

INTERNATIONAL COUNCIL FOR
COMMERCIAL ARBITRATION

REPORT OF THE ICCA-QUEEN MARY TASK FORCE
ON THIRD-PARTY FUNDING IN INTERNATIONAL
ARBITRATION

April 2018

THE ICCA REPORTS NO. 4

ICCA

INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION



Queen Mary
University of London

ICCA is pleased to present the ICCA Reports series in the hope that these occasional papers, prepared by ICCA interest groups and project groups, will stimulate discussion and debate.

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COMMERCIAL ARBITRATION

REPORT OF THE ICCA-QUEEN MARY TASK FORCE
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ARBITRATION

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About ICCA

The International Council for Commercial Arbitration (ICCA) is a worldwide nongovernmental organization (NGO) devoted to promoting the use and improving the processes of arbitration, conciliation and other forms of resolving international disputes. Its activities include convening biennial international arbitration congresses; sponsoring authoritative dispute resolution publications (including the ICCA Yearbook Commercial Arbitration, International Handbook on Commercial Arbitration and ICCA Congress Series); and promoting the harmonization of arbitration and conciliation rules, laws and standards. ICCA has official status as an NGO recognized by the United Nations. See <www.arbitration-icca.org>.

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All views expressed in this Report are those of the Task Force and not those of Queen Mary or ICCA, its Governing Board, or members. This Report is the result of the collective efforts of the Task Force, the views expressed are not attributable to any particular Member, and all Members served in their individual capacity.

Foreword

The ICCA-Queen Mary Task Force on Third-Party Funding is a joint Task Force established by ICCA and Queen Mary, University of London in 2013. The Task Force was composed of a diverse group of leading experts from a wide range of professional backgrounds, and included arbitrators, attorneys from both in-house and law firms, representatives from arbitral institutions, states, academics, and a range of third-party funders and brokers. The Task Force is co-chaired by William W. “Rusty” Park, a member of the Governing Board of ICCA; Stavros Brekoulakis, a professor at Queen Mary, University of London; and Catherine A. Rogers, also a professor at Queen Mary, University of London, and at Penn State Law. The work of the Task Force was coordinated by ICCA Executive Director Lise Bosman and Deputy Executive Director Lisa Bingham.

Preparation of this Report was undertaken by designated individuals who led sub-committees to study specific topics, which included presenting and discussing their work at numerous Task Force roundtable meetings over the course of the past four years. The compiled Report was prepared with the assistance of the co-Chairs, and presented for public comment from 1 September through 31 October 2017. During the public comment period, the Task Force benefitted from discussions at invitational and public events, as well as comments separately submitted by individuals and organizations.

The activities of the Task Force and preparation of this Report were not independently funded, apart from a small donation ICCA made to support the Roundtable event at the Columbia Center for Sustainable Investment. All meetings and events were hosted pro bono by law firms, law schools, and related organizations.

The Task Force is grateful for the generous support it received from various organizations that facilitated its work and hosted Task Force meetings and events and submitted comments during the public comment period, including Arnold & Porter; BCH Advogados; Berwin Leighton Paisner; Clifford Chance; the Columbia Center for Sustainable Investment; Dechert; Dentons; École de Droit de la Sorbonne; Foley Hoag; Institut de Recherche Juridique de la Sorbonne; The Law Society of England and Wales; Litigation Capital Management Limited; The Max Planck Institute Luxembourg for Procedural Law; NortonRose; Queen Mary, University of London; The Rockefeller Brothers Foundation; TDM and OGEMID; Three Crowns; the TPF Observatory; White & Case; and Wilmer Cutler Pickering Hale and Dorr, and its Scholar-in Residence Program.

In addition to support from many organizations, the Task Force received extensive detailed comments from various individuals. For these contributions, the Task Force would like to specially acknowledge the following individuals: Phillip Alier, Trinidad Alonso, Clare Ambrose, Matt Amey, Chiann Bao, Jonathan Barnett, Christopher Bogart, Gary Born, Eric Chang, Christopher Cifrino, Nicola Cox, Ahmed El Far, Alice Fremuth-Wolf, John Gaffney, Frank Garcia, Adriana González, Lukasz Gorywoda,

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** Summary reports from these Roundtable events, along with a listing of the individuals who participated, are attached as Annex B and Annex C, respectively, to this Report.

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*** Annex A collects national reports indicating how different jurisdictions treat issues of privilege with respect to third-party funding and is available online at: http://www.arbitration-icca.org/projects/Third_Party_Funding.html.

Chapter 1

Introduction

I. Introduction

Modern forms of “third-party funding”¹ are no longer new to international arbitration.² Recent years have seen an upsurge in the number of third-party funders, the number of funded cases, the number of law firms working with third-party funders, and the number of reported cases involving issues relating to funding. At the same time, international arbitration is increasingly used not only for disputes among commercial parties, but also disputes between states and commercial parties, and in state-to-state arbitrations. The participation of states has, in turn, focused attention from both within and outside the arbitration community on the integrity of the process, with particular focus on transparency and arbitrator conflicts of interest.

As a result of these various trends, third-party funding has increasingly drawn the attention of commentators and scholars, and even more recently of arbitral institutions, national regulatory authorities, and state trade negotiators.

Despite the increased attention, many questions remain about third-party funding in the context of international arbitration processes, most notably about potential arbitrator conflicts of interest, confidentiality, privilege, and costs issues. To address these questions, in 2013 the International Council for Commercial Arbitration (ICCA), in collaboration with Queen Mary, University of London, convened a Task Force on Third-Party Funding in International Arbitration. Since its inception, the Task Force has undertaken sustained study and discussion of relevant issues, and its findings are presented in the balance of this Report.

This introductory chapter provides an overview of the organization and work of the Task Force. This Report is the result of the collective efforts of the Task Force. The views expressed are not attributable to any particular Member of the Task Force, and all views expressed are those of the Task Force, and not of Queen Mary or ICCA, its Governing Board, or members.

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1. As examined later in the Report, the meaning and contours of the terms “third-party funder” and “third-party funding” can be ambiguous and, in some instances, contested. Unless otherwise specified, for example in analysis of definitions in Chapter 3, the term “third-party funder” may be understood generally to refer to an entity that has no interest in the underlying merits of a dispute but provides funding or resources for the purpose of financing the legal costs and expenses of an international arbitration.
 2. In some sectors, such as maritime, forms of third-party funding have long-existed. In this respect, many of the types of funding addressed in this Report may be regarded as “modern” forms of funding.

II. Composition of the Task Force

The Task Force is co-chaired by William W. “Rusty” Park, a member of the Governing Board of ICCA, Stavros Brekoulakis, a professor at Queen Mary, University of London, and Catherine A. Rogers, also a professor at Queen Mary, University of London, and Penn State Law. The work of the Task Force was coordinated by ICCA Executive Director Lise Bosman and Deputy Executive Director Lisa Bingham.

The Task Force was composed of over fifty members from over twenty different jurisdictions around the world. The members included arbitrators, individuals who work for states,³ attorneys from both law firms and in-house positions, representatives with experience at arbitral institutions, academics, and a range of third-party funders and brokers. The Task Force first met as a group in February 2014, and on several subsequent occasions,⁴ to engage in substantive roundtable discussions.

These discussions were generally organized around reports on specific topics prepared by designated Sub-Committees and presented to the Task Force. Report topics included arbitrator conflicts of interest, costs and security for costs, privilege, and implicated a range of other definitional, policy, and practical issues.

The work of the Task Force and this Report also benefitted from extensive consultations, individual comments, and numerous roundtable discussions and public symposia. During a public comment period that extended from 1 September through 31 October 2017,⁵ the Task Force received over sixty written submissions from individuals, law firms, and organizations. It also benefitted from many additional comments both at the roundtables and symposia organized by the Task Force co-chairs, and numerous other events at which the Draft was discussed.

III. Task Force Objectives

The Task Force’s objectives emerged out of its work. No specific work product was initially envisaged and no specific mandate explicated. Instead, the Task Force took as its starting objective the identification of issues that arise in relation to third-party funding in international arbitration, and the determination of what outputs, if any,

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3. All individuals on the Task Force serve on the Task Force in their individual capacity.
 4. Task Force members met in person on a number of occasions, including in London and Miami in 2014, in London in 2015, in Mauritius in 2016, and again in London in October 2017. These meetings were graciously hosted by Queen Mary, by law firms of Task Force members and, in the case of the October 2017 meeting, by Wilmer Cutler Pickering Hale and Dorr. The Investment Arbitration Sub-Committee met in Paris in 2014, and on several later occasions by phone. The Investment Arbitration Sub-Committee was also invited to participate in subsequent Task Force meetings.
 5. A list of events at which the Task Force’s work and drafts have been presented can be found at http://www.arbitration-icca.org/projects/Third_Party_Funding.html.

would be appropriate to address those issues. Moreover, the diverse composition of the Task Force necessitated that any objectives identified satisfy the range of perspectives and interests represented among its Members.

Initially, the range of views among Task Force members largely reflected the range of perspectives that had been publicly expressed within the larger international arbitration community. Some Members were generally disinclined to produce any form of prescriptive guidance, both for substantive reasons (examined in greater detail below) and in light of what some regard as an excess of “para-regulatory” or soft law instruments in international arbitration.⁶ Others believed that the Task Force should aim to produce for international arbitration either a code of conduct for third-party funders, similar to the Litigation Funders Code in England and Wales, or other form of regulation.

Despite these initial differences, the Task Force quickly identified two points on which Members of the Task Force agreed. First, Members agreed that all stakeholders would benefit from greater understanding about what third-party funding is and from multi-lateral dialogue about the issues it raises in international arbitration. From this observation, one of the Task Force’s primary objectives emerged: to facilitate education and informed dialogue.

Second, Members agreed that stakeholders in international arbitration would benefit from greater consistency and more informed decision-making in addressing issues relating to third-party funding.⁷ The challenge, of course, is that however desirable consistency may be in the abstract, disagreement remains – both on the Task Force and beyond – about how and on what terms such consistency should be achieved.

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6. See generally D. FAVALLI, ed., *The Sense and Non-sense of Guidelines, Rules, and other Para-regulatory Texts in International Arbitration*, ASA Special Series No. 37 (Juris 2015); but see Queen Mary Survey, (finding an overall positive perception of guidelines and soft law instruments, with only 31% responding either that they were too numerous or not useful) Queen Mary, University of London and White & Case, “2015 International Arbitration Survey: Improvements and Innovations in International Arbitration” (2015) available at <<http://www.arbitration.qmul.ac.uk/docs/164761.pdf>> (last accessed 21 August 2017).
 7. Norton Rose Fulbright, International Arbitration Report (September 2016) available at <<http://www.nortonrosefulbright.com/files/international-arbitration-report-issue-7-142408.pdf>> (last accessed 29 August 2017) (In the words of one funder, “What we seek in relation to the twin issues of adverse costs and security for costs is certainty. We simply want to know when and on what bases we will be liable to pay these amounts.”); See also W. H. VAN BOOM (“In investment arbitration, the parties do not have certainty at the beginning of proceedings if, and to what extent, the English or American rule will be applied concerning cost-shifting. This probably renders it unappealing for TPF funders to voluntarily disclose their involvement.”); see also W. H. VAN BOOM, “Third-Party Financing in International Investment Arbitration” (31 December 2011) p. 50, available at: <<https://ssrn.com/abstract=2027114>> or <<http://dx.doi.org/10.2139/ssrn.2027114>> (last accessed 14 March 2018).

In both public debates and on the Task Force, discussion has largely moved beyond questions about whether third-party funding should be permitted,⁸ to evaluation of how to address specific issues implicated by third-party funding.⁹ Divergent perspectives on these issues remain, however, and in turn affect how differently situated stakeholders view the appropriate means and standards for achieving consistency.

The Task Force began its work cognizant of the tensions among a need for consistency, the continued evolution in debates about third-party funding, and (as discussed in greater detail below) the rapid pace of new developments both in international arbitration practice and the funding market. Against the backdrop of these tensions, the Task Force began its work by identifying the most frequently occurring issues that arise in relation to third-party funding in international arbitration.

Since the Task Force was initially constituted in 2013, there have been several important developments relating to third-party funding. The funding market has expanded in several respects. The number of funded cases has increased significantly. The number and geographic diversity of third-party funders has also increased, with new entities continuing to enter the market and consequently increase the aggregate amounts available for funding. It is particularly notable that, since the founding of the Task Force, new third-party funders have emerged in Latin America and China. Perhaps most importantly, the forms of dispute financing have expanded significantly, raising challenging questions about how “third-party funder” or “third-party funding” should be defined.

8. This observation may be less true in investment arbitration. It would be virtually impossible to prohibit funding in international commercial arbitration as parties could (and already do) effectively contract around national law prohibitions. See C. A. ROGERS, *Ethics in International Arbitration* (Oxford University Press 2014), pp. 190-194. It is, however, theoretically possible that funding could be prohibited in investment arbitration, for example if investment treaties or other trade instruments included prohibitions and obligations on party representatives to disclose funding. To date, responses by States in investment treaties and other trade agreements have instead focused on requirements that third-party funding be disclosed, primarily for the purpose of assessing potential conflicts of interest. For a discussion of these disclosure obligations, see Chapter 4, pp. 103-104.

9. See, e.g., F. BLAVI, “It’s About Time to Regulate Third Party Funding”, Kluwer Arbitration Blog (17 December 2015) available at <<http://kluwerarbitrationblog.com/2015/12/17/its-about-time-to-regulate-third-party-funding/?print=pdf>> (last accessed 20 August 2017) (“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.”). Some have criticized the Queen Mary survey results as not taking sufficient account of practices in maritime arbitration. Notably, however, this Report does not attempt to address dispute funding in the maritime arbitration context.

Other developments involve changes in the regulation of third-party funding in international arbitration. Just in 2017, the year prior to publication of this Report, prohibitions against funding international arbitrations were relaxed or eliminated in some important jurisdictions, most notably Hong Kong and Singapore.¹⁰ In conjunction with relaxing prohibitions against funding in international arbitration, these jurisdictions also introduced new regulations, most importantly with respect to disclosure for the purpose of assessing arbitrator conflicts of interest. At the same time, other international bodies have also introduced new obligations, particularly with relation to disclosure.¹¹

Another, more amorphous development is that in recent years the poles of the debate over third-party funding appear to have moderated somewhat.¹² When the Task Force first began its work, it was more common to hear, at least among some third-party funders, that funding is essentially just a form of corporate finance, which should not be subject to any regulation other than what already exists within financial markets.¹³ By contrast, particularly in the international investment context, there were arguments to prohibit third-party funding because of its asserted consequences for the real and perceived legitimacy of investment arbitration.¹⁴

10. For extended discussion of the Hong Kong and Singapore reforms, see Chapter 3 (Definitions) at pp. 56-60, and Chapter 4 (Disclosure and Conflicts of Interest) at pp. 102-103.

11. For a discussion of international investment treaties and agreements that address third-party funding, see Chapter 4, at pp. 103-104.

12. As one article described, at one end of the spectrum third-party funding was regarded as the “arbitration antichrist”, while at the other end it was regarded as “the best thing since sliced bread.” S. PERRY, “Third-Party Funding: The Best Thing Since Sliced Bread?”, *Global Arbitration Review* (28 November 2012) (reporting on GAR Live London debate) available at <<http://globalarbitrationreview.com/news/article/31006/third-party-funding-best-thing-sliced-bread>> (last accessed 27 August 2017).

13. See, e.g., C. P. BOGART, “RSM vs St Lucia: Why Griffith was wrong on security for Costs”, *Global Arbitration Review* (11 September 2014) (“To look to the *identity* of the capital provider and treat specialist firms like Burford differently from other providers of financial support in litigation and arbitration is unfair and discriminatory.”) available at: <<https://globalarbitrationreview.com/article/1033695/rsm-v-st-lucia-why-griffith-was-wrong-on-security-for-costs>> (last accessed 14 March 2018).

14. See E. DE BRABANDERE and J. LEPELTAK, “Third-Party Funding in International Investment Arbitration”, 27 *ICSID Review* (2012, Issue 2) pp. 379-398 available at <<https://doi.org/10.1093/icsidreview/sis017>> (last accessed 22 August 2017); M. DE MORPURGO, “A Comparative Legal and Economic Approach to Third-Party Litigation Funding”, 19 *Cardozo Journal of International and Comparative Law* (2011) p. 343 at p. 384; See M. MANIRUZZAMAN, “Third-Party Funding in International Arbitration – A Menace or Panacea?”, *Kluwer Arbitration Blog* (29 December 2012) available at <http://kluwerarbitrationblog.com/2012/12/29/third-party-funding-in-international-arbitration-a-menace-or-panacea/?doing_wp_cron=1503332583.8441140651702880859375> (last accessed 20 August 2017). For coverage of this issue in the popular press, see BuzzFeed

A number of reasons explain why some of the more extreme positions are not asserted as often or with as much vigour. First, national legal regimes are increasingly relaxing historical prohibitions against third-party funding and recognizing it as a valuable means of enabling domestic parties to access justice, as best illustrated by recent reforms in Hong Kong and Singapore.¹⁵ Meanwhile, in investment arbitration third-party funding has enabled parties to bring meritorious claims that were otherwise financially untenable, and funding has also become available to state parties in investment arbitration. Finally, as attention in international arbitration has focused on finding solutions to the high cost of arbitration for parties, funding is increasingly regarded, at least by some and particularly in the commercial arbitration context, as one potential solution to this problem.

Modern forms of funding are also now recognized as functioning similarly to other more traditional means of financing legal costs, such as contingency and conditional fee arrangements and insurance, which have long-existed and are more widely accepted in many jurisdictions.¹⁶ These functional similarities can make it difficult to draw distinctions that would be a basis for limiting or precluding third-party funding, particularly in international arbitration where parties necessarily enjoy significant rights in determining their legal representation. For proponents and opponents of funding, therefore, it is now generally accepted that funding will be part of the modern reality in international arbitration.¹⁷

As a consequence of these developments, both public attention and the Task Force inquiries have largely focused on more nuanced questions: 1) What issues does funding raise in international arbitration?; and 2) How should those issues be addressed? The premise for the Task Force was that answers to these questions would best be developed through active dialogue that involves a full range of perspectives and takes account of all stakeholder interests.

News, “Let’s make them poorer and we’ll get rich” (31 August 2016) available at <https://www.buzzfeed.com/chrishamby/not-just-a-court-system-its-a-gold-mine?utm_term=.mrD3wzYQZ#.ovZwDejmL> (last accessed 27 August 2017).

15. See Chapter 3, pp. 56-60.

16. See Chapter 2, at pp. 33-37, and Chapter 3, at pp. 46-50.

17. It is at least still theoretically possible that third-party funding could be prohibited in new investment treaties. It appears instead that States are by implication accepting the existence of third-party funding, but increasingly including provisions that, among other things, require disclosure of third-party funders. An overview of these provisions can be found at Chapter 3, pp. 61-62. It would be more difficult, if not impossible, to effectively prohibit third-party funding in international commercial arbitration. See C. A. ROGERS, *Ethics in International Arbitration*, pp. 192-194.

IV. The Scope of the Task Force's Work

Third-party funding raises a number of potential issues. The primary work of the Task Force, however, limited its work to those issues that: (1) directly affect international arbitration proceedings; and (2) are capable of being addressed at an international level. Consideration of these issues necessarily requires not only examination of what might be called “modern third-party funding”, but also the market for third-party funding, competing sources of finance, and historical analogues and functional equivalents of third-party funding. For this reason, the general discussions of the Task Force were premised on a very broad definition that sought to incorporate all these elements.

However, the Task Force's analysis of specific issues that directly affect international arbitration proceedings and are capable of being addressed at an international level (i.e., conflicts of interest, privilege, and costs and security for costs) adopted more targeted definitions that were most relevant in addressing the particular issues. This focus leaves many important issues outside the scope of the Task Force's work and this Report.

Given its focus on issues in international arbitration, the Task Force did not address several issues that are regulated at the national level. For example, many systems impose, through professional regulation or otherwise, obligations or prohibitions on attorney conduct that apply when a client is funded by someone other than the client.¹⁸ Those rules and regulations are not generally implicated in arbitral proceedings, and there is no international consensus about the reasons for and against them.

The Report also does not address (except in background discussions) current and historical prohibitions against champerty and maintenance that exist in some jurisdictions. Nor does it address potentially relevant national regulation of financial markets, minimum capital requirements for funders,¹⁹ or national rules pertaining to lawyer ethics and limitations on assignment of claims.²⁰ Although the Task Force and the Report do not directly address these issues, Chapter 7 provides some guidance for

18. For example, in the United States, attorney codes of ethics have express rules regarding an attorney's duty of loyalty when a third-party is paying the client's fees. Meanwhile, many jurisdictions still prohibit contingency fee arrangements, which are often part of a third-party funding agreement.

19. See, e.g., Code of Conduct, Association of Litigation Funders, available at <<http://associationoflitigationfunders.com/code-of-conduct/>> (last accessed 30 August 2017).

20. Although the historical common law doctrines of champerty and maintenance are the most well-known limits on third-party funding, “civil law jurisdictions' professional attorney ethics rules and ownership of claim constraints take center role” in providing any limitations on third-party funding arrangements. See L. BENCH NIEUWVELD and V. SHANNON SAHANI, *Third-Party Funding in International Arbitration*, 2nd edn. (Kluwer 2017), p. 43.

parties and counsel on those issues that are relevant to their due diligence in entering into a funding agreement.²¹

The Task Force’s primary focus on practical issues that arise in the arbitral proceedings also means the Report does not provide specific guidance on some larger policy issues, such as the extent to which third-party funding actually affects “access to justice” (including the often-disputed meaning of that phrase),²² whether funding may impact the overall number of arbitrations (or the number of frivolous arbitrations), or whether funding may be used for strategic purposes that are distinct from the substantive issues at stake in the merits of a particular case. These are important questions, and it is hoped that this Report may facilitate future discussion and debate about these larger policy issues. To that end, the Report often articulates competing policy arguments that were raised in or implicated by Task Force discussions, even if it does not take a particular position on such issues.

