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Third-party funding in international commercial arbitration: a wolf in sheep's clothing?

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(*)

Introduction

"That there is no such thing as a free lunch remains a debatable statement. But that there is no such thing as a free arbitration is not". (1)

Over the last two decades, international arbitration has experienced a growth, becoming the preferred mechanism of dispute resolution for international transactions. (2) Collaborative research led in 2015 by Queen Mary University of London and White & Case LLP shows it is the favoured method of dispute resolution for 90% of respondents. That being said, when asked about its worst features, nearly 70% of participants unequivocally indicate "costs". (3)

Indeed, over time, arbitration proceedings became long-winded and costly. (4) Arbitration costs followed its popularity and turned exorbitant. (5) Being a "private form of adjudication", (6) those costs are destined to be entirely covered by parties. (7) In this context, third-party funding represents an alternative means of funding. (8)

In its general meaning, third-party funding involves an unrelated party providing financial support to a claimholder in order to support litigation or arbitration costs. (9) As such, it is no new phenomenon and has traditionally P 919 taken several forms, ranging from insurance policies, to attorney financing agreements or loans with financial institutions. (10) However, a new funding alternative emerged, where a third party finances – fully or partly – the arbitration costs in exchange for a share of the gains. (11) Usually, this share oscillates between 15% to 50% of the result. (12) In this configuration, should the funded party prevail, the funder obtains a portion of the proceeds of the award or the settlement. (13) Conversely, should the outcome be unfavourable, the funder loses its initial investment and cannot recover its funding from the funded party. (14)

This industry grew steadily, yet its popularity has sparked much debate globally. By enabling claimants to reach arbitration, third-party funding incarnates a welcome progress to access to justice and therefore is to be saluted. Nevertheless, its fierce detractors do not fail to underline the risks and drawbacks it bears.

This article assesses and discusses both the benefits and the risks of third-party funding in international commercial arbitration (Chapters 1 and 2). Additionally, it analyses the various approaches taken towards third-party funding by renowned jurisdictions, engaged in "a race to the top" (15) (Chapter 3). (16)

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Chapter 1 Benefits of third-party funding

I Access to justice

A The legal costs crisis

Legal costs tend to increase. (17) In the UK, Lord Justice Jackson conducted a review on the matter in 2009, resulting in the commonly called "Jackson Report", which assessed and proposed solutions to this unprecedented crisis. (18)

Regarding arbitration, parties are likely to spend even more, as they do not only pay for common expenses, but also arbitrators' fees as well as other onerous expenditures. (19) Those costs can therefore constitute a financial barrier and act as a catalyst, exacerbating difficulties to access arbitration. In this respect, third-party funding offers a funding alternative benefitting two types of potential claimholders. (20)

B Impecunious claimants and financially stable entities

At the one end of the spectrum, third-party funding might help impecunious or disadvantaged parties. Indeed, when disputants are in a situation of equals, in terms of size, amounts at stake and availability of funds, a battle of equals can take place. (21) Conversely, the battle might be turned into a David-and-Goliath fight when one party is impecunious or much smaller than the other and must initiate proceedings to enforce its rights. (22)

In this scenario, despite a very strong case, a lack of funds might prevent the smaller party to access arbitration. (23) In such a situation, funding arrangements allow smaller companies to put up an equal fight against their opponents, promoting access to justice.

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(24) Overall, even if a portion of the ● prospects will be shared with the funder, “it is better for him to recover a substantial part of his damages than to recover nothing at all”. (25)

At the other end of the spectrum, third-party funding might also be profitable for parties with sufficient assets seeking an alternative route to fund arbitration. (26) Indeed, claimholders may be hesitant to mobilize funds to take a dispute further. The outcome of an arbitration being highly uncertain, parties might hesitate to initiate what could be a long fight. Having recourse to a third-party funding enables them to outsource the risks and the burden of costs tied to the claim. (27)

C Profitability barrier

Increased access to justice also comes with limitation. To fund an arbitration, funders have to label it as “suitable”. (28) Funders are not charities and are aiming to gain a profit. Funding will only be granted when the case is likely to yield staggering results. Thus, the claim must respect a certain calibre and be commercially interesting as well as promising in terms of projected outcome. In the opposite, it is implausible a funder shall invest on it. (29)

II Third-party funding providing experience and input

Funders usually count skilful litigators and legal professionals with in-depth knowledge and case management experience among their employees. Hence, funders are in a good position not only to recommend outside counsel, experts or arbitrators but also to give tactical advice and provide a second opinion on a given case. (30) This might benefit the funded party and its team.

