Kluwer Arbitration Blog

A Trend Towards Mandatory Disclosure of Third Party Funding? Recent Developments and Positive Impact

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More or less since 2010, the topic of third party funding ("TPF") in connection with international arbitration has been everywhere (heard of, seen in practice, written about, presented at conferences, and so on). In a series of recent developments however, TPF has been, for the first time, made subject to mandatory provisions contained in the latest generation of free trade agreements ("FTA") and has also been specifically addressed in new guidelines and arbitration rules. As TPF has rapidly and persistently grown into an industry that is 'maturing nicely' in the words of a large funder's CEO in 2012, arbitration practitioners should become more familiar with the specific issues TPF can raise in international arbitration, common to both commercial and investment, and how to tackle them.

TPF's description, rationale and mechanism have been extensively discussed elsewhere on this blog, as has the applicable regulation (or lack thereof) and issues resulting from its interaction with international arbitration. This post will highlight some recent developments relevant for the arbitration practice in connection with TPF and discuss the advantages of the seemingly growing trend pointing towards mandatory disclosure of TPF. For these purposes, TPF will be understood as referring only to the funding of arbitration claims by specialized entities

1. ***Background and reception of TPF***

The increased involvement of TPF in international arbitration is unsurprising. Arbitration is the preferred method for international dispute resolution, but the average cost of a single arbitration proceeding has sharply increased over time, now being regularly counted in millions. 68% of the 2015 Queen Mary Arbitration Survey respondents indicated high costs as the biggest disadvantage of the process, which also discourages some to include or even initiate arbitration. Thus, it seems very rational for users, if given the option, to pass the substantial costs of this process to an unconnected third party sitting on plenty of cash and with whom proceeds would be shared only if the claim is successful. If not – the money wouldn't have to be repaid, so this looks like a win something – loose nothing scenario.

Then there's the funders' perspective, who see arbitration claims as a very attractive investment presenting unique advantages against risks they can objectively assess, using formulas, criteria or combinations thereof. According to one study, 1 out of 10 cases gets funding and the net return on their investments can be as high as 70% (this rate also includes funding of litigation cases), as seen in Burford Capital's 2015 Annual Report. Considering these numbers, it's no wonder they've been dubbed 'super lawyers'[1], as it seems that no frivolous claims pass through their filters while their financial results have been, so far, impressive.

As the market indicated a clear and growing demand for their services, more funders turned their attention to arbitration claims, commercial and investment alike. However, despite their increased involvement in this field, the arbitration community's reaction to their presence has been, so far, slow, unconvincing and conflicting.

2. ***Initiatives for regulation of TPF in international arbitration***

Until 2014, funding of arbitration claims took place in a complete regulatory void. Known practice comes only from the dozen or so reported investment cases where tribunals ordered disclosure of TPF only at the request of one party, supported with strong indications (see, for example, here and here). Their main points of concern were to assess potential conflicts of interest and decide cost related matters. However, the overall approach has been somewhat inconsistent[2], with one arbitrator using terms such as *"gambler's Nirvana"* to describe TPF's involvement in international arbitration. Thus, it seems that disclosure of TPF and related issues have been decided within the arbitrators' discretion.

The 2014 IBA Guidelines for Conflicts of Interest were the first rules specifically addressing TPF, but they are only soft law and there is no reported practice on their application to TPF so far. General Standard 6(b) and its explanation refer to third-party funders and insurers (!) as any person or entity that is contributing funds, or other material support, to the prosecution or defence of the case that has *a direct economic interest* in, or a duty to indemnify a party for, the award to be rendered in the arbitration. This seems like a broad definition, encompassing multiple types of funders, funding mechanisms and interests (e.g. lawyers' contingency fees), but a broader analysis will not be undertaken here and there are already doubts as to whether the standard will effectively clarify the issue of TPF[3].

Even so, more voices in the arbitration community became preoccupied with the need to address the lack of consistent and effective regulation concerning TPF. The same 2015 Queen Mary survey revealed that 71% of its respondents felt that TPF should be regulated but, ironically, when asked how the response was through IBA Guidelines.