The inclusion of references to policy issues continually drew concern during the drafting process and public comment period, particularly with respect to funding in investment arbitration. Policy debates over third-party funding sometimes included expression of grave concerns about both the nature and effects of third-party funding. These concerns were, in turn, often regarded as unfair and unduly inflammatory to those who provide or use third-party funding. Concerns were also expressed that some critiques of third-party funding were effectively indirect critiques of investment arbitration and investment regimes more generally.

21. For these reasons, this Report does not seek to propose “regulation” of third-party funding, as that term is generally understood. Instead, it seeks to provide limited guidance on select key issues.

22. Debate about the meaning of this term is particularly fierce in the investment context. Those who oppose investment arbitration note that investors have the ability to bring claims in national courts or protect their interests through other means, such as political risk insurance. Under this view, the availability of these alternative channels for recourse means that third-party funding of claims in investment arbitration is not essential to provide access to justice. In addition, they point out that “justice” for an investor may result in injustice for other stakeholders that are not accounted for in investment arbitration. See, e.g., L. JOHNSON and L. SACHS, “The Outsized Costs of Investor-State Dispute Settlement”, 16 AIB Insights (2016, No. 1) p. 10, available at <<http://ccsi.columbia.edu/files/2016/02/AIB-Insights-Vol.-16-Issue-1-The-outsized-costs-of-ISDS-Johnson-Sachs-Feb-2016.pdf>> (last accessed 28 December 2017).

For investors and some commercial parties, the ability to bring claims in arbitration is the talisman of claims for access to justice. The term “access to justice” is also generally used, also in discussions about third-party funding in domestic litigation contexts.

Because the Report is focused on international arbitration, it uses the phrase “access to justice” generally to refer to the ability to bring claims in arbitration, assuming the existence of arbitral jurisdiction. This usage is not intended to ignore the fact that it is a contested term in some contexts, particularly in investment arbitration. For more extended discussion on this issue, see Chapter 8, pp. 206-207.

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On the other hand, in the investment context, economic and market-based analysis of claims as “assets” is regarded by some as improperly diminishing the national policy interests and sovereign prerogatives implicated in investment treaty claims. Under this view, a business model that profits by suing governments, even if in good faith, is simply problematic as it seeks to transfer wealth from the public to the private sector.

In the drafting process, reference to any particular viewpoint of these policy debates typically drew concern that the Report was endorsing or legitimating a particular side of the debate. These concerns were especially acute in drafting Chapter 8, which seeks to provide an overview of policy debates in investment arbitration.

The Report does not aim to resolve these larger policy issues. As noted, the primary focus of its recommendations is on issues that directly affect international arbitral proceedings. Moreover, in the absence of relevant empirical research regarding third-party funding and the rapidity at which it is evolving, such an effort would be folly. Instead, policy discussions in this Report attempt to provide a good faith accounting of the competing viewpoints and some analysis of these issues where relevant for context and to acknowledge that the specific analysis in the Report occurs in a larger and much-debated policy context. In this respect, Chapter 8 provides an independent outline of the policy issues, but again mostly to amplify the sometimes implicit policy issues raised in earlier chapters and to provide a basis for future discussion.

Another important limitation on the work of the Task Force is that its recommendations do not generally apply to maritime arbitration. At least according to some definitions, third-party funding has long existed in maritime arbitration through membership of mutual insurance associations (ordinarily called “P&I Clubs” or “Defence Clubs”) that provide Protection and Indemnity (“P&I”) insurance and Freight, Demurrage and Defence (“FD&D”) cover. Despite its use of funding, the Task Force regards maritime arbitration as outside its recommendations because of its distinctive features, in particular the fact that mutual funding by P&I Clubs is well established and already subject to a set of existing practices and internal norms that were beyond the scope of the Task Force’s work.²³

Notably, most efforts to regulate third-party funding, which focus on more modern forms of funding, do not appear to have contemplated specifically their effect on maritime arbitration and the funding regime that has long existed in that field. For these reasons, even though funding in maritime arbitration might presumptively fit within the Working Definition of third-party funding in this Report, it is expressly carved out

23. The term “maritime arbitration” is not easily given a strict definition. It has been used broadly to refer to arbitrations relating in some way to a ship or to maritime affairs, but sometimes includes arbitrations in disputes regarding the construction of various types of units used in the offshore oil and gas exploration and production industries. C. AMBROSE, K. MAXWELL and M. COLLETT, *London Maritime Arbitration*, 4th edn. (Routledge 2017) p. 1. Although maritime arbitration is specifically identified in this carve out, the recommendations of this Report may also be inapposite for other forms of *ad hoc* and trade association arbitration, where more traditional forms of funding is the norm.

from the recommendations in this Report. To the extent maritime arbitration is occasionally mentioned, the reference is only as a point of comparison.

While excluding maritime arbitration, and insurance regimes that exist in that context, the Task Force did consider how modern third-party funding compares and contrasts with certain types of insurance in Chapter 3, and in its recommendations in Chapter 4 regarding disclosure. Inclusion of insurance in principles relating to disclosure for the purpose of assessing potential arbitrator conflicts is consistent with the IBA Guidelines on Conflicts of Interest, which have included insurers in its disclosure obligations since 2014.

Despite including certain types of insurance consistent with the IBA Guidelines, the Task Force Report acknowledges that some (both on the Task Force and beyond) disagreed with such inclusion. It is also acknowledged that such inclusion may raise practical questions that need to be reassessed as international arbitration develops greater experience with disclosure and assessments of insurance with respect to arbitrator conflicts of interest.²⁴

V. Organization and Structure of the Report

This Report is intended to be used primarily as a reference manual. In this respect, each chapter can be read separately with regard to specific issues, but the whole can also be read together as a comprehensive work.

Each of the main substantive chapters of this Report (Chapters 4, 5 and 6) begins by articulating specific Principles for each of the topics it covers. The Principles from these substantive chapters are collected in a comprehensive list both as an Appendix to this Chapter, and again in Chapter 7. The Principles and Best Practices articulated in this Report may be referred to collectively as ICCA-Queen Mary Task Force Principles on Third-Party Funding or The ICCA-Queen Mary Task Force Best Practices (the “ICCA-Queen Mary Task Force Principles” or “ICCA Queen Mary Task Force Best Practices”, respectively).

The body of each of these chapters provides a detailed analysis of the sources and competing viewpoints the Task Force considered in reaching these Principles, as well as the reasons why particular viewpoints were eventually incorporated into the Principles instead of others. Beyond the Principles themselves, it is hoped that the substantive analysis and articulation of competing viewpoints will be a useful resource for future consideration of the relevant issues, particularly in light of developments that may prompt reconsideration of the Principles themselves.

With respect to the structure of the Report, after this Introduction, Chapter 2 provides an overview of the market and mechanics of third-party funding. It begins with an examination of the reasons parties seek funding, and the process third-party

24. See Chapter 4, pp. 93-96.

funders use to evaluate whether to fund a dispute. It then provides a descriptive overview of the range of means for financing disputes, including both modern case-specific non-recourse funding and a range of other sources that serve similar functions.

Building on Chapter 2's overview of the forms of funding, Chapter 3 examines the definition of third-party funders and third-party funding, and issues relating to definitions. Specifically, Chapter 3 provides broad Working Definitions of "third-party funding" and "third-party funders" that underlie the Task Force's deliberations. These Working Definitions were drafted to facilitate wide-ranging discussion about how modern forms of third-party funding compares, interacts, and competes with other means of financing disputes, including insurance and contingency fees.

The remainder of the chapter examines the reasons for particular language in different possible definitions, surveys the range of definitions that have been adopted by various other sources, and analyses the functional features of different means of dispute financing that relate to how they are definitionally categorized.

Despite adopting a broad Working Definition for the purposes of its overall analysis, the Task Force recognized that addressing particular sub-issues required more narrow definitions that focus attention on the target of specific inquiries. For example, not all types of funding that may be relevant to an assessment of potential conflicts of interest may be relevant for an assessment of a request for security for costs, and vice versa. For this reason, Chapter 3 concludes by examining how different definitions affect analysis of particular issues addressed in subsequent chapters.

As noted above and as elaborated in Chapter 3,²⁵ this Report and its recommendations do not extend to maritime arbitration and the forms of funding that exist in that field. Many definitions of third-party funder and third-party funding, including the Working Definition in this Report, would ostensibly apply to traditional modes of funding in maritime arbitration. However, funding in the maritime context exists within a historical tradition and subject to a set of existing practices and internal norms that were beyond the scope of the Task Force's work.

After the chapter on definitions, the Report turns to three substantive chapters on each of the following topics: Disclosure and Conflicts of Interest (Chapter 4), Privilege (Chapter 5), and Costs and Security for Costs (Chapter 6). As noted above, debate existed on the Task Force about what form any work product should take. On the one hand, there was a desire to avoid contributing to what some regard as an overcrowding of rules and guidelines. It was decided, however, that the essential conclusions of each chapter, particularly given the length of the overall long report, should be easy to reference. For that reason, each of these chapters begins with a distilled set of Principles, which serve to summarize the essential conclusions of the relevant chapter.

The body of each of these substantive chapters both identifies relevant sources and articulates competing viewpoints the Task Force considered in reaching these Principles. They also explain the reasons why particular viewpoints were eventually incorporated into the Principles instead of others.

25. See Chapter 3, p. 55.

Chapter 4 addresses the issue of disclosure and potential arbitrator conflicts of interest. Consistent with other recent sources, the principle it articulates requires disclosure of the existence and identity of third-party funders to facilitate analysis of potential conflicts, but not (for the purposes of conflicts analysis) any other provisions of the funding agreement. It both proposes systemic disclosure by parties and counsel to arbitrators to facilitate assessment of potential conflicts, and confirms that arbitrators have the power to request disclosure of the presence and identity of any funder. The chapter does not, however, provide any new standards for assessing conflicts, but instead refers such issues to existing law, rules, and guidelines. In its analysis the chapter provides a detailed survey and analysis of other disclosure obligations.

Chapter 5 addresses confidentiality and privilege. It examines international standards for evaluating privilege, and provides a survey of national differences regarding privilege, particularly the contrasting treatment by common law and civil law jurisdictions of information and communications provided to third-party funders for the purpose of obtaining funding or performing under a funding agreement. The analysis in the chapter is supported by an online Annex,²⁶ which collects national reports indicating how different jurisdictions treat issues of privilege with respect to third-party funding. Specifically, the chapter recommends that, despite national variances, tribunals generally treat information shared with a third-party funder as protected against disclosure.

Chapter 6 takes up the issue of costs and security for costs. It analyses existing standards for allocating costs and for granting security for costs, based largely on investment arbitration case law. It concludes that the existence of funding is not generally relevant to such determinations, but examines exceptions that may exist.

Chapter 7 collects the Principles articulated in other chapters, and provides a summary of best practices in funding arrangements. Task Force members generally agreed that most aspects of funding arrangements were dealt with in the private agreements between funders and a funded party. Consequently, it was decided that a statement of existing best practices would be the most useful means of providing guidance to new parties seeking funding, new third-party funders entering the market, and the increasing number of arbitrators and counsel that are encountering funding for the first time. The chapter concludes with a checklist of considerations that provide additional guidance for the due diligence process.

Finally, Chapter 8 examines third-party funding in investment arbitration. The analysis in each of the foregoing chapters also addresses issues and sources regarding third-party funding in investment arbitration, but those chapters focus on analysis of the current state of the law. Chapter 8, instead, seeks to examine some of the broader policy issues that may affect how the Principles of this Report are applied in investment arbitration, and a limited range of specialized issues that have arisen with respect to funding in investment arbitration. This Chapter does not seek to offer

26. The Annex (“Annex A, or the “online Annex”) is available at: <http://www.arbitration-icca.org/projects/Third_Party_Funding.html>.

concrete answers on these policy questions, but instead proposes areas for future research and consideration.

VI. Conclusion

The Task Force hopes that parties, counsel, and arbitrators may reference or invoke the Principles and analysis in the Report to address issues that arise in the course of an arbitration, in entering into a funding agreement, and in continued discussions and debates regarding third-party funding.²⁷ The Report may also be useful for national courts in reviewing international arbitral awards or in satellite litigation, and for regulatory bodies and arbitral institutions that seek to address issues relating to third-party funding in international arbitration.

Particularly in light of how rapidly international arbitration practice and funding models are evolving, this Report does not aim to be either definitive or permanent. Changes in the field and considerations that arise within in particular regulatory contexts may require reconsideration of, or readjustment to, the Report's Principles and amplification of its analysis. While this Report will not be the last word on issues relating to third-party funding, it develops an important set of conceptual frameworks and detailed analysis that the Task Force hopes will provide a foundation for future work in the area.

27. The Principles have been drafted to reflect existing norms and emerging trends. To that end, it is not anticipated that they would be applied retroactively, though they may provide guidance for cases that have already been commenced.

APPENDIX

**ICCA-QUEEN MARY TASK FORCE PRINCIPLES ON
THIRD-PARTY FUNDING**

A. Principles Regarding Disclosure and Conflicts of Interest

- A.1. A party and/or its representative should, on their own initiative, disclose the existence of a third-party funding arrangement and the identity of the funder to the arbitrators and the arbitral institution or appointing authority (if any), either as part of a first appearance or submission, or as soon as practicable after funding is provided or an arrangement to provide funding for the arbitration is entered into.
- A.2. Arbitrators and arbitral institutions have the authority to expressly request that the parties and their representatives disclose whether they are receiving support from a third-party funder and, if so, the identity of the funder.
- A.3. For the purposes of disclosure, the term “third-party funder” refers to any natural or legal person who is not a party to the dispute and is not a party’s legal counsel, but who enters into an agreement either with a party, an affiliate of that party, or a law firm representing that party:
 - a) in order to provide material support for or to finance part or all of the cost of the proceedings, either individually or as part of a specific range of cases, and
 - b) such support or financing is provided through a donation, or grant, or in exchange for remuneration or reimbursement wholly or partially dependent on the outcome of the dispute.
- A.4. In light of any disclosures made regarding the participation of any third-party funder or insurer, arbitrators and arbitral institutions should assess whether any potential conflicts of interest exist between an arbitrator and a third-party funder, and assess the need to make appropriate disclosures or take other appropriate actions that may be required under applicable laws, rules, or Guidelines.

B. Principles Regarding Privilege and Professional Secrecy

- B.1. The existence of funding and the identity of a third-party funder is not subject to any legal privilege.
- B.2. The specific provisions of a funding agreement may be subject to confidentiality obligations as between the parties, and may include information that is subject to a legal privilege; as a consequence, production of such provisions should only be ordered in exceptional circumstances.
- B.3. For information that is determined to be privileged under applicable laws or rules, tribunals should not treat that privilege as waived solely because it was provided by parties or their counsel to a third-party funder for the purpose of obtaining funding or supporting the funding relationship.
- B.4. If the funding agreement or information provided to a third-party funder is deemed to be disclosable, the tribunal should permit appropriate redaction, or take other appropriate measures, and limit the purposes for which such information may be used.

C. Principles on Final Award (Allocation) of Costs

- C.1. Generally, at the end of an arbitration, recovery of costs should not be denied on the basis that a party seeking costs is funded by a third-party funder.
- C.2. When recovery of costs is limited to costs which have been “incurred” or “directly incurred”, the obligation of a party to reimburse the funder in the event of a successful outcome is generally sufficient for a tribunal to find that the costs of a funded party come within that limitation.
- C.3. The question of whether any of the cost of funding, including a third-party funder’s return, is recoverable as costs will depend on the definition of recoverable costs in the applicable national legislation and/or procedural rules, but generally should be subject to the test of reasonableness and disclosure of details of such funding costs from the outset of or during the arbitration so that the other party can assess its exposure.
- C.4. In the absence of an express power, in applicable national legislation or procedural rules, a tribunal would lack jurisdiction to issue a costs order against a third-party funder.

D. Principles on Security for Costs

- D.1. An application for security for costs should, in the first instance, be determined on the basis of the applicable test, without regard to the existence of any funding arrangement.
- D.2. The terms of any funding arrangement, including ATE, may be relevant if relied upon to establish that the claimant (or counterclaimant) can meet any adverse costs award (including, in particular, the funder's termination rights).
- D.3. In the event that security turns out not to have been necessary, the tribunal may hold the requesting party liable for the reasonable costs of posting such security.

Chapter 2[†]

Overview of Dispute Funding

I. Dispute Funding: An Introductory Overview

As international arbitration continues to grow in prominence and complexity, so do the attendant costs and, consequently, demands from users of the process to find innovative ways to finance their matters.²⁸ “Whether in favour or against, third-party funding of litigation and, more recently, arbitration, is an undeniable and important reality.”²⁹ Anecdotal reports suggest that the global market for dispute funding – both litigation and arbitration – is currently estimated as exceeding US\$ 10 billion and rapidly growing.³⁰

The business of law is changing and dispute funding is very much an integral part of the future of the global arbitration and litigation markets. It is amidst this backdrop that an exploration of the interplay between dispute funding and international arbitration is not only increasingly timely, but of the utmost importance. The arbitration community must find a way to balance the increasing business need for innovative approaches to the financing of legal matters while protecting the integrity of the arbitral process and the ultimate enforceability of awards. The aim of this Chapter is to provide a general overview of dispute funding as it relates to international commercial and investment arbitration.

[†] This Chapter was authored by James Blick and Erika Levin, with input from other Members of the Task Force.

28. See J. VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure*, International Arbitration Law Library, Volume 35 (Kluwer Law International 2016) pp. 1-2.

29. B. M. CREMADES, “Chapter 12. Concluding remarks”, in B. M. CREMADES SANZ-PASTOR and A. DIMOLITSA, eds., *Third-Party Funding in International Arbitration* (ICC Dossier) (Kluwer 2013) p. 153.

30. See Financial Times, “Arbitration academics are living in the dark ages” (19 November 2017) available at <<https://amp.ft.com/content/926355de-c941-11e7-ab18-7a9fb7d6163e>> (last accessed 1 December 2017). See also Burford Capital’s Quarterly Summer 2017 Overview, available at <<http://www.burfordcapital.com/wp-content/uploads/2017/07/Burford-Quarterly-Summer-2017.pdf>> (last accessed 28 December 2017). (As of Summer 2017, Burford Capital reports that it itself has “over \$2 billion invested in and available to invest in the legal market”); CREMADES, “Chapter 12. Concluding remarks”, p. 154. (“The New York City Bar Association estimated in 2011 that the aggregate amount of litigation financing outstanding exceeds US \$1 billion. Fulbrook management estimated [in 2013] that there is a potential market for claimants in the United States needing financial support in the combined amount of US \$8-10 billion.”).

A. What is Dispute Funding?

In less than a decade, dispute funding has moved from the fringes of a handful of common law jurisdictions to centre stage in the global commercial litigation and arbitration market. Dispute funding first started in Australia and then migrated to the United Kingdom in the beginning of the twenty-first century. While Australia, the United Kingdom, and the United States are now known to have established and thriving legal dispute funding markets, the practice continues to emerge and grow in new jurisdictions around the world (e.g., Singapore, Hong Kong, China, Latin America, and Europe).³¹

In its simplest form, third-party funding involves an entity, with no prior interest in the legal dispute, providing financing to one of the parties (usually the claimant). Typically, this financing is offered on a ‘non-recourse’ basis, meaning that the funder has no recourse against the funded party if the case is unsuccessful. Under this model, the funder’s recourse for repayment of the capital advanced and return on the capital invested is limited only to the claim proceeds recovered, if any.

1. Rising Demand for Funding

It has been suggested that the rapid expansion of this type of funding was fuelled by the economic downturn in 2008. Many corporations and investors experienced economic instability and were unable to proceed with meritorious claims due to reduced cash flow. At the same time, investors were seeking alternative capital outlets, where returns would not be correlated to traditional markets. It remains to be shown, however, whether there is any real as opposed to coincidental correlation between the 2008 crisis and the expansion of third-party funding in international arbitration.

In recent years, with the rising costs of international arbitrations³² and the additional number of constraints being placed upon corporate legal budgets, it is not surprising

31. See C. BAO, “Third Party Funding in Singapore and Hong Kong: The Next Chapter”, 34 *Journal of International Arbitration* (2017, Issue 3) pp. 387-400; M. SECOMB, P. TAN and T. WINGFIELD, “Third Party funding for Arbitration: An Opportunity for Singapore to Lead the Way in Regulation”, 16 *Asian Dispute Review* (2016, Issue 4) pp. 182-188; N. CASADO FILHO, *Arbitragem e Acesso à Justiça: O Novo Paradigma do Third Party Funding* (Saraiva 2017) pp. 1-272.

32. See VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure*, p. 8, fn. 1, citing CIArb Costs of International Arbitration Survey 2011, p. 13. (“Survey of 254 international commercial arbitrations conducted between 1991 and 2010 finding that claimants on average spend GBP 1,580,000 in total, while respondents spend GBP 1,413,000); UNCTAD, *Investor–State Disputes*, pp. 16-18 ([c]ontrary to the expectations, it turns out that costs involved in investor–state arbitration have skyrocketed in recent years ... costs for conducting arbitration procedures are extremely high’) (emphasis original); OECD, *Government Perspectives on Investor-State Dispute Settlement*, p. 8 (‘legal

that the demand for dispute funding has continued to increase. According to Professors Lisa Bench Nieuwveld and Victoria Shannon Sahani:

“[The] four main forces driving the sharp increase in the demand ... [are: (1)] increasing access to justice ... [; (2)] companies seeking a means to pursue a meritorious claim while also maintaining enough cash flow to continue conducting business as usual ... [; (3)] worldwide market turmoil and uncertainty ... which has inspired ... investors to seek investments that are not directly tied to or affected by the volatile and unpredictable financial markets ... [; and (4)] third-party funding as corporate finance, whereby corporate entities ... enter into bespoke arrangements ... as a means of raising capital for general operating expenses or expansion to meet new business goals.”³³

And:

“The global economic slowdown has also inspired companies facing bankruptcy or insolvency to seek funding to pursue claims that may generate cash flow for their businesses or mitigate the risk of losing a ‘bet-the-company’ dispute.”³⁴

Additionally, and not surprisingly, the aforementioned economic situation has increased client pressures upon law firms to deliver innovative solutions, some of which require the use of funding directly by the law firms in conjunction with the offering of alternative fee arrangements, in order to attract legal work.³⁵

Rising demand for third-party funding has led to a rather recent boom in supply. In the last few years, a multitude of new funders have entered the global dispute financing

and arbitration costs for the parties in recent ISDS [investor-state dispute settlement] cases have averaged over USD 8 million’”).