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Chapter 1 Risks and downsides of third-party funding

I Confidentiality and third-party funding

Confidentiality is a keystone of international commercial arbitration. Although this principle suffers several exceptions, materials and information obtained during the arbitral process are confidential and therefore not to be disclosed. (31) A claimholder submitting its case to a potential funder, puts confidentiality at risk, which might result in its violation. (32)

Indeed, prior to funding, a skilled team within the third-party funder routinely performs a due diligence of the case in order to decide whether to finance it or not. (33) This team not only reviews elements linked to the claim (e.g. the prospects of success; the quantum), (34) but also analyses aspects related to the arbitration itself (e.g. the arbitration agreement; the seat; the composition of the arbitral tribunal; the applicable laws; the jurisdiction where the award is to be enforced; (35) the probable duration (36) of the arbitration). If a funding agreement is reached, a second phase begins – the case monitoring phase – where the funder is updated on the case's development. (37)

A funder is considered a non-signatory party in the arbitration. As a consequence, it is not bound by confidentiality, even if applicable as such. (38) When submitting their case to a funder – before or after the arbitration has started – the claimholder risks violating their obligations. This might have disastrous consequences for the non-funded party as the funder could acquire information related to them and use it to their detriment in another case involving them. (39)

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II Conflicts of interest: a hazardous ménage à trois?

A Requirements on arbitrators’ independence and impartiality

The requirements of independence and impartiality of arbitrators are internationally recognized and contained in every institutional rule. (40) Those rules require arbitrators to disclose “all the facts that could reasonably be considered grounds for disqualifications”. (41)

The IBA Guidelines on Conflicts of Interest in International Arbitration of 23 October 2014 introduce a useful color-coded list of situations that might present issues regarding independence and impartiality. Although not binding, the IBA Guidelines propose an international common set of principles well accepted in practice. (42)

B Third-party funding and conflicts of interest: possible scenarios

As things stand, a funded party is under no obligation to disclose being funded, as no rule expressly requires so. That said, the presence of a funder could lead an arbitrator to be in a conflict of interest which might put the efficiency of arbitration at risk. (43) Numerous scenarios could be exposed, including but not limited to, the following examples.

An arbitrator appointed several times by the same funder could be in a situation of conflict of interest. (44) This echoes the orange list of the IBA Guidelines on Conflicts of Interest dealing with arbitrators’ “previous services for one of the parties or other

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involvement in the case”. (45)

Arbitrators might also, somehow, be financially related to the funder. An arbitrator that would be a shareholder in a publicly traded third-party funding corporation could risk being in a conflict of interest. (46) In the same vein, an arbitrator that would be a major shareholder or a director of a funding corporation would probably also be in a conflict of interest. (47)

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C Consequences of a conflict of interest

Third-party funding carries significant risks regarding the efficiency of international arbitration.

A conflict of interest threatens the valid composition of the arbitral tribunal as it could lead to a challenge of the arbitrator on the grounds of lack of independence or impartiality. (48) This would paralyze the arbitration, causing undue delay and increasing costs. (49)

More importantly, if the conflict of interest is only discovered after a final award has already been rendered, it might well be unenforceable or unrecognizable under article V(2) of the New York Convention. (50)

III Unfair terms and control over the claim

Prior to entering a funding agreement, negotiations over the terms will take place between the funder and the claimholder. (51) Due to its financial advantage, the funder has valuable leverage. A funder could therefore abuse its power and impose unfair terms to its contractual partner (52) (e.g. impose a disproportionate share (53)).

