Third-Party Funding in International Arbitration Towards Mandatory Disclosure of Funding Agreements?
For the participants of the 26th Annual ITA Workshop:

Modern Enforcement of Arbitral Awards:
“Show Me the Money” Institute for Transnational Arbitration of the Center for American and International Law
June 18-19, 2014
Third-party funding in international arbitration
Towards mandatory disclosure of funding agreements?

Dr Maxi C. Scherer

INTRODUCTION
Third-party funding has become one of the “hot topics” in international arbitration. More and more parties, whether in financial distress or otherwise, are exploring the possibility of using funders to provide the necessary capital to pay for their lawsuits. Although third-party funding for litigation proceedings in various forms and in various jurisdictions has existed for a long time, it is currently attracting growing attention in the context of international arbitration.

Since the traditional common law prohibitions of champerty and maintenance have mostly faded away, a growing number of professional funders have been actively advertising and marketing their services relating to the funding of international arbitration proceedings. In return for funding a case, third-party funders typically seek a percentage of the proceeds of a successful case, a multiple of the financed costs or an amount calculated using a combination of those factors. The exact definition of third-party funding, however, remains elusive, and its legal and ethical implications in international arbitration are uncertain.

In this context, one of the most difficult questions is whether – and, if so, to what extent – the existence of third-party funding agreements should be disclosed in international arbitration proceedings. Recently, in an arbitration against a state pursuant to a bilateral investment treaty, the claimant disclosed publicly that it had recourse to third-party funding. The claimant, Oxus Gold, issued a press release stating that it had “entered into a litigation funding agreement” and that, under the terms of this agreement, “the Funder [had] agreed to pay [its] legal costs in relation to the international arbitration proceedings … on a non-recourse basis”. The press release also explained that the claimant had “agreed to pay to the Funder a material portion of any final settlement of the arbitration claim against the Defendant”.

This upfront, voluntary and public disclosure of the existence of a funding agreement has intensified on-going discussions in the international arbitration community as to whether these disclosures

* Avocat at the Paris Bar, Solicitor (England and Wales). Special Counsel at Wilmer Cutler Pickering Hale and Dorr LLP London, and Senior Lecturer in International Arbitration and Energy at Queen Mary, School of International Arbitration, University of London.
Third-party funding in international arbitration

should become more common, or even mandatory. More precisely, this issue raises several more specific questions. When should a funding agreement, or its existence, be disclosed? What is the rationale for requiring that disclosure? What exactly should be disclosed (the existence of the funding agreement or the terms of agreement itself) and to whom? Who should impose and effectively enforce any general and mandatory disclosure obligation? This paper aims to address some of these questions and discusses the reasons for a potential obligation to disclose funding agreements, the possible scope of any such obligation, and its modalities.

1 RATIONALE BEHIND A POTENTIAL OBLIGATION TO DISCLOSE THIRD-PARTY FUNDING AGREEMENTS

While many reasons are typically advanced to justify imposing the disclosure of third-party funding agreements in international arbitration proceedings, two arguments seem particularly important and will be discussed below. First, disclosure of third-party funding agreements is arguably necessary to assess whether the funded party should be subject to an order for security for costs. Second, such disclosure is also arguably necessary to avoid possible conflicts of interest and to ensure that the arbitrators’ impartiality and independence are maintained.

a. Disclosure of third-party funding agreements to assess the necessity of security for costs

In international arbitration proceedings, the allocation of liability for costs is usually left to the arbitral tribunal’s discretion, unless the parties’ agreement, the relevant arbitration rules or applicable statutes provide otherwise. While there are no express international standards, and although the “costs follow the event” rule whereby the losing party pays for its adversary’s costs is not universally accepted, tribunals often allow the prevailing party to recover reasonable costs from the losing party. In light of the complexity – and in some cases length – of international arbitration proceedings, the amount of costs awarded to the prevailing party can be quite significant. Therefore, parties are increasingly seeking security for costs at the outset of the proceedings. Although security for costs is not a universally accepted tool and unknown in many civil law jurisdictions, it has become increasingly common in international arbitration proceedings. Under currently prevailing standards, tribunals typically order security for costs if a party shows that (i) it has a prima facie case of succeeding on the merits; and (ii) the other party lacks financial means and is thus likely not to be in a position to satisfy a future adverse costs award.