33. See L. BENCH NIEUWVELD and V. SHANNON SAHANI, *Third-Party Funding in International Arbitration*, 2nd edn. (Kluwer 2017), p. 11. See also, C. P. BOGART, “Third-Party Financing of International Arbitration”, *The European Arbitration Review 2017* (GAR Special Report) (14 October 2016) available at <<http://globalarbitrationreview.com/insight/the-european-arbitration-review-2017/1069316/third-party-financing-of-international-arbitration>> (last accessed 28 December 2017) (“Litigation and arbitration, [particularly investor-state arbitration], are unduly expensive and frequently inefficient, and those deficiencies interfere with their ability to deliver justice.”).

34. See BENCH NIEUWVELD and SHANNON SAHANI, *Third-Party Funding in International Arbitration*, p. 11.

35. See N. ROWLES-DAVIES, *Third Party Litigation Funding* (Oxford University Press 2014) p. 61 at para. 3.08 (Lawyers “are having to be innovative to survive The economic climate since the ‘Great Recession’ which began in around 2008 has caused many, even traditional institutional clients, to look for ways to reduce their legal fees, along with their business costs.”)

market. Additionally, the larger, established players are continually raising significant levels of new capital. The growth of the industry shows no signs of slowing.

2. *Why is Funding Sought and by Whom?*

The key participants in the dispute funding process are the claim holders, funders, lawyers and, potentially, funding brokers. Funding may be sought to cover legal fees, out-of-pocket costs (e.g., expert fees, arbitrator fees, arbitral institution fees, discovery-related fees, etc...), or costs associated with subsequent enforcement actions or appeals and may be structured around a single claim or a portfolio of claims. Dispute finance is also increasingly being used by claim holders for other purposes, such as for raising working capital for the claimant entity, discharging other financial liabilities, or financing other litigation (unrelated to the claim against which the financing is secured).

Historically, third-party funding was considered as being primarily a mechanism by which financially distressed claimants could obtain access to justice. However, much of the focus of the litigation finance market today is on the growing corporate utilization of funding by large, well-resourced entities. These entities may be looking for ways to manage risk, to reduce legal budgets, take the cost of pursuing arbitration off-balance sheet, or to pursue other business priorities instead of allocating resources to financing an arbitration matter.³⁶ Put simply, funding is not only for those that are impecunious. “The use of funding offers the client the ability to minimize risk, does not have any negative effect on their cash flow, and ensures payment of lawyers.”³⁷

a. Claimants

As noted above, the vast majority of recipients of third-party funding are claimants. At one end of the spectrum, there may be a party that has invested all of its resources into a failed project and funding provides this investor with the only mechanism by which the investor can seek redress from the parties that caused its losses.

Somewhere in the middle, exists a claimant who may be adequately capitalized, but nonetheless is a smaller entity than the corporation it wishes to pursue an action against. In his book, Nick Rowles-Davies provides an example that captures this scenario well.³⁸ The example involves a mid-size company that has been wronged by a

36. See C. P. BOGART, “Third-Party Financing of International Arbitration” (Dispute funding “has developed quickly because it allows corporations to unlock the often substantial value they have tied up in unresolved claims, and it allows them to proceed with arbitrations while retaining control of their exposure to loss”).

37. See ROWLES-DAVIES, *Third Party Litigation Funding*, p. 62.

38. See ROWLES-DAVIES, *Third Party Litigation Funding*, pp. 63-64 (highlighting a “real life practical example of a mid-sized company deciding whether to embark on a piece of litigation ... [against] a much larger competitor.”).

much larger competitor and is faced with the decision of whether to spend its capital on vindicating its rights (and unlocking a potential recovery) or allocating those resources to its core business operations.³⁹ Even if it does decide to self-fund the matter, it is likely that it will be outmatched in resources by its opponent. In the absence of external funding, the claimant would be in an untenable position. Funding allows the claimant to grow its business while pursuing the action in a manner that poses no cash flow burden or risk.⁴⁰

At the other end of the spectrum, large corporations with strong balance sheets are increasingly employing dispute funding as a corporate finance tool that allows them to effectively manage their disputes without negatively impacting their balance sheets.⁴¹ Dispute funding for corporate clients can take on a variety of forms including traditional capital outlay by funders as well as insurance/hedge offerings, which enable clients with good liquidity to mitigate litigation risk without paying substantial returns to a third-party funder.⁴² As an alternative to tying up their own capital in litigation or arbitration, corporations can use dispute funding to pursue arbitrations that can help transition their in-house legal departments from cost centres to profit centres.

b. Law Firms

The role played by law firms in the third-party funding market is multi-faceted and evolving. In some instances, law firms, themselves, may be the users of dispute finance. For example, a law firm could seek the use of third-party funding as a way of supporting contingency fee opportunities, as discussed more fully below. In this context, the law firm would approach the funding market directly in order to seek financing options for its own fee risk exposure and enhance its ability to offer alternative billing offerings relative to its competitors.

In other instances, as discussed more fully below,⁴³ a law firm may effectively act as the provider of dispute finance, for example when offering to act on a contingency fee basis.

39. *Ibid.*

40. *Ibid.*, at p. 63.

41. “Litigation can be financed – just like any other corporate expense. Yet most corporations still pay for legal costs out of pocket, and that has a profoundly negative financial impact: reducing operating profits, impacting publicly reported earnings, and thus valuation. Litigation finance removes this problem by shifting the cost and risk of pursuing high-value litigation off corporate balance sheets.” Burford Capital, “Business Solutions”, available at <<http://www.burfordcapital.com/what-we-do/for-businesses/>> (last accessed 14 August 2017).

42. R. STROM, “Litigation Finance, Sure. Litigation Insurance? UK Broker Seeks US Sales”, *The Am Law Daily*, available at <<http://www.americanlawyer.com/id=1202789743668/Litigation-Finance-Sure-Litigation-Insurance-UK-Broker-Seeks-US-Sales?slreturn=20170728074353>> (last accessed 14 June 2017).

43. See Chapter 4, at p. 96.

Even where not directly a party to the funding agreement, the law firm's role is often pivotal in a claimant's decision as to whether it should explore the possibility of third-party funding and the approach taken if funding is sought. Although awareness of litigation finance is rising amongst corporate counsel,⁴⁴ most claimants rely heavily on their legal advisors for advice relating to third-party funding, the costs and practicalities involved, and which funder(s) or broker should be approached.

Funders therefore cultivate relationships with law firms in order to encourage future referrals. In some instances, even where a law firm is not a direct party to the eventual funding agreement, the firm may still be highly invested in the outcome of the approach to funders. It is not uncommon for a law firm acting for a financially distressed client to invest significant time on a speculative basis in preparing a case for presentation to funders, understanding that it will only be able to recoup that time investment if funding is successfully obtained.⁴⁵

While the majority of opportunities presented to the funding market come via law firms, a growing awareness of third-party funding amongst clients has led to an increased percentage of claimants seeking funding directly, often prior to selecting a law firm (e.g., while still engaging in a law firm tender process).

c. Brokers and Other Intermediaries

As an alternative to approaching the funding market directly, some lawyers and claimants opt to use the services of a specialist third-party funding broker. The role of the broker is to advise on potential financing options, access a broader range of funders, and manage the process. With the ever-growing number of funds operating worldwide, as well as the range of alternative insurance structures available, brokers are regarded as playing an increasingly prominent role in the process of sourcing and structuring dispute finance arrangements. Support from funders can be either through traditional advice or new electronic platforms, which boast increased efficiency for parties.

A broker is usually paid either on an up-front basis, with the execution of the funding agreement, or on a contingent basis, which is correlated to the outcome of the funded case. Depending upon the arrangement, the broker's fees may be paid by the funder or by the claimant.

There are also different types of broker services. Some brokers function as an "introducers" who can introduce the claimant to a sub-set of the funding market. Other brokers function as sell-side brokers who can introduce the claimant to the whole or a sub-set of the funding market, but who acts in the interest of the funders, while still

44. See Burford Capital, "Business Solutions", at p. 15.

45. Given their potential self-interest in any funding arrangement, some legal systems require that lawyers advise clients to seek independent legal advice about the funding arrangement. This Report does not directly take up issues of national attorney regulation, but related Best Practices guidance can be found in Chapter 7, p. 191.

other brokers function as buy-side brokers, who can introduce the claimant to the whole or a sub-set of the funding market, and who represent the interest of the claimant.

In order to establish what type of broker they are dealing with, a party or its counsel should seek disclosure from the broker about how they are remunerated and whether they have access to the whole funding market or just a sub-set of it.

Although arguably on the rise and valuable in navigating the expanding funding markets, some questions were raised in the public comment period, particularly from third-party funders, regarding the use of brokers. Some questioned the extent to which brokers may potentially increase costs or slow down the process of obtaining funding. Other comments suggested that there may in the future be questions about confidentiality and privilege with respect to information shared with brokers.

d. Respondents

While far from commonplace, financing for respondents is evolving and becoming more available. Apart from scenarios where a responding party may either via a counterclaim or a successful defence of the arbitration unlock a significant financial upside, funding for respondents is still relatively rare.⁴⁶ The funding of respondents poses challenges with respect to how to remunerate the funder for its provision of capital in the event of a successful defence, while avoiding any potential moral hazards created by the existence of the funding.

One possible option for respondents in situations where they can value their exposure may be to identify a realistic exit point, which, if met, will trigger a payment of some amount to their funders or law firms. Akin to a reverse or inverse contingency scenario, the respondent would pay the funder for some amalgamation of “the amount by which its liability has been reduced, comparing the amount originally claimed with the amount awarded”.⁴⁷ Although this structure is occasionally referenced, in practice, it does not seem to be commonplace, with only a few such arrangements having been successfully negotiated between funders and respondents.

Of the few examples of respondent-side funding that exist, most involve situations where the funder has an independent financial or non-financial interest in the outcome. For example, in *RSM Production Corporation v. Grenada*, the respondent state was funded by a third party that apparently had a competing interest in the oil exploration rights that would have been awarded to the claimant if it prevailed.⁴⁸ In addition, cause-

46. In scenarios like this, a funder could agree to defend the respondent in exchange for a percentage of the proceeds and/or market share that are unlocked as a result of winning the case.

47. VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure*, pp. 48-49.

48. As one commentator describes:

based funding of a defendant has occurred, for example in *Philip Morris v. Uruguay*,⁴⁹ where the Tobacco Free Kids Foundation provided funding to Uruguay. Notably, the Uruguay case may not be an isolated example as the Bloomberg Philanthropies and The Bill and Melinda Gates Foundation have launched an “Anti-Tobacco Trade Litigation Fund” to support low- and middle-income countries.⁵⁰ It has also been suggested that, similar to what occurs in WTO proceedings, states might fund other responding states, either for political reasons or because they have an interest in the legal issues being decided by the tribunal.⁵¹

As noted in following sections, the defence of a claim could also potentially be included in a portfolio arrangement.

B. The Dispute Funding Process

1. Fundamentals

The nature, structure, and features of third-party funding arrangements can vary significantly from case to case, as can the process involved in putting the arrangement in place. The vast majority of cases presented to any given funder are rejected by the funder for one reason or another. There are few published statistics available, however

“It appears from a separate decision in a subsequent case that such third party was a company called ‘Global Petroleum’. See Rachel S Grynberg, Stephen M Grynberg, Miriam S Grynberg and RSM Production Corporation v Grenada, ICSID Case No ARB/10/6, Tribunal’s Decision on Respondent’s Application for Security for Costs (14 October 2010) para. 4.5. Global Petroleum had been awarded the oil exploration rights lost by RSM Production Corporation in Grenada and saw an interest in having the State prevail in the arbitration. See Investment Treaty News (8 April 2010).”

J. C. HONLET, “Recent decisions on third-party funding in investment arbitration”, 30 ICSID Review (Fall 2015, Issue 3) pp. 699-712, at fn. 30, available at: <doi:10.1093/icsidreview/siv035> (last accessed 29 January 2018). See Rachel S Grynberg, Stephen M Grynberg, Miriam S Grynberg and RSM Production Corporation v. Grenada, (ICSID Case No. ARB 10/6), Tribunal’s Decision on Respondent’s Application for Security for Costs (14 October 2010) para. 4.5.

49. *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, ICSID Case No. ARB/10/7).

50. See Bloomberg Philanthropies Press Release, “Bloomberg Philanthropies & The Bill & Melinda Gates Foundation Launch Anti-Tobacco Trade Litigation Fund” (18 March 2015) available at <<https://www.bloomberg.org/press/releases/bloomberg-philanthropies-bill-melinda-gates-foundation-launch-anti-tobacco-trade-litigation-fund/>> (last accessed 1 November 2017).

51. M. NAGELMUELLER, “Dispute Finance for Sovereigns in WTO Disputes – Access To Justice For Developing Countries”, available at <<http://worldtradelaw.typepad.com/ielpblog/2017/09/dispute-finance-for-sovereigns-in-wto-disputes-access-to-justice-for-developing-countries.html>> (last accessed 12 January 2018).

anecdotal reports, as well as statements made by some funders, suggest rejection rates of 90 per cent or higher. This rate may change with the growing number of funders entering the market, coupled with lawyers and their clients' increasing familiarity with the basic requirements of most funders.

The decision about whether to fund a claim will be taken following detailed due diligence by the funder (often using external counsel, and potentially damages or technical experts), and approval by the funder's board or investment committee. Funders are primarily concerned with the case merits, the economics of the proposed investment (criteria listed below), and the enforceability of any award.

In order for a funder to seriously consider a potential opportunity, there must be an adequate demonstration of a solid claim with a healthy, recoverable margin between the anticipated damages recovery and the anticipated budget for legal fees and costs. The facts, the merits, the parties, and their representatives will all play a crucial role in this calculus. "In addition, the analysis will consider other factors such as: 1) value of the law suits; 2) amount to be advanced; 3) jurisdictional obstacles; 4) defenses; 5) nature and length of the proceeding (including whether arbitration or litigation; venue and applicable rules); 6) possibilities of settlement; 7) creditworthiness of client and the opposing party (particularly with a view to collection prospects); 8) visibility and location of the opposing party's assets; 8) counsel chosen and compensation structure (whether there is a contingency fee agreement in place) or 9) additional obligations of the party to be funded linked to the potential risk of recovery (such as previous funding agreements or any other alliance)."⁵²

a. Economics

By far the most common reason for a potential opportunity to be turned down by a funder is not concerns over the legal merits of the case. Instead, when funders turn down a case it is more typically due to concerns that the quantum of the claim (or at least the realistic recovery or likely settlement value) will not be sufficient to justify the level of investment required to finance the arbitration budget.

Funders wish to ensure that the most likely outcome will leave the claim holder with more than a minority share of the recovery. This means ensuring that the combined funding costs (reimbursement of funder's capital and success fee, any contingent litigation insurance premium payable and any contingent fee payment to the legal team) is less than half of the total recovery.

While funders' approaches to this issue vary, many will include a fairly crude economics test in their investment criteria, requiring a minimum ratio between the funding request and a realistic claim value of 1:10. Notably, the 1:10 ratio does not assume a ten-fold return on investment. Instead, return on investment is estimated to be closer to four times the amount invested (including repayment of capital, which is referred to in the industry as a three-fold return (i.e., a return of amount invested, plus

52. B. M. CREMADES, "Chapter 12. Concluding remarks", p. 154.

three times that amount)). The 1:10 ratio instead means that if a funder invests US\$ 1 and the claimant recovers US\$ 10, the funder can recover its investment plus three-fold return, which will leave the claimant with 60 per cent of the proceeds.

Notably, while three-fold or four-fold return on investment is commonly discussed in the funding industry, even those rates of return are somewhat misleading. Not all cases will win. Consequently, for an investor investing in dispute funding, the actual return on investment is unlikely to be a three-fold return, but instead more likely in actual terms to be a double digit percentage.

It may be assumed that these numbers will leave a sufficient margin to allow for the claim holder to retain more than half of the claim proceeds, after deducting the cost of the funding arrangement. In this vein, most funders tend to be highly conservative when valuing claims and will concentrate on the realistic or likely “floor” value of the claim, as opposed to the maximum potential (but inherently more speculative) claim value.

Funders will also carefully scrutinize the arbitration budget (assuming that the financing is being provided primarily or solely for this purpose). A light or overly optimistic budget may be a cause for concern. While the funding commitment will be limited to a fixed or staged sum, a case which exceeds the budget where there is no pre-agreed mechanism in place to deal with the overrun can be problematic for all parties, potentially necessitating renegotiation of the funding agreement mid-way through the case. Funders increasingly will address this issue upfront, potentially requesting a fee cap or an overrun agreement from the claimant’s legal team in order to secure budget certainty.

Ultimately, the most desirable cases are those that have a very high (realistic) claim value as well as a high ratio between the arbitration budget and the quantum of the claim.

b. Return Structures

A dispute funder providing “non-recourse” litigation finance will generally expect to make a multiple return on the capital invested. This reflects both the high-risk nature of the investment as well as the Internal Rate of Return (“IRR”) expectations of those that invest in litigation funds. From the claimant’s perspective, the funder’s return (or success fee) may be structured in a number of different ways. It may be structured as a multiple of the capital invested or as a percentage of the “claim proceeds” (the amount recovered by way of damages or settlement). Some arrangements will involve a combination of these, for example the greater of 3x the capital invested or 35 per cent of the claimant’s recovery. By way of illustration, this was the structure and pricing of the funder’s return in the *Norscott v. Essar* case,⁵³ in which the arbitrator accepted

53. (ICC Case No. 15790/VRO), Award (17 December 2015) Sir Philip Otton sitting as a sole arbitrator in an arbitration subject to the International Chamber of Commerce (ICC) rules made an unusual award requiring that the Respondent be liable for the cost of the claimant’s funding arrangement, in addition to the damages awarded. Essar applied to the English Court

evidence that the cost of the funding was reasonable in the circumstances of the specific case in question.

It is also common for the funding agreement to link the funder's return to the duration of the case (or to the amount of capital that has been drawn down), meaning that the funder's return is lower if the case settles early, but rises throughout the proceedings. Such a structure will facilitate early settlement for the claimant, while ensuring that the return to the funder is more proportionate to the actual capital risk taken if the case settles early.

While many funders target broadly similar returns, the differences from a claimant's perspective between different funding offers on a specific matter can be huge, especially where the claim value is high. Fully understanding the commercial terms of any funding arrangement requires, at a minimum, some basic financial modelling in order to calculate the amount that the funder will be entitled to in a range of theoretical settlement outcomes at different stages of the case with different levels of capital deployed. With the growing number of funders competing for business and the ever-increasing diversity and complexity of funding agreements, claimants are well advised to obtain and compare (either directly or with the advice of brokers or independent counsel) multiple funding offers before entering into a funding agreement.

c. Waterfall Agreement

Closely related to the funder's return structure is what is often referred to as the "waterfall agreement" or "priority agreement". This agreement can either be included within the funding agreement or be a separate document, and will usually require execution by all "stakeholders" (i.e., those entitled to a share or contingent payment from any recovery, typically including the claim holder, the funder, the law firm and any insurer providing coverage for fees, costs or an adverse costs award). The waterfall agreement will set out how the claim proceeds are to be divided between the stakeholders. The terms of this agreement can be as important as the return structure when considering the cost of a potential financing arrangement.

d. Risk Alignment

Risk alignment (or "skin in the game" as it is more colloquially referred to) is an important consideration to many funders when considering a potential opportunity. Some funders have a strict requirement that the law firm should assume some element of risk in relation to its fee budget, either by offering a partial contingency fee and/or fee cap or overrun agreement. Even for those funders that do not require this element as a matter of course, a law firm's (and/or client's) willingness to share in the risk and

to have the award set aside under s. 68(1) of the Act on the ground of serious irregularity, but was unsuccessful in its application.

reward is usually regarded as a positive feature when assessing a potential funding opportunity.

e. Control

The extent to which the funder will assert control over the arbitration and the claimant's decision-making process (e.g., whether, when and at what level to settle the claim) is often a concern expressed by claimants, lawyers, and regulators. In some common law jurisdictions, it can also be an important issue in assessing the legality of the financing arrangement where doctrines of maintenance and champerty still exist.

In reality, the vast majority of third-party funding arrangements are structured carefully to ensure that the funder does not have control over the case or the claimant. In many jurisdictions, this is essential in order to avoid or minimize the risk of a challenge to the lawfulness of the funding agreement. Even in civil law jurisdictions that permit the sale or assignment of claims, many funders still adopt this common law model, although there are also many examples of funds in such jurisdictions seeking to purchase and aggregate (and thus take over control of) claims. This approach is prevalent, for example, in cartel damages claims in jurisdictions such as Germany and the Netherlands, but less common in international arbitration.

However, even where the funding arrangement does not seek excessive control, there are nevertheless certain safeguards built in to protect the funder's investment. A third-party funding arrangement is not an unconditional agreement to fund the case to conclusion. Provision of ongoing funding will be subject to the merits of the case and compliance with the terms of the funding arrangement. Breach of the agreement or a fundamental change in the likelihood of success may entitle the funder to terminate the agreement (and, in some instances of serious breach, may allow the funder to seek recourse for the amount invested). While this does not amount to direct control, if the claimant is financially reliant upon the funder in order to pursue the claim to conclusion, the possibility of the withdrawal of funding may still amount to powerful indirect control.

Related to the issue of control is the question of how actively the funder wishes to monitor its investment. This varies from funder to funder, but it should be assumed that at a minimum, the funder will require reports about the progress of the case, the right to monitor fees and/or approve expenditures, notification of any significant developments (e.g., settlement offers or new information that changes the case outlook) and direct access to the claimant's legal team. In some instances, the funder may play a highly active role, attending client meetings and/or hearings, being copied on correspondence, and providing input on strategic issues. Some clients regard this active involvement by the funder as a 'value added' in terms of budget management and legal, strategic, or technical expertise, beyond the mere provision of capital.

f. Confidentiality/Privilege

Securing funding necessarily requires the sharing of confidential, privileged and, on occasion, highly sensitive information with prospective funders. Ensuring the protection of that confidential information and that any existing privilege is not lost are important issues that claim holders and their advisors must consider before seeking funding.