“He who pays the piper calls the tune” says the famous proverb. Funders’ remuneration depending on the success of the claim, there might be temptation for them to impose their views during the course of the procedure. (54) Sharp disagreements might emerge with regard to strategic approaches undertaken, (55) or, as further explained, regarding settlements. (56)

Regarding funders’ control over the claim, the recent Excalibur decision has sparked debate in the litigation context, where funders –inexperienced in this case – were held liable for adverse costs, even though they were not considered as a party. (57) Costs can therefore be awarded against P 925 funders if they acquire a certain degree of interest and control over the claim, (58) which in this case has been described by the English Court of Appeal as “spurious”, “speculative and opportunistic” with “no sound foundation in fact or law”. (59) This decision confirms that funders should exercise adequate control over a claim, not only by conducting a robust due diligence but also by monitoring the case once started. (60)

Unlike state courts, arbitral tribunals have no discretional powers to hold third-parties liable for costs. (61) That said, this case reinforce most funders’ view regarding control and the current debate on regulating this topic as well as the importance of strong auto-regulation. (62)

IV Frivolous claims and settlements

By facilitating access to justice third-party funding could result in opening the floodgates to trivial claims. (63) Funding could encourage parties to initiate lawsuits – even frivolous – where otherwise it would have been unresolved.

That being said, it is more likely that funders act as gatekeepers, filtering frivolous claims, rather than encouraging it. (64) As underlined by Robert Volterra: “I'm not aware of any funder keen to throw away their money on frivolous litigation”. (65) In the same vein, an ICC study pointed out that on average, only 5% to 10% of all cases submitted are eventually funded. (66)

Additionally, it could be argued that third-party funding discourages settlement as the funded party does not carry the financial risks of an P 926 unsuccessful outcome and therefore loses its incentive to settle. (67) Having said that, practice tends to show it is likely that the opposite occurs.

“Time is money”, says the popular adage. Accordingly, funders might prioritize a faster – and certain – settlement over a long and unpredictable outcome. This is reinforced by the fact that funders also assume the risk of a non-enforcement of the award. (68) Therefore, settlement might well be encouraged rather than deterred when funding is provided. (69) It is noteworthy that a “fast settlement” might be in sharp contrast with the claimholder's notion of an “acceptable settlement”. (70) Funding agreement therefore indicate sometimes who has the final say regarding settlements. (71)

V Security for costs and costs

A Security for costs

i Conditions to grant security for costs

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An arbitral tribunal deciding whether to grant security for costs or not must exercise its power of discretion. No uniform test has been stipulated to this day. (72) Arbitral tribunals tend to exercise their power with caution and carefully analyse the financial situation of the party against whom the measure has been requested. (73) If it is assumed that this party will be in financial difficulty and unlikely to pay the potential awarded costs, an order should be granted. In such cases, the burden of proof should be on the party requesting the measure. (74)

ii Security for costs in a third-party funding scenario

The existence of a third-party funding in such situations has drawn attention notably regarding whether the tribunal should "routinely" award security for costs when the claimant is being funded. (75)

The classic scenario supporting this statement involves an impecunious party entering a funding agreement which stipulates that the funder is not liable P 927 for adverse costs. (76) In such a case, it seems highly unlikely this party would be able to pay the awarded costs, justifying security for costs to be ordered. It has therefore been argued that, in order to preserve the defendant's rights, the mere presence of a funder should justify ordering security for costs. (77)

This opinion has generated a swelling of criticism. There is no doubt that third-party funding is not only sought by impecunious parties but is also frequently solicited by solvent parties looking for a funding alternative. (78)

The recent draft report of the ICCA-QMUL Task Force on third-party funding, issued on September 1st, 2017, indicates that third-party funding should not – *per se* – be sufficient to order security for costs, (79) stating:

> "[T]hird-party funding is increasingly used by large, solvent companies that simply wish to share risk and maintain liquidity [...]. It is thus suggested that applications for security for costs [...] should be determined irrespective of any funding arrangement, and on the basis of impecuniousness.". (80)

B Costs

Once the arbitral tribunal has dealt with substantial issues, it has to address the question of costs. Firstly, it has to decide whether to award costs or not. (81) Secondly, it must then determine how to allocate them. Several institutional rules indicate that "costs should follow the event", unless circumstances suggest it is not appropriate. (82)

In this context, it has notably been widely debated whether or not the mere presence of external funding should be taken into consideration when awarding costs. (83) In this regard, a recent turnaround in the UK has shaken the nascent case law. (84)

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In this recent Essar v. Norscot case, while awarding costs to the claimant, the arbitral tribunal decided to include the amount owed by the claimant to the funder in conformity with their agreement.

