Kluwer Arbitration Blog

Whose Line of Credit is it Anyway? Third Party Funding Issues in Arbitration

Noor Kadhim (Armstrong Teasdale) · Monday, July 17th, 2017

In the middle of uncertainty over the economic implications of a European Union without Britain and against a continuing rise in the popularity of arbitration as an avenue for redress by corporate investors, a round-table discussion at a chambers on third-party funding of disputes on Tuesday 12 July 2017 could not have come at a more important time. The discussion involved less than a dozen legal practitioners, was organised by Frederico Singarajah, and was chaired by Peter Goldsmith QC. Aptly, it focused on third party funding in the arbitration sector.

Third-party funding in some shape or form of impecunious parties' arbitrations is almost as old as the modern process of arbitration itself. One cannot deny that arbitration is, in general, a luxury that few can afford. And arbitration clauses that were historically negotiated sometimes blithely without forward-looking costs assessments have become steadily more expensive to employ over the years. This has contributed to the perceived lacuna in the attainment of justice for many otherwise meritorious and frustrated claimants. The unfortunate situation led Lord Neuberger in 2013 to conclude, in support of third-party funding, that *"access to the courts is a right and the state should not stand in the way of individuals availing themselves of that right."* (Lord Neuberger, "From barretry, maintenance and champerty to litigation funding", Gray's Inn speech, May 8, 2013)

The origins of modern third-party funders have been said to be traceable back to the late 19th century in the establishment of mutual before-the-event insurance associations (Freight, Demurrage and Defence (FD&D) Clubs) were formed to fund the costs of shipping claims. FD&D Clubs have been funding international arbitration claims for well over a century and they continue to do so with success. Indeed, Nordisk Skibsrederforening, a FD&D club set up in 1889, registered over 2,300 cases in just one year (2015) in its two offices in Oslo and Singapore. These are staffed by lawyers dedicated to working exclusively on funded arbitrations. Over time, the economic benefits associated with taking a stake in the financial gains started to appeal to a greater cross-section than the insurance market. The so-called disparity of approach between the legal treatment of insurance against a party's losses (which did not offend historic champerty and maintenance laws) and third-party funders' contributions to a party's costs in the expectation of profit from gain (which had previously been forbidden in England and other arbitration-friendly jurisdictions) was

seen by many as a distinction without a real difference. One commentator pointed out in 2014 that the core similarity between liability insurance and third-party litigation funding is the transfer of litigation risk: *"[b]y purchasing insurance, a potential defendant trades a fixed loss in the present for a carrier's willingness to bear an uncertain loss in the future. Third-party litigation funding is the mirror image of this arrangement" .* (Charles Silver, Litigation Funding versus Liability Insurance: What's the Difference?, DePaul Law Review, Volume 63 Issue 2 Winter 2014: Symposium – A Brave New World: The Changing Face of Litigation and Law Firm Finance, Article 15)

Certainly, the upward trend in third party funding in England has been prompted by the relaxation of the rules of champerty and maintenance. Equivalent rules forbidding unconnected third-party interests in claims in other states (such as Australia, Switzerland, and the United States, to name three prominent arbitration-friendly jurisdictions) have also been relaxed, paving the way forward for more funds to enter the financing scene. More recently, other jurisdictions have started to follow suit. Singapore changed its laws only three months ago to allow third party-funding in international commercial arbitration. Just over a week ago, Burford Capital announced that it was funding a claimant in a Singapore-seated arbitration.

Against this background, Lord Goldsmith invited us to explore three topics.

First, which reasons underlie the increase in third party funding in arbitration, and will this trend continue? In particular, why the increased focus on arbitration as a ripe field for funding? In large part, the thinking was that this appetite was mostly associated with the high value of arbitration claims, the perceived finality of awards, and the relative ease of enforcement of awards. The question whether enforceability may be hampered by arbitrators' limited ability to grant interim relief to claimants in arbitration compared to litigation was not investigated, however. It is a question to consider seriously, especially in jurisdictions where the courts are not as supportive of the arbitral function as the UK.

Second, which issues – particularly ethical and conflict issues – does third-party funding give rise to, and how can these be addressed? Lord Goldsmith noted that the UK Litigation Funder's Code of Conduct issued in 2014 identified the following areas of concern: (i) confidentiality of funding arrangements (a thing that lawyers take for granted but should not necessarily be the norm for third-party funding), (ii) protection of claimants being funded, (iii) the permissibility or otherwise of control of the litigation proceedings by a third-party funder (this is apparently condoned by Australian law but is at risk of breaching English law), (iv) responsibility of funders for costs, and (v) the obligation that funds must in fact be readily available by a funder. A very recent decision on the permissibility to grant security for costs against a third party-funded litigant in an ICSID case involving the Venezuelan state has placed renewed emphasis on this last aspect, although the outcome of that decision is pending.

