicable outcome-based methods of costs allocation if the prevailing party's costs have been funded?

*The fact that a party's costs have been paid by a third-party funder should not generally be regarded as a relevant factor in determining whether or not costs are to be allocated based on the outcome of the case.* As explained in the previous section, these costs are incurred by the funded party who typically is obliged, under the funding agreement, to repay the funder if it is successful in the claim. Otherwise, the funded party would be left uncompensated for the costs it has incurred which it would have recovered had it not been funded.

[2] What amount and type of 'costs' can a prevailing funded party recover?

Funding arrangements will typically require the funded party not only to reimburse the funder for the actual arbitration costs covered, but also to pay for the cost of that capital, i.e. the funding costs (such as a conditional fee, or a litigation funder's return) over and above normal legal costs.

Depending on the circumstances, the successful funded party might be able to claim funding costs as damages against the unsuccessful party in a separate claim. However, the requirements for causation and foreseeability would be difficult tests to meet under most national substantive laws.<sup>295</sup>

It would seem more reasonable for the successful funded party to attempt to recover funding costs from the unsuccessful party as part of the costs allocation exercise at the end of the arbitration, although the question whether an arbitrator can and should allocate funding costs is disputed.

In a survey of practice of arbitral tribunals under the ICC Rules, the ICC Report on Costs in International Arbitration states that funding costs, including the third-party funder's success fee may be recoverable in certain circumstances.<sup>296</sup>

Further, there is recent authority for arbitration conducted in England under the English Arbitration Act suggesting that when funding costs are necessary for the claimant to bring its claim,

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<sup>295</sup> See Jonas VON GOELER, *Third-Party Funding in International Arbitration and Its Impact on Procedure* (Kluwer 2016) at p. 414-415.

<sup>296</sup> ICC Commission on Arbitration and ADR Report, "Decisions on Costs in International Arbitration" (2015) paras 92-93, available at: <<http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2015/Decisions-on-Costs-in-International-Arbitration---ICC-Arbitration-and-ADR-Commission-Report/>> (last accessed 18 August 2016).

funding costs are recoverable as part of the costs for the conduct of the arbitration. In the recent decision *Essar Oilfield Services Ltd v Norscot Rig Management Pvt Ltd*<sup>297</sup> before the English High Court, the applicant applied to set aside an arbitration award on costs in which the respondent was awarded the costs of third-party funding. The arbitrator had ordered the applicant to pay costs on an indemnity basis, including a substantial amount which the respondent had paid to a third-party funder. The arbitrator held that the concept of costs was not merely limited to legal costs, but extended to any other reasonable costs incurred by parties, including funding costs. The arbitrator held that the applicant had deliberately put the respondent in a position where it could not fund the arbitration out of its own resources and it was therefore reasonable for the respondent to obtain funding from a third party on terms that if it succeeded it would pay the usual market standards for funding costs, namely 300% of the amount advanced or 35% of the amount recovered. The applicant challenged the decision of the arbitrator on the basis that the terms “other costs of the parties” (under s.59(1)(c) of the 1996 Arbitration Act)<sup>298</sup> and “recoverable costs of the arbitration” (under s.63(3) of the 1996 Arbitration Act)<sup>299</sup> do not include the costs of funding of the arbitration. The English court refused the application, holding that it was within the arbitrator’s discretion to construe the phrase “other costs” in s.59(1)(c) and “costs of the arbitration” in s.63(3) of the 1996 Arbitration Act as including costs of funding.<sup>300</sup> The court stated that the correct approach was to take a functional approach to the term “other costs” and “costs of the arbitration”, and consider what other costs were incurred in bringing or defending the claim. The court noted that as a matter of language, context and logic “other costs” could include third-party funding costs.<sup>301</sup>

The decision of the English courts in *Essar* has attracted considerable attention. Eventually, however, the *Essar* ruling should be treated as English authority for arbitrations seated in London under the English Arbitration Act and the English “indemnity rule”.

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<sup>297</sup> *Essar Oilfield Services Ltd v Norscot Rig Management Pvt Ltd*, Queen's Bench Division (Commercial Court)

15 September 2016, [2016] EWHC 2361 (Comm).

<sup>298</sup> s.59 of the English Arbitration Act (1996) provides as follows: “59.— Costs of the arbitration.

(1) References in this Part to the costs of the arbitration are to—

(a) the arbitrators' fees and expenses,  
(b) the fees and expenses of any arbitral institution concerned, and  
(c) the legal *or other costs of the parties*.

(2) Any such reference includes the costs of or incidental to any proceedings to determine the amount of the recoverable costs of the arbitration (see section 63).”

<sup>299</sup> s. 63 of the English Arbitration Act (1996) provides as follows:

“(1) The parties are free to agree what costs of the arbitration are recoverable;  
(2) If there is no such agreement, the following provisions apply;  
(3) “The tribunal may determine by an Award the recoverable costs of the arbitration on such basis as it thinks fit. If it does so, it shall specify—  
(a) the basis on which it has acted, and  
(b) the items of recoverable costs and the amount referable to each”.

<sup>300</sup> *Essar Oilfield Services Ltd v Norscot Rig Management Pvt Ltd*, Queen's Bench Division (Commercial Court)

15 September 2016, [2016] EWHC 2361 (Comm), paras 68-69.

<sup>301</sup> *Ibid*, paras 56 and 68.

While it is accepted that arbitration costs may, in principle, include funding costs, it is suggested that funding costs, including success fees, should ordinarily not be recoverable. Most commentators agree that awarding funding costs as part of arbitration costs would substantially and unfairly increase the amounts owed by the losing party.<sup>302</sup> A success fee payment to a funder results from a trade-off between the party and the funder and it is unreasonable for the respondent to be asked to pay the costs of a contract to which it is not a party. For these reasons, it is suggested that success fees or other premiums not be included in cost awards.

In arbitrations conducted under the English Arbitration Act the funded party may recover the third-party funder's success fee under exceptional circumstances. This would be the case, for example, where the tribunal is satisfied that the conduct of the losing party was sufficiently egregious to warrant an award of costs (as was the case in *Essar*, where costs were awarded on the indemnity principle).

In the absence of exceptional circumstances involving egregious conduct of the losing party, third-party funder's success fees might be recoverable only if the tribunal is satisfied that *the funding cost has been incurred specifically to pursue the arbitration* and only to the extent that the funding cost *is reasonable*, which should prevent recovery of success fees as high as 300% of the legal costs.<sup>303</sup> By way of comparison, lawyers' success fees in the context of conditional or contingency fee arrangements are typically capped in a number of jurisdictions. In Australia and in England, for example lawyers' success fees are capped at 25-40%.<sup>304</sup>

In all cases, the requirement that costs must be reasonable provides the necessary assurances that the parties will be treated fairly and equally in terms of costs and that third-party funders will not enjoy unwarranted windfalls.<sup>305</sup> Indeed, tribunals have occasionally dealt with similar issues on the basis of reasonableness, and have either included the funders' return in the allocation of costs<sup>306</sup> or not depending on their assessment of the case as a whole.

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<sup>302</sup> See Jonas VON GOELER, *Third-Party Funding in International Arbitration and Its Impact on Procedure* (Kluwer 2016) at p. 387-396; Marie BERARD, "'Other Costs' in International Arbitration" in Cesar BETANCOURT (ed) *Defining Issues in International Arbitration* (OUP 2016) p. 27-44; Daniel WEHRLI, "Contingency Fees/Pactum de palmario 'Civil Law Approach'", 26 ASA Bull 241 (2008) p. 253; Michael O'REILLY, *Costs in Arbitration Proceedings*, 2<sup>nd</sup> edn, (Informa Law 1997) 67-8; Bernard HANOTIAU, "The Parties' Costs of Arbitration" in Richard H KREIDLER and Yves DERAÏNS (eds) *Evaluation of Damages in International Arbitration* (Dossier IV of the ICC Institute of World Business Law 2006) p. 219, Jeffrey Waincymer, *Procedure and Evidence in International Arbitration* (Kluwer 2012) p. 1246.

<sup>303</sup> ICC Report on Costs in International Arbitration paras 92-93; for the opposite view, see Jonas VON GOELER, *Third-Party Funding in International Arbitration and Its Impact on Procedure* (2016) p. 387-409.

<sup>304</sup> Hong Kong Law Reform Committee Report, "Third Party Funding for Arbitration" (2015) 3.14 available at <[http://www.hkreform.gov.hk/en/docs/tpf\\_e.pdf](http://www.hkreform.gov.hk/en/docs/tpf_e.pdf)> (last accessed 18 August 2017) .

<sup>305</sup> ICC Commission on Arbitration and ADR Report, "Decisions on Costs in International Arbitration" (2015) paras 92-93, available at: <<http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2015/Decisions-on-Costs-in-International-Arbitration---ICC-Arbitration-and-ADR-Commission-Report/>> (last accessed 18 August 2016).

<sup>306</sup> Compare *Adem Dogan v. Turkmenistan*, (ICSID Case No. ARB/09/9), Award (12 August 2014) not public, reported by Peterson, IA Reporter (19 August 2014) (where the tribunal awarded the claimant two thirds of

While the above analysis primarily refers to non-recourse funding costs, recourse based funding costs should not ordinarily be recoverable either. Indeed, ATE premiums are generally considered irrecoverable in arbitral proceedings.<sup>307</sup> In the context of English litigation, the Jackson report, which approved third-party funding, considered that recoverability of ATE premiums led to disproportionate costs in civil litigation in England, and from April 2013, such costs are no longer recoverable in English litigation.<sup>308</sup> There is no justification that ATE premiums should be recoverable as “reasonable costs” for an arbitration claim, not least because ATE does not fund the claim; rather it is there to meet any adverse costs.

As regards P&I and FD&D Clubs and other forms of mutual insurance, “calls” (i.e. premiums) are offered, usually annually, by members in advance of the dispute and are paid even if a dispute never arises for one of the members for the duration of the call. Thus, it would be difficult to classify them as “necessary” costs for arbitration even under the broader meaning of the term, given by English courts in the *Essar* case. This may explain why there is no reported case awarding a party funded by a P&I and FD&D club its membership call as part of costs.

The same should apply to conditional or contingency fee arrangements (so that the uplift or success fee beyond the fees for the law firm’s time spent should not be recovered) as it essentially constitute funding of a party’s participation in arbitration by a law firm. As noted above, recoverability of lawyers’ success fees is typically capped in a number of jurisdictions.<sup>309</sup>

[3] *Can arbitral tribunals render costs orders directly against third-party funders?*

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the actual sums owed to its counsel under a contingency fee arrangement, which included a 20% share in the final award).

<sup>307</sup> Marie BERARD, “‘Other Costs’ in International Arbitration” in Cesar BETANCOURT (ed) *Defining Issues in International Arbitration* (OUP 2016) 27.35 et seq.

<sup>308</sup> Lord Rupert JACKSON, “Review of Civil Litigation Costs” (2009) Foreword, available at <<https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf>> (last accessed 19 August 2016).

<sup>309</sup> See, e.g., *City of Burlington v. Dague*, Supreme Court of the United States, Judgement of 24 April 1992, 505 U.S. 557 (only reasonable hourly fees recoverable instead of contingency fees); British Courts and Legal Services Act (1990), Section 58A(6) (as changed by virtue of section 44(4) Legal Aid, Sentencing and Punishment of Offenders Act 2012) provides that ‘[a] costs order made in proceedings may not include provision requiring the payment by one party of all or part of a success fee payable by another party under a conditional fee agreement’.

As regards the question whether a third-party funder may be ordered to pay adverse costs should the funded claim fail, state courts in England<sup>310</sup> and the United States<sup>311</sup> have ruled, in the context of litigation funding, that costs can be awarded against third-party funders if they have obtained a sufficient degree of economic interest and control in relation to the claim. In the context of litigation funding courts have emphasised that the third-party funders seek to gain financially from claims in as much as the funded parties and that “the derivative nature of a commercial funder’s involvement should ordinarily lead to his being required to contribute to the costs” on the same basis as the funded claimant.<sup>312</sup>

The rationale behind these cases is simple: a funder who benefits financially if the client wins should not be able to walk away without any responsibility for adverse costs if the client loses. The important question, however, is whether the considerations underlying these cases can be transferred into the framework of international arbitral procedures.

Unlike state courts, which may be endowed with the power to order third parties to bear procedural costs by virtue of statutory procedural law, arbitral tribunals will typically lack jurisdiction to issue a costs order against a third-party funder because of the consensual nature of arbitration. The third-party funder is not normally party to the arbitration agreement, and has no involvement in the underlying dispute between the two parties in arbitration.<sup>313</sup> While a number of non-signatory theories have been relied upon by national courts and arbitral tribunals to find that a non-signatory party is bound by an arbitration agreement, most of these theories will not apply to a typical third-party funding scenario. It would be difficult to envisage, for example, factual circumstances under which a third-party funder might qualify as the third party beneficiary, or an assignee or a principal, or the alter ego of the funded party, given the typical one-off and arm’s length commercial relationship and the lack of corporate links between a third-party funder and a funded party. Equally, while (depending on the factual circumstances) funders might be

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<sup>310</sup> *Excalibur Ventures LLC v. Texas Keystone Inc. & Ors v. Psari Holdings Limited & Ors*, English High Court (Queen’s Bench, Commercial Court), (Case No. 2010 Folio 1517), Order of 23 October 2014, [2014] EWHC 3436, paras 4, 161 confirmed by the Court of Appeal in *Excalibur Ventures LLC v Texas Keystone Inc & Ors* [2016] EWCA Civ 1144.; *Arkin v. Borchard Lines Ltd. & Ors*, English Court of Appeal, Judgement of 16 May 2005, [2005] EWCA Civ. 655 (“[w]here ... the non-party not merely funds the proceedings but substantially also controls or at any rate is to benefit from them, justice will ordinarily require that, if the proceedings fail, he will pay the successful party’s costs”). See also the most recent case about a non-party costs order against insurers

*Legg and others v Sterte Garage Ltd and another* [2016] EWCA Civ 97, where the Court of Appeal held that a costs order against the insurers was warranted because “(1) the insurers determined that the claim would be fought;(2) the insurers funded the defence of the claim;(3) the insurers had the conduct of the litigation;(4) the insurers fought the claim exclusively to defend their own interests;(5) the defence failed in its entirety.”

<sup>311</sup> *Abu-Ghazaleh v. Chaul*, Florida Third District Court of Appeal, (Nos. 3D07–3128, 3D07–3130) Decision of 2 December 2009, 36 So. 3d 691.

<sup>312</sup> *Excalibur Ventures LLC v Texas Keystone Inc & Ors* [2016] EWCA Civ 1144.