Essar brought a challenge to the English High Court over its liability regarding the awarded costs. Judge Waksman QC confirmed the arbitral tribunal's power to award those costs. (85) It should be noted that the arbitrator's costs decision, and its confirmation by a judge, have been influenced by the "reprehensible" conduct Essar adopted before the arbitration was initiated. (86) This case could therefore remain quite exceptional, as not every party adopts such a bad conduct.

That said, this decision turned the ship around, stating that under English law, the amount owed to the funder according to a funding agreement, is now – theoretically at least – recoverable.

VI Bundling of claims and derivative products

The industry of third-party funding is, without a doubt, exponentially expanding globally. (87) The UK-based funder Burford Capital saw its profit raising by 400%, between 2008 to 2014, (88) whereas its main competitor, Juridica Investment, experienced a very similar growth. (89)

Motivated by maximisation of profits, this industry evolved over time, going from "funding" to "finance" in less than a decade. (90) This evolution has been accompanied by diversification and sophistication of the products offered by funders. (91)

As the market grows, funders lose interest in case-by-case investments, (92) and are increasingly interested in "bundling claims". By doing so, the funder invests in several claims, held by the same party, turning those P 929 into a single "portfolio" or "basket". (93) Stand-alone cases with high risks can be considered too risky and uncertain for funders. Portfolios enable them to offset a high-risk case with low risk cases where liability is clear. (94) In order to diversify risks, each portfolio will be composed of different claims with different levels of risk. This enables the funder to absorb losses more easily. That said, it also results in more complex instruments. This practice has only been growing: in 2009, 100% of Burford's capital was invested in "single cases" whereas in 2016, this

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proportion plummeted to 12% while 88% was invested in portfolios and "complex matters". (95)

Eventually, in order to generate more profit, products even more complex and opaque might be created. A commercial claim is an asset like any other (96) and in theory, there is no obstacle to trade it as a derivative product. (97) As the co-founder of Burford Capital indicated: "There is even the possibility – heaven forbid – that we could fund a case and then resell it to third parties, a bit like credit default swaps". (98)

These new investments might result in the emergence of new unregulated financial products, (99) that could become real "time bombs", as described by Warren Buffet. (100) Indeed, obscure products could emerge resulting in the creation of products close to credit default swaps which led, in a recent past, to the downfall of Lehman Brothers and the collapse of the global economy. (101)

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Chapter 3 Renowned international arbitration seats: A Game of Thrones?

I Competitiveness of famous seats

"Winter is coming" warned Gary Born, world-leading arbitrator, President of the Singapore International Arbitration Centre (SIAC) and seemingly HBO series addict. (102) While his warning prescribed the arbitration community to defend their grounds against States' intervention ("an army of undead"), this amusing quote could equally apply to famous seats defending their popularity. (103)

Collaborative research led in 2015 by Queen Mary University of London and White & Case LLP reveals that participants' "most preferred and widely used arbitration seats are London, Paris, Hong Kong, Singapore and Geneva". (104) This research also indicates that 71% of arbitration stakeholders consider that third-party funding requires regulation, being of the opinion that disclosure is the most concerning issue. (105) Simply put, this means that a majority of arbitration potential users – that could opt for famous seats in case of a dispute – advocate a legal groundwork to be implemented, framing the activities of third-party funding, notably regarding disclosure matters.

Famous seats wishing to take the lead in terms of popularity or remain competitive should therefore maybe acknowledge and act upon the emergence of third-party funding. Thus, the question remains to determine where those five particular jurisdictions stand on third-party funding to this day.

II Third-party funding in the UK

English case law stated that a person is guilty of "maintenance" "if they support litigation in which they have no legitimate concern without just cause or excuse". Regarding "champerty", it occurs "when the person maintaining another stipulates for a share of the proceeds of the action or suit." (106) Anchored for a long time, those doctrines were considered to (P 931) infringe public policy and were illegal in the UK. (107) Over time, this position evolved and their application has been significantly relaxed, (108) notably regarding third-party funding.

