The Ethical Paradox Put to Play by Guerilla Tacticians

Kluwer Arbitration Blog
November 4, 2018

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Please refer to this post as: Alban Dautaj, 'The Ethical Paradox Put to Play by Guerilla Tacticians', Kluwer Arbitration Blog, November 4 2018, http://arbitrationblog.kluwerarbitration.com/2018/11/04/the-ethical-paradox-put-to-play-by-guerilla-tacticians/

Some rules, although made to protect the integrity of an arbitration procedure, open up opportunities for bad faith actors to utilize "legislative" shortcomings. Too often these actors engage in guerilla tactics. Soft law has developed to remedy these grievances. For example, the IBA Guidelines on Conflicts of Interest in International Arbitration (***IBA Guidelines***) seek to remedy situations where a relationship potentially can lead to bad faith conduct in the course of the arbitration procedure, e.g. where a third-party funder has a pre-existing relationship with an arbitrator. This post will demonstrate how new, untested rules risk paving the way for another set of unethical behaviors. This post's central thesis is that the IBA Guidelines have used analogies (or legal fictions) to rein in third-party funders in circumstances where an alleged bias and independence can occur in their relationship with an arbitrator. This is good, but can also have unintended consequences—I highlight only one. However, guerilla tacticians will stand ready to further exploit any regulatory opening.

Regulating conduct is hard and often invites unintended and unwelcome consequences. The world of modern international arbitration is relatively transparent, rules-based, and judicialized. With this move towards a judicialized arbitration system comes advocates for further ethical standards, including but not limited to, "disclosure requirements." While building an institution that can sustain criticism and foster legitimacy, best practices must be drawn from other sectors. The contemporary uncertainty—and unfortunate craving for detailed rules—can

leave the door half-open to a great regulatory fallacy—i.e. that reactive, detailed ethical rules solve issues. Without delving too far into speculations, I want to highlight the paradoxical nature of regulating ethics by rules, rather than custom, practice, and markets. Reactive regulation often solves backwards, but the unknown can never be anticipated in detail. [fn] For a good discussion of "governance techniques" in the financial sector, *see* Julia Black, *Paradoxes and Failures: New Governance Techniques and the Financial Crisis*.[/fn] We ought to operate with caution before developing too detailed soft laws or we might be caught unprepared when rogue actors prove very capable and creative in using detailed rules to their advantage.

One example on regulating reactively

The IBA Guidelines treat third-party funders as a party in order to decide whether a conflict of interest exists.[fn] IBA Guidelines on Conflicts of Interest General Standards 6(b).[/fn] I will outline how this, albeit well-intended, legal fiction can create unfortunate opportunities for unethical parties to use the rules to disqualify an arbitrator. Arbitrators have a duty to be and remain unbiased throughout the proceeding. An arbitrator can be determined to be unbiased at any point.

Existing rules on independence often concern relations between arbitrators and parties to the underlying agreement, and these parties are known and can be identified when an agreement is entered into. Arbitrator bias that stems from these known relations is almost always existent since before the appointment of the arbitrator. The parties and the arbitrator can anticipate these and choose an arbitrator accordingly. Third-party funders, on the other hand, are not parties to the underlying agreement and therefore they cannot be identified when the agreement is entered into because they are not involved with the parties until after a dispute has occurred.

Having rules where a third-party funder bears the identity of a party creates a situation where a party could bring in a funder at any point to *create* an appearance of bias. This could be used as a guerilla tactic. With the freedom to bring in a third-party funder at any stage of an arbitration, a party has the power to create an appearance of bias at any time and potentially disqualify an arbitrator. Traditional parties cannot be brought in to create a conflict and even if they would, a tribunal can use its discretion to minimize their influence.

Creating a tool for removing arbitrators was not the desire of IBA. The immutability of an arbitral tribunal is essential to secure the integrity and efficiency of the procedure as well as to protect the independence of the tribunal. This principle could be undermined if a challenge to an arbitrator would successfully lead to a removal of him or her due to one party's inclusion of a funder. Also, efficiency favors a non-disruption of the arbitration procedure. Furthermore, a challenge to one of the arbitrators in a functioning tribunal can cause delay and expenses.