<sup>313</sup> Compare Stavros BREKOULAKIS, *Third Parties in International Commercial Arbitration* (OUP 2010) paras 1.76-1.84.

involved (occasionally actively) in the arbitration proceedings, this will not usually be sufficient to establish implied consent to the arbitration agreement by conduct.<sup>314</sup> The test for treating a non-signatory as a party in arbitration is demanding, and courts, particularly in common law jurisdictions, have noted that it is the signatories on the face of an agreement who should normally be considered as the parties in an arbitration.<sup>315</sup>

Notwithstanding the above, it is worth noting that the 2017 SIAC Investment Arbitration Rules provide in Article 35 that “The Tribunal shall have the authority to order in its Award that all or a part of the legal or other costs of a Party be paid by another Party. The Tribunal may take into account any third- party funding arrangements in ordering in its Award that all or a part of the legal or other costs of a Party be paid by another Party.” Eventually, whether such a cost award would be enforceable against a third party in an arbitration should depend on the national law of the place of enforcement, although as discussed above non-signatories, including third-party funders, are difficult to be held bound by an arbitration agreement or an arbitration award under most national laws.

In policy terms, there are conflicting considerations. While on the one hand there is an argument to the effect that a funder who benefits financially (if the funded party is successful) should not be able to escape responsibility for adverse costs if the funded party loses, on the other hand, a funder will lose its investment the funded party loses its cases. Ultimately, any policy considerations are not sufficient to amend fundamental principles of consent underpinning the idea of arbitration. A lesser degree of (costs) control over third parties is a typical feature of arbitration and must arguably be accepted if one chooses arbitration over litigation.

The position does not differ in the case of recourse based funding. Both ATE insurers and P&I and FD&D clubs will typically assume the contractual obligation to pay adverse costs, although such contractual obligation is vis-à-vis the insured, i.e. the funded party. The level of control of BTE and ATE insurers over the claim differs. For example, a FD&D club will typically exert a high degree of control over the claim as is often permitted by its rules. Whether such control can allow tribunals in practice to decide that a FD&D club has effectively become a proper party to the arbitration on the basis of any of the known non-signatory theories will depend on the factual circumstances of the case. In the context of English litigation, and for comparative purposes, the Court of Appeal held in the recent *Legg and others v Sterte Garage Ltd and another* [2016] EWCA

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<sup>314</sup> See Jonas VON GOELER, *Third-Party Funding in International Arbitration and Its Impact on Procedure* (Kluwer 2016) p. 419-420.

<sup>315</sup> See for example, the decisions of the English Supreme Court in *Dallah v Government of Pakistan*, [2010] UKSC 46, and the decision of the English High Court in *Peterson Farms Inc v C&M Farming Ltd* [2004] 1 Lloyd’s Rep 603, the decision of the Court of Singapore in *PT First Media TBK v Astro Nusantara International BV and others* [2013] SGCA 57, the decision of the Swiss Federal Tribunal, Decision 4A\_450/2013 on 7 April 2014.

Civ 97, that a costs award against a third party insurer that first ran the case and then withdrew support was warranted. While the level of control by the funder in this case was significant, the difference with arbitration is the compulsory jurisdiction enjoyed by the court as to opposed to the arbitration tribunal's reliance on consent.

DRAFT



## 2. Security for Costs

Like any party, where a funded party is unsuccessful, it may be unable to comply with any costs award rendered against it, especially if it is impecunious. If there is evidence that the existence of a funding agreement may impact on the non-funded party's ability to recover costs, that party (typically the respondent) can apply to a tribunal for interim or conservatory measures to ensure that any costs awarded against the claimant will be complied with. In those circumstances, an arbitral tribunal must balance the claimant's interest in having access to arbitral justice and the respondent's interests to recover costs if it wins. Both in commercial and investment arbitrations, arbitral tribunals will typically have the power to order security for costs either pursuant to arbitration laws and rules which explicitly provide for such power<sup>316</sup> or general provisions on interim measures<sup>317</sup> which, as is generally accepted, include security for costs orders. Assuming that an arbitral tribunal will shift costs to the losing party (see previous section), the question arises as to how third-party funding arrangements may affect whether an arbitral tribunal should grant security for these – potentially recoverable – costs. Two questions arise here: the first is whether tribunals do have the power to (i.e. can) award security for costs. The second is whether they should award security for costs when the claimant is funded by a third party.

### A. Whether Tribunals Have the Power to Award Security for Costs

As regards an arbitral tribunal's power to order security for costs, three situations can broadly be identified. No problems should arise where the parties have expressly conferred to the tribunal the power to order security for costs, or have agreed to arbitrate under an arbitration law that expressly allows arbitrators to order security for costs,<sup>318</sup> or have chosen arbitral rules containing such provisions<sup>319</sup>. The situation is less clear where the applicable arbitration law or arbitration rules only contain a general clause providing for interim measures.<sup>320</sup> Recently, an ICSID tribunal noted that one of the reasons why the general clause on interim measures contained in Article 47 ICSID Convention should cover security for costs is that, when the ICSID Convention was drafted in 1965, 'issues such as third party funding and thus the shifting of the financial risk

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<sup>316</sup> See, e.g., English Arbitration Act (1996), s. 38(3); LCIA Rules (2014), Art. 25(2).

<sup>317</sup> See, e.g., French Code of Civil Procedure (2011), Art. 1468; Swiss Private International Law Act (2017), Art. 183(1); German Code of Civil Procedure, (2013) s. 1041(1); ICSID Convention, Art. 47; ICC Rules, (2017) Art. 28(1); ICDR Rules, (2014) Art. 21(1).

<sup>318</sup> See, e.g., English Arbitration Act (1996), s. 38(3); Hong Kong Arbitration Ordinance (2011), s. 56(1)(a).

<sup>319</sup> See, e.g., LCIA Rules, (2014) Art. 25(2); HKIAC Rules (2013), Art. 24; CEPANI Rules (2013), Art. 27(1); SIAC Rules, Art. 27(k).

<sup>320</sup> See, e.g., French Code of Civil Procedure (2011), Art. 1468; Swiss Private International Law Act, (2017) Art. 183(1); German Code of Civil Procedure, (2013) s. 1041(1); ICC Rules, (2017) Art. 28(1); ICDR Rules, (2014) Art. 21(1).

away from the claiming party were not as frequent, if at all, as they are today'.<sup>321</sup> In the third situation, neither express provisions nor a general clause on interim measures exists that could serve as a basis for the tribunal's power to order security for costs. In that case, it can still be argued that the tribunal's power to order security for costs is anchored in its inherent power to preserve the integrity of the proceedings,<sup>322</sup> albeit in such a case the respondent may have to prove the requirements for interim relief set out by the applicable national law, which often include necessity and urgency and no prejudgment.<sup>323</sup>

## **B. Whether Tribunals should Award Security for Costs when the Claimant is Funded by a Third Party**

While tribunals normally apply different tests depending on whether the case is an investment or commercial arbitration, the common, and ultimate, consideration is the evaluation of the claimant's financial situation. The following sections provide an overview of the tests and considerations under both investment and commercial arbitration. The analysis concludes with general observations applying to both types of arbitration.

### **1. Investment Arbitration**

#### **[a] Do states have a protected right to security for costs under ICSID arbitration?**

While the ICSID Convention provides that each party must abide by and comply with the terms of the award,<sup>324</sup> execution of the award is left to the national applicable law.<sup>325</sup> Accordingly, because the ICSID Convention is not concerned with execution or collection of awards, including the collection of a possible costs award, some tribunals and arbitrators have questioned whether a defendant State has a "right" to security for costs which is protected under the ICSID regime. In *Maffezini v Spain* for example, the tribunal noted that there was no present rights of the respondent

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<sup>321</sup> *RSM Production Corporation v. Saint Lucia*, (ICSID Case No. ARB/12/10) Decision on Saint Lucia's Request for Security for Costs (13 August 2014) para. 55. Whether the explanation offered by the Tribunal in this case is accurate or supported by the history of drafting the ICSID Convention is questionable, and the question of the propriety and jurisdiction to order a State to post security for costs is much more complex.

<sup>322</sup> Laurence CRAIG, William PARK and Jan PAULSSON, *International Chamber of Commerce Arbitration*, 3<sup>rd</sup> edn (OUP 2000) p. 467 (who report that even when the ICC Rules did not yet contain a general clause for granting interim measures, 'ICC tribunals had found that they had the power to grant security for costs as part of their inherent powers in connection with the conduct of arbitral proceedings') (with further references); *Commerce Group Corp. & San Sebastian Gold Mines, Inc. v the Republic of El Salvador*, (ICSID Case No. ARB/09/17), Annulment Proceeding, Decision on El Salvador's Application for Security for Costs, (20 September 2012), para. 45.

<sup>323</sup> Compare *South American Silver Limited v. Bolivia*, (PCA Case No. 2013-15) Procedural Order No. 10 (11 January 2016), para. 57.

<sup>324</sup> ICSID Article 53(1).

<sup>325</sup> ICSID Article 54(3).

State to be preserved.<sup>326</sup> In *Grynberg v Grenada*, the dissenting arbitrator stated that “the use of the words ‘preserve’ and ‘preserved’ in [ICSID] Article 47 and Rule 39 presupposes that the right to be preserved exists. Because Respondent has no existing right to an ultimate award of costs, the Tribunal is thus without jurisdiction”.<sup>327</sup>

Other ICSID tribunals, such as the tribunal in *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic*<sup>328</sup> and the majority decision in *Grynberg v Grenada*, accepted that States have a right in a security for costs application, which is protected under the ICSID regime, even if under the circumstances of the case tribunals refused to grant States the requested security for costs.

In this regard, the tribunal in the recent, *Eskosol S.P.A. in Liquidazione v Italian Republic*,<sup>329</sup> noted that “there is something analytically curious about the notion that an ICSID tribunal, while not empowered to protect a claimant’s ability to collect on a possible merits award, nonetheless should intervene to protect a State’s asserted “right” to collect on a possible costs award”. While the tribunal in the *Eskosol* case decided not to address this matter as the respondent had failed to demonstrate that the security for costs request was urgent even assuming that the State had a protectable right, it went on to observe that:

“The Tribunal accepts that respondent States have genuine concerns about their ability to enforce an eventual costs award against unsuccessful claimants, and some States are starting to raise the possibility of reforms to the ICSID system to protect themselves more systematically. But at the same time, such States would be unhappy to see a similar argument about a right to effective relief used against them, for example by claimants worried about collection risk associated with any final merits award of compensation.”<sup>330</sup>

Ultimately, this is still an emerging matter, which is included here for the sake of completion. The Task Force does not wish to take a position on this matter at this stage.

## [b] Additional Criteria

From a review of a growing number of cases dealing with this matter, it is clear that tribunals in ICSID arbitration tend to adopt a stricter test than the claimant’s impecuniosity to order security for costs: they usually require evidence of abusive conduct or bad faith on the part of the

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<sup>326</sup> *Emilio Agustín Maffezini v. Kingdom of Spain*, (ICSID Case No. ARB/97/7) Procedural Order No. 2 (28 October 1999), para. 15.

<sup>327</sup> *Rachel S. Grynberg, Stephen M. Grynberg, Miriam Z. Grynberg and RSM Production Company v. Grenada*, (ICSID Case No. ARB/10/6), Tribunal’s Decision on Respondent’s Application for Security for Costs (14 October 2010), para. 5.16, in fn. 9.

<sup>328</sup> *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic*, (ICSID Case No. ARB/14/14), Procedural Order No. 3 (23 June 2015).

<sup>329</sup> *Eskosol S.P.A. in Liquidazione v Italian Republic*, (ICSID Case No. ARB/15/50) Procedural Order No. 3 (Decision on Respondent’s Request for Provisional Measures), (12 June 2017) para. 35.

<sup>330</sup> *Ibid.*, para. 34.

claimant,<sup>331</sup> such as evidence that the claimant has a track record of deliberately failing to comply with costs awards.

While this appears to be an increasingly accepted test for investment arbitration tribunals, it is questionable whether such high threshold is warranted. It can reasonably be argued that, if the respondent state was subject to an unsuccessful claim, it should be able to recover costs at the end of the arbitration regardless of whether the claimant is acting in bad faith or not.

On the other hand, an investor may claim that it would be unreasonable for a tribunal to order an investor to meet a security for costs order, because the state's unlawful conduct (assuming that the state's conduct in question is indeed unlawful) has diminished or even expropriated their investment in the first place, and have left the investor with limited or no available funds to conduct a usually costly investor-state arbitration. This can be a powerful claim, not least because it raises obvious issues of access to justice for the investors.

In practice however, when investor-state tribunals decide, usually at an early stage of the arbitration process, security for costs requests they tend not to accept an assumption that the state's conduct has indeed left an investor with limited available funds to avoid prejudging the merits of the dispute and thus violating fundamental principles of procedural fairness.

This explains why investment tribunals tend to focus on other considerations, which are not directly related to the merits of the dispute, but nevertheless set a high threshold for a claimant to be subject to a security for costs order in investment arbitration, including for example the requirement that the claimant has exhibited abusive conduct by repeatedly failing to comply with costs orders or deliberately dissipating its assets.

Against this background, it is perhaps unsurprising that investment arbitration tribunals have consistently dismissed applications for security for costs in the past. In doing so, these tribunals have relied on a range of different arguments, such as the following:

- improper to prejudice the claimant's case;<sup>332</sup>
- failure to establish concrete risk of non-payment;<sup>333</sup>

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<sup>331</sup> See, e.g., *South American Silver Limited v. The Plurinational State of Bolivia*, (PCA Case No.2013-15), Procedural Order No. 10 (11 January 2016), para. 59; *RSM Production Corporation v. Saint Lucia*, (ICSID Case No. ARB/12/10), Decision on Saint Lucia's Request for Security for Costs (13 August 2014), para. 75 and the cases cited therein.

<sup>332</sup> *Emilio Agustín Maffezini v. Kingdom of Spain*, (ICSID Case No. ARB/97/7), Procedural Order No. 2 (28 October 1999), para. 21; *Libananco Holdings Co. Limited v. Republic of Turkey*, (ICSID Case. No. ARB/06/8), Decision on Preliminary Issues (23 June 2008), para. 59; *Guaracachi America, Inc. (U.S.A.) and Rurelec plc (United Kingdom) v. Plurinational State of Bolivia*, (PCA Case No. 2011-17), Procedural Order No. 14 (11 March 2013), para. 8.

<sup>333</sup> *Victor Pey Casado and President Allende Foundation v. Republic of Chile*, (ICSID Case No. ARB/98/2), Decision on Provisional Measures (25 September 2001), para. 89; *Burimi S.R.L. and Eagle Games S.H.A. v. Republic of Albania*, (ICSID Case No. ARB/11/18), Procedural Order No. 2 (3 May 2012), para. 39; *Alasdair Ross Anderson et al. v. Republic of Costa Rica*, (ICSID Case No. ARB(AF)/07/3), Award (19 May 2010), para. 9; *Abaclat and others v. The Argentine Republic*, (ICSID Case No. ARB/07/5), Procedural Order No. 10 (18 June 2012); *Rachel S. Grynberg, Stephen M. Grynberg, Miriam Z. Grynberg and RSM Production Company v. Grenada*, (ICSID Case No. ARB/10/6) Tribunal's Decision on Respondent's Application for Security for Costs (14 October 2010), para. 5.21; *Libananco*

- not unusual that the claimant is a vehicle or has no assets;<sup>334</sup>
- would limit claimant's access to justice;<sup>335</sup>
- no threat to the integrity of the proceedings.<sup>336</sup>

### [c] Third-Party Funding as Abuse or Bad Faith?

If we assume that the test in investment arbitration is thus that the respondent must demonstrate exceptional circumstances in the form of an element of bad faith or abuse on the claimant side, what does a claimant's recourse to third-party funding indicate in this respect?