The UK represents today a thriving market fort third-party funding. (109) Funders' golden era started with the Arkin v. Borchard decision which recognized it was "highly desirable" to increase access to justice through third-party funding. (110) Following this decision, the famous Jackson Report gave approbation to third-party funding as it "promotes access to justice". (111)

Following the report, the Association of Litigation Funders (ALF) was created by funders in the UK which established a voluntarily code of conduct. This self-regulatory association is not mandatory and funding can still be provided by non-members. (112) Essentially, this code requires capital adequacy, limits intervention in the attorney-client relationship and states that the agreement should provide a clause regarding control, notably settlement of the dispute. That said, the code does not require disclosure of the funding agreement. (113)

To this day, the UK has not enacted any regulation on third-party funding yet. The British Parliament has not engaged in this rocky road, seemingly fearing it might result in stifling the industry's growth. (114) Therefore, the question remains to determine whether a voluntary code is still satisfactory or if a regulation would be more appropriate.

This question is all the more pertinent in light of the recent voted Brexit. Unquestionably, London remains an arbitration-friendly seat with great tradition of arbitration. (115) Nonetheless, should a "hard Brexit" take place, London may suffer from an overall reduction in the volume of transactions that might result – in the long run – in a decline in London's (P 932) popularity as an international seat. (116) In this respect, a proper legislation could bring some certainty amidst the uncertainty benefitting London in the "post-Brexit tomorrow".

III Third-party funding in Singapore and Hong Kong

A Singapore

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The above cited research reveals that Singapore is considered to be the most improved arbitral seat. (117) Indeed, Singapore has reacted fast on third-party funding. The legal reforms adopted under the Civil Law (Amendment) Bill 2016 ("The Funding Bill") followed a "light touch" approach (118) and came into force on March 1, 2017, along with amendments of related legislations.

Essentially, these reforms abolish maintenance and champerty in international arbitration and related litigation making third-party funding legal in these areas, and implement a framework for their activities. In order to qualify, funders must meet certain requirements, notably in terms of capital. (119) In order to avoid conflicts of interest, lawyers must disclose the existence, the identity and the address of the funder. (120) Confidentiality issues should be addressed in the future, through "industry-promulgated guidelines and best practices for third party funders, lawyers and arbitrators" that will be issued "in due course". (121) Regarding control issues, Singapore took a similar view to the ALF, prescribing that control over the claim "should be dealt with in the funding agreement". (122)

Singapore seems therefore to be one step ahead of the curve. By anticipating third-party funding issues and offering concrete solutions, surely Singapore is firmly in the race to remain the "key seat of arbitration in Asia", as stated by their Ministry of Law.

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B Hong Kong

According to the above-mentioned study, Hong Kong follows Singapore in terms of "improvements". (123) On June 14, 2017, the Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016 passed. Hong Kong has unlocked the gates to third-party funding in international arbitration, by adopting a "light touch" approach.

This reform provides definitions, notably a broad definition of the term "third-party funding". In order to qualify, funders must meet minimum criteria, such as adequacy of capital. (124) To avoid conflicts of interest, the funded party has an obligation to disclose the presence of a funder. (125) Regarding confidentiality matters, disclosure of information and documents related to the arbitration to the funder is now permitted. That said, the funder is required to maintain confidentiality over it. (126) Finally, as concerns of control, a Code of Practice for funders is to be drafted in the future. In its current version, it is prescribed that funders must provide in the funding agreement that they will not take control or influence the arbitration proceedings. (127) Hong Kong has therefore taken a step further than the UK and Singapore regarding control.

