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It’s About Time To Regulate Third Party Funding

Francisco Blavi (Coz Jofré & Blavi) · Thursday, December 17th, 2015

Third party funding (“TPF”) has attracted a great deal of attention from the legal community, as it offers significant advantages and poses serious risks for international arbitration. Besides guaranteeing access to justice for those who are financially incapable of bearing the costs of an arbitration proceeding, the funded party will most certainly benefit from limiting the potential losses of an unfavorable award as well as from having an external assessment of the strengths and weaknesses of the case. The funders can take advantage from expanding their portfolios to more predictable investments not subject to the volatile conditions of the financial market. Even the arbitral system can gain from the involvement of a wide network of skilled professionals interested in making international arbitration as sound and efficient as possible.

However, when the involvement of the funder is not properly disclosed the impartiality and independence of the arbitrators might be at risk because of potential conflicts of interest. Several objections and delays may affect the arbitral process due to the undisclosed use of external funding, like the removal of the arbitrator, the challenge or annulment of the award and the impossibility of enforcement.

Accordingly, it is important to support the development of TPF and take advantage of its benefits, while at the same time regulate what is necessary to avoid uncertainties and limit its dangers. Although the use of TPF has grown exponentially, it has still been considered the “wild west” because of the lack of consistent regulation. While some countries have prohibited the practice (see, for instance, Singapore), most of them have no laws or have applied dissimilar rules for regulating the industry (the case of Hong Kong, which generally prohibits TPF in litigation but to some extent has allowed the practice in international arbitration).

International regulations are currently silent in connection with TPF, mainly because the funders are not comprised in any of the roles outlined under the arbitration rules and international conventions. Strictly speaking they are only investors, not subject to the responsibilities applicable to the key players involved in an international arbitration. Some commentators have enthusiastically argued that the parties would have an affirmative responsibility to disclose the presence of a funder even if the rules do not contain an explicit provision, in order to comply with the duty to participate in the arbitration proceeding with good faith.

Favorably, international institutions and professional organizations are beginning to address the involvement of third party funders in international arbitration. For example, under the 2014 IBA Guidelines on Conflicts of Interest the parties should disclose any relationship, either direct or

indirect, between the arbitrator and one of the parties, being the concept of “party” extended “to relationships with persons or entities having a direct economic interest in the award to be rendered in the arbitration, such as an entity providing funding for the arbitration”.

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.

The practice suggests that any regulation of the TPF industry should focus on the disclosure of relevant information rather than on creating a broad substantive regime. Requiring full disclosure of the funding terms in all international arbitrations is definitely unnecessary. Funded parties would be reluctant to disclose the complete funding agreement not only because of standard confidentiality provisions, but more importantly because sensitive data could be revealed, such as information regarding the assessment of the dispute or the reservation value for possible settlements.

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. This approach is confirmed by the results of the 2015 Queen Mary School of International Arbitration survey, as most practitioners believed that it should be mandatory to disclose the use of TPF (76%) and the identity of the funders (63%), but not the full terms of the funding agreement (71%), because such information would be irrelevant for the management of the case.

Arbitral institutions could lead the effort of regulating the industry by imposing specific duties to the parties and the arbitrators under the institutional rules of arbitration. Other forms of regulation do not guarantee such a broad applicability, as international guidelines –like the IBA Guidelines on Conflicts of Interest– are problematically not binding. Similarly, domestic rules can be inconsistent among jurisdictions, allowing the parties of the funding agreement to circumvent their duties by selecting a governing law that is favorable or silent on the matter.

Ultimately, not all conflicts of interest will lead to the disqualification of the arbitrator or to the annulment of the award. However, if international arbitration is truly designed to offer the parties a fair and equal treatment, it is essential that they have access to all relevant information to protect and enforce their rights. As the current lack of a uniform regulatory framework poses serious risks for the arbitral system, regulating TPF is essential at the moment. Undeniably, it’s about time to regulate third party funding in international arbitration.

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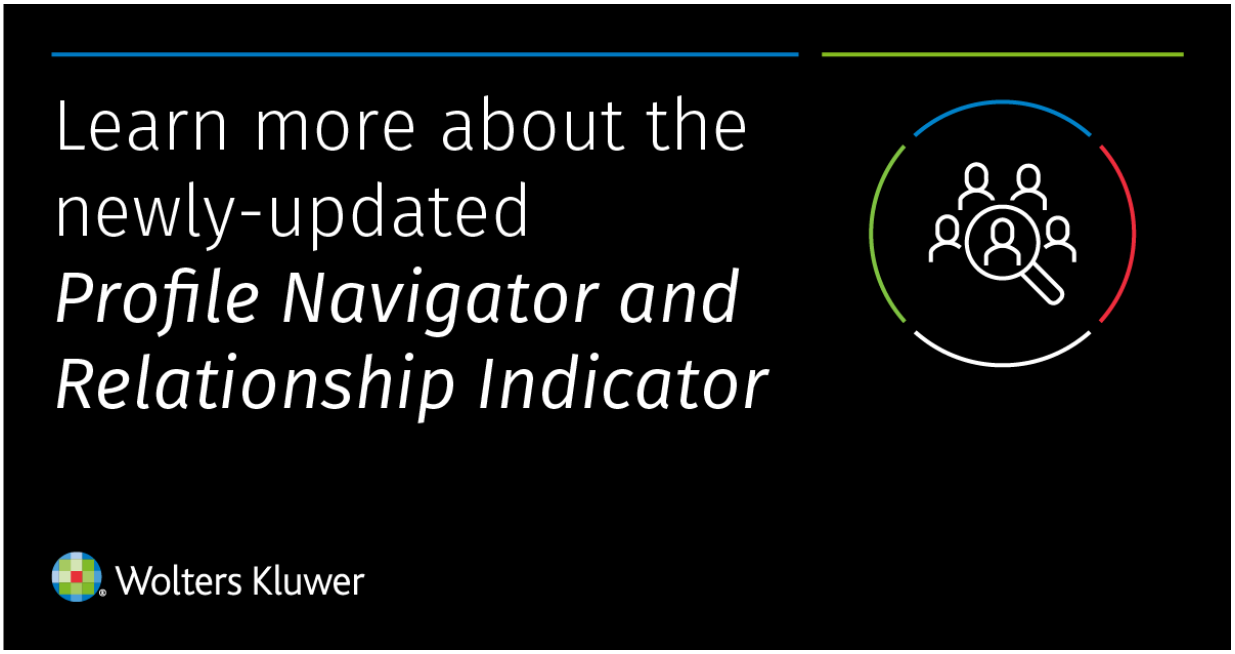

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