Anyone navigating the process must balance the disclosure of information required for assessment/due diligence and minimizing the risk of waiving privilege. Certain basic steps, such as entering into non-disclosure agreements before sharing any information and limiting the information shared early on, are fairly standard practice. The concerns and protocols for protecting confidential and privileged information necessarily vary depending on the jurisdiction or jurisdictions involved. In some national jurisdictions, the law is fairly well-established, whereas in others it is still evolving (although generally in the direction of accepting that parties should be able to share information with funders without waiving privilege).⁵⁴

Issues of privilege are particularly complex in international arbitration. Tribunals often use conflict-of-laws analysis to determine which national law applies to the determination of whether a privilege exists. Some international standards are also developing, for example to resolve when different potentially applicable national rules point to opposite outcomes or to determine when waiver has occurred. The Task Force's Principles on confidentiality and privilege are set forth in Chapter 5, and Chapter 6 also includes some guidance on best practices.

g. Conflicts of Interest

The third-party funding market necessarily has to grapple with the issue of conflicts of interest (whether actual, potential or perceived) that arise as a result of the funder's participation in a particular case. The issue of arbitrator conflicts of interest is addressed in Chapter 4, and so will not be discussed at length here.

A related issue is how the claimant's legal team can mitigate or manage potential conflicts of interest arising between its duties to the claimant and its relationship with the funder. While the majority of funded cases proceed smoothly with an aligned interest between the funder and claimant (and legal team), there is always the potential for an issue to arise. For example, under some funding structures, the funder is entitled to a multiple of the capital invested as a priority over the claimant. Under such an arrangement, there is a theoretical possibility that the funder could receive a healthy return (for example, repayment of its investment plus a return of 3x the invested capital), but the claimant receives nothing. Such a structure (while not uncommon) can clearly give rise to tensions when it comes to considering an offer of settlement proposed by the respondent that would produce that kind of result under the funding

54. See *Viamedia, Inc. v. Comcast Corp.* (30 June 2017), [2017] WL 2834535.

agreement. Similarly, issues such as budget overrun, a change in legal representation during the proceedings, or a deterioration in the merits of the case can create situations where the interests of the claimant diverge from those of the funder.

Most of these issues are addressed fairly and effectively through a well-written funding agreement. The most common structure of a third-party funding arrangement is one that clearly demarcates the duties the law firm owes to the claimant and those (if any) owed to the funder. The claimant and the funder enter into an arrangement under which the funder provides the claimant with capital in order to finance the legal fees and costs associated with the arbitration. Under this structure, the claimant's lawyer advises and owes duties only to the claimant (the funder typically having taken separate advice from its own external counsel).

In reality, however, the relationships between funders and law firms are often more complex. It may be for example that the client entered into the funding arrangement as a result of the law firm's introduction to or relationship with the funder. It may even be that the law firm relies upon the funder for financing across a portfolio of matters, which can make it more difficult to avoid or manage perceived conflicts of interest where a disagreement arises between the funder and one of the funded clients in the portfolio.

Many of these issues can be managed through adherence to industry-based best practices (see Chapter 7, below) and careful drafting of the funding agreement. Many of these issues are also subject to national or local ethical rules. In addition, some clients use and law firms recommend the services of independent brokers (or independent law firms) in order to maintain distance from the funder selection process and mitigate any perceived conflict issues.

2. The Process for Obtaining Funding

a. The Approach

The dispute funding market is changing rapidly, with a continued influx of new capital providers, greater competition amongst funders, and an increasing availability of alternative insurance-based structures. Since most clients are not repeat users of dispute funding, it may be increasingly important to rely upon a specialist broker or lawyer with expertise in this area for advice and guidance and to manage the process throughout.

Regardless of whether an independent lawyer or broker is used, any party considering third-party funding for a claim will be well-advised to simultaneously approach multiple prospective funders. This increases the chances of securing funding (as noted above, individual funds reject the vast majority of opportunities presented to them), while creating a competitive process to enable the terms of any funding offer received to be weighed up in the context of any competing offers available.

Once a decision has been made to approach prospective funds with a particular matter, success in securing funding will often depend on careful funder selection based

upon the case profile and specifics, and taking into account each funder's investment criteria, as well as the types of structure and commercial terms sought.

Case presentation is also important. As noted above, funders' investment decisions will be based upon a range of factors. A well-prepared and comprehensive case presentation covering the items listed at section B(ii) above will enable prospective funders to form a preliminary view on the case and move quickly to a decision on whether or not to offer terms.

b. Case Assessment

Each funder's approach and decision-making process is different, as is the speed with which each can move from initial case presentation to execution of a funding agreement. The most common approach is a two-stage process. The first stage involves an initial (usually internal) evaluation of the opportunity by the funder. This evaluation will include an assessment of the items discussed above, such as the case merits, amount of the funding request, claim value, legal landscape, enforcement, etc.⁵⁵ If satisfied that the case meets the funder's investment criteria, the funder will make an offer (usually in the form of a term sheet or conditional funding agreement). The offer will usually be subject to the funder completing a second more detailed due diligence process, often using external counsel. Given the time and expense incurred during the second phase, many funders request a period of exclusivity in order to complete this process.

The requirement for exclusivity is not universal, but it is a relatively common practice amongst funders. While it should generally be accepted as a legitimate requirement by a funder about to embark upon an intensive and potentially costly due diligence process, it should also be approached with caution by claimants. Agreeing to a lengthy exclusivity period in a time-sensitive case can be highly damaging if the funding agreement is not executed at the end of the process.

Some funders also employ a third level of review, which requires submission of the claim and the proposed funding terms to an investment committee for a final decision.

55. See M. SMITH, "Chapter 2: Mechanics of Third-Party Funding Agreements: A Funder's Perspective" in L. BENCH NIEUWVELD and V. SHANNON SAHANI, *Third-Party Funding in International Arbitration*, 2nd edn. (Kluwer 2017), pp. 34-38, for a discussion of the valuation of a claim from a funder's perspective, including an overview of a matrix approach employed by Calunius Capital.

c. The Funding Agreement⁵⁶

The funding agreement sets forth the terms upon which the funding is provided to the claimant, including the extent of funding commitment, return structure, rights and obligations of the parties and termination rights.

For purposes of providing an overview, the sample Therium funding agreement contained within Nick Rowles-Davies' book is useful, as is his explanation and those of other authors.⁵⁷ However, each funder's standard funding agreement is different and most funding agreements eventually executed by a claimant are individually negotiated and therefore depart from the funder's standard form to some extent. As such, it is beyond the scope of this Chapter to attempt to comment in detail upon the commonalities and differences between various agreements.

However, there are some provisions that are worthy of particular consideration. For example, the circumstances in which the funder may suspend or terminate the funding or potentially seek recourse against the claimant for the amount invested are especially important. The Association of Litigation Funders of England and Wales ("ALF") Code of Conduct envisages the following grounds for the funder seeking termination of the funding agreement (the last of which potentially entitling the funder to recourse for the capital invested to that point):

"11.2.1 reasonably ceases to be satisfied about the merits of the dispute;
 11.2.2 reasonably believes that the dispute is no longer commercially viable; or
 11.2.3 reasonably believes that there has been a material breach of the LFA by the Funded Party."⁵⁸

While on the face of it, these are reasonable grounds for the withdrawal of funding, the manner in which the merits and commercial viability of the claim are to be judged and by whom are significant.

The ALF Code of Conduct requires that any dispute about settlement or termination should be resolved by independent counsel. A dispute resolution clause along these lines is a common feature in many funding agreements (including agreements with funders who are not members of the ALF) to enable a funder to exercise reasonable

56. For a more thorough discussion, please see VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure*, pp. 11-72; SMITH, "Chapter 2: Mechanics of Third-Party Funding Agreements: A Funder's Perspective", pp. 19-38; and ROWLES-DAVIES, *Third Party Litigation Funding*, pp. 120-125, 221-247 (Appendix 1, which provides a copy of a sample Therium Litigation Funding Agreement).

57. *Ibid.* See also M. STEINITZ and A. C. FIELD, "A Model Litigation Funding Contract", 99 *Iowa Law Review* (2014) p. 711.

58. Code of Conduct for Litigation Funders (November 2016), available at <<http://associationoflitigationfunders.com/code-of-conduct/>> (last accessed 30 August 2017).

termination rights, while protecting the client from a unilateral and unreasonable decision by the funder to cease funding.

It should also be noted that in addition to the funding agreement, various ancillary agreements may also be entered into as a part of formalizing the overall funding arrangement, such as the so-called waterfall or priorities agreement,⁵⁹ a retention or engagement agreement with the law firm, and/or related insurance policies. As noted above, the waterfall agreement is a particularly important document (or section within the funding agreement). It can also be one of the more challenging items to negotiate, given that multiple parties, potentially with competing interests, need to agree to the framework.

II. Other Dispute Funding Models

Although third-party funding has only relatively recently emerged as a distinct industry, it should be viewed in context as one of a number of the alternative ways of financing arbitrations. This Section provides some examples of the other models that exist.

A. Insurance

Insurance is one of the oldest alternative sources of funding for disputes.⁶⁰ Liability insurance generally involves funding the “legal representation in any action to defend against liability or recover damages, or to pay any award, order, or judgment against the insured, or both”.⁶¹

There are also specialized forms of legal expenses insurance, sometimes referred to as “before-the-event” (BTE) and “after-the-event” (ATE) insurance. Both forms of insurance are specifically intended to cover the insured’s liability for legal fees and costs incurred in relation to litigation or arbitration. Depending on the structure, coverage may be provided for the insured’s own legal fees and costs and/or the

59. See VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure*, p. 34 (The priorities “agreement involves all relevant stakeholders in the claim and stipulates who will receive what in case of successful recovery.”); SMITH, “Chapter 2: Mechanics of Third-Party Funding Agreements: A Funder’s Perspective”, at pp. 24-25 (describing and providing an example of a typical priority of payments structure).

60. J. CLANCHY, “Navigating the Waters of Third Party Funding in Arbitration”, 82 *The International Journal of Arbitration, Mediation and Dispute Management* (2016, No. 3) pp. 222-232.

61. See BENCH NIEUWVELD and SHANNON SAHANI, *Third-Party Funding in International Arbitration*, p. 4.

insured's potential liability for the opponent's legal fees and costs if the claim is unsuccessful.⁶²

BTE is taken out to cover the risk of possible future litigation arising. It is sometimes sold as an add-on to other kinds of insurance and is usually limited in the types of dispute covered and the level of coverage provided. It will provide funding for bringing a claim falling within the scope of cover, paying lawyers', arbitrators' and experts' fees during the course of the arbitration. It may also cover an insured's liability for a costs award in its opponent's favour.

A BTE insurer is remunerated through premiums paid in advance (usually annually). It has no interest in the proceeds of an arbitral award, other than (for arbitrations in which cost shifting is ordered) avoiding cover for an adverse costs award and potentially receiving reimbursement of the amount funded. When an insured dispute arises, the BTE insurer therefore has an interest in seeking to minimize its loss by controlling the conduct of the claim as closely as it can. Depending upon the policy terms, this may include requiring the policyholder to utilize the insurer's choice of legal representative.

ATE insurance (increasingly known as litigation/arbitration insurance) is taken out after a legal dispute has arisen and covers the risk that the insured party will be unsuccessful in the litigation/arbitration. The industry flourished in the UK in the early 2000's and was historically aimed primarily at insuring against the risk of fee shifting (liability for adverse costs), although most policies also covered the claimant's own 'disbursements', such as expert fees, barrister fees, court fees etc., on the basis that the law firm would be engaged on a conditional fee basis.

Today, the litigation/arbitration insurance industry is mature and well-established, albeit still niche and highly specialized. Coverage may be provided for the insured's attorney's fees and out of pocket costs as an alternative or complementary option to third-party funding. In addition, in forums and jurisdictions where fee shifting applies, insurance generally remains the most cost-effective way for parties to hedge the adverse costs risk and provide security for costs where necessary. The UK is still one of the largest markets, but the industry is growing rapidly, especially in North America and Asia, but also across Europe. Many insurers are now experienced in underwriting large, complex international arbitrations (both commercial and investor/state). The term "ATE insurance" may be regarded as too narrow when describing the broader global litigation /arbitration insurance market. Whilst it is true that some of the structures, premium pricing, underwriting criteria and policy wordings have their origins in the UK ATE insurance market, the market has evolved significantly in scope

62. BRISTOWS, "Guide to Litigation Costs Funding and Insurance", available at <http://www.zorinlegal.com/fileadmin/user_upload/docs/Litigation_funding_insurance_guide.pdf> (last accessed 31 October 2011); Raconteur Media, "Raconteur on Legal Efficiency", The Times (Supplement) (25 March 2010) available at <<http://np.netpublicator.com/netpublication/n89269938>> (last accessed 28 August 2017).

and sophistication and indeed many of the present day market participants would not regard themselves as writing ATE insurance.

Litigation/arbitration (including ATE) insurance premiums can be structured in a number of ways. A common model, which is unique to this type of insurance, is a “contingent premium” model, by which the insured only pays the insurer a premium if and when they are successful in the claim (in which case the premium is usually paid out of the settlement or damages award obtained, in a similar manner to a third-party funder’s return, although usually much lower in amount).

As the ATE/litigation/arbitration insurance market expands internationally, it is increasingly competing directly with (as well as in some instances supporting and complementing) the third-party funding market. In practical terms, a claimant considering third-party funding as an option may also, in parallel, consider using insurance to cover its legal fees and/or out-of-pocket costs (both historic and future) in exchange for which it will only pay the insurer a premium if it wins the case and collects damages or a monetary settlement. In this form, litigation/arbitration insurance is structurally very similar to third-party funding. The only material differences are that the insurer does not provide day-to-day financing, but instead will pay out on an indemnity basis if the case is unsuccessful. The other important difference is that insurance premiums are typically much lower than the typical return sought by a third-party funder.

B. Loans, Corporate Financing, Equity-based and Inter-Corporate Funding

Arbitrations may also be funded through traditional loans, corporate finance, equity-based investments, or some hybrid. For example, a parent company may make a loan to a subsidiary to enable it to pursue a claim, or the shareholders, creditors or beneficial owners of an entity may provide financial support for the pursuit of a claim which will in turn provide a financial benefit which will flow back to them.

Some types of funding are effectively a form of private equity.⁶³ There have been some examples of third-party funders taking an equity position in the claimant entity and, as such, gaining control over its investment through traditional corporate governance (i.e., membership on the Board of Directors).

Corporate financing specifically to fund a party’s costs in a dispute can raise some of the same issues as third-party funding. Those issues, however, have traditionally been resolved through traditional corporate governance mechanisms and existing rules that govern corporate relationships. For example, the potential for conflicts of interest between an arbitrator and a party extends not only to the party itself, but also to

63. Examples include in *Churchill Mining PLC and Planet Mining Pty Ltd v. Republic Indonesia*, (ICSID Case No. ARB/12/14 and 12/40 (not public) Award (6 December 2016)), and *Crystallex International Corporation v. Bolivarian Republic of Venezuela*, (ICSID Case No. ARB(AF)/11/2) Award (4 April 2016).

affiliates of and entities that have a “controlling influence” on that party.⁶⁴ An extended discussion of arbitrator conflicts of interest analysis with respect to such arrangements is provided in Chapter 4.⁶⁵

C. Attorneys as Funders

Attorneys may effectively act as funders when engaged to act on a full or partial contingency fee basis.⁶⁶ In either instance, the attorney bears some or all of the cost of the arbitration and assumes the risk of loss. A common structure involves the client financing the out of pocket costs and expenses (either from its own resources or with external financing) with the law firm forgoing payment of some or all its fees in exchange for a share of any award or settlement obtained. However, in some instances, the law firm may also agree to cover the out of pocket expenses, including tribunal fees, in exchange for a larger contingency fee.

This type of arrangement (especially where the law firm pays the out of pocket costs) is conceptually and structurally similar to third-party funding in many ways. It may also produce comparable economics from the claim holder’s perspective – the law firm’s share of the proceeds for taking a case on full contingency, including covering the out of pocket costs, may reasonably be expected to be similar to the share required by a funder for financing the case in full. Where, as is not uncommon, the law firm and a third-party funder share in the risk / reward (e.g., by the firm forgoing payment of fees with the funder covering the expenses), each party should expect a share of the proceeds which is commensurate with the relative risk taken by each.

Although there are a number of law firms that have amassed significant “war chests” to support contingent fee work, many of the more conservative law firms are not able to assume significant fee risks on large claims. Such firms have historically been more likely to turn to third-party funders. However, developments in the availability of insurance options to enable law firms to hedge fee risk,⁶⁷ as well as the rise in law firm portfolio financing is enabling historically conservative firms to take on more contingent fee work, while mitigating fee risk and cash flow concerns.

In addition to traditional contingency fee arrangements, other alternative fee arrangements may divide the risk between clients and attorneys. Examples include a reduced hourly rate, or capped fees, but with a “success fee” added as a bonus if the claimant wins, as well as fee collars, staged fee caps, etc. Such arrangements will often

64. See IBA Guidelines on Conflicts of Interest in International Arbitration, Guidelines 4.4.2-4.4.4.

65. See Chapter 4.

66. See generally BENCH NIEUWVELD and SHANNON SAHANI, *Third-Party Funding in International Arbitration*, pp. 4-5, for a discussion of how contingency fee arrangements may act as financing.

67. Solicitors Journal, “‘Game-changer’ for UK litigators with launch of first DBA insurance” (24 May 2017) available at <<https://www.solicitorsjournal.com/news/201705/‘game-changer’-uk-litigators-launch-first-dba-insurance>> (last accessed 28 August 2017).

bear much less resemblance to third-party funding and may in practice represent only a small departure, in risk/reward terms, from the law firm's normal hourly rate model. However, such a fee agreement is still highly relevant to the third-party funding structure. For example, a fee cap which ensures that there is no risk of budget overrun will be a positive feature from the perspective of potential funders and may in some instances be preferable to a discounted hourly rate.

With pro bono lawyering, the attorney may absorb all or most of the cost of representing a client, who is usually indigent or otherwise unable to pay, without any guarantee or reasonable expectation of reimbursement or profit. To date, pro bono representation has been relatively rare in international arbitration, but certain NGOs are active as *amici* and it is plausible they could end up providing representation for certain claims that implicate causes they support. Although it has some similar markers and may raise some similar issues, pro bono representation is not usually treated as a type of "financing" because no money changes hands. But as Bench Nieuwveld and Shannon Sahani point out, "the practical effect of the attorney representing the client without requiring payment could certainly be viewed as a form of 'financing', because the financial burden of legal representation has been shifted from the client to the attorney".⁶⁸

III. Current Trends and Evolution of Funding Models

The rising global prominence of dispute funding has led to some jurisdictional liberalization and a re-analysis of the status of champerty and maintenance in a number of jurisdictions,⁶⁹ with some notable exceptions, such as Ireland, where the Supreme Court recently held that third-party funding was unlawful on the ground of champerty.⁷⁰

In its modern incarnation, dispute funding has the ability to transform a legal claim into a financial asset, which can potentially be monetized or used as collateral in order to secure finance. At present, dispute funding is moving more into the realm of corporate finance, with increasingly diverse and sophisticated options becoming available.

At the same time, the global third-party funding market is growing exponentially, both in terms of the number of funds operating, and in terms of the amount of capital available. However, when it comes to individual dispute funding, many funders have

68. See BENCH NIEUWVELD and SHANNON SAHANI, *Third-Party Funding in International Arbitration*, pp. 4-5.

69. For example, *Arkin v. Borchard Lines Ltd and others* [2005] EWCA Civ 655; see also Hong Kong Legislative Council's 2017 amendments to the Arbitration Ordinance (Cap. 609), Part 10A (ss. 98E-98W) abolishing the doctrines of champerty and maintenance for arbitration.

70. *Persona Digital Telephony Ltd & ors v. The Minister for Public Enterprise & ors* [2017] IESC 27.

similar appetites and underwriting criteria, meaning that in some jurisdictions, the market is become increasingly crowded, forcing funders to compete more aggressively for opportunities and explore alternative ways of deploying capital. What follows are some examples of the ways in which the market is evolving.

A. Portfolio Funding

Portfolio funding is gaining prominence as an alternative to financing on a case-by-case basis and is an approach that many funders now actively promote. A portfolio arrangement can be structured in many ways, but there are two major types of arrangements: (1) finance structured around a law firm, or department within a law firm, where the claim holders may be various clients of the firm; or (2) finance structured around a corporate claim holder or other entity, which is likely to be involved in multiple legal disputes over a relatively short period of time.

Structuring finance around multiple claims under either model usually involves some form of cross-collateralization, meaning that the funder's return is dependent upon the overall net financial performance of the portfolio as opposed to the outcome of each particular claim. This type of structure may enable the entity (e.g., the law firm or corporate client) to secure third-party funding more quickly, on pre-arranged terms, and, depending on the structure, the ability to benefit from the overall success of the portfolio. Additionally, there may also be economic benefits to this approach – if the funder's risk is spread across multiple claims, this should in turn dictate a lower cost of capital for the funded party (although this does not always materialize in practice).

From a corporate claim holder's perspective, portfolio financing offer some interesting options, such as the possible inclusion of some types of cases within the portfolio that would not ordinarily be capable of being funded on an individual basis (e.g., defence or non-monetary cases). This is possible because the funder's return is collateralized by the claimant cases within the portfolio. Such a model may also enable the corporate claimant to monetize the portfolio, drawing capital secured against the dispute portfolio to utilize not just for financing legal expenditure but for other business purposes and/or to declare as profits.

A law firm portfolio may be structurally similar, where the finance is provided to support a law firm's contingency fee portfolio, with the funder's return pegged to the law firm's success. Again, such a model potentially allows for the law firm to draw capital more flexibly than a single case funding scenario, as well as enabling, for example, fee overruns on one case to be offset by another case that is operating below budget. Under the above model, the funder may have no direct contractual relationship with the law firm's clients, as the portfolio funding agreement is only between the law firm and the funder.