As to control of litigation proceedings, one participant emphasised that this varies from funder to funder, with some being more interventionist than others. Against the prospect of an adverse costs order against a funder – which has not yet, to participants' knowledge, been imposed – I would suggest that it is difficult not to be

interventionist and to step in to ensure that an arbitration is being run effectively. The temptation, however, is to take on a matter without adequate due diligence (for example, failing to conduct adequate checks as to whether the law firm/ lawyer chosen by the client to represent it is capable of handling the case being funded). This may cause irresolvable problems later in the process. On this, Lord Goldsmith's opinion was that if funders should indeed be allowed to control the arbitration, it would stand to reason that their liability in the proceedings (i.e. whether they could face an adverse costs order) would become unlimited.

Linked to the issue of interference are ethical concerns and conflicts of interest. Third-party funders may have pre-existing relationships with arbitrators who may hold advisory positions within the fund. This rings obvious alarm bells. It recently prompted the decision of a prominent arbitrator to decline an appointment. Without the obligation of disclosure of the funding arrangement, it is uncertain how many similar relationships continue to pass under the radar. Another ethics related issue arises with regard to the identity of the funder itself. With the emergence of more and more players on the market, including foreign funders, the source of funds becomes an issue in itself. To what extent does an arbitrator or a court need to investigate whether the funds themselves are clean and untainted by fraud, corruption or links with potentially criminal or terrorist organisations? Should funders be subject to the "know-your-client" checks and to what extent would the stricter imposition of these checks in some jurisdictions cause discrimination compared to funding clients in less stringent states? Accordingly, although disclosure of funding arrangements is not required in some jurisdictions, it should be expected across the board and is an inevitable condition for the legitimacy of the system.

Unconnected with disclosure but intertwined with conflict issues is the problematic scenario of settlement discussions. Specifically, how does one resolve a conflict of interest between a funder whose interests in settlement conflict with those of a client who may wish to fight the case all the way to a final hearing, given that he/she is not responsible for the legal costs? There is, as yet, no satisfactory answer to this issue.

This last topic led to Lord Goldsmith's final discussion area: costs. The arbitration matter of *Norscot Rig Management Pvt Limited (Norscot) v Essar Oilfields Services Limited (Essar)*, in which the arbitrator, Sir Philip Otton, issued a ground-breaking fifth partial award in the case to allow the claimant to recover the costs of funding based on a permissive interpretation of section 59(1)(c) of the English Arbitration Act 1996 (EAA) embracing litigation funding as part of a party's "other costs", was discussed in detail at the roundtable. Essar's later application to set aside the award in the English courts due to "serious irregularity" was rejected. The latest award had followed earlier awards in which Essar had been found liable to pay damages for the repudiatory breach of an operations management agreement. In my personal view, the case turns on its facts. But if this case is to be taken as a precursor of the future, the door is open for the recovery of third party funding costs, which in Norscot's case amounted to 300% of uplift on the funding provided (35% of the recovery). Indeed, arbitrators in England, by virtue of section 63 of the EAA, have wide latitude in determining the costs of arbitration assuming that an alternative procedure for costs has not been set out in the arbitration clause.

However, Norscot turns on its facts and should not be used as a template. The arbitrator found this respondent's behaviour to be oppressive towards Norscot. He held that Essar crippled Norscot's finances by withholding payments due under the agreement such that Norscot did not have sufficient resources to fund its case. The benchmark of "reasonableness" under the EAA was met regarding the costs decision. This does not mean that future claimants will generally be successful in recovering their funding costs. But it is almost certain that most claimants will try, albeit that it is questionable whether they should be allowed to have their cake and eat it. When entering into the funding agreement, the claimant makes a choice: in return for the funding, he foregoes a part of the damages. In essence, a discounted product is accepted and the losing party should not have to pay extra for that decision.

The above discussion boils down at its core to a question of ethics. What are the moral contours applicable to each aspect of an arrangement in which an unconnected party may indirectly profit from the claim of an actual owner? Naturally, the conversation about arbitration funding these days has moved on from simply asking whether an arrangement is morally acceptable. For parties who are unable to fight their claim, third-party funding is often the only way. There is nothing inherently distasteful in this. The funder's return should be commensurate with the risk it undertakes.

But if we pass beyond arbitration funding and into the next frontier, that of arbitration award trading (selling of awards to third parties at a fraction of their potential enforcement value), the ethical line becomes even more obfuscated. Of course, access to justice can be impeded at more than one stage. This is because the process of enforcement of an award is where the real obstacles can arise. The struggle can become even more of an uphill battle for high value and politically sensitive claims (for this, one only has to take the Yukos saga as an example). However, lawmakers – and arbitrators – need to be careful in this relatively uncharted territory. The soil is fertile, not just for winning parties in need of ready cash, but also for corruption, and complex strategizing by unscrupulous litigants.

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