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Third-Party Funding's Older Sibling: Legal Costs Insurance and The Issue Of Regulation

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Third-Party Funding (TPF) has certainly captured the attention of the arbitration community in the last few years. This has led to an interesting debate on its implications and potential need for regulation that has, however, failed to include all stakeholders. Insurance has been, in this sense, the Great Forgotten.

TPF is only one of the shapes that funding can take in international arbitration. Yet, it has been perceived as a new phenomenon that raises a number of novel issues such as conflicts of interest, disclosure, security for costs, control over the claim or confidentiality, among others. In order to determine whether TPF is in fact a new, stand-alone phenomenon that deserves special treatment - and regulation- it is necessary to take a comprehensive look at the funding market in international arbitration.

Funding of claims by third parties in arbitration has existed for hundreds of years, notably in the form of insurance. Yet, little or inconsistent consideration has been given to insurance throughout the debate on regulation. Of the insurance schemes available in international arbitration, BTE ('before the event') legal costs insurance deserves special attention for its resemblance to TPF. In return for a premium paid in advance, the BTE insurer covers the risk of the legal costs of a potential litigation. It will fund the costs of bringing or defending a claim in arbitration, but it will not take a share in the proceeds of a successful award.

BTE is not liability insurance as it does not cover the amount at the core of the dispute. It is also not ATE ('after the event') insurance, which is coverage purchased once a dispute has arisen. ATE provides cover against an adverse costs award or against non-recovery of 'own costs' and is usually paid for by a contingent premium, that is, only if the claim succeeds, which is why it is sometimes equated with TPF. However, this type of insurance does not usually provide funding: it is not the purpose of this insurance scheme.

Most saliently, one key form of BTE insurance is of crucial importance in international arbitration due to its ubiquity: FD&D (Freight, Demurrage and Defense) cover. This type of insurance is BTE mutual legal costs cover offered by P&I Clubs or FD&D Clubs in the shipping industry. As BTE insurance, it funds legal costs associated with bringing or defending a claim. Interestingly, and in

parallel to TPF, FD&D is discretionary: only when Clubs have carried out an extensive assessment of the prospects of success of a claim brought by one of its members will they agree to support the claim. FD&D thus considerably resembles TPF: both schemes fund the legal costs of a proceeding in return for an economic benefit, whether in the form of a premium (in the case of FD&D) or a share in the proceeds (in the case of TPF). [1)]

This parallel between FD&D, as a form of BTE insurance, and TPF generates its overarching significance from FD&D's long-established and highly successful roots in the historically significant realm of maritime arbitration – a field that represents approximately a quarter of international commercial arbitrations per year globally.

This qualifies BTE insurance, and more specifically FD&D insurance, as a yardstick to evaluate the question of necessity for regulation.

BTE insurance, particularly FD&D, and TPF may be considered as sibling phenomena. Issues such as control over the claim, conflicts of interest or confidentiality do arise in both contexts. Yet, insurers supporting parties in arbitration have not been considered in the need of regulation as a form of TPF. The disclosure of BTE insurance has never been required and there has been no demand for it. As noted below, the revisions to the IBA Guidelines, which added TPF and ATE insurers, did not include BTE insurers. Objections arising solely in the context of TPF may not be justified and could possibly be better addressed by examining insurance practices which have not been made subject to regulation in arbitrations at any point throughout their centenary and successful existence.

It can be argued that in the current debate on TPF the approach taken towards TPF has been inconsistent in the light of the broader funding context. Attempts at putting together a definition have been made by practitioners, arbitral institutions, legislatures, and academia alike.

The ICCA-Queen Mary Task Force took the lead in addressing the supposedly new issues raised by TPF. Its working definition[2)] brings both TPF and ATE insurers under the same umbrella. The Task Force convened that ordinary insurers (arguably BTE legal costs insurers) would be excluded as a separate feature of dispute resolution and on the basis that they do not get involved in case management as much as TPF providers do. This is certainly not the case in BTE insurance, however: BTE insurers monitor cases closely because, without an interest in the outcome, it is important to ensure money is well spent. In any case, the inclusion of another type of insurance – ATE – in the definition of TPF seems inconsistent and unjustified: an ATE insurer is indeed a third party in a proceeding, but providing funding is neither a common feature nor the purpose of this type of insurance.

A similar approach to the Task Force's has been propagated in the IBA Guidelines on Conflicts of Interest in International Arbitration. According to the IBA Guidelines (see General Standard 6b)), liability and ATE insurers can be equated to TPF while, paradoxically, BTE insurers cannot, as follows from the Guidelines' wording. Neither do BTE insurers have a direct economic interest in the outcome of the case nor do they indemnify a party. Thus, the fact that liability and ATE insurance are included while BTE insurance remains outside of its scope is again inconsistent.

With regards to legislative efforts, Hong Kong and Singapore have recently permitted TPF in arbitration under local law for the first time. Legislation at both seats envisage regulation of TPF in arbitration but not of insurance.

Recent academic literature on the topic of TPF has generally approached it as a unique phenomenon focusing on the alleged new issues that it is said to raise while failing to address other funding practices from which parallels to TPF can in fact be drawn. Other authors, however, have already taken note of insurance and carried out a more extensive research into the broader funding market concluding that some of those issues are not new or particular to TPF. Here, Michele DeStefano's contributions are a bright spot in an otherwise compartmentalized debate.[3)]

This notion shall be emphasized here: as the discussion on TPF continues and develops, it would be commendable to elevate the perspective of the debate and take a holistic, consistent and comprehensive look at the broader arbitration funding practices -notably to those that most resemble to TPF, i.e. BTE insurance. BTE's successful unregulated existence may justify its exclusion from attempts at regulation while it serves as a yardstick with the help of which to assess the need for regulation of TPF. Ultimately, this discussion may or may not lead to the conclusion that there is an imminent need for the regulation of TPF.

Either way, approaching insurance practices consistently and with transparency not only pays tribute to the quality of the debate on TPF, but it provides its users with clear and defined parameters on how to proceed when making use of the advantages of international arbitration.

References

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?3 DeStefano, M. (2012). Nonlawyers Influencing Lawyers: Too Many Cooks in the Kitchen or Stone Soup? Fordham L. Rev., 80, 2791 – 2845.

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