An alternative variety of law firm portfolio (which may exist alongside the structure described above) is one where the law firm's clients enter into individual funding agreements with the funder, but the terms of those agreements and/or the process for putting finance in place is dictated by the law firm's wider arrangement with the

funder. Such arrangements are arguably not portfolio arrangements as defined above, as it is unlikely that cross-collateralization would be possible amongst the funded cases. (It would be surprising for one claimant to agree that some portion of its claim proceeds should go to offset losses suffered by another unrelated client of the firm.) Such arrangements can still offer clear benefits to the law firm, if for example the funder offers an expedited due diligence process, pre-agreed funding terms, etc. However, such arrangements do create potential conflict of interest issues, which law firms need to navigate carefully.

B. Going Beyond Financing Legal Cost

Another developing area with respect to the litigation finance market is the increasing willingness of funders to consider (and in some instances, actively pursue) opportunities where the funder's capital is to be used for a purpose other than solely financing legal fees and costs. For instance, funders are providing working capital to the claimant entity during the life of the proceedings, providing financing to enable the claimant to discharge pre-existing liabilities or simply providing an advance on the damages to the claimant. Such structures are substantially similar to "traditional" third-party funding, in that the funder commits to provide a certain amount of capital with the funder's return tied to the success of litigation or arbitration. Using this model, a claim holder can use the claim as an asset in order to raise capital for a variety of potential purposes.

In the early life of the market, this structure was viewed by many funders as unattractive. Where offered, it was usually only relatively modest in sum and incidental to a larger funding provision for legal costs. However, as the market has become more competitive, funders are increasingly seeking to differentiate themselves and offer alternative applications for their capital, including in some instances inviting prospective clients to consider third-party funding not only as a means of financing their litigation but simply as a way of raising capital on a non-recourse or limited recourse basis.

That said, the practical availability of such arrangements should not be overstated. Whether a deal is capable of being structured in practice depends upon a large number of factors. The dynamics of such arrangements may be unattractive. For example, if the majority or entirety of the funder's committed capital is to be drawn on day one, this may be a significant departure from the traditional litigation finance economics, where the funder expects its funding commitment to be gradually drawn down during the life of the proceedings. This may entail a greater cost of capital to the funder and therefore less favourable funding terms.

Additionally, there is the problem of the case itself. If the claim holder wishes to use the claim to raise capital, it is likely that they may also require financing for legal costs. In such a case, the overall funding commitment will be materially larger than it would have been if the funding was limited solely to the arbitration budget, therefore requiring a much larger claim value in order for the arrangement to work. Funders will

be wary of a deal that puts too much cash into the client's pocket upfront or too heavily erodes the client's expected net recovery, because of the risk that the client may lose interest in the outcome of the case and not commit itself fully to maximizing the chances of success.

C. Equity Financing

As noted above, under the traditional model of dispute funding, the funding commitment, the expected level of return, and the terms of the investment are set out within and governed by contract (e.g., the funding agreement and/or a waterfall or priority agreement that sets out the distribution of any recovery). However, if the claim holder is a special purpose vehicle ("SPV") or entity with no other material assets other than the claim in question, the third-party funder may be able to structure its investment and return by purchasing equity in the claimant entity. Under this model, the funder's return is derived from distributable profits generated from the success of the arbitration, as opposed to a contractual return. Such a structure may offer a number of potential benefits. It may, for example, enable the funder to take greater or total control over the litigation without running afoul of champerty restrictions. For example, it has been expressly recognized by the Irish Supreme Court that structuring investment in this way would not be deemed to be champertous, whereas third-party funding would be.⁷¹

Furthermore, owning a stake in the claim holder may enable the funder to be brought within the circle of privilege, allowing the funder access to all privileged information without concerns about a potential discovery application for information shared with the funder.

D. Assignment/Sale of Claims

There are many situations where the outright sale of the claim may be preferable for both the claim holder and the funder to the 'traditional' third-party funding model. A claim holder may view lengthy arbitration (or litigation) proceedings as a costly and time-consuming nuisance and would prefer to transfer the rights to another party in exchange for an immediate payment of cents on the dollar. From the funder's perspective, having total, unfettered control of the claim (including, in particular, control of settlement decisions) may be highly desirable.

In common law jurisdictions, the outright sale or assignment of claims may not be permitted. In jurisdictions where champerty still exists, funders may be prohibited from taking control of another party's litigation in this way. The traditional definition of third-party funding in common law jurisdictions will therefore typically describe the

71. *Persona Digital Telephony Ltd & ors v. The Minister for Public Enterprise & ors* [2017] IESC 27.

arrangement as an investment in the claim holder's litigation in exchange for a financial interest in the outcome,⁷² as opposed to an outright sale.

However, as noted above, in some civil law jurisdictions, funders may adopt a model where the claim is simply purchased outright and pursued by the purchaser, possibly aggregated to other similar claims in order to produce costs savings. The market for the purchase and aggregation of cartel damages claims in Germany and the Netherlands is a good example of this approach. To date, there are few examples of international arbitration claims being arrogated in this way.

In the UK, the exemption for liquidators allows the assignment of claims to other parties. This option has led to a rise in the practice of funders offering to buy claims arising in insolvency rather than fund the claims directly. The structure may involve an upfront purchase price (allowing an immediate distribution to creditors), a deferred structure where the funder pays a share of any amounts recovered to the insolvent estate, or a combined part upfront, part deferred payment structure.

E. Enforcement Financing

By definition, the non-recourse litigation financing model requires the funder to accept both what may be described as “dispute risk” (i.e., the risk of an adverse ruling or award) and enforcement or collection risk. In other words, in order to see a return on invested capital, the funded party must not only win the case, but must also successfully enforce the award.

Traditionally, many third-party funders have been more comfortable assessing litigation risk than enforcement risk, which is perhaps a reflection of the fact that most third-party funders are managed by former lawyers. In the early stages of the market's development, it was common for funders to simply turn down cases where enforcement was likely to be challenging due to the lack of identifiable, locatable assets. However, as the market has developed, funders have recognized that many of the largest and potentially most lucrative disputes might require an acceptance of material enforcement risk.

Today, many funders have in-house asset-tracing and enforcement capability, and may seek to differentiate themselves on that basis. Similarly, there are a number of funders that originally started out as award enforcement or debt recovery agencies, but have gradually embraced opportunities to get involved and finance contested claims at earlier stages in the arbitration process and now finance contested claims. Some such funders may now be known generally as third-party funders, even though their businesses may pre-date the modern third-party funding industry. Others may not describe themselves as third-party funders, but nevertheless offer similar structures.

In practice, enforcement financing may be expressly or implicitly built into an agreement to fund an arbitration claim on the basis that the funder will not see a return until the award is successfully enforced. Funders will also often consider enforcement-

72. See ALF Code of Conduct for Litigation Funders (November 2016).

only opportunities, where an award has already been obtained and the claimant seeks financial support and/or expertise to secure collection. Enforcement financing is therefore a necessary component of third-party funding and something which most funders today provide, albeit with different risk appetites and levels of expertise.

F. Assignment/Sale of Awards

Related to the purchase of claims (discussed above) is the market for the purchase/assignment of awards and judgments. This practice is permitted in most jurisdictions and pre-dates modern concepts of third-party funding. Many of the funds that operate in this space would not consider themselves to be third-party funders, however many third-party funders will also consider such opportunities. Like claims sales, the sale of awards can be structured in a number of different ways, from a simple upfront purchase price to a payment which is in whole or in part based upon the amount collected.

IV. Conclusion

In the last decade, the global dispute finance industry has grown beyond all recognition and continues to expand, both in terms of the number of funders operating and in terms of the amount of capital raised and deployed. This market growth has gone hand-in-hand with rising awareness amongst the legal community. There are few arbitration attorneys that are not at least aware of the basic premise of third-party funding, and there is an ever-growing proportion that have first-hand experience of the market.

Much of the focus of the larger dispute funders today is on encouraging greater corporate use of such forms of finance. While historically third-party funding was considered an option of last resort for financially distressed claimants, funders are today increasingly encouraging corporate entities with strong balance sheets to use dispute finance as an alternative to tying up their own capital in litigation or arbitration. The idea and advantages of off-balance sheet litigation and turning in-house legal departments into profit centres are well-established.

While the market is becoming more diverse, the larger funders have tended to follow a relatively similar pattern. They commonly seek primarily to invest in a relatively small volume of very large commercial disputes and portfolios. The amount of capital committed to each investment tends to be in the millions of dollars, the claim values in the tens or hundreds of millions (or more), and the funders are expecting to make a multiple return on the capital invested in successful cases.

Investing in this profile of cases with the levels of financial risk involved tends to necessitate both high rejection rates and detailed due diligence. While many funders advertise speed of execution by comparison to their competitors, the reality is securing funding can be a lengthy and complex process. More streamlined options for financing

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smaller to medium-sized claims are still limited in many jurisdictions, although this is an area which is gradually attracting interest from the dispute finance market and is expected to continue to develop in the next few years.

The growing number of funders has already produced and should continue to yield positive developments for prospective users of dispute funding, requiring funders to compete on speed and cost of capital in order to win business and meet target capital deployment levels.

Third-party funding must also be seen in the context of the wider arbitration finance and risk management market. As noted above, law firms may play an increasingly prominent role in this regard. Currently, some historically conservative firms are using external finance and insurance to support development of contingency fee portfolios. As more innovative financing solutions become available to law firms, potentially with lower capital costs than traditional third-party funding, law firms and funders may also start to compete for opportunities.

In addition, the dispute risk insurance market is developing rapidly, growing in prominence and expanding into new markets and jurisdictions. These insurance options are now being presented by lawyers and brokers alongside third-party funding as part of a broader discussion about the potential options available to finance or de-risk arbitration.

Chapter 3[†]

Definitions

I. Introduction

As it considered various substantive topics, the Task Force’s discussions frequently returned to important and fundamental questions about the definition of third-party funding and third-party funders. This focus on definitions is not surprising given the need for a clear understanding of the object and the scope of the Task Force’s work and, relatedly, of any recommendations or guidance produced by the Task Force.

For these reasons, and in light of the range of definitions adopted by various entities seeking to regulate third-party funding, it was decided that the Task Force Report would benefit from a deliberative analysis of issues related to definitions of third-party funding and third-party funders. This Chapter provides that analysis.

To facilitate broad-based analysis of questions about the implications and trade-offs among different definitions, this Chapter is organized around Working Definitions of “third-party funder” and “third-party funding”. The Chapter provides a systematic survey of various definitions adopted in other sources, and a conceptual analysis of functional aspects of funding that may affect definitions.

This Chapter is intended to be read as background to other Chapters, each of which effectively adopts a specific definition of the funding activities addressed in its analysis. It may also be useful to future efforts at regulation in its analysis of the regulatory implications of definitional issues.

This Chapter proceeds as follows. After this introduction, the Chapter begins with general background regarding issues implicated in definitions [II], and then provides an explanation of funding models that are within and outside the scope of the broad Working Definition that is the starting point for the Task Force’s analysis [III]. The Chapter then provides a survey of the definitions that have been adopted by various institutions, legislation, treaties, policy makers, and scholars in the international arbitration context [IV] and then engages in a functional analysis of certain key features of third-party funding [V]. Finally, the Chapter concludes with an overview of the more specific definitions adopted in various subsequent chapters in order to limit the scope of their application to the specific topics taken up by those chapters [VI].

[†] Primary contributors to this Chapter include Catherine Rogers, Stavros Brekoulakis, James Clanchy, and Duarte Henriques. Mr. Ahmed El Far also contributed valuable research assistance.

II. Background

Despite their increasing presence in international arbitration, the precise definitions of third-party funder and third-party funding continue to be subject to considerable debate. Even funders themselves disagree over the precise definition of third-party funding or whether it is even capable of definition.⁷³ Several reasons explain this definitional difficulty.

One reason for definitional ambiguities is that modern outside funding of a party's costs can resemble, or be co-terminous with, other forms of financing that have existed long before the modern phenomenon. For example, in some jurisdictions, contingency fee arrangements are widely used to facilitate legal representation, and in some instances to cover claimants' expenses. Although rarely referenced explicitly as a form of third-party funding, the practice is implicitly subsumed in many general definitions that refer to a non-party financing pursuit of a case, unless expressly excluded.⁷⁴ Even if a law firm does not advance any specific amounts for costs, they are effectively contributing something of material value – legal services – in exchange for an interest in the final award.

73. See M. SCHERER, A. GOLDSMITH and C. FLÉCHET, “Third-Party Funding in International Arbitration in Europe: Part 1 – Funders’ Perspectives”, 2 RDAI/IBLJ (2012) pp. 209-210, available at <<https://www.transnational-dispute-management.com/news/20120312.pdf>> (last accessed 27 October 2016), reporting on a roundtable, attended by various major litigation funding firms, where the participants could not agree on a definition of third-party funding. This confusion is apparent even at a terminological level. As one commentator describes, “[t]he nomenclature to describe this kind of third-party capital investment in arbitration or litigation claims is all over the map and woefully un-descriptive. It has been referred to as “third-party funding”, “third-party litigation funding or financing”, or most commonly “alternative litigation funding or financing””. M. DESTEFANO, “Non-Lawyers Influencing Lawyers: Too Many Cooks in the Kitchen or Stone Soup”, 80 Fordham L. Rev. (2012) p. 2791 at p. 2794.

74. For example, the Hong Kong Arbitration and Mediation Legislation (Third Party Funding) (Amendment Ordinance), sections 98 K to N, expressly permits third-party funding provided for arbitration, mediation, and related litigation under the Arbitration Ordinance (Cap 609). Sections 98K and 98L provide that the common law offences of maintenance (including champerty) and barratry and the tort of maintenance (including champerty) do not apply to third-party funding of arbitration. However, its section 98O provides that these amendments to Hong Kong law do not apply to provision of funding to a party by lawyers acting for any parties in relation to such arbitration, mediation, and related litigation proceedings. This exclusion suggests that, in the absence of such an exclusion, the Hong Kong definition of third-party funding could include lawyer funding through contingency fees (although section 64 of the Legal Practitioners Ordinance (Cap. 159) prohibits a solicitor from purchasing an interest in his client's contentious proceedings or agreeing to charge success fees for contentious work). See also Section 107(3A) read with Section 107(3B) of the Legal Profession Act, and Rule 49B of the Legal Profession (Professional Conduct) Rules 2015 (Singapore).

In a similar manner, modern third-party funding arrangements are often functionally similar to, serve purposes similar to, and operate as market alternatives for before-the-event (BTE), after-the-event (ATE), or traditional liability insurance. In fact, as described in Chapter 2, many modern third-party funders are providing products that are effectively a form of (or at least grew out of) ATE insurance, and ATE insurance is often purchased contemporaneously with entering into a third-party funding agreement.⁷⁵ Meanwhile, financial support for litigation and arbitration costs are also increasingly being sought from conventional forms of corporate finance, including both debt-based and equity-based financing.⁷⁶

Defining third-party funding is also difficult because of the wide range of funding models that exist and are rapidly evolving, even since when the Task Force was constituted. Funding may be structured through corporate debt or equity (as noted above), or as risk-avoidance instruments, or full transfers of the underlying claims. More recently, “law firm financing” and “portfolio funding” have emerged. These models fund an identified range of cases involving a particular party or law firm. In the latter instance, funding is provided to the law firm, not the party, which can raise additional practical and definitional challenges.

One reason for additional complexity with law firm and portfolio funding is that one portfolio of cases can be identified to receive funding, while another portfolio is the basis for a funder’s return or securitization of its investment. In addition, it is also possible that portfolios of funded cases can be “refinanced”, meaning a second third-party funder (or multiple other investors) can invest in a portfolio or a “bundle” of cases of another funder.

Meanwhile, third-party funders may become involved either before a claim is filed or later in the process.⁷⁷ Some funders specialize only in award execution or funding for expert witness costs, while others fund all costs, including a potential adverse award of costs. Funders also separately incorporate “special purpose vehicles” (SPVs) to facilitate the funding arrangement,⁷⁸ a practice that in itself can raise practical

75. See Chapter 2, pp. 34-35.

76. See Chapter 2, pp. 35-36. See also A. J. SEBOK, “The Inauthentic Claim”, 64 *Vand. L. Rev.* (2011) p. 61 at pp. 63-67. Given the potential overlap between modern non-recourse third-party funding and other traditional means of supporting litigation expenses, some on the Task Force argued that the Report should adopt the term “modern third-party funding” to distinguish more recent phenomena from more traditional forms of litigation support. For reasons explained in greater detail in this Chapter, however, the Task Force decided not to circumscribe its analysis to modern forms, but instead sought to locate more modern forms of funding in the constellation of existing forms.

77. See M. KANTOR, “Third-Party Funding in International Arbitration: An Essay About New Developments”, 24 *ICSID Review* (2009, Issue 1) p. 65 at p. 74; J. A. TRUSZ, “Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration”, 101 *The Georgetown Law Journal* (2013) p. 1649 at p. 1654.

78. See C. VELJANOVSKI, “Third-Party Litigation Funding in Europe”, 8 *J.L. Econ. & Pol’y* (Spring 2012, No. 3) p. 405 at p. 430 (“Third-party litigation funding investors] rely on

questions about both the identity of the funder or about the application of particular rules.⁷⁹

Funding agreements also vary significantly in how they order the rights and obligations of the parties, counsel, and third-party funders. Some funding agreements permit or require active participation of the third-party funder in key strategic decisions in the arbitration, depending on parties' and funders' preferences and applicable law. Other agreements provide for a more limited role for funders, providing only for periodic updates and limited opportunities for intervention.

While most funders invest for profit, not all do, particularly if they fund responding parties. For example, in the investment arbitration brought by Philip Morris against Uruguay, The Bloomberg Foundation and its 'Campaign for Tobacco-Free Kids' provided outside financial support for the Uruguayan government.⁸⁰ While this arrangement involves funding of a case by a third party, funding was for a respondent (not claimant) and the funder's interest was not financial, but instead tied to the political and policy implications of the award.

Respondent states can also, as occurs in WTO proceedings, be funded by another state or, as has been reported anecdotally by some funders, be funded through a model similar to after-the-event insurance. There has also been at least one case in which a respondent state was funded by an oil company that had a competing claim to the oil rights being sought by the investor in the funded case.⁸¹

In addition to the variety of existing funding models, modern funding is expanding as a result of an influx of new funders and the expansion of funding into new regions

Special Purpose Vehicles, which ... are legal entities created for ... the acquisition, financing, or both, of a project or the setup of an investment. They are usually used because they are free from pre-existing obligations and debts, and are separate from the parties that set them up for tax and insolvency purposes.”), available at <<https://ssrn.com/abstract=1971502>> (last accessed 14 March 2018).

79. For example, just as excessive repeat appointment of an individual arbitrator by a party or law firm can be a basis for challenging that arbitrator, under the IBA Guidelines on Conflicts of Interest in International Arbitration repeat appointment of an arbitrator by the same third-party funder can raise similar challenges. See IBA Guidelines 3.1.3. If funding is done through a special purpose vehicle created for the particular case, it may mask the repeated appointment by a particular third-party funder that owns the SPV.

80. See Press Release by Uruguay's Counsel, Foley Hoag LLP, "Government of Uruguay Taps Foley Hoag for Representation in International Arbitration Brought by Philip Morris to Overturn Country's Tobacco Regulations", p. 8 (October 2010) available at <<http://www.foleyhoag.com/news-and-events/news/2010/october/uruguay-taps-foley-hoag-for-representation>> (last accessed 19 August 2017).

81. See F. CABRERA DIAZ, "RSM Production Corp. files second arbitration against Grenada, sues Freshfields", available at <<https://www.iisd.org/itn/2010/04/08/rsm-production-corp-files-second-arbitration-against-grenada-sues-freshfields/>> (last accessed 30 August 2017).

and jurisdictions.⁸² A desire to invest in assets that are not tied to market fluctuations has enticed many funders. Some of these new entrants may not be familiar with the nuances of dispute funding in international arbitration.

The proliferation of funders and funding models raises questions about how to define funding for the purpose of the Task Force's study and any potential recommendations. Some disagreement existed on the Task Force about whether to focus its study on the narrow, modern practice of case-specific non-recourse funding, or to adopt a broader definition that takes account not only modern non-recourse models, but other forms of financing that are conceptually or functionally similar to and/or function as alternatives in the same market. As explained in greater detail below, for the purpose of study and discussion the Task Force adopted a broad definition. Meanwhile, specific recommendations in subsequent chapters of this Report are based on more targeted, narrowly tailored definitions.

Given the pace of developments in the field, this Chapter includes not only a discussion of conceptual definitions of funding, but also an analysis of the functional similarities and differences among different types of financing that may either come within a definition of funding or be considered by analogy alongside funding. Like debates about the scope of the Task Force's working definitions, some members on the Task Force questioned the utility of including any discussion of functional aspects of third-party funding.⁸³ On the other hand, it was observed that various national, international, and scholarly debates about funding often include analogical reasoning based on functional distinctions between modern funding and other sources of litigation finance. It was therefore decided that the functional analysis should be

82. For example, third-party funding of arbitration and related proceedings only become permissible in Singapore in March 2017 and as a result of legislative change that abolished the doctrines of champerty and maintenance for international arbitration. In June 2017 Hong Kong legislation was passed providing a framework for third-party funding of arbitration and related proceedings providing that it is not prohibited. Meanwhile, litigation finance has also recently arrived in Latin America with the emergence of Leste based in Brazil and Lex Finance based in Peru. Third-party funding is also rapidly expanding in China. B. ZHANG and M. HU, "A snapshot of the Chinese Third-Party Funding market", submission on file with Task Force.

83. The Task Force benefitted from the expertise of its members and consultation with other experts on various forms of litigation support, including insurance. During the public comment period, the Task Force co-hosted, together with The Law Society of England and Wales, a roundtable discussion to seek input on issues relating to insurance and maritime. Mutual insurers in the insurance industry and an individual with former experience in ATE insurance attended. Unfortunately, no non-maritime insurers were included on the invitation list. The absence of non-maritime insurers was noted and, as a result, the Task Force was encouraged to seek out additional input from those with insurance expertise and from the insurance industry.

included in keeping with one of the primary purposes of the Task Force – to provide analysis that can serve as a reference for other entities.⁸⁴

III. The Task Force Working Definition

Given the range of existing third-party funding models, and the likelihood that new models will continue to develop and flourish, this Report has taken as a starting point broad Working Definitions of third-party funder and third-party funding.⁸⁵ These broad definitions facilitate consideration of the full range of funding models, as well as close analogies that provide important context.