Guerrilla tactics

As described in the scenario above, while certainly unethical, guerrilla tactics may not always violate written rules. However, these "tricks" interfere with a fair arbitral proceeding. All unethical behavior are not illegal. According to a survey made on this topic, "fifty-five out of eighty-one international arbitration practitioners had witnessed the use of guerrilla tactics in cases in which they were involved."[fn]Günther J., and Stephan Wilske. Guerrilla tactics in international arbitration. Kluwer Law International, 2013.[/fn] Sometimes "guerrilleros" utilize the unintended consequences of a rule. Paradoxically, rules that are intended to "protect the integrity of the process are abused."

How to solve the third-party funding problem?

Third party funders and their involvement in conflict of interest situations is and has been a talking point for a while. Still, we have no clear view on how to treat these funders when a situation appears where an arbitrator's independence is questioned because of his/her relationship to the funder.[fn] Rogers, Catherine A. *Ethics in International Arbitration*. Oxford University Press, 2014, pg 183.[/fn] Rogers writes "As with any new phenomenon, the inclination is to search for similar activities as points of reference. Several possible analogies have been suggested."

Some argue that a third-party funder is no different from an equity funder, others that the funder is a counselor – a "super-counselor." Because of differing opinions on this, discussions are held on whether and how it should be regulated. The IBA Guidelines have solved this by creating a legal fiction where a third-party funder "may be considered to bear the identity of [a] party" to decide on whether a conflict exists.

Treating a third-party funder as an equity funder or a counselor is not the solution

for reasons discussed below.

Legal fiction (Third-party funder = Equity funder)

The involvement of an equity funder only needs to be disclosed if the funder reaches a sufficient threshold of ownership in a party. Therefore, it is attractive to some third-party funders to identify as something analogous to an equity funder. [fn]Id, pg 204.[/fn] The proponents of this view argue that "private equity investors may (and sometimes do) control aspects of case management in ways that are similar to third-party funders." As discussed on this blog previously, in some cases, equity funders even exercise more influence in the case than a third-party funder could or would.

In clear and convincing language, using "the concentration effect," Rogers argues that a third-party funder, investing the same amount, will have a more significant interest in a case than an equity funder. Rogers illustrates this by a hypothetical scenario where a party with an overall value of 100 US dollars, 10 US dollars being the value of a claim owned by the party. In the hypothetical scenario, an equity funder investing 1 US dollar would have a 1% ownership of the company and therefore also a 1% interest in the claim. In this scenario, the 1% ownership need not be disclosed. If, on the other hand, a funder invests 1 US dollar directly in the claim, this funder would have a 10% interest in the claim. Two investments with the same dollar value will lead to two different situations with differing amounts of interest in the claim.

Legal fiction (Third-party funder = counselor)

An arbitral tribunal has broad discretion over procedural matters.[fn] Redfern, Alan, and Martin Hunter*, Law and practice of international commercial arbitration*, Sweet & Maxwell, 2004, Page 309; This has been expressed in Art.44 ICSID Convention, Art.IV4(d) European Convention, §1, 34(1) English Arbitration Act, Art.1494 & 1460 French New Code of Civil Procedure, Art.15(a) Revised Uniform Arbitration Act, Art.15(1) UNCITRAL Arbitration Rules, Art.15(1) ICC Rules, and in Art.14(1) LCIA Rules.[/fn] This discretion stems from the principle of party autonomy and the procedural autonomy of arbitrators. It provides for efficiency and flexibility and prevents parties from abusing the process in arbitration. A tribunal can, therefore, disqualify a counselor from participating in an arbitration. This was the case in *Hrvatska Elektroprivreda v. Republic of Slovenia*, where a

conflict of interest based on a relationship between a counselor and an arbitrator led to the disqualification of the counselor. However, disqualifying a third-party funder is not as effective as disqualifying a counsel.

Creating a legal fiction where a third-party funder is identified as a counselor or as a part of the counsel's team would not be adequate to solve a conflict of interest. A tribunal has discretionary powers to prevent a counselor from participating in hearings, receiving briefs/information and more. A counselor cannot function in a practical way when restricted by a tribunal. A funder can function effectively despite the above-mentioned restrictions.

Conclusion

The question that lingers here is the very one asked in the book "Guerrilla Tactics in International Arbitration": How can a protective rule itself be protected from abusive employment as a guerilla tactic?

Treating a third-party funder as a party, as provided by the IBA Guidelines, creates opportunities for unethical behavior. Other legal fictions and their shortcomings have been discussed. Maybe we need a complementary rule to the one in the IBA Guidelines, and then a complementary rule to that rule.