Some have argued that third-party funding should in itself be a reason for ordering security against the funded party, or at least shift the burden of proof to the effect that the funded party must make a case why security should not be granted.<sup>337</sup> Another point frequently raised by respondents in order to demonstrate an element of bad faith is that recourse to funding would result in situations where the claimant's expenses are being covered by a related entity or individual who stands to gain if the claimant wins, but would not be liable to meet any award of costs that might be made against the claimant if it lost.

The growing body of arbitral case law on this question, however, provides a clear picture: mere recourse to third-party funding does not carry an element of bad faith or abuse; the existence of a funding agreement alone is not sufficient to grant security for costs.

The first case to explicitly address the issue was *RSM Production Corporation v. St Lucia*, where an ICSID tribunal – for the first time ever in investment treaty arbitration – issued a security for costs order.<sup>338</sup> The respondent argued that, while no ICSID tribunal had ordered security

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*Holdings Co. Limited v. Republic of Turkey*, (ICSID Case No. ARB/06/8), Decision on Preliminary Issues (23 June 2008), para.59; *Guaracachi America, Inc. (U.S.A.) and Rurelec plc (United Kingdom) v. Plurinational State of Bolivia*, (PCA Case No. 2011-17), Procedural Order No. 14 (11 March 2013), para. 7.

<sup>334</sup> *BSG Resources Limited v. Republic of Guinea*, (ICSID Case No. ARB/14/22), Procedural Order No. 3 (25 November 2015), para. 78; *Libananco Holdings Co. Limited v. Republic of Turkey*, (ICSID Case No. ARB/06/8), Decision on Preliminary Issues (23 June 2008), para. 59; *Rachel S. Grynberg, Stephen M. Grynberg, Miriam Z. Grynberg and RSM Production Company v. Grenada*, (ICSID Case No. ARB/10/6) Tribunal's Decision on Respondent's Application for Security for Costs (14 October 2010), para. 5.19.

<sup>335</sup> *Burimi S.R.L. and Eagle Games S.H.A. v. Republic of Albania*, (ICSID Case No. ARB/11/18), Procedural Order No. 2 (3 May 2012), para. 41; *Gustav F W Hamester GmbH & Co KG v. Republic of Ghana*, (ICSID Case No. ARB/07/24), Award (18 June 2010), para. 17; *Commerce Group Corp. & San Sebastian Gold Mines, Inc. v. the Republic of El Salvador*, (ICSID Case No. ARB/09/17), Annulment Proceeding, Decision on El Salvador's Application for Security for Costs (20 September 2012), para. 52.

<sup>336</sup> *Commerce Group Corp. & San Sebastian Gold Mines, Inc. v. the Republic of El Salvador*, (ICSID Case No. ARB/09/17), Annulment Proceeding, Decision on El Salvador's Application for Security for Costs (20 September 2012), para. 49.

<sup>337</sup> See notably *RSM Production Corporation v. Saint Lucia*, (ICSID Case No. ARB/12/10), Assenting Reasons of Gavan Griffith (12 August 2014).

<sup>338</sup> *RSM Production Corporation v. Saint Lucia*, ICSID Case No. ARB/12/10, Decision on Saint Lucia's Request for Security for Costs of 13 August 2014.

before, such measure would be justified here, pointing out that the claimant had failed to pay ICSID's advance on costs, had not honoured costs awards rendered against it in a number of previous ICSID arbitrations, and that "the proceedings initiated by Claimant are funded by third parties". Claimant's counsel had admitted this already at a hearing on ICSID's advance on costs. The respondent further claimed that these third parties would not be liable for adverse costs, enabling the claimant to engage in "arbitral hit and run". The claimant contested the tribunal's jurisdiction to order security and additionally argued that a difficult financial situation would not be sufficient to grant security payment against claimants in ICSID proceedings. It moreover stated that its current conduct would not give reason to doubt its willingness to pay adverse costs. In reaching its decision to order security payment, the RSM tribunal did take into account that the claimant was impecunious and was funded by a third-party that could presumably not be made responsible for any adverse costs award. Notably, the tribunal pointed out that it would be "unjustified to burden Respondent with the risk emanating from the uncertainty as to whether or not the unknown third party will be willing to comply with a potential cost award". Yet, the decisive factor for the tribunal to grant the requested security for costs was the fact that the claimant had a proven history of not complying with costs awards rendered against it, and that the third-party funder was not revealed (and was therefore unknown) to the tribunal.<sup>339</sup>

In another decision on the matter, *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic*,<sup>340</sup> the respondent advanced strikingly similar arguments, arguing not only that it had a good case on the merits, but also that the claimants "have a history of engaging in fraud and renegeing on payment obligations" and that they do not have the means to pay for the costs of the arbitration proceedings, which are entirely funded by third parties". The claimants contested the tribunal's power to order security for costs, argued that ordering security would unduly restrict their access to justice, and that their financial difficulties are "in large part attributable to acts and omissions of Respondent". The arbitrators explicitly distinguished the case before them from *RSM Production Corporation v. Saint Lucia* and denied the respondent's security request, pointing out that "the underlying facts in [the RSM] arbitration were rather exceptional since the claimant was not only impecunious and funded by a third party, but also had a proven history of not complying with cost orders. As underlined by the arbitral tribunal, these circumstances were considered cumulatively." The tribunal went on to note that the respondent had failed to establish that the claimants had defaulted on their payment obligations in the present proceedings or in other arbitration proceedings. It concluded by making it clear that "financial difficulties and third-party funding – which has become a common practice – do not necessarily constitute per se exceptional circumstances justifying that the Respondent be granted an order of security for costs."

In *South American Silver Limited v. The Plurinational State of Bolivia*, the respondent argued that the claimant was an impecunious shell company which was funded by a third party, which in combination, according to some arbitrators, would create "a prima facie case for granting

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<sup>339</sup> *Ibid*, para. 86.

<sup>340</sup> *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic*, (ICSID Case No. ARB/14/14), Procedural Order No. 3 (23 June 2015).

the *cautio judicatum solvi*”, meaning that the burden of proof is transferred to the funded party, who must prove why the *cautio judicatum solvi* should not be ordered.<sup>341</sup> Referring to *RSM v. St. Lucia*, the claimant pointed out that “the only investment tribunal that has ever issued security for costs did so primarily because of the claimant’s notorious history of failing to pay prior cost awards”, and that the position that “the mere uncertainty as to the existence of a third-party funder’s obligation to reimburse constitutes ‘compelling grounds for security for costs’ correspond[s] to a minority view”, while “[t]he majority of international tribunals have stated the contrary in recent decisions, and on the contrary, the existence of a funder indicates that the claim is plausible on the merits”. The PCA tribunal transferred the “extreme and exceptional circumstances-test” favoured by ICSID tribunals into the framework of Article 26 of the applicable UNCITRAL Arbitration Rules, concluding that “Bolivia’s mere analysis of SAS’ or SASC’s balances and other related accounting documents, or the mere existence of a third-party funder do not meet the high threshold set forth by investment tribunals.”<sup>342</sup> In reaching this conclusion, the tribunal explicitly referred to the two previously mentioned cases, and confirmed that “the mere existence of a third-party funder is not an exceptional situation justifying security for costs”, explaining that:

“[i]f the existence of these third-parties alone, without considering other factors, becomes determinative on granting or rejecting a request for security for costs, respondents could request and obtain the security on a systematic basis, increasing the risk of blocking potentially legitimate claims.”<sup>343</sup>

In a procedural order issued in April 2017 in the case *Eskosol S.P.A. in Liquidazione v Italian Republic*,<sup>344</sup> the tribunal rejected the respondent’s request for an order that the claimant post a bank guarantee of US \$ 250,000 or prove it had obtained an undertaking from its third-party funder to pay any costs awards against it, notwithstanding the fact that the claimant had been declared insolvent and placed under receivership in 2013. In its security for costs application the respondent argued that the claimant’s insolvency made it unlikely that it would be able to meet any adverse costs, if the claim was declined. The respondent further argued that a security for costs order was necessary and urgent because it had “a suspicion” that the claimant was funded by a third-party funder, which –according to the respondent- increased the risk that the claimant would not comply with a costs order. Responding to the security for costs application, the claimant confirmed that it had been funded by a third-party funder which had assisted the claimant to purchase an ATE insurance policy protecting the company against adverse costs of up to Euros 1 million. While accepting that the claimant’s insolvency meant that the claimant would be unable

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<sup>341</sup> *South American Silver Limited v. The Plurinational State of Bolivia*, (PCA Case No.2013-15), Procedural Order No. 10 (11 January 2016), para. 27, citing *RSM Production Corporation v. Saint Lucia*, (ICSID Case No. ARB/12/10), Assenting Reasons of Gavan Griffith (12 August 2014).

<sup>342</sup> *South American Silver Limited v. The Plurinational State of Bolivia*, (PCA Case No.2013-15), Procedural Order No. 10 (11 January 2016), paras 59, 83.

<sup>343</sup> *Ibid.*, para. 77.

<sup>344</sup> *Eskosol S.P.A. in Liquidazione v Italian Republic*, (ICSID Case No. ARB/15/50) Procedural Order No. 3 (Decision on Respondent’s Request for Provisional Measures), (12 June 2017). See also above p.118.

to meet an adverse costs award from its own funds, the tribunal stated that the ATE insurance policy was sufficient to cover the amount of costs requested by the respondent. The tribunal thus concluded that the respondent had failed to demonstrate that it is either necessary or urgent to grant the security for costs application.

However, in two recent procedural orders issued in July 2017 in relation to the same investment dispute in the parallel cases of *Luis Garcia Armas v Venezuela and Manuel Garcia Armas et al. v Venezuela*,<sup>345</sup> the tribunal (sitting on both cases) ordered the funded claimants to provide evidence on their solvency before deciding a request for security for costs made by the respondent State.

In the cases, the claimants had voluntarily disclosed the existence of a third-party funding agreement. In response to a request by the respondent State, the tribunal had subsequently ordered the claimants to disclose the actual terms of their funding arrangements. Because the funding agreement included a provision that the funder did not undertake to finance any adverse costs related to the arbitration, the respondent requested that the tribunal order the claimants to post a US\$5 million bond as security for adverse costs.

Before deciding on the request for security, the tribunal asked the claimants to provide reliable evidence of their solvency, including asset valuations. The claimants were also directed to inform the tribunal of the jurisdiction(s) where those assets were located, in order to assess the enforceability of any future adverse costs order. These proceedings are still ongoing and the decision on the respondent's security for costs application is still pending, but the tribunal's request that the claimants provide evidence of their solvency appears to have shifted the burden of proof of impecuniosity from the respondent to the claimants.

### **3. Commercial Arbitration**

#### **[a] Additional Criteria**

In international commercial arbitration, no uniform test for security for costs applications exists at this point. One approach is to ask whether the prospect of the claimant honouring a potential adverse costs award has substantially and unforeseeably deteriorated since the conclusion of the arbitration agreement.<sup>346</sup> The idea here is to take into account that the parties to an international commercial arbitration have agreed to arbitrate, which can be taken as a reference point in determining a party's legitimate expectations in recovering costs. For instance, a respondent that has agreed to arbitrate with a claimant that was in financial distress at the time the

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<sup>345</sup> *Luis Garcia Armas v Venezuela and Manuel Garcia Armas et al. v Venezuela*, (ICSID AF Case No. ARB(AF)/16/1) Procedural Order (7 July 2017) administered by ICSID's Additional Facility Rules; PCA Case No. 2016-08, administered by the Permanent Court of Arbitration, (Both with the seat in The Hague, The Netherlands).

<sup>346</sup> See, e.g., *XXX INC., incorporée dans une île des Caraïbes v. YYY S.A., incorporée dans un pays d'Amérique latine*, (ICC Case No. 15951/FM), Procedural Order No. 2 (29 May 2009), ASA Bulletin 2010 (75).



arbitration agreement was signed should expect that, if a dispute arises, its counterparty may not be financially able to comply with an adverse costs award. Moreover, the possibility that the credit standing of a business partner changes over time is part of normal commercial risk, in other words, cannot readily be characterized as commercially unforeseeable.

Another approach would be to apply a broader fairness test, *i.e.* requiring “that the present situation is of such a nature as to render it highly unfair to require it to conduct the arbitration proceedings without the benefit of such security.”<sup>347</sup> This perspective allows arbitrators to capture the nuances of the particular case, but, on its own, may be considered excessively vague and open-ended.

**[b] Application to Third-Party Funding Scenarios**

**[aa] Conclusion of Funding Agreement as Material Change of Circumstances?**

When deciding security for costs applications, the majority of commercial tribunals adopt a consent-based approach, looking into whether a material and unforeseeable change of circumstances has occurred since the conclusion of the arbitration agreement. In this regard, the relevant question is whether the conclusion of a funding agreement constitutes such material and unforeseeable change of circumstances.

There is an argument to the effect that the existence of third-party funding is relevant to an application for security for costs, as it implies that the funded party is impecunious *per se*. Further, there have been cases where arbitral tribunals have found that the entering into of an arbitration funding agreement did constitute ‘a fundamental change of circumstances which would justify granting security for costs’.<sup>348</sup>

On the other hand, however, there is rising concern that non-funded parties are using the “impecuniousness assumption” to justify routinely submitting security applications as a means of delaying and deliberately increasing the costs of the resolution of meritorious claims.

Obtaining funding from a third party should not be taken to suggest material deterioration of the claimant’s finances, since funding is widely used by financially stable parties in order to share risk and maintain liquidity.

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<sup>347</sup> ICC Case No. 10032, Procedural Order (9 November 1999), para. 45, cited in Pierre KARRER and Marcus DESAX, “Security for Costs in International Arbitration – Why, When and What if ...”, in Robert Georg BRINER, Yves L. FORTIER, Klaus Peter BERGER and Jens BREDOW, *Law of International Business and Dispute Settlement in the 21st Century: Liber Amicorum Karl-Heinz Böckstiegel* (Verlag 2001) p. 348.

<sup>348</sup> Although the tribunal in this case seems to have applied a broader fairness test (see discussion under [bb]): *X v. Y and Z*, (ICC Case) Procedural Order (3 August 2012), published in Philippe PINSOLLE, “Third Party Funding and Security for Costs” *Cahiers de l’arbitrage/Paris J. Int’l Arb.* 399, 2013(2), paras 28, 33. See also discussion above in p. 71.