For these reasons, the Task Force considered all types of dispute funding that would fit within the following definition:

The term “third-party funding” refers to an agreement by an entity that is not a party to the dispute to provide a party, an affiliate of that party or a law firm representing that party,

- a) funds or other material support in order to finance part or all of the cost of the proceedings, either individually or as part of a specific range of cases, and**
- b) such support or financing is either provided in exchange for remuneration or reimbursement that is wholly or partially dependent on the outcome of the dispute, or provided through a grant or in return for a premium payment.**

For the purposes of this Report, the definition of “third-party funder” largely follows from this definition of third-party funder:

The term “third-party funder” refers to any natural or legal person who is not a party to the dispute but who enters into an agreement either with a party, an affiliate of that party, or a law firm representing that party:

- a) in order to provide material support for or to finance part or all of the cost of the proceedings, either individually or as part of a specific range of cases, and**
- b) such support or financing is either provided in exchange for remuneration or reimbursement that is wholly or partially dependent on the outcome of the dispute, or provided through a grant or in return for a premium payment.**

84. See Chapter 1, p. 13.

85. See L. BENCH NIEUWVELD and V. SHANNON SAHANI, *Third-Party Funding in International Arbitration*, 2nd edn. (Kluwer 2017), p. 2.

These definitions borrow elements from various existing definitions in an effort to amplify the scope.⁸⁶ The key elements of these definitions are 1) a person or entity that is not a party to the dispute; 2) the provision of financing or material support; and 3) remuneration that is either dependent on the outcome of the dispute, or is given as a grant or in return for a premium.

Beyond conventional forms of modern non-recourse funding, these Working Definitions also comprehend respondent-side funding, contingency fees by law firms, and certain types of insurance. They apply not only to funding models that are premised on an expectation of a return on investment, but also to pro bono representation and funding for non-profit purposes. As a consequence, the definition of third-party funder is not limited to commercial funders, but extends to any third party who provides funding or support for an arbitration.

These definitions are also intended to apply not only to individually funded cases, in which a funder's support is directed specifically at individual cases, but also to funding of a portfolio of claims held by a business, or in financing provided to a law firm and collateralized by funds anticipated to be received from cases represented by that firm.

The purpose in adopting broad Working Definitions for the Task Force's study and analysis is to ensure consideration of the full range of funding models. Using broad definitions as an analytical starting point also facilitates examination of the extent to which issues under consideration are identical to, similar to, or different from those that arise or do not arise with respect to other more long-standing forms of funding.

For example, definitions that are too narrow may either exclude certain types of funding or preclude clear application of specific rules or guidelines that are intended to apply to third-party funders. For example, a special purpose vehicle created to fund one case might avoid easy application of the IBA Guidelines on Conflicts of Interest in International Arbitration (IBA Guidelines on Conflicts) that require disclosure and possible disqualification of an arbitrator who has been reappointed numerous times in a case involving the same funder.⁸⁷

In another example, many existing definitions that require financial interest in the award would exclude respondent- or defence-side funding (where no counter-claim has been filed). Respondent- or defence-side funding undertaken, for example, to generate favourable precedent or advance policies implicated in the award, can raise concerns identical to those in modern claimant-side third-party funding.⁸⁸ For example, an

86. See discussion below discussion of definitions in the EU-Vietnam BIT, the TTIP, and the IBA Guidelines on Conflicts.

87. See "Standard 6" of the IBA Guidelines on Conflicts of Interest in International Arbitration, and Explanation to Standard 6 (b), available at <https://www.ibanet.org/ENews_Archive/IBA_July_2008_ENews_ArbitrationMultipleLang.aspx> (last accessed 15 July 2017) ("IBA Guidelines").

88. In the case of *Quasar de Valores SICAV S.A. et al. v. The Russian Federation*, (SCC Arbitration No. 24/2007). The funder, Group Menatep Limited, was a former majority

arbitrator may represent or sit on the Board of Directors of a non-governmental organization that is funding an arbitration or otherwise be conflicted with a non-party that is providing funds for the dispute.

The Task Force considered the full range of third-party funding and analogues so that its ultimate recommendations would be coherent and fair, treating similarly actors and financing that have similar purposes and effects. For example, in some cases insurance companies or pro bono supporters may exert influence in selecting an arbitrator or making case management decisions. Conclusions and recommendations based on narrower definitions that exclude these types of dispute financing might inadvertently preference one form of funding over another, even though they function as equivalents or alternatives, compete in the same market, or implicate identical issues.

Despite adopting these broad definitions for the purposes of the Task Force’s analysis and discussions, later chapters generally adopt narrower definitions that are more tailored to specific recommendations or guidance on particular issues. For example, insurance markets and the participation of insurers in adjudicatory proceedings are already generally regulated in various legal regimes through national insurance regulations, procedural rules, privilege rules that apply to communications with insurers, and professional ethical regulations. Similarly, contingency fee arrangements are generally regulated through national attorney regulation, and potential conflicts with law firms providing contingency fee funding are governed by other sources aimed at the conduct of lawyers, such as the IBA Guidelines on Conflicts’ provisions regarding conflicts with attorneys and law firms,⁸⁹ and the IBA Guidelines on Party Representatives in International Arbitration.⁹⁰

To sum up, the Task Force has adopted board Working Definitions to facilitate thorough discussion, to capture (to the extent possible) the full range of existing funding models, and to provide a baseline from which narrower definitions can be tailored for particular issues.

shareholder in the Russian oil company Yukos (rather than a commercial third-party funding entity) and there was no formal written funding agreement that required claimant to reimburse Menatep (see Award 20 July 2012 para. 223). Speculation is that Menatep was funding the case in an effort to create a favourable “precedent” that would be helpful in its future, much larger, shareholder dispute against Russia under the Energy Charter Treaty. See V. SHANNON SAHANI, “Revealing Not-for-Profit Third-Party Funders in Investment Arbitration”, available at <<http://oxia.ouplaw.com/page/third-party-funders>> (last accessed 19 August 2017).

89. See IBA Guidelines on Conflicts of Interest, 3.1.3.

90. Notably, Article 4 of the IBA Guidelines on Party Representatives requires “A Party should promptly inform the Arbitral Tribunal and the other Party or Parties of any change in such representation.” This provision, along with general procedures and practices that require disclosure of representation at the commencement of an arbitration, ensure that arbitrators are aware of the participation and identity of any attorneys or law firms in an arbitration.

A. Inclusion of “Insurance” in the Working Definition

Debate existed on the Task Force both about whether its Working Definitions would, as an interpretive matter, and should, as a normative matter, extend to certain types of insurance. At the most basic level, an insurer is not a party to the merits of the dispute, but generally provides financing that facilitates the bringing of or defence against claims. Like modern third-party funders, insurers also have some financial interest that is affected by the final outcome of the arbitration. Moreover, many insurance products are sold as alternatives to, or in conjunction with, third-party funding. These basic points, however, elide some of the more nuanced aspects of different types of insurance, and do not fully answer the normative questions.

Some sources, such as the IBA Guidelines on Conflicts of Interest, have already included insurance as part of reforms designed to address third-party funding. The reason is that conflicts of interest that arise with respect to third-party funders may also arise with respect to various types of insurance. For example, an arbitrator may own substantial stock in an insurance company or an arbitrator’s law firm may do substantial work for an insurance company. Like third-party funding, an arbitrator would not know to evaluate and potentially disclose those potential conflicts absent disclosure to the arbitrator of the existence of insurance.

In the long run, it may not be that precisely the same standards or considerations for disclosure by and disqualification of an arbitrator are deemed necessarily to apply to insurers in comparison with modern third-party funders. Those differences, and the bases for such distinctions, can only be meaningfully evaluated, however, if disclosure is more systematic to facilitate assessment.

B. BTE Insurance

With regard to interpretation, an argument was raised that BTE insurance was not comprehended within earlier versions of the Working Definition because BTE insurers are, typically, reimbursed before the claim arises and by way of a premium, rather than on the basis of the outcome of the arbitration. Under this view, any amounts a BTE insurer receives at the end of the case would not, therefore, be “dependent on the outcome of an arbitration”. It was for this reason that language was added to the Working Definition to indicate that the financing could be provided in exchange for a premium.

Those who favoured including BTE insurance in the Working Definition⁹¹ noted that a BTE insurer will be able to recover its costs in the event a claimant prevails and is awarded costs, and thus a BTE insurer could benefit financially from a favourable outcome in the arbitration. In this way, the financial interests of a BTE insurer may be

91. For a description of BTE insurance, see Chapter 2, pp. 33-35.

considered “dependent on the outcome of the dispute”.⁹² As described in Chapter 2, like modern third-party funding, BTE insurance “will provide funding for bringing a claim falling within the scope of cover, paying lawyers’, arbitrators’ and experts’ fees during the course of the arbitration”.⁹³

At a functional level, BTE insurers may also (depending on the policy and market) either select counsel or, in those jurisdictions where lawyers do not have a monopoly on legal services, BTE insurers may directly take on legal representation of the claim.⁹⁴ In sum, a BTE insurer will, like modern third-party funders often do, “control the conduct of the claim as closely as it can”.⁹⁵ Despite the extended debate, and initial efforts to include it, BTE insurance was not ultimately included in any Task Force recommendations because it is reportedly rare in modern international commercial arbitration, outside the context of maritime arbitration (which as noted is categorically excluded from the Task Force’s recommendations).

C. ATE Insurance

Similarly, there was debate about whether ATE insurance⁹⁶ would or should come within the Working Definition. Some argued that ATE insurance does not involve financing during the arbitration. Like other types of third-party funding, however, premiums under most ATE policies are only payable in the event of success. As one scholar explains, “This means that the insured claimant ... is only liable to pay the premium if the claim is won [and]...if the insured loses the case, no ATE premium is due.”⁹⁷ Under such policies, because the ATE insurer will recover payment for policies only in the event of an award in favour of the insured, most on the Task Force regarded ATE insurance as being tied to the outcome of a dispute in a manner that brings it within the Working Definition. In addition, some ATE policies also provide for reimbursement not only of an adverse cost award, but also for coverage of a party’s

92. There was further debate on the Task Force about whether BTE insurance would come under the IBA Guidelines’ definition. That issue is discussed below.

93. See Chapter 2, p. 34.

94. See M. TUIL and L. VISSCHER, *New Trends in Financing Civil Litigation in Europe, A Legal, Empirical, and Economic Analysis* (Edward Elgar 2010) pp. 96-98.

95. *Ibid.*

96. For a description of ATE insurance, see Chapter 2, pp. 34-35.

97. VELJANOVSKI, “Third-Party Litigation Funding in Europe”, p. 405; see also M. DE MORPURGO, “A Comparative Legal And Economic Approach To Third-Party Litigation Funding”, 19 *Cardozo J. Int’l & Comp. L.* (2011) p. 343 at p. 353 (“From the viewpoint of third parties, ATE insurance is another way to invest in the outcome of litigation. ATE insurance is a particular type of insurance that can be taken out after an event, such as an accident that has caused an injury, to insure the policyholder for disbursements, as well as any costs should he lose his case.”). In addition, under some policies, premiums for the policy are only due dependent on particular outcomes, such as if the insured wins the case. See also overview of ATE and BTE insurance in Chapter 2, pp. 33-35.

own legal fees and costs.⁹⁸ With these provisions, ATE insurance closely resembles modern forms of third-party funding and would fit within the Working Definition.

Apart from questions of interpretation, there was also significant debate about normative questions about whether the Working Definition should include insurance. While some members objected to inclusion of insurance, particularly because no representatives from insurers were among the Task Force's membership, the vast majority of members favoured including it.⁹⁹ As a practical matter, the inclusion of insurance within the definition of third-party funding is only relevant with respect to the Report's analysis and recommendations regarding disclosure for the purpose of assessing potential conflicts of interest (i.e., should the existence and identity of insurers be subject to the same disclosure obligations as third-party funders?).

D. Exclusion of P&I and Defence Clubs

Despite including insurance in its Working Definition, the Task Force did not generally treat mutual funding by P&I and Defence Clubs that exists in maritime arbitration as part of this definition (although it is recognized that in several important seats maritime arbitration represents the largest number of the international arbitrations conducted in the seat). The purpose of this exclusion is not to mark out any strictly defined blanket exclusion or imply that modern forms of third-party funding (and the recommendations in this Report) have no possible relevance in disputes relating to shipping. Instead, the Task Force recognizes that the vast majority of disputes in the maritime sector have special features that make the recommendations of this Report inapplicable. In particular, maritime arbitrations tend to involve a small but specialized pool of highly independent, full-time arbitrators and practitioners together with well-regulated mutual funding by P&I and Defence Clubs. This regime has developed over many decades and is well known within the maritime industry, such that there is substantial transparency as to how this funding works and its impact on matters such as disclosure, conflicts, and security for costs.

Despite the exclusion for maritime arbitration, this Report includes references to P&I and Defence Clubs in the maritime field, for purposes of comparison only, because their long traditions are a helpful and important point of reference for analysing modern funding arrangements.

98. V. WAYE, *Trading in Legal Claims: Law, Policy & Future Directions in Australia, UK & US* (2008) p. 87; see also The Judge Website, available at <<https://www.thejudgeglobal.com/litigation-and-arbitration-insurance/>> (last accessed 30 August 2017).

99. Similarly, while a few comments were received during the public comment period that counselled against including insurance, the vast majority of comments favoured including insurance.

IV. Survey of Existing Definitions

This section provides a survey of various definitions of third-party funders and third-party funding that have been adopted by national and international entities in addressing these issues.

A. Legislation and Codes of Conduct

Debate still exists in some domestic contexts about whether and to what extent third-party funding should be permitted or regulated. While common law doctrines against champerty and maintenance are most well known, in “civil law jurisdictions professional attorney ethics rules and ownership of claim constraints take center role” in providing any limitations on third-party funding arrangements.¹⁰⁰ As a result, national laws regarding third-party funding in domestic litigation vary considerably.

To date, however, only two states appear to have taken any action to regulate, and therefore define, third-party funding in international arbitration. These legislative efforts have been undertaken as part of an effort to legalize the use of funding in international arbitration, which had previously been prohibited under the doctrines of champerty and maintenance.

Singapore has recently amended its law and permit third-party funding in relation to prescribed dispute resolution proceedings.¹⁰¹ For that reform, the definition of third-party funding is found in the recent Civil Law Amendment Bill and in the Civil Law Regulations.

In its final version, which came into effect on 1 March 2017, Regulation 4 of the Civil Law (Third-Party Funding) Regulations of 2017 defines a qualifying third-party funder as an entity that “carries on the principal business, in Singapore or elsewhere, of the funding of the costs of dispute resolution proceedings to which the Third Party Funder is not a party” and “has a paid-up share capital of not less than S\$ 5 million or the equivalent amount in foreign currency or not less than S\$ 5 million or the equivalent amount in foreign currency in managed assets”.¹⁰²

100. See BENCH NIEUWVELD and SHANNON SAHANI, *Third-Party Funding in International Arbitration*, p. 43.

101. Civil Law (Amendment) Act 2017 was passed by Parliament on 10 January 2017. See A. HENDERSON and D. WALDEK, “Singapore Arbitration Update: Third Party Funding and New SIAC Rules 2016”, Herbert Smith Freehills Arbitration Notes (1 July 2016), available at <<https://hsfnotes.com/arbitration/2016/07/01/singapore-arbitration-update-third-party-funding-and-new-siac-rules-2016/>> (last accessed 19 February 2018).

102. Section 2 of the Civil Law (Amendment) Act 2017 to amend the Civil Law Act (Chapter 43 of the 1999 Revised Edition) (the “Act”) and to make a related amendment to the Legal Profession Act (Chapter 161 of the 2009 Revised Edition), passed 10 January 2017 and assented by the President on 3 February 2017 (“Civil Law (Amendment) Act 2017”).

A “third-party funding contract” is defined as:

“a contract or agreement by a party or potential party to dispute resolution proceedings with a Third-Party Funder for the funding of all or part of the costs of the proceedings in return for a share or other interest in the proceeds or potential proceeds of the proceedings to which the party or potential party may become entitled.”¹⁰³

Under these provisions, the definition of a “third-party funder” is intended to ensure that funders who provide funding for international arbitration proceedings in Singapore are reputable, professional funders who have an incentive to comply with the legislative requirements. This definition does not appear to extend to non-commercial funders (such as individual persons). As a consequence, such funding agreements would apparently be unenforceable under Singapore law, but such agreements may still be enforceable if the parties select other law and another jurisdiction for enforcement of the agreement.¹⁰⁴ Meanwhile, the provision that the funding contract provide for “a share or other interest in the proceeds or potential proceeds of the proceeding” would seem to exclude pro-bono,¹⁰⁵ as well as BTE and ATE insurance that is not offered through a third-party funding agreement.¹⁰⁶

The relatively narrow scope of the Singapore definition of a qualifying third-party funding contract appears to be confirmed in the explanation in the draft version of the Bill regarding funder obligations required for enforcement of their rights under the funding contract.¹⁰⁷

In a similar vein, Hong Kong recently enacted legislative reforms to permit third-party funding arrangements that had arguably been previously prohibited under the doctrines of champerty and maintenance.¹⁰⁸ Under the Hong Kong Ordinance, like the

103. *Ibid.*

104. C. A. ROGERS, *Ethics in International Arbitration* (Oxford University Press 2014), p. 194.

105. This limitation is confirmed in the Law Society of Singapore, Guidance Note 10.1.1, which describes “Third-party funding” as involving “a commercial funder agreeing to pay some or all of the claimant's legal fees and expenses.” See <http://www.lawsociety.org.sg/Portals/0/ForLawyers/GuidanceOnProfessionalAndPracticeIssues/PDF/Council_GN_Third_Party_Funding.pdf> (last accessed 20 February 2018).

106. The exclusion in the Singapore Act definition of BTE and ATE insurance is likely related to the fact that the starting point for the legislative effort was to abolish the tort of maintenance and champerty, and these types of funding historically have not been regarded as implicating that tort.

107. See Article (4) the Civil Law (Amendment) Bill of 2016, and see Explanatory Statement of the Civil Law (Amendment) Bill of 2016.

108. It is currently unclear in Hong Kong whether the doctrines of maintenance and champerty apply to third-party funding for arbitrations taking place in Hong Kong: see the Court of Final Appeal judgment in *Unruh v. Seeberger* (2007) 10 HKCFAR 31, at para. 123 where the Court expressly left open this question. While earlier in *Cannonway Consultants*

Singapore legislation, “third-party funding” and the “funding agreement” are defined terms, but the Hong Kong legislation also defines separately “third-party funding”. Specifically, in defining funding, Section 98G of the Hong Kong Ordinance provides:

“Third-party funding of arbitration is the provision of arbitration funding for an arbitration –

- (a) under a funding agreement;
- (b) to a funded party;
- (c) by a third-party funder; and
- (d) in return for the third-party funder receiving a financial benefit only if the arbitration is successful within the meaning of the funding agreement.”

Section 90O provides that “Part 10A is not applicable to lawyers acting for parties in arbitration” as follows:

- “(1) This Part does not apply in relation to the provision of arbitration funding to a party by a lawyer who, in the course of the lawyer’s legal practice, acts for any party in relation to the arbitration;
- (2) If a lawyer works for, or is a member of, a legal practice (however described or structured) the references in subsection (1) to “lawyer” include the legal practice and any other lawyer who works for, and is a member of, the legal practice.
- (3) In this section –

Lawyer... means

- (a) a person who is enrolled on the roll of barristers kept under section 29 of the Legal Practitioners Ordinance (Cap. 159);
- (b) a person who is enrolled on the roll of solicitors kept under section 5 of that Ordinance; or
- (c) a person who is qualified to practise the law of a jurisdiction other than Hong Kong, including a foreign lawyer as defined by section 2(1) of that Ordinance;

party... means a party to an arbitration within the meaning of section 98I.”

Limited v. Kenworth Engineering Ltd, [1995] 2 HKLR 475, Judge Kaplan had held that the law of champerty did not extend to arbitration, later in *Unruh v. Seeberger*, (2007) 10 HKCFAR 31, at para. 123, the Court did not refer to this aspect of Judge Kaplan’s judgment. Accordingly, the permissibility of third-party funding with respect to arbitration in Hong Kong had been subject to uncertainty. See para. 1.6 of “The Law Reform Commission of Hong Kong Final Report on Third Party Funding for Arbitration” (October 2016) available at <<http://www.hkreform.gov.hk/en/publications/rtpf.htm>> (last accessed 29 January 2018).

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Notably, the Hong Kong legislative reforms exclude funding by attorneys in the same case in which they are acting as legal representatives, meaning that Hong Kong legislators intentionally excluded contingency fee arrangements from their definition of third-party funding. Hong Kong regulatory authorities are reportedly considering as a separate initiative whether and how to enact reforms that would permit contingency fee representation in arbitration and related proceedings.

Under the Hong Kong legislation, a “third-party funder” is defined in 98J as follows:

- “(1) A third-party funder is a person –
 - (a) who is a party to a funding agreement for the provision of arbitration funding for an arbitration to a funded party by the person; and
 - (b) who does not have an interest recognized by law in the arbitration other than under the funding agreement.
- (2) In subsection (1)(b), the reference to a person who does not have an interest in an arbitration includes –
 - (a) a person who does not have an interest in the matter about which an arbitration is yet to commence; and
 - (b) a person who did not have an interest in an arbitration that has ended.”

Under this definition, key aspects of the definition of a third-party funder is someone who enters into a funding agreement and does not have “an interest recognized by law” either in “the matter” of an arbitration that has commenced, is yet to be commenced, or in “an arbitration that has ended”. “Arbitration” is defined in Section 2 of the Arbitration Ordinance Cap 609 to mean “any arbitration, whether or not administered by a permanent arbitral institution”. Section 98F of the Arbitration Ordinance extends this definition to include proceedings under it in court, before an emergency arbitrator or in mediation proceedings. For the purposes of third-party funding of arbitration, this definitional approach contrasts with the approach of the International Bar Association, which rests on a “direct interest” in the award.

In a separate Section 98H, the Hong Kong Ordinance defines the “funding agreement”, as follows:

- “A funding agreement is an agreement for third-party funding of arbitration that is –
 - (a) in writing;
 - (b) made between a funded party and a third-party funder; and
 - (c) made on or after the commencement date of Division 3.”