Finally, in the past two years we've seen a series of developments and initiatives that tackle the need for a more comprehensive and effective regulation of TPF in international commercial arbitration, investment arbitration or both. For the purposes of this post, the following are relevant:

- in October 2015 the Third Party Funding for Arbitration Sub-committee of the Law Reform Commission in Hong Kong (set up in June 2013) released a public consultation paper recommending that TPF should be allowed in Hong Kong and that clear ethical and financial standards should be developed in this respect, addressing a number of 8 issues (including conflicts of interest, control of arbitration by the funder, disclosure);

- in 2014 an ICCA – Queen Mary Task Force has been established to examine the impact TPF has on specific issues in the arbitration process; in February 2016 a draft report on costs has been published and its recommendations (that, generally, the presence of TPF should not decisively influence the tribunal's decision on costs) have also been open to public consultation; the task force will also investigate other areas of interest, such as conflicts of interest, attorney-client privileges and best practices in investment arbitration, and publish reports on its findings;

- (i) the text of the recently agreed EU-Vietnam FTA released in January 2016 contains a specific provision which requires that the presence of TPF be disclosed (but not the terms of the funding agreement); (ii) in February 2016 the revised version of CETA was released and besides the reworked ISDS provisions, it now also includes a provision requiring the disclosure of TPF; (iii) in November 2015, the EU sent its finalised investment chapter of the TTIP to the US and, unsurprisingly, it also contains a similar provision requiring disclosure of TPF; (iv) as the EU is currently negotiating FTAs with Japan, India and China, it is highly likely that these agreements will follow suit if they would be finalized and the above provisions would be EU's standard position on TPF;Perhaps the EU's choice to specifically address TPF in these FTAs has something to do with the *Philip Morris v Uruguay* case where an NGO has voluntarily contributed funds towards the defence costs of the state. This case, along with the other much more publicised against Australia, were often referenced in the context of the ISDS debate. It might be that EU officials saw one side of the coin and envisaged the potential consequences of the reverse (and more likely) scenario. Otherwise, it seems unlikely that the other known investment arbitration cases in which funding was present, reported only in arbitration publications, reached EU officials' ears.
- (i) in February 2016 SIAC released its newly drafted arbitration rules specifically tailored for investment arbitration which contain express powers for tribunals to order the disclosure of TPF and to take this into consideration when deciding cost matters; (ii) also in February 2016, the ICC adopted the *"Guidance Note for the disclosure of conflicts by arbitrators"* requiring that arbitrators (!) disclose *"relationships with any entity having a direct economic interest in the dispute or an obligation to indemnify a party for the award"*; both, however, stop short of requiring mandatory disclosure of TPF but they nevertheless show the increasing spotlight arbitral institutions are placing on this subject, and rightly so, in the author's opinion;

A detailed analysis of the above developments extends beyond the scope of this article, yet they all point towards a clear trend, which is emerging on multiple fronts – to regulate the interaction of TPF with international arbitration. Considering the particular consequences TPF has on a single arbitration proceeding but also the wider policy arguments, this trend is both reasonable as it is justified. But before applying (or, indeed, drafting) any other rules, the first step must necessarily be the mandatory disclosure of TPF by the party using it, which can be easily achieved through a simple 'yes' and '[name of funder]' statement at the onset of proceedings. No further details are necessary (or even relevant, at this point) and there is no reason why this disclosure should be treated differently than any other factual circumstance at the arbitrators' discretion – as has already been seen in practice so far.

Funders will dislike the growing spotlight on their involvement and will resist this trend towards mandatory disclosure. However, the language of this discussion should not contain negative connotations but rather concentrate on the positive effects disclosure of TPF would bring overall. First, there is the benefit of achieving greater transparency (a) for the players inside the microcosm of an arbitration and (b) for everyone else, in the wider context of the ISDS debate. Second, regulating TPF – without, however, interfering with its mechanism – is a sign of open and legitimate acceptance of the funding industry. Third, early disclosure of TPF would eliminate the real and substantial risk of challenges to arbitrators or awards, based on previously existing – but undisclosed – ties between an arbitrator and a funder.