The existence of a third-party funding agreement is likely to give rise to a number of issues regarding the costs of the arbitration. In particular, one can easily imagine situations in which a party in financial distress obtains the necessary capital to bring a claim in international arbitration proceedings as a result of third-party funding but does not have the financial means to pay any adverse costs if its claim is unsuccessful. In such cases, it is unlikely that the prevailing party will recover its costs from the losing party that obtained funding. It is equally unlikely that the
prevailing party will be able to turn to the third-party funder to recover its costs. Some funding agreements specifically provide that the funder is not liable for adverse costs. More importantly, however, the arbitral tribunal very likely lacks jurisdiction to order the third-party funder to pay adverse costs, because the funder is not a signatory to the arbitration agreement or a party to the arbitration proceedings. Unless the arbitration agreement is construed to have been extended (e.g., under available theories of *alter ego*, implied consent, etc.) or *de facto* assigned to the funder, the tribunal lacks jurisdiction to order the funder to pay any adverse costs.

To avoid a situation in which the prevailing party is unable to recover reasonable costs because the opposing party has been able to entertain the arbitration due to third-party funding, it might be preferable to require disclosure of the funding at the outset of the arbitration. With that disclosure, the tribunal is in a position to assess whether it is necessary to order the funded party to provide security for costs. The tribunal might order security for costs if the funded party lacks the financial means to participate in the arbitration but for the existence of the funding agreement and is therefore likely to be unable to satisfy a future adverse costs award. However, the existence of a funding agreement cannot automatically lead the tribunal to order security for costs, particularly under the currently prevailing standards for such orders. For instance, it might well be that the funded party has substantial financial resources but decided to use third-party funding for other reasons (e.g., to manage risk or facilitate cash flow).

b. Disclosure of third-party funding agreements to avoid conflicts of interest

The requirement of an impartial and independent tribunal is undoubtedly one the most fundamental principles in international arbitration. Taken together with the limited number of professional funders active in the field of international arbitration, the seemingly growing percentage of cases involving third-party funding is likely to raise conflicts of interest threatening the tribunal’s impartiality and independence.

For instance, assume that in arbitration A1 one of the parties is funded by the funder F and the presiding arbitrator is X. Now, assume further that X is counsel to the claimant in another unrelated arbitration A2 and that the claim in this case is funded by the same funder F. The fact that X’s fees in A2 are paid by F and that X is likely to have significant contacts with F on the basis of the funding agreement makes it inappropriate for X to sit as an arbitrator in A1. In other words, X is not impartial and independent vis-à-vis the claimant in A1, since the claimant is funded by the same funder F that also has a say on X’s financial income in A2.

If the solution to the problem illustrated by this example seems self-evident (i.e., X should not be able to sit as arbitrator in A1), irrespective of the specific provisions on impartiality and independence in the governing arbitration statute and rules, this would imply that X is aware of the existence of a funding agreement. Accordingly, in order to be in a position to assess possible conflicts of interest, it is necessary for the arbitral tribunal to be informed about the existence of third-party funding.
agreements from the outset. It could seriously disrupt the arbitral process if an arbitrator learns about the existence of the funding agreement during the course of the proceedings and needs to step down after a significant part of the arbitration has already been completed.

**SCOPE OF A POTENTIAL OBLIGATION TO DISCLOSE THIRD-PARTY FUNDING AGREEMENTS**

Although there are valid arguments for imposing disclosure of third-party funding agreements in international arbitration proceedings, as noted above, such a disclosure obligation would be difficult to establish and implement in practice. Indeed, it is difficult to define what constitutes a “third-party funding agreement” that would fall within the scope of a disclosure obligation relating to such agreements.

Third-party funding has sometimes been defined as “any financial solution offered to a party regarding the funding of proceedings in a given case”.

Such a broad definition would not only cover funding agreements like the one described in the above-mentioned Oxus Gold press release but also other types of funding, such as lawyers’ contingency fees (or other success-oriented fee arrangements) and certain types of insurance products, as well as any *ad hoc* solution (e.g., money borrowed from a family member). Under such a broad definition, a party might arguably have to disclose the existence of funding arrangements in all of the above-mentioned situations.