Only part of the Hong Kong law reform package has come into effect as at the time of writing. Full implementation is expected during the course of 2018. In any event, the legislative efforts by Singapore and Hong Kong to regulate third-party funding are unique in their effort to regulate third-party funding in international arbitration. One

reason is that these jurisdictions were later than many others in relaxing their prohibitions against champerty and maintenance (save in exceptional circumstances). Only a few other jurisdictions have expressly regulated litigation funding in domestic contexts.

In England and Wales, in January 2014, a voluntary Code of Conduct for Litigation Funders (Code) was published by the Association of Litigation Funders.¹⁰⁹ Because it pertains primarily to domestic litigation, it refers to “litigation funding”, even if that definition includes arbitration.¹¹⁰ Specifically, the Code provides:

“Litigation funding is where a third party provides the financial resources to enable costly litigation or arbitration cases to proceed. The litigant obtains all or part of the financing to cover its legal costs from a private commercial litigation funder, who has no direct interest in the proceedings. In return, if the case is won, the funder receives an agreed share of the proceeds of the claim. If the case is unsuccessful, the funder loses its money and nothing is owed by the litigant.”¹¹¹

This definition is similar to the older version of the Code published in 2011.¹¹² Notably, like the Singapore definition, it is limited to commercial funders. This focus is not surprising given the composition of the group that drafted it. This definition notably refers only to non-recourse funding of individual cases, and thus excludes many forms of funding that have been introduced since 2011.

As various institutions and entities have undertaken to assess issues that may arise with the participation of funders, and/or develop guidance or regulations relating to those issues, each institution or entity will have to base its analysis and final outputs on a definition. For this reason, it anticipated that the range of definitions presented in this Part will continue to expand.

109. See BENCH NIEUWVELD and SHANNON SAHANI, *Third-Party Funding in International Arbitration* (Kluwer 2012) p. 114.

110. See Article (2.4) of the Code of Conduct for Litigation Funders (January 2014) available at: <http://associationoflitigationfunders.com/wp-content/uploads/2014/02/Code-of-conduct-Jan-2014-Final-PDFv2-2.pdf> (last accessed 29 October 2016); B. OSMANOGLU, “Third-Party Funding in International Commercial Arbitration and Arbitrator Conflict of Interest”, 32 *Journal of International Arbitration* (2015) p. 325 at p. 338.

111. See Association of Litigation Funders, definition available at: <http://associationoflitigationfunders.com/litigation-finance/> (last accessed 29 October 2016).

112. See Article (2) of the Code of Conduct for Litigation Funders (November 2011) available at <http://associationoflitigationfunders.com/wp-content/uploads/2014/02/CodeofConductforLitigationFundersNovember20111.pdf> (last accessed 29 October 2016).

B. Bi-Lateral Investment Treaties and Free Trade Agreements

In contrast to national legislation focused on commercial funders and claim-side non-recourse funding, definitions developed by international bodies have tended to adopt broader definitions. For example, certain several investment treaties and free trade agreements have introduced provisions addressing third-party funding, which adopt significantly broader definitions.

The draft European Union-Vietnam Free Trade Agreement was the first investment agreement to include a reference to, and purport to regulate, third-party funding.

Specifically, Article 2 of the draft EU-Vietnam Free Trade Agreement provides that:

“Third Party funding means any funding provided by a natural or juridical person who is not a party to the dispute but who enters into an agreement with a disputing party in order to finance part or all of the cost of the proceedings in return for a remuneration dependent on the outcome of the dispute or in the form of a donation or grant.”¹¹³

The above definition is similar to the definition included in the European Union’s proposal for Investment Protection and Resolution of Investment Disputes under the Transatlantic Trade and Investment Partnership (TTIP). To that effect, Article 1 of Section 3 provides that:

“Third Party funding means any funding provided by a natural or legal person who is not a party to the dispute but who enters into an agreement with a disputing party in order to finance part or all of the cost of the proceedings in return for a remuneration dependent on the outcome of the dispute or in the form of a donation or grant”.¹¹⁴

Similarly, the revised version of the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union adopted an explicit definition of third-party funding. Article 8.1 provides that:

“third party funding means any funding provided by a natural or legal person who is not a party to the dispute but who enters into an agreement with a

113. See Article (2) of Chapter 8 of the [draft] EU-Vietnam Free Trade Agreement, January 2016, available at <<http://trade.ec.europa.eu/doclib/press/index.cfm?id=1437>> (last accessed 19 February 2018).

114. See Article (1) of Section (3) of the European Union’s proposal for Investment Protection and Resolution of Investment Disputes under the Transatlantic Trade and Investment Partnership, dated 12 November 2015, available at <http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc_153955.pdf> (last accessed 29 January 2018).

disputing party in order to finance part or all of the cost of the proceedings either through a donation or grant, or in return for remuneration dependent on the outcome of the dispute”.¹¹⁵

As one commentator notes, the CETA defines “a not-for-profit funder by focusing on whether the funder expects repayment for the capital it advances to the funded party rather than focusing on what other motivations the funder might have besides profit”.¹¹⁶ In drawing this distinction, the CETA definition extends only to pro bono funding arrangements that contemplate reimbursement. In that author’s view, “[t]his definition is an appropriate catch-all, since the variety of motivations a funder could have may be endless.” According to one Member on the Task Force, the CETA definition would not extend to BTE insurers because their remuneration, in that Member’s perspective, is not dependent on the outcome of the dispute and the definition does not include the word “premium” in addition to “grant or donation”.

During its work, the Task Force benefitted from previews of draft bi-lateral investment treaty provisions regarding third-party funding, which included definitions of third-party funders. For example, a draft French Model BIT provides that:

“third party funder means any natural or legal person other than the disputing party who supports part or all of the costs of the arbitration in return for remuneration as a percentage of the compensation awarded by the tribunal entrusted to settle a dispute between an investor and the recipient host state of the investment of this investor”.¹¹⁷

Meanwhile, a draft Slovak Model BIT provides:

“A request for consultations must contain identification of any government, person or organization that has provided or agreed to provide any financial or other assistance to the investor in connection with the claim, or has an interest in the outcome of the claim.”

The final versions of these Model BITs are not publicly available and research has not identified other BITs that include specific language regarding third-party funding.

115. See Article (8.1) of the revised version of the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union, (29 February 2016) available at <http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf> (last accessed 26 October 2016).

116. SHANNON SAHANI, “Revealing Not-for-Profit Third-Party Funders in Investment Arbitration”.

117. Draft French Model BIT (2006) available at <https://www.italaw.com/documents/ModelTreaty_France2006.pdf> (last accessed 19 August 2017).

C. The IBA Guidelines and Institutional Rules

To date only a handful of arbitral institutions have addressed third-party funding directly. Of those that have, most appear to have taken the IBA Guidelines as a starting point.

1. The IBA Guidelines on Conflicts of Interest

Before any arbitral institution took up the issue of third-party funding, the Task Force revising the 2014 IBA Guidelines on Conflicts of Interest sought to address the issue and adopted an expansive definition of funders. Specifically, General Standard 6(b) includes a requirement that arbitrators disclose the following relationships:

“[...] direct or indirect, between the arbitrator and the party (or another company of the same group of companies, or an individual having a controlling influence on the party in the arbitration), or between the arbitrator and any person or entity with a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration”.

The Explanation to General Standard 6(b) defines “third-party funder” or “insurer” as:

“[...] any person or entity that is contributing funds, or other material support, to the prosecution or defence of the case and that has a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration”.

Reading the two provisions together, although General Standard 6(b) does not include the requirement that the entity “is contributing funds, or other material support, to the prosecution or defence of the case”, it would appear the two are meant to be read together. Under this reading, the definition in General Standard 6(b) is limited by the additional language in the definition in the Explanation to 6(b).

To date, no reported cases have adopted or provided clarification of the definition of third-party funding including in the IBA Guidelines. Debate existed on the Task Force, similar to debates noted above, about the extent to which the IBA definition extends to ATE and BTE insurance.

In addition to the arguments raised above, some Task Force members were of the view that the requirement that there be a “direct economic interest” precluded this definition from applying to ATE or BTE insurance. This view hinges on the observation that ATE and BTE insurers do not have a direct claim to proceeds from an award. Instead, for example, BTE insurers were said not to be entitled to “remuneration” since any amounts they receive would be in the form of premiums paid. Consequently, it was argued, ATE and BTE insurers cannot be said to have a “direct economic interest” in the award.

Others were of the view that this analysis was unduly formalistic and based on a restrictive interpretation of “remuneration”. Under this latter view, ATE and BTE insurers have the potential to receive recompense or “remuneration”, though potentially dependent on the terms of the insurance agreement and only in the event of a favourable costs award.

2. *Arbitral Institutions*

Mostly institutional rules do not include any provisions explicitly defining or addressing third-party funding, with only a few exceptions.¹¹⁸

The first exception is the Brazilian CAM-CCBC, which in Administrative Resolution No. 18 of 20 July 2016 provides in Article 1:

“It is considered third-party funding when a natural or legal person who is not party to the arbitration proceedings provides full or partial resources to one party so as to enable or assist the payment of the arbitration costs, receiving in return a portion or percentage of any profits earned from the award or from the agreement.”¹¹⁹

The second exception, apparently adopted in response to the new legislation in Singapore, is a practice note adopted by the Singapore International Arbitration Centre in 31 March 2017.¹²⁰ The note addresses arbitrator conduct in cases involving “External Funding”.¹²¹ The note includes the following relevant definitions:

“‘External Funder’ means any person, either legal or natural, who has a Direct Economic Interest in the outcome of the arbitration proceedings.”

“‘Direct Economic Interest’ means an interest in the arbitration proceedings resulting from the provision by a non-Disputant Party to a Disputant Party of funding for or indemnity against the award to be rendered in the arbitration proceedings.”

118. See A. GOLDSMITH and L. MELCHIONDA, “The ICC’s Guidance Note on Disclosure and Third-Party Funding: A Step in the Right Direction”, Kluwer Arbitration Blog (14 March 2016) available at <[http://kluwerarbitrationblog.com/2016/03/14/the-iccs-guidance-note-on-disclosure-and-third-party-funding -a-step-in-the-right-direction/](http://kluwerarbitrationblog.com/2016/03/14/the-iccs-guidance-note-on-disclosure-and-third-party-funding-a-step-in-the-right-direction/)> (last accessed 18 August 2017).

119. Article 1 of Brazilian CAM-CCBC Administrative Resolution No. 18 (20 July 2016) available at <<http://www.ccbc.org.br/Materia/2890/resolucao-administrativa-182016/en-US>> (last accessed 19 August 2017).

120. See Practice Note of 31 March 2017, available at <<http://www.siac.org.sg/images/stories/articles/rules/Third%20Party%20Funding%20Practice%20Note%2031%20March%202017.pdf>> (last accessed 31 May 2017).

121. *Ibid.*

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These definitions appear broad enough to include both liability, and BTE and ATE insurance, though for reasons discuss above, there was some debate on the Task Force about whether the requirement that there be a “direct economic interest” might exclude ATE and BTE insurance from this definition. Notably, this SIAC practice note appears to be broader than the definition in Singapore legislation, discussed above.

Also in Singapore, the new SIAC Investment Arbitration Rules of 2017 provide in Article 24 that the arbitral tribunal have the power to

“order the disclosure of the existence of a Party’s third party funding arrangement and/or the identity of the third-party funder and, where appropriate, details of the third-party funder’s interest in the outcome of the proceedings, and/or whether or not the third-party funder has committed to undertake adverse costs liability”.¹²²

The SIAC Investment Arbitration Rules do not appear to include a specific definition of third-party funding.

Also recently, the Singapore Institute of Arbitrators released its “Guidelines for Third Party Funders”, which describe third-party funding as follows:

“Third party funding arises when a third party (the Funder) provides financial support to enable a party (the Funded Party) to pursue or defend an arbitration or related court or mediation proceedings. Such financial support is provided in exchange for an economic interest in any favourable award or outcome that may ensue.”¹²³

The SI Arb Guidelines are presumed to be based on the London Association of Litigation Funders’ Code of Conduct. Under this view, ATE insurers have an economic interest in a favourable award, but as described above, they do not provide financial support, only protection against a financial risk. For this reason, it appears that the SI Arb Guidelines do not extend to ATE insurers, though arguable it may apply to funders who also provide ATE insurance (or a financial equivalent) as part of a larger funding arrangement.

The ICC Guidance Note for the disclosure of conflicts by arbitrators endorsed a similar description of third-party funding, alongside ATE and liability insurers. The Note provides that arbitrators should consider, when evaluating whether to make disclosures, “Relationships between arbitrators, as well as relationships with any entity

122. Singapore International Arbitration Centre investment arbitration rules, available at <<http://www.siac.org.sg/our-rules/rules/siac-ia-rules-2017>> (last accessed 19 August 2017).

123. See the “Guidelines for Third Party Funders”, Singapore Institute of Arbitrators, available at <http://siarb.org.sg/images/SIARB-TPF-Guidelines-2017_final18-May-2017.pdf> (last accessed 31 May 2017).

having a direct economic interest in the dispute or an obligation to indemnify a party for the award, should also be considered in the circumstances of each case.”¹²⁴

Finally, the China International Economic and Trade Arbitration Commission Hong Kong Arbitration Center (CIETAC) issued for public consultations guidelines for third-party funding in arbitration.¹²⁵

For the purposes of the guidelines, third-party funding was defined as:

“third party funding (“Funding”) arises when a professional third person or entity (“Funder”) contributes funds, or other material support to a party in arbitration (“Funded party”) and has a direct economic interest in the award to be rendered in the arbitration”.¹²⁶

While these are the first institutions to directly address the participation of third-party funders, other institutions – most notably ICSID – are working to follow suit.

D. Scholarship and Commentary

Several scholars have also attempted to define third-party funding. As is discussed below, some commentators adopt a narrow definition of the concept, while others adopt a broader definition.

Generally, those who adopt a narrow definition of third-party funding often limit their definition to the funding of arbitration cases by specialized funders who are not connected to the dispute and who provide funding in return for a potential profit.¹²⁷

124. See ICC Note to Parties and Arbitral Tribunals on the Conduct of the Arbitration under the ICC Rules of Arbitration (22 September 2016) p. 5, at para. 24; GOLDSMITH and MELCHIONDA, “The ICC’s Guidance Note on Disclosure and Third-Party Funding: A Step in the Right Direction”.

125. See J. ROGERS and M. TOWNSEND, “CIETAC Hong Kong Consults on Draft Guidelines on Third Party Funding”, Kluwer Arbitration Blog (14 August 2016), available at: <<http://kluwerarbitrationblog.com/2016/08/13/cietac-hong-kong-consults-on-draft-guidelines-on-third-party-funding/>> (last accessed 28 October 2016).

126. See China International Economic and Trade Arbitration Commission Hong Kong Center, “Guidelines for Third Party Funding in Arbitration” (23 May 2016) para. 1.2.

127. See A. ENDICOTT, N. GIRALDO-CARILLO and J. KALICKI, “Third-Party Funding in Arbitration: Innovation and Limits in Self-Regulation (Part 1 of 2)”, Kluwer Arbitration Blog (13 March 2012) available at <<http://kluwerarbitrationblog.com/2012/03/13/third-party-funding-in-arbitration-innovation-and-limits-in-self-regulation-part-1-of-2/>> (last accessed 27 October 2016); R. HARFOUCHE and J. SEARBY, “Third Party Funding: Incentives and Outcomes”, *Global Arbitration Review* (2013) p. 10, available at <<http://globalarbitrationreview.com/chapter/103673T7/third-party-funding-incentives-and-outcomes>> (last accessed 27 October 2016); L. LÉVY and R. BONNAN, “Third-party Funding: Disclosure, joinder and impact on arbitral proceedings” in B. M. CREMADES and A. DIMOLITSA, eds., *Third-party Funding in International Arbitration*

Moreover, it appears from the survey that there has been a shift over time. Earlier attempts to define third-party funding were necessarily confined to the modern commercial third-party funders, but later definitions attempt to account more systematically for related sources of financing and functional equivalents.

One example of an early inclusive definition that was broad is found in the first edition (and again in the second edition) of the leading monograph on the topic, Victoria Shannon Sahani and Lisa Bench Nieuwveld define third-party funding as:

“a financing method in which an entity that is not a party to a particular dispute funds another party's legal fees or pays an order, award, or judgment rendered against that party, or both. The agreement between the funder and the funded party may also include paying another party's attorney fees if the funded party loses the case or the decision-maker (i.e., an arbitrator or panel of arbitrators, a judge or panel of judges, or a jury) orders the funded party to pay the attorney fees of another party.”¹²⁸

The inclusion of payment of an order or award (and later reference to payment of a party's attorneys' fees) suggests that this definition may extend to liability insurance, and potentially ATE and BTE.

In a more recent law review article Shannon Sahani has defined third-party funding as follows:

“[...] an arrangement where a party involved in a dispute seeks funding from an outside entity for its legal representation. The outside entity--a third-party funder--finances the party's legal representation in anticipation of making a profit. The third-party funder could be a bank, hedge fund, insurance company, or some other entity or individual. If the funded party is the plaintiff, then the funder contracts to receive a percentage or fraction of the proceeds if the plaintiff wins the case. Unlike a loan, the funded plaintiff does not have to repay the funder if it loses the case or does not recover any money. If the funded party is the defendant, then the funder contracts to receive a predetermined payment from the defendant, similar to an insurance premium, and the agreement may include an extra payment to the funder if the defendant wins the case.”¹²⁹

(ICC 2013) p. 78; G. AFFAKI, “A financing is a financing is a financing”, in CREMADES and DIMOLITSA, *Third-party Funding in International Arbitration*, p. 11.

128. See BENCH NIEUWVELD and SHANNON SAHANI, *Third-Party Funding in International Arbitration* (Kluwer 2012) p. 3; also see M. STEINITZ, “Whose Claim is This Anyway? Third-Party Litigation Funding”, 95 *Minnesota Law Review* (2011) p. 1268 at pp. 1275-1276.

129. See V. SHANNON SAHANI, “Judging Third-Party Funding”, 63 *UCLA Law Review* (2016) p. 388 at pp. 392-393.

By expressly referencing insurance companies and banks, this definition further clarifies Shannon Sahani's inclusion of entities other than commercial funders, and hence forms of an extended range of mechanisms that would qualify as third-party funding, including insurance.

In another early definition, Willem van Boom provided this definition, which seems specifically trained on modern commercial funding:

“a contract between a claimant in an investment arbitration procedure and a party who has no pre-existing interest in the arbitration. The TPF funder will bear specific parts of the claimants' out-of-pocket expenses concerning arbitration. The claimant will share a portion of the proceeds of the award or settlement with the funder. However, the funder is not entitled to remuneration should the claim fail. Additionally, the TPF funder may agree to (in whole or part) indemnify the claimant for adverse cost orders.”¹³⁰

Notably, by referring to a funding agreement potentially including indemnification for adverse costs, this definition expressly encompasses ATE, at least if provided by a commercial funder.

In a similar vein, Yves Derains defined third-party funding as:

“a scheme where a party unconnected to a claim finances all or part of one of the parties' arbitration costs, in most cases the claimant. The funder is then remunerated by an agreed percentage of the proceeds of the award, a success fee, or a combination of the two or through more sophisticated devices. In the case of an unfavourable award, the funder's investment is lost.”¹³¹

Catherine Rogers' early work adopted the following narrow definition:

“Third-party funding can be defined as the financing of an arbitration by a party who has no pre-existing interest in the dispute, usually on the basis that, if the funded party is successful in the dispute, the funder will be paid out of the proceeds of any amounts recovered as a consequence of the dispute, often as a percentage of the recovered amount”.¹³²

Another article defined third-party funding as follows:

130. See W. H. VAN BOOM, “Third-Party Financing in International Investment Arbitration” (31 December 2011) p. 25, available at: <<https://ssrn.com/abstract=2027114>> or <<http://dx.doi.org/10.2139/ssrn.2027114>> (last accessed 14 March 2018).

131. See Y. DERAINS, “Foreword”, in CREMADES and DIMOLITSA, eds., *Third-Party Funding in International Arbitration*, p. 5.

132. See C. A. ROGERS, *Ethics in International Arbitration*, p. 182.

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“in general terms, third party funding involves a commercial funder agreeing to pay some or all of the claimant’s legal fees and expenses associated with a dispute in return for reimbursement of the funder’s direct outlays and a share of any sum recovered from the resolution of the claim (whether following settlement, judgment or award)”.¹³³

Similarly, in the context of litigation, Lord Jackson notes that third-party funding is:

“The funding of litigation by a party who has no pre-existing interest in the litigation, usually on the basis that (i) the funder will be paid out of the proceeds of any amounts recovered as a consequence of the litigation, often as a percentage of the recovery sum; and (ii) the funder is not entitled to payment should the claim fail.”¹³⁴

Third-party funding has attracted significant attention from students and young scholars, who regard funding as an important trend that will impact their practice. In this regard, the following definitions have been adopted by young scholars and practitioners:

“A system by which one of the parties’ arbitration costs is being financed by a third-party to the arbitration proceedings, partially or in totality. In case of a favourable award, the third-party funder is generally paid by a previously agreed percentage of the proceeds of the award; however, in this context, third-party funding is a non-recourse loan, and in case of an unsuccessful claim, the claimholder does not have to repay the funder.”¹³⁵

“The third-party funding relationship involves a contract between the third party funding corporation and the claimholder. The funder provides money to allow the claimholder to pursue the claim in exchange for a share of a successful claim, whether by settlement, a court’s judgment, or an arbitrator’s award. After being reimbursed for its costs, the funding corporation generally receives between one-third and two-thirds of the claim. As a nonrecourse loan, however,

133. See S. KHOURI, K. HURFORD and C. BOWMAN, “Third Party Funding in International Commercial and Treaty Arbitration – a Panacea or a plague? A Discussion of the Risks and Benefits of Third Party Funding”, 8 *Transnational Dispute Management* (2011, issue 4) p. 3, available at: <https://www.benthamimf.com/docs/default-source/default-document-library/573330_1.pdf?sfvrsn=2> (last accessed 29 October 2016).

134. R. JACKSON, “Review of Civil Litigation Costs – Final Report” (December 2009), available at <<https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf>> (last accessed 29 January 2018).