**[bb] Broader Fairness Concerns**

The situation looks quite different if one applies a broader fairness test to third-party funding scenarios, which is essentially what an ICC tribunal did in an order dated 3 August 2012. The terms of the funding agreement were on the record because claimant’s counsel had previously transferred the agreement to the respondent, without indicating any reasons for this. The tribunal therefore examined in great detail the terms of the funding agreement and ultimately granted the security order, essentially because (1) the claimant was a holding company based in Cyprus that was unlikely to be able to pay adverse costs; (2) the funding agreement did not cover adverse costs; and (3) in the tribunal’s view the funder’s termination rights under the funding agreement meant that the funder was “empowered to terminate the Agreement at any time, entirely at its discretion”.<sup>349</sup>

The tribunal pointed out that the claimant engaged in an unfair “cherry-picking”: the funding agreement enabled the claimant to arbitrate as if it was solvent while not assuming the economic risk of this arbitration due to its impecuniosity. In addition, according to the reading of the arbitrators, there was a risk of the funder walking out at any time, leaving the claimant without means to continue with the arbitration or pay adverse costs. Some may even want to go a step further and argue that the asymmetric situation of a claimant being able to arbitrate while not running economic risks as to the arbitration is in itself sufficient to grant security for costs. Certainly, there are valid counter-arguments: the claimant here was impecunious from the start, so that the respondent could never really expect to have security to recover its costs. If a tribunal indeed wishes to take into account broader fairness considerations and ask whether it would be unfair for the funded party to proceed without security in light of all circumstances, this will require an analysis of the precise terms of the funding agreement, which might in turn be used as an argument in favour of disclosure of such agreement. Another important aspect for arbitrators to be aware of and take into account are arrangements between the funder and the funded party as to whether the former has undertaken to finance any adverse costs. Where the funder is liable to the funded party to cover an adverse costs order and the capital adequacy of the funder to meet an adverse costs award is shown, an order for security for costs may be seen as dispensable.

While looking into broader fairness considerations is an interesting approach, it clearly remains a minority one,<sup>350</sup> with tribunals in commercial arbitration normally adopting a consent-based view on security for costs applications and applying a “material of change of circumstances” test.

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<sup>349</sup> *X v. Y and Z*, (ICC Case), Procedural Order (3 August 2012), published in Philippe PINSOLLE, “Third Party Funding and Security for Costs” *Cahiers de l’arbitrage/Paris J. Int’l Arb.* 399, 2013(2), para. 43. It should be pointed out here that this type of termination rights in a funding agreement would be anomalous in the TPF market today (cf: CI UK Code of Conduct).

<sup>350</sup> No other case than the ICC *X v. Y and Z*, (ICC Case), Procedural Order (3 August 2012), referred to above has been reported taking a broader fairness approach.

### 3. Concluding analysis for both investment and commercial arbitration

A key aspect in any security for costs analysis will be the financial situation of the party against which security payment is requested. There must be sufficient evidence to conclude that the current financial circumstances of the claimant are such that it will not be able to pay the respondent's costs at the end of the proceedings.

What, then, is the relevance of a third-party funding agreement in determining whether the claimant is impecunious? On the one hand, it could be argued that the fact that a claimant is actively seeking external funding to pursue its claim is evidence (or at least an indication) of the claimant's difficult financial circumstances. It might even be said that the existence of third-party funding arrangements should set a rebuttable presumption for the claimant's impecuniosity.<sup>351</sup> However, the assumption that a funded Party is impecunious miscomprehends the current state of third-party funding. Most of the funders, including in the Task Force, suggest and arbitration practitioners confirm that third-party funding is increasingly used by large, solvent companies that simply wish to share risk and maintain liquidity. As it has been pointed out, "companies that want to maintain sufficient cash flow to continue their regular business while the arbitral proceedings are ongoing, or that simply want to share the risk of the arbitration with a third party" may "seek financing to pursue a meritorious claim."<sup>352</sup> As has been noted "third-party financing is increasingly a tool of choice, not of necessity. Some of the world's largest companies are regular users of outside financing."<sup>353</sup>

It is thus suggested that applications for security for costs in international arbitration should be determined irrespective of any funding arrangement, and on the basis of impecuniousness. In the first instance, the burden should be on the moving party, and it is suggested that no party should have to defend a motion for security unless and until the moving party makes a *prima facie* showing of impecuniousness. If no such showing is made, then the motion should be denied outright.

If a party is found to be impecunious, that party should then be given the opportunity to present additional evidence of funding or have a security for costs award imposed. If the party has third party arrangements in place, in which the funder agrees to pay any costs award, it could then be submitted to the tribunal as evidence that no security need be posted.

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<sup>351</sup> See for example, *RSM Production Corporation v. Saint Lucia*, (ICSID Case No. ARB/12/10), Assenting Reasons of Gavan Griffith, (12 August 2014).

<sup>352</sup> See Valentina FRIGNATI, "Ethical Implications of Third Party Funding in International Arbitration", *Arbitration International* 32, (2016), p. 506.

<sup>353</sup> Christopher P. BOGART, *Third-party financing of international arbitration*, *The European Arbitration Review* 2017 (14 October 2016) p. 10, available at <<http://globalarbitrationreview.com/insight/the-european-arbitration-review-2017/1069316/third-party-financing-of-international-arbitration>> (last accessed 19 August 2016).

At that stage, a request for disclosure of third-party funding agreements should normally be accepted as the moving party and the tribunal should be able to examine the relevant parts of the third-party funding agreement in the context of the security for costs application against an impecunious party. In this regard, ordering disclosure of the third-party funding agreements in their entirety may have a negative effect on the arbitration proceedings. Tribunals are thus encouraged to limit disclosure orders to the provisions that are strictly necessary to assess the extent to which the funder may cover (or not) an adverse costs order. Another approach could be to allow the funded party, its counsel or even the funder to provide the tribunal with an affidavit stating its identity and whether under the third funding party agreements it can be held liable for adverse costs.

One important provision in a third-party funding agreement, which the tribunals should review, will be the provision about whether the funder has agreed to cover adverse costs, including an order for security for costs. The funding agreement should normally clearly set out whether the funder will pay a defined sum to the claimant in the event of an adverse award of costs, whether that promise endures if the funding agreement has been breached or otherwise terminated, and whether the funder will pay any order of security for costs. And if the party is impecunious, both the funder and party should be aware that a funding agreement in which a funder is not obligated to irrevocably pay an award of costs may cause the tribunal to order security for costs. The recent Hong Kong Arbitration and Mediation (Third-Party Funding) (Amendment) Bill 2016 includes as an Annex a non-binding Code of Practice for third-party funders in arbitration which provides in s.2.14(3) that “the third party funding agreement must state whether (and if so to what extent) the third party funder, a subsidiary or an associated entity is liable to the funded party to provide security for costs”. In all cases, where a funder has agreed with the funded party to finance any adverse costs, the capital adequacy of that funder to meet an adverse costs award, whether in its own right or by virtue of an ATE policy, is clearly relevant in assessing whether adequate security has been provided.

Another relevant provision in the context of a security for costs application will be the provision in a third-party funding agreement about the funder’s termination rights. Where a third-party funder has agreed to finance adverse costs, whether and under which conditions a funder can discontinue funding may be a relevant consideration for tribunals to take into account. Most professional funders have very clear termination provisions which set out, in circumstances where they have agreed to be liable for adverse costs, when they are liable for such costs, which typically is for the duration of their funding. Where a funder is a member of the Association of Litigation Funders of England and Wales (ALF), its funding agreements must comply with the ALF Code of Conduct for Litigation Funders (ALF Code, January 2014). Article 13.2 ALF Code requires that, in case of a dispute over termination, ‘a binding opinion shall be obtained from a Queen’s Counsel who shall be instructed jointly or nominated by the Chairman of the Bar Council’. Only if the Queen’s Counsel agrees with the funder that it is lawful to terminate, will the Termination Notice be valid. Funders operating in other jurisdictions have internal codes that set out their practice in respect of whether and under which circumstances they can terminate funding. In all cases where

the defendant has previously knowingly proceeded on the basis that the funder would meet the adverse costs, it is suggested that third-party funders or funded parties should notify the defendant if funding is discontinued.

If a tribunal decides that a security for costs order is warranted, it can order security for costs by way of a bank guarantee. That should be a sufficient form of assurance. By way of comparison, in cases where the claimant is funded by a P&I and FD&D club or an ordinary insurer, security for costs can be provided by way of a club letter of guarantee or an insurer's bond. The club and insurer have a contractual obligation to indemnify its member or insured for any liability incurred, including costs award. For the same reasons, an ATE insurance policy should also be considered adequate evidence that the claimant will meet an adverse costs award. Payment into a bank account may be ordered for security for costs in exceptional circumstances, and where there is no ATE or any other form of evidence of indemnification arrangements already in place.<sup>354</sup>

Finally, when a security for costs application is lodged, an arbitral tribunal should consider indicating to the respondent (the requesting party) that, should the claimant prevails on the merits of the case, the respondent will be held liable for the costs reasonably incurred by the claimant (funded party) in posting security. It should be for the claimant (funded party) to substantiate the amount of costs it reasonably incurred in posting security. This seems desirable from a policy perspective, as it provides a legally fair and financially risk neutral solution to granting security for costs. At the beginning of the proceedings, the tribunal can at best perform a *prima facie* assessment of the respondent's chances of succeeding on the merits. If the tribunal denies the respondent's application for security it risks evaluating the merits in a way that *ex post* may prejudice the respondent, should the respondent ultimately prevails and be unable to recover costs. At the same time, if the tribunal grants the respondent's security request and the claimant ultimately prevails, the security application would turn out to be a win-win option for the respondent, as there would be no downside for having requested (as it turned out unnecessary) security. By granting security payment on the premise that the respondent must contribute towards the cost of the security should the claimant prevail on the merits, the tribunal can restore the financial balance between the parties, both of which continue to run risks in relation to the money posted. This avoids prejudging the case in favour of either side.

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<sup>354</sup> Unless of course the claimant offers to pay a cash deposit, if this is easier and cheaper than arranging for a bank guarantee.

## Chapter 7<sup>†</sup>

### Best Practices in Third-Party Funding Arrangements

As noted in Chapter One, in its early work, the Task Force engaged in considerable debate about what form its final work product should take. Early suggestions ranged from drafting a code of conduct for third-party funders in international arbitration, similar to the Association of Litigation Funders Code of Conduct in England and Wales, to abstaining from producing any form of guidance. Against the backdrop of these discussions, the Task Force ultimately agreed on two general objectives for the Task Force's work: (1) to promote greater understanding about what third-party funding is and the issues it raises in international arbitration; and (2) to facilitate greater consistency and more informed decision-making in addressing issues relating to third-party funding. In pursuing these objectives, the Task Force also decided to limited its work to those issues that: (1) directly affect international arbitration proceedings; and, (2) are capable of being addressed at an international level.

The issues addressed in the preceding chapters largely fulfil these objectives and limitations. Chapter Four addresses issues relating to disclosure and arbitrator conflicts of interest; Chapter Five addresses issues relating to privilege; and Chapter Six addresses issues relating to costs and security for costs.

While those chapters provide analysis of the issues they address, they do not address many more basic questions that parties and counsel new to third-party funding, and funders new to international arbitration, often have. Moreover, many of the principles in those chapters rely on certain fundamentals being effectively addressed either in the funding agreement or in the parties' negotiations. For example, the principles regarding privilege in Chapter Five rely on, or at least are most effective when, the funder and the party have entered into a non-disclosure agreement.

This Chapter aims to fill that gap by providing further guidance in the form of articulation of what constitutes good and responsible practices in entering a funding arrangement, including a checklist for parties and counsel to consult. To that end, the Chapter proceeds as follows: it first provides some general background about funding in national legal systems [I]; it then collects the Principles articulated in other Chapters of this Report and articulates additional best practice norms [II], and finally provides a due diligence checklist that parties (and their counsel) can use as they consider entering into a funding agreement [III].

#### I. Background

Many common law jurisdictions have historically prohibited the funding of litigation (and other forms of dispute resolution) by parties other than those directly involved in the dispute. And some still do. Although such prohibitions have come in many forms over the years, in common law jurisdictions they usually appear as laws prohibiting maintenance and champerty. In plain terms, maintenance is the support of litigation by a stranger without just cause. Champerty, a form of maintenance, is the support of litigation by a stranger in return for a share of the proceeds.

In those jurisdictions where such laws still exist, third-party funding is prohibited. In Ireland, for example, maintenance and champerty are both criminal offences and civil torts, and have been since the 1600s. As recently as 2016, The High Court of Ireland held that third-party

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<sup>†</sup> Primary contributors to this Chapter were John Roesser, Alain Grec, Michael McIlwrath, and Ralph Sutton.

litigation funding violated its maintenance and champerty laws.<sup>355</sup> In the *Persona* decision, the High Court confirmed—consistent with a long line of authority—that the provision of financial assistance to support litigation by a third party in return for a share of the proceeds is both contrary to public policy and an abuse of process, unless that third party has a genuine interest in the litigation. Although an appeal has been accepted by the Supreme Court of Ireland, for now, third-party funding is prohibited in Ireland.

Other jurisdictions that historically prohibited third-party funding under maintenance and champerty laws have recently introduced reforms to expressly permit third-party funding in international arbitration. Notably, Hong Kong recently enacted legislative reforms to permit third-party funding arrangements that were previously prohibited. The new legislation expressly provides that the doctrines of maintenance and champerty do not apply to domestic or international arbitrations.<sup>356</sup> The proposed amendments also establish certain disclosure obligations for funded parties, as well as ethical and other standards for counsel and third-party funders.

Singapore has also recently amended its laws to allow for third-party funding in arbitration. As in Hong Kong, the new Singapore law makes clear that the use of third-party funding in international arbitration is not prohibited by existing maintenance and champerty laws, nor is it contrary to public policy.<sup>357</sup> The new law also provides certain disclosure obligations for funded parties and imposes certain regulations and financial standards on third-party funders.

The purpose of these Best Practices is not to identify the various legal permutations that may affect the ability of a party to obtain third-party funding in a particular jurisdiction. But parties should be aware that third-party funding remains prohibited in some jurisdictions and should generally seek the advice of local counsel before engaging a third-party funder.

The questions on this Checklist are designed to help parties, counsel, and third-party funders identify the kinds of questions should be considered when deciding whether to enter into third-party funding arrangement. In particular, this document seeks to identify the key questions that may assist a potential user of third-party funding in determining whether (i) the potential funder is financially able to fund the case in accordance with a state of the art funding agreement, (ii) the potential funder's interests are compatible with those of the potential party, and (iii) the potential funder offers adequate assurances in relation to the integrity and conduct of the case.

The main purpose of the Checklist is to prompt consideration and inquiries that may assist in identifying important details for inclusion in a proposed funding agreement in order to reduce the likelihood of potential misunderstandings due to incompleteness and/or lack of clarity.

## II. Principles and Best Practices

This Part of the Chapter collects [A.] the Principles provided for in other chapters, and articulates [B.] several Principles of Best Practices for consideration by parties, funders, counsel, and arbitrators.

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<sup>355</sup> See *Persona Digital Telephony, Ltd. v. Minister for Public Enterprise* [2016] IEHC 187.