As noted by the Hong Kong Bar Association, by legislating on third-party funding, the government aimed at "maintaining and consolidating its premier position as an international dispute resolution centre". (128)

IV Third-party funding in France

While third-party funding is not made illegal under French law, the practice seems not to be much confronted to it. (129) This might be explained by the fact that French litigation costs have not been as costly as other jurisdictions. (130) However, the topic gains importance as the *Barreau de Paris* has endorsed it and funders seem to be increasingly interested and even being P 934 implemented in the French market (e.g. La Française IC Fund). (131) Theoretically speaking, no barriers are raised against the principle and therefore a funding agreement should be enforceable. That said, case law has been scarce and the issue seems not to be completely settled by courts. (132)

V Third-party funding in Switzerland

A Legal developments

Only recently the concept of third-party funding has been introduced in Switzerland. Until the beginning of the 2000s, it had never been addressed. (133)

In 2003, the Cantonal Council of Zurich approached the issue and drafted a resolution to prevent third-party funding in litigation. (134) The law was challenged before the Swiss Supreme Court. On December 10, 2004, the Swiss Supreme Court invalidated Zurich's prohibition on third-party funding on the grounds that it was unconstitutional. The Court held that prohibiting as such third-party funding would restrict in a disproportionate way the freedom of commerce guaranteed by the Swiss constitution. (135) As a result, third-party funding has been legally permitted in Switzerland and implicitly been considered legal under the Swiss Federal Attorney Act, regulating attorneys' professional and ethical duties. (136)

More recently, in 2014, the Supreme Court reiterated its previous ruling, allowing third-party funding in Switzerland. The Swiss Supreme Court went even further, by reminding lawyers that it is part of their professional duties, should the circumstances arise, to inform their clients about funding alternatives. (137)

Overall, these decisions have made "Switzerland a favourable jurisdiction for third-party funding". (138) Following those developments, the P 935 industry has grown steadily and there are now funders present in the Swiss market (e.g. Omni Bridgeway, Invest4Justice,

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JuraPlus, Nivalion AG). (139)

B Regulations, financial policies and endorsement

The Swiss Federal Council, in its 2013 Report on Collective Redress, endorsed third-party funding activities in litigation in Switzerland. (140) Although noting it is still "relatively uncommon", it stated that a "development of an efficient third-party funding market in Switzerland" would be "desirable". Regarding a potential promotion of these activities, it underlined it has to be "in respect with the existing economic and finance policies". (141) To this day, no federal act regulates third-party funding in Switzerland.

The Swiss Supreme Court confirmed that third-party funders are to be dissociated from insurances. Therefore, funding agreements with a funder are not to be treated as insurance contract with an insurer under which contingency fees agreements are prohibited. (142)

As such, funders activities should not fall under the Swiss financial market laws, and thus should not be under the monitoring of the Swiss Financial Market Supervisory Authority (FINMA). (143) That said, depending on the funding structure, funders might be placed under the FINMA monitoring. Article 13 of the Swiss Federal Act on Collective Investment Schemes requires an authorisation from the FINMA to be delivered for corporations qualified as asset managers of collective investment schemes. (144)

Conclusion

In an interconnected world where cross-border transactions are commonplace, arbitration agreements have become a standard staple. Due to arbitration elevated costs, third-party funding has become an important funding alternative.

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Third-party funding undoubtedly increases access to justice and therefore levels the playing field for international arbitration. That said, without a doubt, third-party funding also comes with great risks for its users.

This topic remains a burning issue and only few jurisdictions have taken the following step. As presented, when addressed, all presented issues might well be neutralized and third-party funding only be a sheep in wolf's clothing.

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Summary

Third-party funding involves an external party financing one party's arbitration costs in return for a share of the gains. If the funded party wins the case, the funder obtains the agreed share of the proceeds of the award or the settlement. In the opposite case, should the funded party lose, the funder loses its investment and cannot recover it.

Third-party funding increases access to justice by offering a funding alternative not only to impecunious parties but also to financially stable ones. That said, third-party funding also comes with various. First of all, it compromises the confidentiality doctrine. The funder is not a party and therefore is not, as such, bound by confidentiality requirements. Additionally, third-party funding might entail risks of conflicts of interest for arbitrators. This might, eventually, jeopardize the integrity of the award, or at least delay the procedure. The funder – that has considerable financial power – might also take control over the procedure, denying the disputant of its rights over the claim. Last but not least, third-party funding could favour the emergence of unregulated – potentially dangerous – financial products.

Due to its popularity, arbitration-friendly jurisdictions have taken different views on how to act upon third-party funding. While Hong-Kong and Singapore have expressly permitted it, opting for clear-cut regulations on the matter, the UK, France and Switzerland, have permitted it – in principle at least – yet did not expressly regulate it to this day.

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