The definition of third-party funding could, of course, be narrowed by adding further requirements, such as: (i) the funder has to be a third party to the proceedings (thus excluding lawyers’ contingency fees or other success-oriented fee arrangements); (ii) the funder has to be a professional (thus excluding *ad hoc* solutions like money borrowed from a family member); and (iii) the funder is paid a percentage of a favourable award or a cost multiple (thus excluding certain types of insurance products).

The question remains, however, why such narrowly-defined third-party funding agreements should be subject to mandatory disclosure requirements while other similar types of funding, falling within the scope of the broader definition, would not need to be disclosed. In fact, the reasons discussed above to justify the disclosure obligation arguably apply not only to third-party funding agreements in the narrow sense but also – at least partially – to the broader types of funding agreements. For instance, the concerns about liability for adverse costs may be equally justified if the claimant has recourse to funding through contingency fee arrangements or financial assistance from a family member. Similarly, a conflict of interest could arise if the presiding arbitrator in an arbitration in which the claimant is funded by an insurer is simultaneously involved in another proceeding in which the same insurer is funding his or her client. In conclusion, the real difficulty in this area relates to the imprecision of the definition of “third-party funding agreements”, which makes it difficult to determine the situations in which funding arrangements in international arbitration proceedings should be subject to disclosure obligations.
MODALITIES OF A POTENTIAL OBLIGATION TO DISCLOSE THIRD-PARTY FUNDING AGREEMENTS

Assuming that the above-mentioned difficulties regarding the definition of “third-party funding agreements” and the scope of any related disclosure obligation can be resolved, further questions remain as to the modalities of such an obligation.

First, what exactly should be disclosed: the mere existence of a third-party funding arrangement or the actual funding agreement itself? Funders will generally be reluctant to disclose the exact terms of any funding agreement they have entered into. However, in some situations, the assessment of potential conflicts of interest might well make it necessary to consider the exact terms of the funding agreement. For instance, in the above-mentioned example of arbitrator/counsel X, the assessment of X’s impartiality and independence as presiding arbitrator in arbitration A1 might depend on how much control the funder has over the claimant represented by X as counsel in arbitration A2. The outcome might not be the same, depending on whether or not the funder has substantial control over the conduct of the proceedings in A2 (including a veto right on settlement offers, choice of counsel or other strategic issues).

Second, to whom should the third-party funding be disclosed: the arbitral tribunal or all parties and players involved in the arbitration? The above-mentioned reasons for disclosure (i.e., to assess the necessity of security for costs and in order to avoid conflicts of interest) suggest that disclosure to the arbitral tribunal in the first instance might be sufficient. This is because the tribunal will be the ultimate decision-maker with regard to security for costs and conflicts of interest. However, disclosure to the arbitral tribunal could raise important issues regarding procedural fairness or the right to be heard for the other party, which would not have the opportunity to present its case on questions related to costs or conflicts of interest.

Finally, who could impose and enforce a general and mandatory obligation to disclose third-party funding agreements? The inclusion of disclosure requirements in the codes of conduct of self-regulated industries, such as the English Association of Litigation Funders’ 2011 Code of Conduct, seems unlikely. In any event, membership of this association and compliance with its code of conduct is purely voluntary and therefore lacks effective sanction mechanisms. It has been suggested that institutional arbitration rules should include provisions requiring the disclosure of third-party funding agreements in arbitration proceedings conducted under those rules. However, this raises the question what a possible and adequate sanction of a breach of such a disclosure obligation might be.
CONCLUSION

At this stage of the debate in the international arbitration community, the questions surrounding the definition of third-party funding, let alone a requirement to disclose such funding, are far from resolved. There continue to be fundamental theoretical and practical questions as to whether mandatory disclosure of third-party funding should be required - and, if so, to what extent. It remains to be seen whether agreed standards will be developed and whether pragmatic solutions will be identified in response to what has become an issue of growing concern in international arbitration.

ENDNOTES


4 Scherer et al. supra note 1, at p. 213.


10 Scherer et al., supra note 1, at p. 209.

11 Id., at p. 217.


13 Scherer et al., supra note 6, at p. 653.