<sup>356</sup> See Melody CHAN, Matthew SECOMB and Philip TAN, “Third Party Funding: a New Chapter in Hong Kong & Singapore”, (29 July 2016) available at <<http://www.jdsupra.com/legalnews/third-party-funding-a-new-chapter-in-40360/>> (last accessed 22 August 2017).

<sup>357</sup> See Civil Law (Amendment) Act 2017, §5(b)(2), available at <http://statutes.agc.gov.sg/aol/search/display/view.w3p;orderBy=date-rev,loadTime;page=0;query=Id%3Aae379db0-c3da-4abe-ad09-1d1518181ee9;rec=0#legis>>, (last accessed 28 August 2017).

## A. Principles

This section collects those principles articulated in other Chapters of the Report. In the final version of this Report, additional commentary regarding these Principles will also be included in this section.

### Principles regarding Disclosure and Conflicts of Interest

[ALTERNATIVE A]:\*

1. A party should, on its own initiative, disclose the existence of a third-party funding arrangement and the identity of the funder to the arbitrators and an arbitral institution or appointing authority (if any), either as part of its first appearance or submission, or as soon as practicable after funding is provided or an arrangement to provide funding for the arbitration is entered into.

[ALTERNATIVE B]:

1. Arbitrators and arbitral institutions have the authority to, during the selection and appointment process, expressly request that the parties disclose whether they are receiving support from a third-party funder and, if so, the identity of the funder.

[ALTERNATIVE A]:

2. For the purposes of the Principles in Chapter 4, the term “third-party funder” is defined as follows:

*For the purposes of assessing potential conflicts of interest, the terms ‘third-party funder’ and ‘insurer’ refer to any natural or legal person who is not a party to the dispute but who enters into an agreement either with a disputing party, an affiliate of that party, or a law firm representing that party, in order to finance part or all of the cost of the proceedings, either individually or as part of a selected range of cases, and such financing is provided either through a donation or grant or in return for remuneration dependent on the outcome of the dispute.*

[ALTERNATIVE B]:

2. For the purposes of the Principles in Chapter 4, the term “third-party funder” is defined as follows:

*For the purposes of assessing potential conflicts of interest, the terms ‘third-party funder’ refers to any natural or legal person who is not a party to the dispute but who enters into an agreement either with a disputing party, an affiliate of that party, or a law firm representing that party, in order to finance part or all of the*

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\* This Chapter presents alternative options for the Principles it articulates. These alternatives are based on continued differences that existed among Members of the Task Force and on which input during the public comment period is specifically sought.



*cost of the proceedings, either individually or as part of a selected range of cases, and such financing is provided either through a donation or grant or in return for remuneration dependent on the outcome of the dispute. This definition does not extend to agreements that provide insurance or to persons who provide insurance.*

#### **Principles regarding Privilege**

5. **Generally, the existence of funding and the identity of a third-party funder is not privileged information.**
6. **Generally, the specific provisions of a funding agreement may include privileged information, and production of it should only be ordered in exceptional circumstances.**
7. **For information that is determined to be privileged under applicable laws or rules, tribunals should not treat that privilege as waived solely because it was provided by parties or their counsel to a third-party funder for the purpose of obtaining funding or supporting the funding relationship.**
8. **If the funding agreement or information provided to a third-party funder is deemed to be disclosable, the tribunal should generally permit appropriate redaction and limit the purposes for which such information may be used.**

#### **Principles regarding Costs and Security for Costs**

##### **Final award (allocation) of costs:**

9. **Generally, at the end of an arbitration recovery for costs should not be denied on the basis that a party seeking costs is funded by a third-party funder.**
10. **When recovery for costs is limited to costs have been “incurred” or “directly incurred,” the obligation of a party to reimburse the funder in the event of successful recovery is generally sufficient for a tribunal to find that a funded party comes within that limitation.**
11. **In the absence of exceptional circumstances, the cost of funding, including a third-party funder’s return, is ordinarily not recoverable as costs.**
12. **Generally, a tribunal lacks jurisdiction to issue a costs order against a third-party funder.**

**Security for costs:**

- 13. Applications for security for costs should be determined irrespective of any funding arrangement and on the basis of impecuniousness.**
- 14. In the first instance, the burden is on the moving party; no party should have to defend a motion for security unless and until the moving party makes a *prima facie* showing of impecuniousness.**
- 15. If a party is found to be impecunious, that party should be given the opportunity to present additional evidence of funding or have a security for costs award imposed.**
- 16. At that stage, a request for disclosure of third-party funding agreements should normally be accepted as the moving party and the tribunal should be able to examine the relevant parts of the third-party funding agreement (in particular provisions on the funder's termination of funding rights and funder's obligation to cover adverse costs) in the context of the security for costs application against an impecunious party. However, tribunals should limit disclosure orders to the provisions that are strictly necessary to assess the extent to which the funder may cover (or not) an adverse costs order.**
- 17. If a tribunal decides that a security for costs order is warranted, it can order security for costs by way of a bank guarantee. Payment into a bank account may be ordered for security for costs in exceptional circumstances, and where there is no ATE or any other form of evidence of indemnification arrangements already in place.**
- 18. In addition, an arbitral tribunal should consider indicating to the requesting party that, should the defence fail, it will be held liable for the costs reasonably incurred by the funded party in posting security. It should be for the funded party to substantiate the amount of costs it reasonably incurred in posting security.**

**B. Best Practices**

As a starting point, there are considerable difficulties in articulating best practices that would be relevant and applicable across a range of jurisdictions, forms of funding transactions, and lawyering norms. Moreover, parties' freedom of contract and the need for flexibility in structuring arbitral proceedings counselled against any rigid formulation. This Section provides a series of considerations that comprise best practices with respect to the funding agreement and the funding relationship.<sup>358</sup>

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<sup>358</sup> When the Report is finalized, this analysis of Best Practices will be supplemented to provide discussion of those Principles articulated in Chapters Four (Disclosure and Conflicts of Interest), Five (Privilege), and Six (Costs and Security for Costs).

These best practices focus on addressing those issues that arise most typically in third-party funding of claims in individual cases, and may not directly apply to other forms of funding.

## 1. Basic Funding Agreement Terms

- (a) Funding agreements should be in writing, and their terms should be clear, unequivocal, and reflect the intentions of the parties;
- (b) Funding agreements should state the amount of funding to be provided, the return to the third-party funder and how the proceeds of an award are to be distributed among the parties;
- (c) Funding agreements should provide a fair, transparent, and independent dispute resolution process; and
- (d) Funding agreements should include a recommendation that a party obtain independent legal advice.

*Parties to the Agreement.* Ordinarily, a third-party funder and a party should be the sole parties to the funding agreement in order to avoid any potential attorney conflicts of interest should the party and the funder disagree on a material issue during the arbitration. In the United States, and perhaps in other jurisdictions, the inclusion of lawyers as parties could raise concerns regarding counsel's duty of undivided loyalty to the client.

*Terms of Funding.* With respect to the funding itself, a party and the third-party funder must consider and address in the funding agreement the scope and extent of the funding; i.e., whether the third-party funder will fund the arbitration through the end of the proceedings (or through enforcement), will fund up to a specific amount, will fund a specific piece of or milestone in the arbitration, or will fund the arbitration in some other fashion.

A party and the third-party funder should consider the consequences of any limitation on funding, including the cost to a party of continuing to fund the arbitration in the absence of the third-party funder's participation, as well as the cost of enforcing any award. One key aspect that a party should consider is whether the third-party funder is basing its internal calculations on the occurrence of a certain event, such as the potential for an early settlement, thereby possibly underestimating the budget required.

A party and the third-party funder should also address which of them will be responsible for fees and costs for any related or ancillary claims, including counterclaims, and who will be financially responsible for an adverse award of costs (addressed in greater detail below).

*Division of Proceeds from Award.* Any agreement to fund an arbitration should specify how a future recovery will be divided between the third-party funder and a party, as noted. In general, a well-crafted funding agreement should afford a party the opportunity to retain a majority of the expected recovery (above and beyond the subject of fees and costs), based on the likeliest projected outcome. But any allocation will need to be proportionate to the measure of risk and costs assumed by a party and the third-party funder, respectively.

For example, the risk incurred by the third-party funder to pursue a successful \$10 million claim will be very different from the risk on a \$1 billion claim; the third-party funder's return will also likely be different. Similarly, a third-party funder that undertakes to pursue a claim from the filing of the request for arbitration through the enforcement of the award will have considerably higher costs than a third-party funder that undertakes only to pursue enforcement of an arbitral award that has already been rendered. A third-party funder's return may be in a fixed dollar amount, a fixed percentage, a multiple of deployed or committed capital, or a structure involving a greater of a multiple or a percentage. Any such return may also include a time-based element, and may provide a greater return to the third-party funder for longer-term recoveries.

The funding agreement should reflect the intention of both a party and the third-party funder as to the priority of the distribution of proceeds: *i.e.*, who should be first to receive what amount, followed by the next recovery, etc. For example, third-party funders typically seek priority recovery of their principal deployed in the case before all other recoveries. Thereafter, depending on the return structure, the third-party funder, counsel and the parties may share *pro rata* their respective percent returns. At times, the parties may choose to establish a separate escrow account specifically created for the purpose of distributing the proceeds of an arbitration award.

*Termination of Agreement or Withdrawal.* Provisions for termination and withdrawal are some of the most important issues to consider in any funding agreement. In considering such terms, the parties should clearly address the following:

- i. When either or both parties can terminate the agreement and on what bases, including the impact on funding already provided, any future funding, and returns due to the third-party funder, if any;
- ii. Whether notice of intent to terminate or withdraw must be provided and whether it must be in writing;
- iii. Whether there is a point in the proceedings after which termination of the agreement is precluded;
- iv. How any amendments or modification of the terms of the agreement will be handled;
- v. How differences of opinion between the third-party funder and a party concerning strategy for the conduct of the case, cooperation by the party in the case or settlement are to be resolved; and
- vi. What further obligation of confidentiality is owed by the third-party funder to a party should the agreement be terminated.

*Dispute Resolution Provision.* In entering into a funding agreement, a party and a third-party funder should include a provision in the agreement governing how any potential disputes between the third-party funder and a party will be resolved expeditiously and efficiently. At their option, they may incorporate a mediation or conciliation step before proceeding to binding adjudication, typically private arbitration.

*Transparency.* A number of additional topics fall under the topic of transparency. It may be useful to consider the following in the funding agreement negotiations:

- i. Whether the third-party funder is audited annually by a reputable firm;
- ii. Whether the third-party funder will periodically provide a statement of the invested capital during the pendency of the case, the percentage of the budget consumed, and the risk, if any, that the budget may be exhausted;
- iii. A clear expression in the funding agreement that only a party can terminate the agreement with its legal counsel, but only after notice to the third-party funder;
- iv. The third-party funder should provide accurate and non-misleading information, particularly regarding its financial conditions, and its intended funding commitment; and
- v. Whether and in what circumstances the third-party funder will manage a party's litigation itself or the litigation expenses of the case.

## **2. Day-to-Day Case Management and Strategic Decisions (Party Control)**

- (a) The scope of a third-party funder's involvement or control of day-to-day management and on all key issues such as strategy and settlement is an issue generally determined by a party and the third-party funder in the funding agreement; and
- (b) The funding agreement should clearly and unequivocally reflect the intentions of the parties with respect to the scope of involvement or control on all such issues and the procedures, rights, and duties that apply when an unresolved dispute over management and strategy arises.

A key issue in any funding arrangement is determining the appropriate level of third-party funder control. Put another way, what happens when the third-party funder and a party or the third-party funder and a party's counsel fundamentally disagree over strategy or settlement (for example, whether to accept a settlement offer or whether to add additional claims)? Some third-party funders have no interest in controlling strategy or settlement, while others believe they can meaningfully add value by contributing to or even controlling certain aspects of the case.

Some commentators contend that funding arrangements pose risks to the international arbitration process through excessive control because "the funded party becomes a proxy for the funder's interests."<sup>359</sup> Although perhaps put in extreme terms, critics argue that the third-party funder "may pressure the funded party to accept certain short-cut procedures to save costs[.]" including by circumscribing pre-hearing information exchange, insisting on shortened pre-hearing written submissions or accelerated hearings, etc.<sup>360</sup>

Other commentators argue along similar lines that, although the interests of the third-party funder and a party are typically aligned to maximize the award proceeds, the arbitral process may become "flawed if not substantially corrupted" if the needs of the third-party funder mask or

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<sup>359</sup> Elizabeth CHAN, *Proposed Guidelines for the Disclosure of Third-Party Funding Arrangements in International Arbitration*, 26 Am. Rev. Int'l Arb. 281, 308 (2015).

<sup>360</sup> *Id.*, at 309.

override those of a party.<sup>361</sup> Still others have raised the related concern that disagreements between a party (and/or its counsel) and the third-party funder could potentially create untenable conflicts of interest for a party's counsel where the third-party funder has been retained to manage the arbitration, or retains excessive control over the proceedings.<sup>362</sup>

On the other hand, a number of commentators have noted the extensive history of parties ceding control over litigation in both tort and insurance law contexts. According to these writers, “courts and policymakers should be sceptical of arguments that use party control as a justification to block [Third-Party Funding].”<sup>363</sup> One scholar, Sebok, observes: “in the context of insurance law, courts have permitted strangers to take total control over a party's litigation.”<sup>364</sup> Others have similarly noted that insurance agreements already give the insurers the right to select counsel, decide litigation strategy, consider settlement opportunities, and impose expense audits on counsel.<sup>365</sup> Still other commentators go further, suggesting that third-party funders should affirmatively exercise extensive control over the proceeding.<sup>366</sup>

Although insurers can “make it very expensive for the insured to regain the freedom to tell her attorney to do things to which the funder is opposed[,] . . . this is an artifact of the terms of the contract between the client and the investor[.]”<sup>367</sup> And as Silver succinctly summarizes, “[t]hat the client may feel pressure from the funder to follow a particular course should have no bearing on the result. Clients reject lawyers' recommendations for all sorts of reasons, including expense, and must often make unpleasant trade-offs when doing so.”<sup>368</sup> (In such cases, a party and the third-party funder's dispute will be governed by the funding agreement and should not implicate the attorney).<sup>369</sup>

Beyond commentators, there is practical experience. In Australia, for example, there exists High Court authority (and over a decade of subsequent funding experience) to support the proposition that claimants should have the right to freely choose the level of control ceded to a third-party funder, provided there is no prejudice to the court or tribunal's process.<sup>370</sup>

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<sup>361</sup> Marc J. GOLDSTEIN, *Should the Real Parties in Interest have to Stand Up? – Thoughts About a Disclosure Regime for Third-Party Funding in International Arbitration*, 8 *Transnational Dispute Management* 1 (2011).

<sup>362</sup> Anthony J. SEBOK, *Should the Law Preserve Party Control? Litigation Investment, Insurance Law, and Double Standards*, 56 *Wm. & Mary Law Rev.* 833, 853 (2015).

<sup>363</sup> *Id.*, at 833–34, 859.