3. ***Protecting awards and arbitration through early disclosure of TPF***

It is easy to imagine various scenarios in which conflicts of interest can arise between an arbitrator and a funder, particularly when inserting, for example, the 5 largest funders in the relatively small network of arbitration practitioners. Indeed, while some funders have already expressed their concern that disclosing their presence would give rise to satellite litigation[4], at the same time there is nothing currently in place to prevent that from happening anyway if and when the other party finds out about funding and starts digging for potential connections. Besides a protracted battle and additional (perhaps unforeseen?) costs, the real danger is if a court will set aside an award or deny its enforcement based on the existence of such an undisclosed conflict. If so, then the entire finality of an arbitration proceeding – obtaining a valid and enforceable award – would have been for nothing, as was the time, effort and money spent by everyone involved, including the funder.

At present, there is no known court decision tackling head on the above issue and the discussions so far only been based on analogy. Furthermore, it is difficult to predict what national courts would decide when TPF is involved, as there are considerable differences and views that exist (or don't!) in various jurisdictions concerning funding of judicial claims. Courts have previously upheld challenges of awards for arbitrators' undisclosed ties with parties' affiliates or counsel, even if those ties were unknown to the arbitrator and the matter of arbitrators' independence and impartiality needs no further comments on its importance.

There is also the risk of a substantial reputational damage the arbitration community – and not the funders – would suffer from a negative court decision. The effort through which arbitration earned its reputation and the trust of the business community, national courts and policy makers could be severely bruised. All the more so if a headline in non-arbitration press would read *"Secretive tribunal had links with investor funding a claim against State X"* – hopefully not due to some 'detrimental' health or environmental measures. All stakeholders are exposed and arbitral institutions should realize that their integrity and reputation is also at stake – after all, it might be an ICC, LCIA, SCC, etc. award that is targeted. ICSID is not isolated either, since public opinion (in fact opposition) was clearly and greatly underestimated until it forced a bureaucratic apparatus such as the EU's DG Trade to substantially change its entire approach to ISDS.

4. ***Conclusion***

One pragmatic approach in legal practice could be that it's better to have an issue out in the open with some rules in place on how to deal with it (good or bad as they might turn out initially) rather than risk being caught off guard with potential negative consequences in the background. Once an isolated presence, TPF has steadily grown and funders are now part of the discussion. It's clear that they're here to stay, since their presence is financially justified and beneficial for a number of players involved in an arbitration.

Nevertheless, TPF's interaction with arbitration, whether in the commercial or investment arena, raises several issues that need to be addressed effectively and coherently to protect the interests of all the players involved but also of the process in general. A clear obligation to disclose TPF would only move closer to this objective while shortening the list of possible things that could go very wrong, increasing costs, duration and uncertainty along the way.

Some of the recent developments we've seen have recognized the need to address TPF while others have already taken the first step in this direction – to require the mandatory disclosure of TPF. Having substantive and binding provisions, either in arbitration rules or underlying treaties, seems like the right approach since there would be little or no way of circumventing them (unlike national laws) and they would be powerful enough to level the playing field. Although other questions remain unanswered at this point, particularly concerning enforcement of such provisions and sanctions, time and practice will indicate if the existing safeguards and tools available in arbitration aren't good enough.

Provisions leading towards open acceptance of TPF would also help the industry grow even further by legitimizing the framework in which it operates and eliminating some of the unknowns in this respect. Perhaps even suspicious or prudent counsel would more readily consider informing their clients about TPF, since it is, after all, in their best interest. New markets could be tapped in jurisdictions where the prohibitively high costs of arbitration lead to potential good claims (or investments) being abandoned. And then, more claimants would have access to funds and from there we all know how the story goes. But until more such provisions are in place, arbitration practitioners and funders should not rule out voluntarily disclosing TPF even where there is no apparent need to do so, if not to get used to doing so, then for the sake of everything else.

[1] Catherine Rogers, *Ethics in International Arbitration*, Oxford University Press, 2014, para. 5.31

[2] see Jean-Christophe Honlet, *Recent decisions on third-party funding in investment arbitration,* ICSID Review, Vol. 30, No. 3 (2015), pp. 699–712

[3] Jonas von Goeler, *Third-Party Funding in International Arbitration and its Impact on Procedure*, Kluwer Law International, 2016, pag. 262

[4] Victoria Shannon and Lisa Bench Nieuwveld, *Third-Party Funding in International Arbitration*, Kluwer Law International 2012, pag. 26. The chapter containing this remark was written by Mick Smith of Calunius Capital

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