<sup>364</sup> *Id.*, at 838.

<sup>365</sup> Charles SILVER, *Litigation Funding versus Liability Insurance: What's the Difference?*, 63 *DePaul L. Rev.* 617, 623 (2014).

<sup>366</sup> *Id.*, n. 20.

<sup>367</sup> See SEBOK, *supra* n. 12, at 856.

<sup>368</sup> See SILVER, *supra* n. 15, at 638.

<sup>369</sup> Some argue that the comparison to insurers is not apt because insurance is a highly regulated industry. However, national regulation of insurance does not always extend to the insurers' conduct of litigation. In the United States, insurers' control defense counsel, strategy, tactics and settlement within policy limits is typically absolute. Chapter 3 of the Report discusses control because it is often references in debates about definitions. References to control do not, however, suggest that third-party funders could not nor should not be able to contract for control over certain aspects of a funded dispute.

<sup>370</sup> The experience in Australia in the last 10 years since the High Court's decision in *Campbells Cash and Carry Pty Limited v Fostif Pty Limited NSW* [2006] HCA 41 [Austl.]; 229 CLR 386 suggests that initial concerns that third-party funders would subvert the civil justice system there if they were allowed “control” over proceedings were unfounded. The typical provisions in Australian funding agreements enabling funded parties to override instructions

Given the historical judicial acceptance of contractual arrangements in which parties transfer control in the insurance and subrogation contexts, this Sub-Committee takes the position that a third-party funder's control should be an issue decided by the parties during the negotiations of the funding agreement. Because there is a dearth of decisional law on point in the arbitration and litigation contexts, the parties should focus on the potential risks and concerns raised by excessive control by third-party funders during contract negotiations.

Regardless of the amount of control retained by a party and/or the third-party funder, the funding agreement should clearly reflect the parties' understanding of who has final say on management and strategy for the funded dispute, and what happens when there is an unresolved dispute over management and strategy.

### **III. Due Diligence Checklist**

This final section of the Chapter provides a due diligence checklist of questions and issues that funders and funded parties should consider before entering into a funding agreement.

#### **1. Concerning the third-party funder's legal and financial/capital structures:**

- a. Is it publicly listed?
- b. Is the funder regulated and/or bound to comply with official and/or publicly published guidelines, whether having the force of law or merely by way of recommendations? Is it subject to the control of any regulating authority?
- c. Is it a limited liability company and, if so, what is its:
  - (i) paid-up capital;
  - (ii) objects clause;
  - (iii) indebtedness and leverage level (indebtedness vs. equity capital)?
- d. Is it an investment fund and, if so,
  - (i) where is it established?
  - (ii) is it regulated and if so, by whom?
  - (iii) what is its duration?
  - (iv) What is its indebtedness and leverage level (indebtedness vs. equity capital)?

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given by third-party funders to the lawyers, and instigate a highly expedited dispute resolution process, can be described as a system of efficient checks and balances, rather than outright control.

- e. Did the third-party funder take any steps to ensure that there is no actual or potential conflicts of interest between any shareholder/investor and a party, arbitrator(s), and/or opposing parties?
- f. How and when does the third-party funder raise the funds necessary to fund the case? Are these funds kept in segregated accounts? If funds are subject to successive capital calls, have precautions been taken to ensure that the committed equity capital is available for the successive calls?
- g. Is the third-party funder regularly reviewed by an external auditing company?
- h. Does the third-party funder raise funds on a case by case basis (“pledge fund”: investors decide which case they are funding)?

**2. Concerning the third-party funder’s specific obligations to a party:**

- a. Is the funding agreement intended to provide for the funding of the arbitration proceedings up to the stage of the rendering of an award (lawyers’ and expert(s)’ fees, arbitrators’ and arbitral institution’s fees), up to the collection of the proceeds, or up to a different milestone?
- b. Is there a selective budget? Which types of costs are not included? Which precise costs/expenses are funded by the third-party funder?
- c. Which aspect of the arbitration or of the enforcement is possibly not included?
- d. Does the funding agreement provide for funding in respect of a potential annulment proceeding (by the respondent, by the claimant)?
- e. Does the third-party funder intend to bear the costs related to enforcement of the award or related judgment resulting from the funded proceedings?
- f. Does the funding agreement cover fees or costs related to ancillary claims, including defense against counterclaims?
- g. Does the funding agreement address the issue of security for costs?
- h. If the decisions of the third-party funder are taken by an investment (or similar) committee, does a professional arbitrator or a legal counsel specialized in arbitration participate in the decisions of the investment committee?
- i. If so, how is the risk of an actual or potential conflict of interest between such person, a party, the opposing party and/or any of the arbitrators dealt with?

**3. The third-party funder’s professional responsibilities**

- a. Does the third-party funder have an internal code of conduct or does it adhere to an external (*e.g.*, industry) one?
- b. Is the third-party funder’s code of conduct compatible with the party’s own ethical principles, and those of the lawyers representing the party?

**4. The Funding Agreement**

- a. Who are the parties to the funding agreement?



- b. Has a separate non-disclosure agreement been signed or does the funding agreement deal with confidentiality-related issues?
- c. If the funding agreement sets out a pre-established budget for the proceedings, does it also provide a solution in case this budget is exceeded?
- d. Does the funding agreement specify the conditions for and degree of control the funder may exercise over case strategy?
- e. Does the funding agreement deal with situations of disagreement between the parties with respect to the strategy to be implemented or pursued? In particular, does it address the issue of resolution of disagreements between the third-party funder and a party concerning settlement proposals?
- f. What remuneration will the funder be entitled to, and how will it be calculated?
- g. Does the funding agreement include provisions regarding a potential adverse costs award against the funded party?
- h. Does the funding agreement include provisions regarding who will bear the costs for enforcing the award?
- i. Does the funding agreement provide for whether and under what conditions it can be terminated?
- j. Does the funding agreement include provisions for modification?
- k. Does the funding agreement provide for a dispute resolution mechanism in case disagreements cannot be solved amicably?

## Chapter 8

### Third-Party Funding in Investment Arbitration

#### I. Introduction

Debates over third-party funding in investment arbitration trace back to underlying differences regarding the purpose and efficacy and legitimacy of investment arbitration itself. The debate over third-party funding in investment arbitration is, therefore, infused with the underlying political dynamics of investment arbitration more generally.

Third-party funding in investment arbitration is a particularly divisive issue in a larger debate over the legitimacy of the investment arbitration regime. The range of sub-issues addressed in the earlier Chapters of this Report exist against the backdrop of these larger policy and systemic issues, but they are not necessarily capable of full consideration or resolution by arbitral tribunals in individual cases.

These complex policy issues and the competing viewpoints regarding them exist within a larger political context. Moreover, key elements of these debates are often premised on factual assumptions, for which empirical information regarding third-party funding specifically is not generally available. This Chapter does not seek to resolve the existing policy issues, but instead to outline the existing debates regarding third-party funding in investment arbitration, provide a meaningful conceptual framework for continued discussion, and propose future areas of inquiry and research as discussion and debate about third-party funding in investment arbitration continues.

Interestingly, most of the cases cited in previous chapters involving decisions over third-party funding are investment disputes and are publicly available. Instead of resolving some of the policy debates, these decisions instead appear to some to have intensified the debate over third-party funding in investment arbitration. For these reasons, the process of drafting this Report has presented many challenges, as acknowledgment of either side of the debate prompts reciprocal concerns by the other side.

Despite these formidable challenges, this Chapter aims to articulate, without fully assessing or resolving, the competing viewpoints that inform this debate. While undertaken with full acknowledgment that some views presented in this Chapter will be unpalatable to one side or the other, it is hoped that this presentation of issues will facilitate meaningful discussion during the public comment period, and perhaps beyond.

Toward that aim, this Chapter will first explore some of the policy and systemic issues that inform specific debates about third-party funding [1.]. The Chapter then proceeds to substantive issues [2.]; in particular, jurisdictional questions regarding the effect of third-party funding on investor and nationality status [A]; whether awarding security for costs protects respondent States or unjustifiably penalizes funded parties [B]; and potential conflicts of interest [C]. It will then

draw some conclusions regarding policy decisions taken by States in their domestic frameworks, in their investment treaties and by international arbitration institutions and professional organizations [D] and then identify areas for further stocktaking, research and discussions [E].

## II. Policy and Systemic Issues

Many of the technical issues, including debates over disclosure and costs and security for costs, are predicated on larger policy debates about the legitimacy of investment arbitration more generally, and the role of third-party funding in that debate. In this regard, meaningful analysis can be difficult because both sides begin with underlying assumptions about the effects of third-party funding on structural aspects of the investment arbitration regime and on the rights of investors within that regime.

On one side of the debate, investment arbitration may be regarded as a legitimate process only to the extent it facilitates and promotes investment seen as an engine for sustainable economic and social development. Under this view, certain categories of cases are considered directly objectionable, and the overall rise in the number of cases—sometimes attributed to third-party funding—has also been an independent cause for concern. The profit incentive of third-party funders is often regarded as inherently incompatible given that arbitral awards are paid from public funds. The notion that some amounts recovered from States would go to third-party funders, instead of solely to aggrieved investors, is considered inconsistent with the underlying goal of promoting sustainable development.<sup>371</sup>

On the other side of the debate, investment arbitration is regarded as an essential means of providing recourse for foreign investors when governments act in ways that violate applicable treaty-based protections for their investments such as protection against expropriation, discrimination or violation of an obligation to provide fair and equitable treatment or full protection and security. Under this view, third-party funding is an essential tool for facilitating access to justice, particularly for that class of investors whose investments have been wrongfully expropriated and therefore would lack the means to pursue an investment claim in the absence of third-party funding.

Even for those claimants whose investments have not been expropriated, the argument goes, investor-claimants should not have to forego business opportunities by using their own capital to pursue recourse for harms allegedly caused by the wrongful conduct of a State.

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<sup>371</sup> See Vernon (“The object and purpose of a number of bilateral investment treaties is to advance sustainable development, a goal potentially at odds with the involvement of profit-driven funders.”). James Egerton VERNON, “Taming the ‘Mercantile Adventurers’: Third Party Funding and Investment Arbitration – A Report from the 14th Annual ITA-ASIL Conference” Kluwer Arbitration Blog (21 April 2017) available at <<http://kluwerarbitrationblog.com/2017/04/21/taming-the-mercantile-adventurers-third-party-funding-and-investment-arbitration-a-report-from-the-14th-annual-ita-asil-conference/>> (last accessed 29 August 2017)

Alternative means of financing claims allows claimants to minimize continued harm from the alleged misconduct, and strategically reduce the risks of pursuing the claims. It is also argued, more generally, that modern third-party funding is not functionally or economically different from alternative means of financing claims, such as contingency fees and certain types of insurance. Under this view, modern third-party funding should not be singled out for different treatment particularly with respect to security for costs.

While these opposing views continue to animate discussion on specific topics relating to third-party funding, as a practical matter they do not move the needle very much. Recent legislative trends are increasingly permitting third-party funding, and no meaningful effort has been made to preclude third-party funding in investment arbitration. Instead, all recent reforms appear to acknowledge implicitly that third-party funding is now there to stay and must be accepted. Where the efforts of regulating and framing third-party funding have gone and could be going in future is towards more transparency. Questions remain about the extent and limits of such transparency, particularly in light of the potential for time-consuming and expensive procedural abuses and the implication of confidential information.

With third-party funding now regularly involved in investment arbitration, there are also more specific policy debates about its effect on caseloads, costs, and investor rights. One of the most common arguments from critics of third-party funding in investment arbitration is that it supports or encourages the bringing of claims that would otherwise not be brought. This critique falls into two categories.

The first area of concern is that third-party funding increases the overall number of investment arbitration claims brought against States. This argument ties into related concerns that, as damages are the primary remedy in investment cases, the effect of alleged expansion would disrupt the balance between investor protection and State interests.<sup>372</sup>

The second, more particular objection is that third-party funding increases not simply the number of cases generally, but the number of speculative, marginal, or frivolous investor claims. Proponents of this view point to the high recoveries sought by claimants,<sup>373</sup> which they argue creates an incentive to fund even cases with a low probability of success because any single success can cover the cost of funding a portfolio that includes other cases that are likely to fail. Notably, there is no clear empirical evidence about whether the increase in investor claims is indeed related to third-party funding, or more specifically about whether funding is increasing the number of

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<sup>372</sup> See Public Statement on the International Investment Regime – (31 August 2010), available at <http://www.osgoode.yorku.ca/public-statement-international-investment-regime-31-august-2010/> (last accessed 29 August 2017).

<sup>373</sup> Liang-Ying TAN and Amal BOUCHENAKI, *Limiting Investor Access to Investment Arbitration: A Solution without a Problem?* in Jean E. KALICKI and Anna JOUBIN-BRET, *Reshaping the Investor-State Dispute System*, (Brill 2015) p. 250 (identifying perceptions that some investment arbitration decisions “award unrealistic and unfair damages to claimants with insufficient regard to public interest, national security or other extenuating circumstances.”).

speculative, marginal, or frivolous cases, given the lack of information or empirical research about the participation of third-party funding in individual cases.

Several responses are offered to these critiques. First, funders argue that such concerns are premised on a misunderstanding of the processes by which funders select cases. As described in Chapter 2, before deciding to fund a case, a funder engages in a rigorous assessment of the claimant's likelihood of success on the merits. The result of this rigorous review, funders report, is that they decide to fund only those cases that are deemed to be highly likely to succeed, which translates into a tiny fraction of cases in which funding is sought. Anecdotally, the funders on the Task Force and those queried in preparing this Report suggest they fund only about one in ten cases for which funding is sought.<sup>374</sup>

Of the cases that qualify for and receive funding, funders report that many of those cases could not be brought in the absence of funding. As a result, they argue, third-party funding operates to provide access to justice that would otherwise be denied to genuinely aggrieved claimants. Relatedly, funders report that some claims for which they forecast a high likelihood of success on the merits do not provide the potential for sufficient return on investment. As a result, some investors are still unable to bring legitimate and potentially meritorious claims. Under this view, even if third-party funding raises the overall number of cases brought, that increase is among presumptively meritorious claims and is attributable to other causes (the increased number of BITS, unlawful behaviour by States, etc.), which account for the increase in cases.

One problem in attempting to sort through these competing arguments is that they arise in the context of larger debates about the legitimacy of investment arbitration. Accordingly, even if most may agree that access to justice is an important goal, they cannot agree on what constitutes a frivolous, marginal or speculative case since that determination is effectively only made once the claims have been rejected by a tribunal, after considerable expense has been incurred by the two sides in dispute.

Critics note that at least some claimants with third-party funding have brought claims that tribunals determined were frivolous or otherwise associated questionable conduct by claimants with funders.<sup>375</sup> Building on this background, some argue that the risks are particularly acute in investment arbitration because of the conditions for jurisdiction and admissibility are stringent and standards of protection in investment treaties, especially fair and equitable treatment, remain vague. As these standards have been broadly developed, they argue, the system is endangered not only by frivolous claims, but also by claims that are speculative or seek to expand the bases for liability for States beyond the originally intended meanings in investment and trade agreements.

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<sup>374</sup> See Chapter 2, at p. 56.

<sup>376</sup> Sam REISMAN, "Critics Pushing Back on 3<sup>rd</sup>-Party Funding Disclosure Rule", (21 June 2017) available at <https://www.law360.com/articles/935786/critics-pushing-back-on-3rd-party-funding-disclosure-rule> (last accessed 28 August 2017), (quoting a partner at a major international law firm as saying "From my experience working with third-party funders, considering the extensive diligence they do on cases, it is unlikely that the existence of litigation funding would increase the number of frivolous lawsuits"); Bernardo M. Cremades Jr., 'Third Party Litigation Funding: Investing in Arbitration', 8(4) Transnational Dispute Management (2011), pp. 12-15.

The primary response to these concerns is that third-party funders do not intentionally fund frivolous cases because it goes against their business model. Moreover, the risk of unintentionally funding a potentially frivolous case is low because of the extensive due diligence funders engage in as part of their decision about whether to fund a case. In support of these views, funders report that they generally fund only one out of every ten cases in which funding is sought. These views have been articulated publicly by many funders and attorneys who have worked with funders,<sup>376</sup> and were underscored in Task Force discussions.

Despite instance that the funding of frivolous, or even high risk, cases could never be good for business or part of an overall strategy for funders, critics of investment arbitration seem as yet unconvinced. One reason might simply be lack of understanding about how funding works. In this sense, it is hoped that the work of the Task Force and the explanations in Chapter 2 of this Report will promote clearer understanding of criteria and processes for selecting cases.

Another possible basis for continued scepticism is that not all funders are created equal. In fact, since constitution of the Task Force, the number of funders has increased significantly, with new venture capitalists and in some instances banks announcing they are “entering this space” (meaning financing of investment arbitration claims). In fact, some cases cited in this Report would seem to illustrate critics’ worst fears about funders,<sup>377</sup> In a field as politicized as investment arbitration, it is perhaps not surprising that these cases may have taken on exaggerated importance. To critics, they are taken as exemplars of all their worst fears about third-party funders, even if many would describe them as anomalous outliers that are not representative.

This debate about the overall impact of third-party funding is not unique to investment arbitration. Similar arguments have been raised with respect to litigation funding in national courts. For example, in the United States, in a petition written by the U.S. Chamber of Commerce and signed by the International Association of Defense Counsel, one argument advanced was that funding would result in an “expected ... increase the filing of ill-considered cases.”<sup>378</sup> There has been some limited empirical research regarding litigation in national courts. For example, a recent study examined the effects of third-party funding in litigation in Australian courts, and concludes that third-party funding leads to an overall increase in the number of claims being brought. It also concluded that third-party funders have funded cases that raise novel issues and involve riskier, more uncertain claims,<sup>379</sup> and that decisions in funded cases were particularly influential in developing the law as they were reversed less and cited more than non-funded cases. By contrast,

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<sup>376</sup> Sam REISMAN, “Critics Pushing Back on 3<sup>rd</sup>-Party Funding Disclosure Rule”, (21 June 2017) available at <<https://www.law360.com/articles/935786/critics-pushing-back-on-3rd-party-funding-disclosure-rule>> (last accessed 28 August 2017), (quoting a partner at a major international law firm as saying “From my experience working with third-party funders, considering the extensive diligence they do on cases, it is unlikely that the existence of litigation funding would increase the number of frivolous lawsuits”); Bernardo M. Cremades Jr., ‘Third Party Litigation Funding: Investing in Arbitration’, 8(4) Transnational Dispute Management (2011), pp. 12-15.

<sup>377</sup> RSM & Turkmenistan

<sup>378</sup> *Ibid.*

<sup>379</sup> Daniel L. CHEN, “Can Markets Stimulate Rights?”, 46(1) RAND Journal of Economics, (2015).

another study of funding of personal injury claims in The Netherlands suggests that greater availability of funding does not lead to an increase in the overall number of claims filed.<sup>380</sup>

Studies of trends in domestic litigation do not necessarily translate into investment arbitration. Meanwhile, there are numerous practical obstacles to doing similar empirical research in the investment arbitration context. To the extent such research is undertaken, three important features of investment arbitration will need to be considered: 1) the high values for relief sought; the high cost of pursuing claims in investment arbitration; and 3) the fact that States can only be responding parties.

Critics argue that if claimants and funders are not compelled to pay the respondent State's costs when they lose, they have an incentive to bring risky claims.<sup>381</sup> Meanwhile, the high cost of pursuing claims make access to justice issues particular poignant, and the need for funding increasingly relevant. However, here again, critics argue that third-party funding contributes to inflating the damages sought and the costs of pursuing such claims.

Notably, most recent investment and trade agreements, while attempting some procedural changes, do not preclude or even limit the use of third-party funding.<sup>382</sup> Instead, the focus is on transparency and on disclosure of the existence and, in some instances the terms of a funding arrangement by a third-party funder. Although few examples are available publicly apart from Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union,<sup>383</sup> some proposed language from draft model investment treaties were presented during Task Force discussions

### III. TECHNICAL AND DOCTRINAL ISSUES

#### A. JURISDICTIONAL QUESTIONS ABOUT THE EFFECT OF THIRD-PARTY FUNDING ON INVESTOR & NATIONALITY STATUS

Third-party funding raises some specific issues in investment arbitration given the language of investment treaties or investment contracts where the subject matter of investment and

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<sup>380</sup> Michael G. FAURE, Ton HARTLIEF and Niels J. PHILIPSEN, “*Funding of Personal Injury Litigation and Claims Culture: Evidence from the Netherlands*”, 2 Utrecht L. Rev. 1 (2006) (finding that Between 1999 and 2003, the number of policies for legal expenses insurance increased by over 30 percent, but the number of personal injury claims remained stable).

<sup>381</sup> *RSM Production Corporation v. Saint Lucia*, (ICSID Case No. ARB/12/10), Assenting Reasons of Gavan Griffith (12 August 2014).

<sup>382</sup> CETA Article 8.

<sup>383</sup> See Article (8.1) of the revised version of the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union, (29 February 2016), available at: <[http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc\\_152806.pdf](http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf)> (last accessed on 26 October 2016).

the investor are precisely defined and often give rise to jurisdictional and admissibility objections. Potential jurisdictional issues relating to the status of the investor. Jurisdiction in investment arbitration is premised on requirements that the claimant “be a covered ‘investor’, carry the nationality of one of the contracting parties, and hold a protected ‘investment’ in the territory of the host state.”<sup>384</sup> Out of these requirements, with respect to third-party funders, two questions have been raised:

- 1) whether the participation of a funder may change the status of, and therefore disqualify, a claimant from qualifying as an ‘investor’; and
- 2) whether third-party funding itself may qualify as an ‘investment’.

These questions can be complicated to answer since the modern forms of non-recourse financing in exchange for a percentage of any potential recovery is now but one of many possible forms. Third-party funding increasingly involves complex and diverse funding structures, which has prompted arguments in some cases that the participation of a third-party funder or transfer or transfer of economic interests may affect the claimant’s status as an investor and its nationality.

Before turning to these arguments, it is worth noting that modern third-party funding has been a specific focus for this argument, but the same and similar arguments could be raised with respect to other funding mechanisms that are functionally similar to modern third-party funding. For example, political risk insurance (PRI) is an important means of encouraging investment, and typically requires the claimant to subrogate the claim to the insurer.<sup>385</sup> As Mark Kantor explains:

[B]y operation of the doctrine of subrogation and the express terms of the PRI programs operated by public insurers like OPIC and MIGA, the insurance provider automatically steps into the shoes of the investor and succeeds to the investor’s claim against the State upon payment under the PRI policy. The subrogated PRI provider is then entitled to pursue that claim against the expropriating State directly – in fact, ordinarily by means of arbitration[.]<sup>386</sup>

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<sup>384</sup> Jonas VON GOELER, *Third Party Funding*, (Kluwer 2016) p. 224.

<sup>385</sup> Jonas VON GOELER, *Third Party Funding*, (Kluwer 2016) p. 226 (“[i]f international commercial practice and international investment practice would not find offensive the involvement of subrogated Political Risk Insurance (PRI) insurance companies, why would they take issue with third-party funding?”) (quoting VAN BOOM, *Investment Arbitration*, at p. 50).

<sup>386</sup> Mark KANTOR, “Comparing Political Risk Insurance and Investment Treaty Arbitration” in Borzu SABAH, Nicholas J. BIRCH, Ian A. LAIRD, José Antonio RIVAS (eds.) *A Revolution in the International Rule of Law: Essays in Honor of Don Wallace, Jr.* (Juris 2014) p. 455, at p. 461.



PRI has generally been regarded as a valuable tool for increasing the flow of foreign investment to developing and emerging economies that need such investment,<sup>387</sup> and claims are routinely brought by subrogated insurers through arbitration. Such claims are not usually brought directly under the investment treaty,<sup>388</sup> and therefore do not directly raise the same issues. Perhaps for this reason, and perhaps because some of the most prominent forms of PRI are government or international organization – sponsored and part of the same package as bilateral investment treaties providing the protection, PRI has not generally been subject to the same criticisms as third-party funding and subrogation practices with respect to insured claims have likewise not raised jurisdictional challenges.

By contrast to the general acceptance of PRI, modern third-party funding by private entities has been met with jurisdictional challenges. For example, the Respondents in *Teinver S.A. v. Argentine Republic* challenged jurisdiction based on an assignment.<sup>389</sup> Respondent argued that “once the assignment is made, the assignor is replaced in the proceedings by the assignee, which has not been the case in this arbitration proceeding.”<sup>390</sup> Under this view, the funder, not the claimant, became “the real party interested in this arbitration” after the assignment, a point supported by the fact that only the funder “would seem to be potentially benefited in the case of a hypothetical award against Argentina in the instant case.”<sup>391</sup>

Claimants’ primary response was related to timing—the funding agreement was entered into after that there was “no applicable legal standard that would prevent this Tribunal from issuing an award of damages in Claimants’ favour due to the assignment agreement.”<sup>392</sup> The Tribunal did not decide the issue in the decision on jurisdiction and left it for the final award.<sup>393</sup> In the final award, the Tribunal found that the assignment was not for “contentious claims” but rather for the “proceeds from any award issued” and, therefore, in the eyes of the Tribunal no assignment occurred that affected Claimants’ standing in the proceedings.<sup>394</sup>

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<sup>387</sup> OPIC, “New Opic Political Risk Insurance Will Cover Investments by Private Equity Funds”, “PRI coverage can significantly mitigate the risks posed to emerging market private equity investors, and thereby increase their appetite to pursue the opportunities available in the developing world.” OPIC, “New Opic Political Risk Insurance Will Cover Investments by Private Equity Funds”, available at <<https://www.opic.gov/press-releases/2011/new-opic-political-risk-insurance-will-cover-investments-private-equity-funds>> (last accessed 29 August 2017).

<sup>388</sup> See Mark KANTOR, “Comparing Political Risk Insurance and Investment Treaty Arbitration” in Borzu SABAH, Nicholas J. BIRCH, Ian A. LAIRD, José Antonio RIVAS (eds.) *A Revolution in the International Rule of Law: Essays in Honor of Don Wallace, Jr.* (Juris 2014) p. 455 pp. 461-62 (describing arbitrations brought by the United States against India and Indonesia to recover on subrogated claims insured under OPIC).

<sup>389</sup> *Teinver S.A. v. Argentine Republic* (ICSID Case No. ARB/09/1) Decision on Jurisdiction, (21 December 2012).

<sup>390</sup> *Teinver S.A. v. Argentine Republic*, (ICSID Case No. ARB/09/1) Award (21 July 2017) p. 60.

<sup>391</sup> *Ibid* p. 60.

<sup>392</sup> *Ibid* p. 60.

<sup>393</sup> *Teinver S.A. v. Argentine Republic*, (ICSID Case No. ARB/09/1) Decision on Jurisdiction, (21 December 2012) p. 61.

<sup>394</sup> *Teinver S.A. v. Argentine Republic*, (ICSID Case No. ARB/09/1) Award, (21 July 2017) p. 61-62.

Another line of investor-State cases took up related challenges that various forms of funding may be a *de facto* “transfer of case control to a funder before the initiation of arbitral proceedings” that may “lead to a change of the claimant’s identity, and thus does not affect the admissibility of a funded investor’s claim”.<sup>395</sup> In some cases, tribunals relied on the timing of any alleged transfer of control to conclude that the role of a third-party funder does not affect jurisdiction.<sup>396</sup>

For example, in *CSOB v. Slovakia*, CSOB assigned its claims to its home State. In concluding that it retained jurisdiction, the tribunal reasoned that “the transfer of rights after the institution of proceedings should not be taken into account at all, and consequently cannot affect jurisdiction.”<sup>397</sup> Another tribunal, with reference to *CSOB v. Slovakia* and related case law from the International Court of Justice, found that “once established, jurisdiction cannot be defeated [...] [i]t is simply not affected by subsequent events [...] this principle applies in particular to the nationality requirements under Art. 25 of the ICSID Convention.”<sup>398</sup>

The decision in *RosInvestCo UK Ltd. v. The Russian Federation*, went further, concluding that timing was not the primary consideration. The tribunal in that case concluded that even a funding agreement entered into *before* the initiation of arbitral proceedings would not affect the meaning of the terms “investment” and “investor.”<sup>399</sup> The tribunal in *RosInvestCo* reasoned that the assignment from RosInvest “to a funder of a different nationality than the funded party before the initiation of the arbitral proceedings does not affect jurisdiction” unless the relevant investment treaty states otherwise in clear language.<sup>400</sup> As a consequence, the tribunal concluded that financing for a claim does not affect jurisdiction for the arbitration.

Based on these arbitral awards and in the absence of any new investment treaty language, the existing position in investment arbitration appears to be that third-party funding, regardless of the form, does not alter the national identity of a claimant and hence the jurisdiction of arbitral tribunals. This outcome arguably produces a result similar to the long-established use of political risk insurance, and the practice of subrogating claims that is typical in that context because, as analyzed in Chapters Two and Three, subrogation can fit within some definitions of third-party funding. Although a similar outcome is reached through subrogation in the PRI context, the claims are actually brought pursuant to a separate arbitration agreement, so does not directly implicate the technical definitional issue.

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<sup>395</sup> Jonas VON GOELER, *Third Party Funding*, (Kluwer 2016) p. 243.

<sup>396</sup> As noted in Chapters 2 and 3, the extent and nature of control exercised can vary both among funders, and among funding agreements.

<sup>397</sup> Jonas VON GOELER, *Third Party Funding*, (Kluwer 2016) p. 227-228.

<sup>398</sup> Jonas VON GOELER, *Third Party Funding*, (Kluwer 2016) p. 230.

<sup>399</sup> *Ibid* at p. 233 (“The award in *RosInvest* provides considerable support for the position that a litigation funding agreement does not negatively affect jurisdiction, even if concluded *before* the date the proceedings are initiated.”).

<sup>400</sup> *Ibid* at p. 239.

This position is also consistent with the use of contingency and conditional fees, which in many respects are functionally equivalent to third-party funding, but likewise have not been asserted as a basis for challenging jurisdiction. Moreover, given that the few known treaty revisions that address third-party funding have focused on disclosure issues, it seems unlikely that States are or will seek to introduce provisions that affect investor or nationality status based on funding.

**[B] SECURITY FOR COSTS: NECESSARY TO PROTECT RESPONDENT STATES VS. UNJUSTIFIABLY PENALIZING FUNDED PARTIES**

The legal frameworks and practical considerations regarding costs and security for costs, in both investment and international commercial arbitration, are analyzed in Chapter 6. The conclusions there, based on analysis of existing sources and reported investment arbitration cases is that the existence of third-party funding is generally irrelevant to either a determination of a request for security for costs or a final allocation of costs at the end of the case.<sup>401</sup> The Task Force concluded that the principles articulated are a sound reflection of existing standards and economic principles that affect analysis in particular cases. It nevertheless recognized that these issues can also implicate larger macro-economic and structural debates in investment arbitration, which are reflected on briefly in this Section.

State parties and critics often tie their concerns about third-party funding to structural issues regarding increasing investment arbitration caseloads and the potential financial strain on States.<sup>402</sup> This concern stems from the fact that in investment treaty arbitration, States are always respondents and are not able to bring counter-claims. Even when a State prevails, it does not receive compensation and will have to pay for the costs of its own defence. Funding is now available (albeit on a very different basis, typically more akin to after-the-event insurance) for responding States. One of the most prominent examples of third-party funding of a respondent State is the financial support for Uruguay in the *Philip Morris v. Uruguay* case.<sup>403</sup>

In this context, security for costs and allocation of costs at the end of case are regarded as a means of deterring frivolous claims and ensuring that, if the respondent prevails and is awarded costs at the end of the case, a losing claimant will be able to pay the adverse costs award.<sup>404</sup> The

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<sup>401</sup> For a discussion on existing standards for allocating costs and granting security for costs, see Chapter 6.

<sup>402</sup> Marco de Morpurgo, 'A Comparative Legal and Economic Approach to Third-Party Litigation Funding', 19 *Cardozo Journal of International and Comparative Law* (2011), p. 352 and Maya Steinitz, 'Whose Claim Is It Anyway? Third-Party Litigation Funding', 95 *Minn. L. Rev.* 2011, p. 1267.

<sup>403</sup> "The Anti-Tobacco Trade Litigation Fund", available at <[http://global.tobaccofreekids.org/en/about\\_us/trade\\_litigation\\_fund/](http://global.tobaccofreekids.org/en/about_us/trade_litigation_fund/)> (last accessed 27 August 2017) ("The fund will support low- and middle-income countries that have been sued by tobacco companies in arbitration under international trade agreements. Managed by the Campaign for Tobacco-Free Kids, the fund will provide financial and technical assistance to governments committed to defending their laws to reduce tobacco use.").

<sup>404</sup> See Memorandum of 12 June 2016 from Iván A. ZARAK, Acting Minister of Economy and Finance of Panama, to Meg Kinnear, International Centre for Settlement of Investment Disputes, available at

increasing number of investment arbitration cases raises concerns about States' ability to offset the costs of responding to such cases, particularly small States and States facing domestic economic challenges. These concerns were historically also accompanied by assumptions that the provision of third-party funding necessarily implied a funded party was impecunious or would otherwise be unable to satisfy a potential costs award.

Today, as described in Chapter 2, the assumption that funding *necessarily* signals an impecunious claimant is no longer sustainable.<sup>405</sup> As noted above, it can provide resources for a respondent State, and is increasingly being undertaken not out of financial necessity, but as a means of allocating corporate resources and risks. Nevertheless, there are still many cases in which claimants seek funding because they do not otherwise have the resources to pursue those claims. In this category of cases, however, third-party funding can enable a party that has had all of its assets wrongfully expropriated to nevertheless to pursue a remedy. In such a case, an order for security for costs would penalize a party for not having resources, even though its lack of resources was caused by the responding State's allegedly improper expropriation of its assets.

On this issue, the prevailing view among respondent States and related stakeholders is that it would be particularly unfair, now that the trend is for costs to follow the event, if a prevailing State cannot collect costs against an impecunious claimant or be reimbursed by the third-party funder that was prepared at the outset to share in the risk of making a potential gain. As noted by Panama in its recent letter to ICSID, an increasing number of enforcement cases are being brought by prevailing States before the domestic courts in an investor's home State.

On the other side of the spectrum, some argue that the monitoring of fees and expenses by third-party funders may generally reduce the overall cost of obtaining a successful award. Given their incentive to keep legal costs within predicted budget projections, the argument is that they may be more focused on efficiency than law firm representation based on a straight hourly rate.<sup>406</sup>

Another recurring argument raised by funders, however, is that when the presence and identity of a funder is revealed, respondents use the disclosure as a basis for bringing challenges to arbitrators, requests for further disclosure, and requests for security for costs. These reactions to disclosure of funding arrangements can slow arbitral proceedings considerably, and consequently significantly increase the costs of an arbitration. Funders and funded parties argue that many of these efforts are substantively unfounded and are instead simply tactics to delay proceedings and increase the costs of proceedings to make the funding model untenable.<sup>407</sup> In fact,

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<[http://res.cloudinary.com/lbresearch/image/upload/v1477064514/rop\\_memorandum\\_to\\_icsid\\_administrative\\_council\\_re\\_effective\\_protection\\_english\\_version\\_2\\_219116\\_1641.pdf](http://res.cloudinary.com/lbresearch/image/upload/v1477064514/rop_memorandum_to_icsid_administrative_council_re_effective_protection_english_version_2_219116_1641.pdf)> (last accessed 27 August 2017).

<sup>405</sup> See Chapter 2, at p.13 (describing why parties seek funding, and different types of financing or insurance that can provide for satisfaction of an adverse costs award).

<sup>406</sup> Funders' cost-monitoring function has raised some questions about attorneys' independent professional judgments. These issues are generally the province of national ethical rules and the funding agreement, and for these reasons not considered directly in this Report, other than generally in Chapter 7 in a discussion of Best Practices. See Chapter 2, at p. 20; Chapter 7.

<sup>407</sup> Unforeseen delays or increases in legal costs can change the assumptions on which funding was provided and make otherwise potentially meritorious claims unprofitable from the funder's perspective. See Chapter 2, at p. 20.

the potential for such challenges is the primary reason why funders express reluctance at having their presence and identity disclosed.

Debates about costs and security for costs, and the existing standards articulated in Chapter 6, are being challenged based on larger macro arguments about structural incentives and disincentives, and the ability of States to effectively recover costs that they may be awarded at the end of a case, described above in Part I of this Chapter.

Some funders have argued that security for costs does not have a place in arbitration generally. Under this view, the risk of an unenforceable award (including an unenforceable award for costs) is like any litigation risk, and should not be treated differently in the investment context. Systematic issuance of security for costs orders will simply raise the cost of third-party funding for investors, which will translate into reduced recovery margins for funders or a restriction on the availability of funds. Either scenario, it is argued, will reduce the ability of genuinely aggrieved investors to access justice.

Other funders have argued that they are rather agnostic about the imposition of security for costs because any costs added by such an order can simply be added into the funding agreement. The greater problem, under this view, is uncertainty about whether security for costs will be granted. In a related vein, at least one tribunal has found that the existence of after-the-event, or ATE, insurance is sufficient security and no order is necessary. As described in Chapter Two, this type of insurance can be purchased to provide for coverage in the event a claimant is liable for adverse costs.<sup>408</sup> Indeed, in *Eskosol S.p.A. v. Italy*, the tribunal found that Italy's request for security for costs was not urgent because the claimant had purchased ATE insurance.<sup>409</sup>

Premiums for ATE or added financial burdens to cover a potential adverse costs in a funding agreement may still raise questions. On the one hand, particularly for claimants in financial difficulties, they may not be able to afford the premiums for ATE insurance. Alternatively, the inclusion in a funding agreement of coverage for a potential adverse cost award necessarily raises the cost of securing such funding. A reasonable argument could be made that ATE or coverage in a funding agreement can be a workable alternative to an order for security for costs, and can provide a benefit to all by avoiding the added delay and expense that comes with an application for such an order. A natural question, however, might become who pays for the cost of such security in the event a responding State loses, and how might the cost savings of translating this point of contention and uncertainty into a more simple question of insurance and structural planning.

### C. POTENTIAL CONFLICTS OF INTEREST

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<sup>408</sup> See *Eskosol S.p.A. v. Italy*, ICSID Case No ARB/15/50.

<sup>409</sup> See Chapter 6, at p. 134.

The issue that has attracted the most attention regarding third-party funding is with respect to arbitrator's potential conflicts of interest. As with parties and law firms, an arbitrator may have potential conflicts of interest with third-party funders. Until recently, however, the existence of funding and identity of funders was not disclosed to facilitate assessment of potential conflicts by arbitrators.

As part of their rigorous assessment of a case prior to agreeing to funding, particularly in the context of investment arbitration where a number of technical and substantive issues as well as high amounts at stake make the funding more risky, funders recurrently ask for first or second opinions from experienced arbitration lawyers, often arbitrators themselves. Some examples of reputed arbitrators sitting on the board of funds or acting as advisors have made headlines of professional press.<sup>410</sup> Meanwhile, as noted, disclosure has led to what some contend are unfounded challenges to arbitrators.

Chapter Three of this Report examines recent developments, introduced by various arbitral institutions, national regulators, international trade agreements, and international soft law, which increasingly require disclosure about the identity of funders to enable arbitrators to assess potential conflicts of interest. Chapter Three proposes that the existence and identity of a funder be disclosed, either as a matter of course or in response to a request from an arbitral tribunal or institution. It does not, however, propose any new standards for substantively assessing potential conflicts of interest, but instead leaves such assessment to existing standards. This trend has been followed also in the context of investment arbitration either by States in their recent treaties or by arbitral institutions. As indicated earlier, the fact that third-party funding is now part of the picture is acknowledged but regulated and framed by provisions requiring disclosure. The trend is particularly strong in investment arbitration given the underlying goal of achieving more transparency to alleviate concerns about the system itself and increase its legitimacy.

#### **D. Recent moves towards regulating third-party funding in investment arbitration**

Notably, neither the IBA Guidelines nor the Principles in Chapter Three of this Report are formally binding, and the ICC Guidance Note is also similarly an advisory,<sup>411</sup> not mandatory

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<sup>410</sup> *Beechey to advise third-party funder*, available at <<http://globalarbitrationreview.com/article/1032778/beechey-to-advise-third-party-funder>>, last visited 21 August 2017.

<sup>411</sup> See ICC Note to Parties and Arbitral Tribunals on the “Conduct of the Arbitration under the ICC Rules of Arbitration”, (22 September 2016), p. 5, at para. 24 available at <<https://iccwbo.org/publication/note-parties-arbitral-tribunals-conduct-arbitration/>> (last accessed 29 August 2017); Aren GOLDSMITH and Lorenzo MELCHIONDA, “The ICC’s Guidance Note on Disclosure and Third-Party Funding: A Step in the Right Direction”, Kluwer Arbitration Blog, (14 March 2016) available at <<http://kluwerarbitrationblog.com/2016/03/14/the-iccs-guidance-note-on-disclosure-and-third-party-funding-a-step-in-the-right-direction/>> (last accessed 18 August 2017); See also “Standard

instrument. Meanwhile, the SIAC Investment Arbitration Rules 2017 expressly authorize arbitral tribunals to require disclosure of third-party funding, but they do not require such disclosure.<sup>412</sup> The only mandatory disclosure requirements that apply to international arbitration appear to be the national legislative reforms in Hong Kong and Singapore, and a few provisions in investment treaties.<sup>413</sup>

ICSID has recently announced that it will be considering rules governing disclosure of third-party funding as part of its process of updating its rules and regulations.<sup>414</sup> It remains to be seen whether ICSID and other institutions will mandate systematic disclosure of funding and the identity of funders or, consistent with the approach of the SIAC Investment Arbitration Rules, simply authorize arbitrators to order such information.

#### IV CONCLUSION

As noted in the introduction, this Chapter does not seek to provide concrete answers to the larger considerations and policy debates in which third-party funding issues are often raised. Instead it aims to provide a fair-minded presentation of competing viewpoints in the larger political debates, sharpen the focus of such debates and, in this conclusion, suggest some possible areas for future research and work.

As described in Chapter One,<sup>415</sup> the central purposes of the Task Force include promoting a clearer understanding of issues relating to third-party funding and engaging a range of stakeholders in meaningful dialogue about those issues. From this view, the Task Force's means were an end in themselves. In the work of the Task Force itself, Members shared generously from their experiences and distinct perspectives, but also listened and engaged in dialogue that, at least in some instances, changed otherwise settled minds. It is hoped that, through this Draft Report, the public comment period, and publication of the final Report, the work of the Task Force will provide for better composite understandings of the issues and greater appreciation of the reasons for differing viewpoints.

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6" of the IBA Guidelines on Conflicts of Interest in International Arbitration, and Explanation to Standard 6 (b), available at [https://www.ibanet.org/ENews\\_Archive/IBA\\_July\\_2008\\_ENews\\_ArbitrationMultipleLang.aspx](https://www.ibanet.org/ENews_Archive/IBA_July_2008_ENews_ArbitrationMultipleLang.aspx) (last accessed 15 July 2017).

<sup>412</sup> Mark MANGAN and Henry DEFRIEZ, "SIAC Investment Arbitration Rules 2017", available at <http://oxia.ouplaw.com/page/siac-ia-rules> (last accessed 28 August 2017) (stating that "The new rules are the first of any major arbitral institution to grant tribunals the express authority to require the disclosure of any third-party funding arrangements").

<sup>413</sup> See Chapter 3.

<sup>414</sup> Global Arbitration Review, "ICSID Secretary General's Top Priorities for Reform", available at <http://globalarbitrationreview.com/article/1140847/icsid-secretary-generals-top-priorities-for-reform> (last accessed 28 August 2017).

<sup>415</sup> See Chapter 1, at p. 2.

Dialogue alone will not, of course, necessarily produce consensus. In fact, even after extensive discussions, many areas of disagreement remained among Task Force Members. Particularly as the number of third-party funders and funded cases increase, and the pace of related reforms quickens, and as public scrutiny remains trained on investment arbitration, the need for constructive dialogue has never been greater.

Meaningful and engaged dialogue can help identify more clearly areas of actual agreement and disagreement, sharpen focus and analysis, and help collectively distinguish between what are priorities and what is background noise. At a minimum, some collective understandings can help identify the critical issues for sustained independent empirical research that is needed to bring clear-eyed assessment to some of the factual assumptions that animate arguments on both sides. It is also at least possible that such dialogue may also facilitate some creative solutions to seemingly entrenched opposition on issues relating to third-party funding. In this respect, the Task Force hopes that input received during the public comment period will further advance our understanding.

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