135. See OSMANOGLU, “Third-Party Funding in International Commercial Arbitration and Arbitrator Conflict of Interest”, at pp. 329-330.

the claimholder does not have to repay the third-party funder for its investment if the claim is unsuccessful.”¹³⁶

Other scholars have endorsed broader definitions of third-party funding that include other financing agreements as well. Thus, some described it as “every possible contract where the pay-out under that contract is linked to the proceeds of litigation”.¹³⁷ While this definition necessarily includes third-party funding, it would also appear to include also includes lawyers’ contingency and conditional fee arrangements and insurance contracts, even though they are held by different stakeholders and are heavily regulated under national laws. The purposes of such a broad definition are numerous, but primarily to facilitate systematic study of funding alternatives that are functionally similar and to arrive at insights and recommendations that are fair and rational.

A similarly broad definition of third-party funding has been suggested by other commentators to the effect that:

“In its broadest definition, TPF is the funding of the costs of bringing or defending a claim by a party which is not itself a party to the arbitration. This would include funding by insurers, such as ‘before the event’ and liability insurers, who regularly stand behind parties in commercial arbitrations[.]”¹³⁸

In this regard, others have suggested that third-party funding should be distinguished from other related financial agreements. Proponents of this position argue that BTE and liability insurers differ from non-recourse third-party funding both in the level of control exercised over the dispute and in the applicable industry and ethical rules applicable to each.¹³⁹

Despite the many definitions above by scholars that are limited to funding of individual cases on a non-recourse basis, it seems scholars and commentators are expanding to address the changing market and regulatory challenges that come with assessment of funding in light of other similar means for financing a dispute.

136. See TRUSZ, “Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration”, at p. 1654; S. L. PARADAU, “Alternative Litigation Financing: Perils and Opportunities”, 12 U.C. Davis Law Journal (2011) p. 65 at p. 66.

137. See M. SCHERER, A. GOLDSMITH and C. FLÉCHET, “Third-Party Funding in International Arbitration in Europe: Part 1 – Funders’ Perspectives”, p. 209.

138. J. CLANCHY, “Third Party Funding in Arbitration: breaking down barriers and building bridges” Croatian Arbitration Yearbook (2016) available at <<http://d16k7u6c7cc6m2.cloudfront.net/Clanchy-J-Third-Party-Funding-CAY-23.pdf>> (last accessed 18 February 2018).

139. See OSMANOGLU, “Third-Party Funding in International Commercial Arbitration and Arbitrator Conflict of Interest”, at p. 329.

V. Functional Considerations

Given difficulties in defining third-party funding in conceptual terms, this Part examines functional and comparative aspects of funding that may be helpful in assessing alternative definitions. This functional approach aims to move beyond formal definitions to determine the key functions of different means of financing disputes in order to focus on those functions that are unique or not unique to third-party funding.

By identifying specific types of conduct, rather than conceptual categories, a functional or conduct-based approach may help avoid development of overly broad or unduly narrow standards, guidelines, or rules. A functional analysis may also facilitate more nuanced analysis to distinguish between conduct in which funders' activities do not raise issues that are or should be the target of such rules and guidance. Alternatively, functional similarities between third-party funding and other types of finance may provide a basis for extending existing rules or doctrines that apply to other actors. For example, the need to assess cases in both contexts is part of the reason why some jurisdictions have extended the common interest privilege from the insurance industry to third-party funding.¹⁴⁰

A. Case Assessment and Risk-Assumption

One important benefit third-party funders bring to dispute settlement is an ability to engage in a disinterested, dispassionate and highly detailed assessment of claims. This function is necessary for their decision to fund a case, but differs from how either a client or its attorney may assess a case. A client, no matter how sophisticated, may be influenced by business incentives and subjective perceptions about the facts underlying the claim. Meanwhile, a party's lawyers may, intentionally or unintentionally, be influenced both by an effort to please a client interested in bringing a claim and their own potential to earn hourly fees. By contrast, funders and traditional insurers have both structural detachment and financial incentives to engage in a uniquely independent assessment that, by many accounts, leads to an assessment of the case that is distinctly fine-tuned.

Leading funders report an average review-acceptance rate of 10-1, meaning that for every ten cases reviewed, they only agree to fund one case.¹⁴¹ In deciding whether to accept a case, they assess its legal, factual, practical, temporal, and (sometimes) political variables to determine risks, likelihood of success, and potential rate of return. In making assessment, funders are free from many of the pressures that can cloud a party's or law firm's assessment of the same claim. They are also subject to pressures from shareholders to pick claims that are likely to deliver high rates of return.

140. For an analysis of the common interest privilege for insurers and related privilege extended to third-party funders, see Chapter 5, pp. 133-135.

141. VELJANOVSKI, "Third-Party Litigation Funding in Europe", p. 420.

In assessing claims, some argue that funders bring a level of sophistication and precision unique even among large, sophisticated multi-national companies and law firms.¹⁴² There have also been anecdotal reports, however, of inadequate due diligence or inaccurate assessments in particular cases.¹⁴³ In addition, one point repeatedly raised is that effective risk assessment is most feasible by the leading commercial third-party funders, which have considerable expertise and experience with international arbitration. Moreover, in the case of funders that are not sophisticated commercial funders, but for example may become involved for policy-related reasons, risk assessment may not be part of their calculus in deciding to fund an arbitration.

With the exception of assessing the rate of return, BTE insurers undertake a very similar process of assessing the probability of success for cases. For this reason, some commented that the rise of third-party funding may eventually reduce or eliminate the need for BTE insurance, at least in certain economic sectors.

To assess risk, as described in Chapter 2, commercial third-party funders generally create a risk-assessment model or matrix that takes into account the percentage likelihood of different outcomes in light of specific factors. These factors include, among others, the jurisdiction of the claim, strength of the claimant's legal arguments, strength of facts supporting the arguments, extent of loss flowing directly from the respondent's conduct, a claimant's motivation, commitment and honesty, the experience of the claimant's legal team, the respondent's ability/likelihood to pay, reasonable duration to obtain an award, and costs of bringing the claim.¹⁴⁴

Data for the matrix is obtained through due diligence by the funder, its legal team, and accountants (and other experts, such as intelligence and data recollection). The analysis entails inquiries of the claimant's lawyers regarding timing and evidentiary issues, legal strategy, and compilation and assessment of material documents. Importantly, conducting this kind of due diligence often requires assessment of information that might otherwise be subject to privileges under applicable law. Based on this matrix, the funder determines the likelihood of estimated returns on investment over a period of years, which will be weighed against other investments in the funder's overall portfolio.

142. See M. SMITH, "Chapter 2: Mechanics of Third-Party Funding Agreements: A Funder's Perspective", pp. 28-35, available at <[http://www.calunius.com/media/7098/mechanics%20of%20third-party%20funding%20agreements%20\(mick%20smith%20-%202012\).pdf](http://www.calunius.com/media/7098/mechanics%20of%20third-party%20funding%20agreements%20(mick%20smith%20-%202012).pdf)> (last accessed 10 August 2017); VELJANOVSKI, "Third-Party Litigation Funding in Europe", pp. 418-420.

143. See, e.g., R. BLACKETT, "Still Stuck in the Stone: Third Party Funding in the Excalibur Case" available at <<https://www.andrewskurth.com/insights-1491.html>> (last accessed 3 August 2017).

144. See M. SCHERER, A. GOLDSMITH and C. FLÉCHET, "Third-Party Funding in International Arbitration in Europe: Part 1 – Funders' Perspectives", pp. 212-213; SMITH, "Chapter 2: Mechanics of Third-Party Funding Agreements: A Funder's Perspective", pp. 30-32.

The extent of funders' due diligence in comparison with insurance is ultimately an empirical question and may vary among funders (or insurers), and from case to date.¹⁴⁵ For the purposes of definitions, however, the fact that insurers (most notably ATE and BTE insurers)¹⁴⁶ undertake similar due diligence confirms that case assessment is not new or unique to modern third-party funders, and indeed may be considered an essential predicate for any entity contemplating assuming risk tied to the outcome of a particular case.

It is uncertain the extent to which these case assessment procedures are as rigorous when cases are financed as part of a portfolio. "Portfolio financing" is a relatively new model that may challenge some of these basic features of conventional third-party funding. As one funder describes, "the portfolio approach is inherently flexible and ideally suited for defensive matters as well as claims, and for matters that would otherwise be less attractive for funding. Pricing is generally lower because risk is diversified."¹⁴⁷

Diversifying risk may make initial assessment of risk less essential. As a consequence, it is at least plausible that the assessment criteria are diluted when investment is made through a portfolio, which is designed to spread the risk of higher risk investments.

In portfolio financing, the rationale is apparently similar to contracting risks in the insurance industry. Indeed, in the words of one author, the "practice has shown that the losses can be offset by the wins across the board and as long as the value of the winning cases is greater than the amount expended on a losing case, the funder will make a profit."¹⁴⁸

Similarly, spreading the risk in terms of volume and quantity reduces the negative consequences of an unsuccessful portfolio. In this sense, a funder may well provide funds for twenty or more cases at a time, each of them with different chances of success and different amounts at stake. The funder may anticipate that it will likely lose some of those cases, but considers the overall investment will likely be worthwhile if success is achieved in a sufficient number of cases to render the overall portfolio profitable. At the same time, a loss incurred in a case will be unlikely to affect the performance of the portfolio as a whole.

145. The Task Force did not pursue empirical research on this topic, but future empirical research on this issue may be useful.

146. To the extent liability insurers undertake case assessment, it would most likely be for the purpose of assessing potential exposure and settlement values (rather than whether to pursue the case if they are obliged to under the relevant policy).

147. Burford Capital, "Beyond Litigation Finance" available at <http://www.burfordcapital.com/wp-content/uploads/2016/09/Burford-Beyond_Litigation_Finance-US_Web.pdf> (last accessed 19 August 2016).

148. See N. ROWLES-DAVIES, *Third-Party Litigation Funding* (Oxford University Press 2014) p. 72.

It is unclear the extent to which portfolio funding involves only international arbitration cases, as opposed to a mix of international arbitrations in a mix with domestic litigation cases.¹⁴⁹ No evidence has come to the attention of the Task Force, as of the date of this publication, of other funders actively engaging in portfolio funding exclusively in international arbitration, apart from anecdotal evidence of defence-side portfolio funding of states in investment arbitration.

To the extent portfolio funding becomes more prevalent, it may require reconsideration of issues relating to how cases are assessed for funding. If assessment (and control) are minimized in certain types of portfolio funding, it may be that that funding model more resembles other forms of passive corporate financing that do not implicate certain issues implicated in third-party funding of individual cases.

B. Control and Cost Containment

Another functional consideration that may affect whether or how to regulate third-party funding is the level of control that a funder may exercise over case strategy, particularly in its efforts to control costs. Control over case management is not viewed by the Task Force as either an inherently good or bad feature of funding, but it may be relevant in evaluating certain issues such as how similar modern third-party funding is to other means of dispute financing, which may in turn affect analysis of certain issues, such as disclosure and conflicts.

In some jurisdictions, the exercise of control by a funder – particularly over a case’s larger objectives like settlement – can also raise ethical issues for counsel. As national ethical rules vary considerably both on whether and how they regulate these issues, the Task Force did not consider or endeavour to articulate any guidance about attorney obligations in light of funder control. As examined in Chapter 7 on Best Practices, the extent, nature, and conditions of control are largely a function of the funding agreement negotiated by the party and funder, applicable law, and, in some jurisdictions, applicable ethical or industry rules.

Unfortunately, there are inconsistent reports and no empirical evidence regarding the actual degree of control that funders exercise over management of a case. Some funders report that, after careful initial assessment, they function only as distant and detached monitors who are entitled to receive regular updates.¹⁵⁰ Other anecdotal reports indicate that, on more than one occasion, a third-party funder has directly appointed an arbitrator or physically appeared at an arbitral hearing.

149. See S. REISMAN, “Burford Clinches Portfolio Funding Deal With UK Firm”, available at <<https://www.law360.com/articles/949613/burford-clinches-portfolio-funding-deal-with-uk-firm>> (last accessed 15 August 2017).

150. J. MOLOT, “Theory and Practice in Litigation Risk” and “Burford has no control over litigation or settlement decisions and it does not interfere with the attorney client relationship”, available at <<http://rippmedia.com/Molot-TheoryandPractice.pdf>> (last accessed 15 August 2017).

Meanwhile, some argue that a relatively high degree of control would be important for funders to be able to protect their investment and ensure that a case is prosecuted consistent with the assumptions and analysis that facilitated the funding in the first place. This view has effectively been endorsed by the Court of Appeal in England, which reasoned that a third-party funder's "rigorous analysis of law, facts and witnesses, consideration of proportionality and review at appropriate intervals' is what is to be expected of a responsible funder".¹⁵¹

Consistent with this view, third-party funders may control or exercise detailed oversight over numerous strategic decisions in a case, including arbitrator selection, expenditure of significant funds (such as retention of experts), changes in legal teams, drafting of memoranda, oral pleadings, and settlement. The extent to which any particular funder in any particular case exercises all or some of these controls will depend on internal practices and protocols of the funder, the nature of the case, the professional relationship the funder has with the funded party and legal team, the financial terms in the funding agreement (which may include financial incentives that reduce the need for monitoring), as well as specific provisions in the funding arrangement that either expressly authorize or limit certain forms of control.

Termination rights also factor into concepts of control. As Jonas von Goeler explains:

“when some major litigation funders emphasise in their webpages that they do not control cases, perhaps what they mean is that such express contractual rights to veto specific decisions tend to be absent. However, to what degree a litigation funder will be able to exercise control over the conduct of a claim is not only determined by the existence or not of express veto rights over key decisions. This will also depend on the funder's termination rights and, not least, on the configuration of the litigation funder's case monitoring.”¹⁵²

In some respects, the control exercised by third-party funders is similar to the control exercised by liability insurers, at least in the United States. As Charles Silver describes:

“Liability insurers manage quality and cost ruthlessly and creatively. They make defense-related decisions directly, thereby obtaining complete freedom to use their vast experience dealing with lawyers to minimize litigation costs. They decide which lawyers to hire, obtain volume discounts by concentrating work in a small number of firms, maintain staff counsel operations in areas where the volume of work is sufficient to justify the expense, subject lawyers to litigation management guidelines and audits, and use innovative fee arrangements to motivate outstanding performance. Insurers also control settlement negotiations

151. *Excalibur Ventures v. Texas Keystone and others* [2016] EWCA Civ 1144.

152. J. VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure* (Kluwer 2016), p. 35.

and decision making. This enables them to act on their incentive to minimize costs by deploying their knowledge of claim values with maximum effect.”¹⁵³

The similarities between the control exercised by third-party funders and insurers are often treated as relevant to various questions regarding whether and how to regulate third-party funders. For example, the “common interest privilege” that applies to insurers in some common law jurisdictions is often pointed to as a basis for extending attorney-client privilege to third-party funders (see discussion in Chapter 5, below).

The comparison between funders and insurers is also raised with respect to issues of disclosure. For example, in many jurisdictions, such as the United States, the presence of an insurer that would be liable for all or part of the judgment in a case is required to be disclosed¹⁵⁴, but the fact that a party is insured may not be considered in assessing the damages to be awarded. Although legislative reforms have not yet extended the disclosure rules to third-party funders in the United States, the similarity in their function may be the reason why disclosure of third-party funding is required in some contexts in Australia, England, and New Zealand.¹⁵⁵

Shipowners’ and Defence Clubs are excluded from any recommendations or guidance provided by the Task Force as part of the carve-out of maritime arbitration, identified above.¹⁵⁶ They are, however, an interesting point of reference in discussions of control over funded cases.

Shipowners’ and Defence Clubs exercise discretion over whether to provide their members with funding for litigation or arbitration, leaving the decision to club managers or boards.¹⁵⁷ Shipowners’ Club rules usually allow the club’s managers to

153. C. SILVER, “Litigation Funding Versus Liability Insurance: What’s the Difference?”, 63 *DePaul L. Rev.* 617 (2014), pp. 621-622.

154. See U.S. Federal Rule of Civil Procedure 26(a)(1)(A)(iv); see also, SHANNON SAHANI, “Judging Third-Party Funding”, pp. 413-416 (explaining why Rule 26(a)(1)(A)(iv) does not apply to third-party funders based on the legislative comments to the rule, which are called “Advisory Committee Notes”).

155. For an overview of disclosure obligations in various jurisdictions, see generally BENCH NIEUWVELD and SHANNON SAHANI *Third-Party Funding in International Arbitration*.

156. See Chapter 1, pp. 9-10.

157. J. CLANCHY, “Third Party Funding in Arbitration: the First 125 Years”, LexisNexis Dispute Resolution Blog (17 May 2016) available at <<http://blogs.lexisnexis.co.uk/dr/third-party-funding-in-arbitration-the-first-125-years/>> (last accessed 19 August 2016); see also Britannia, “FD&D: Scope of Cover”, available at <<https://www.britanniapandi.com/services/fd-and-d/>> (last accessed 19 August 2017); The Standard, “Defence”, available at <<http://www.standard-club.com/what-we-do/tailored-covers/defence/>> (last accessed 3 August 2017); The Swedish Club, “Rules for P&I Insurance, Rules for FD&D Insurance, Articles of Association” (2016/17) p. 71, Rule 5 available at <http://www.swedishclub.com/media_upload/files/Publications/TSC%20PI%20and%20FDD%20Rules%202016_17.pdf> (last accessed 10 August 2017); UK

appoint lawyers on behalf of their ship-owner members. For example, Rule 6 of the UK Shipowners' Club Rules 2015 provides:

“All persons appointed by the Association on behalf of the Member or appointed by the Member with the approval of the Association shall be or be deemed to be appointed on the terms that they have been instructed by the Member at all times (both while so acting and after they have ceased so to act): (a) to give advice and to report to the Association in connection with the claim, dispute or Proceedings; (b) to seek and act on the instructions of the Association; and (c) to produce to the Association any documents or information in their possession or power relating to the claim, dispute or Proceedings, as if such persons had been appointed to act and had at all times been acting on behalf of the Association.”¹⁵⁸

Shipowners' Clubs may also provide a cap for maximum recovery amounts,¹⁵⁹ and can further require members to contribute to the costs of all legal expenses should they pass beyond a specified threshold.¹⁶⁰

Clubs exercise decision-making control throughout arbitral proceedings they fund, typically requiring either that members' lawyers follow the club's instructions or that members use lawyers chosen by the club.¹⁶¹ “Unlike other forms of legal expenses

Shipowners' Club, Rules 2016, p. 4, Section 2, Rule 3(1) available at <<http://ukdefence.com/images/assets/documents/555-UKDC-A5-TC-2016-VFW.pdf#page=12>> (last accessed 14 November 2016).

158. UK Shipowners' Club Rules 2016, Rule 6 available at <http://www.ukdefence.com/section/209/6/Club_Rules_2015> (last accessed 14 November 2016).
159. Britannia, “FD&D: Deductibles and Limits” available at <<https://www.britanniapandi.com/services/fd-and-d/>> (last accessed 19 August 2017); The Standard, “Defence”, available at <<http://www.standard-club.com/what-we-do/tailored-covers/defence/>> (last accessed 3 August 2017); UK Shipowners' Club Rules 2016, p. 4, Section 2, Rule 2(6) available at <<http://ukdefence.com/images/assets/documents/555-UKDC-A5-TC-2016-VFW.pdf#page=12>> (last accessed 14 November 2016).
160. Britannia, “FD&D: Deductibles and Limits”, available at <<https://www.britanniapandi.com/services/fd-and-d/>> (last accessed 19 August 2017).
161. The Standard, “P&I and Defence Rules and Correspondents” (2016/17) p. 28, Rules 8.1-8.4, available at <<http://www.standard-club.com/media/1992587/pi-and-defence-rules-and-correspondents-2016-17.pdf>> (last accessed 19 August 2017); The Swedish Club, “Rules for P&I Insurance, Rules for FD&D Insurance, Articles of Association” (2016/17) pp. 72-73, Rules 7-8 available at <http://www.swedishclub.com/media_upload/files/Publications/TSC%20PI-%20and%20FDD%20Rules%202016_17.pdf> (last accessed 10 August 2017); UK Shipowners' Club Rules 2016, p. 14, Section 3, Rule 6(1)-(2) available at <<http://ukdefence.com/images/assets/documents/555-UKDC-A5-TC-2016-VFW.pdf#page=12>> (last accessed 14 November 2016).

insurance (which FD&D cover largely predated), the Club’s managers (who are often qualified lawyers) remain involved with the day-to-day handling of the case, with the assistance of external lawyers where necessary.”¹⁶²

Regarding the insured’s right to select their own lawyers, an exemption in the English Insurance Companies (Legal Expenses Insurance) Regulations 1990 provides that its provisions ensuring the insured’s right to select its own lawyers do not “apply to legal expenses insurance contracts concerning disputes or risks arising out of, or in connection with, the use of sea-going vessels”.¹⁶³

In contrast to both third-party funding and insurance, with attorney financing (most typically through contingency-fee arrangements), control in theory remains with the client. This assumption exists despite the fact that the attorney is assuming most or all of the risk of the client losing the case and despite the fact that in class action cases, the clients may have little at stake in the case in comparison to the attorneys.¹⁶⁴

Attorney financing, usually through contingency or conditional fee arrangements, is another context in which an entity that is not an original party to the underlying dispute may nevertheless exercise a degree of control over certain aspects of the proceedings. When lawyers or law firms represent parties on a contingency or conditional fee basis, they are also in a position to exert considerable control over aspects of the dispute.

In those jurisdictions that permit contingency and conditional fee arrangements, applicable codes of conduct and professional ethical rules generally require attorneys to be loyal to their clients, even in the face of their own competing interests. In the United States, courts also operate as a check on attorneys in contingency and conditional fee and class action cases. Notably, some third-party funding agreements include contingency and conditional fee arrangements with law firms providing representation. For those agreements, the funding arrangement may be subject to attorneys’ ethical rules, in addition to contractual provisions between the parties or other applicable legal rules.

162. S. J. HAZELWOOD and D. SEMARK, *P&I Clubs Law and Practice*, 4th edn. (Lloyds of London Press 2010) para. 26.2. Notably, Clubs “strive to do as much work in-house as is possible”, FD&D: Claims Handling, available at <<https://www.britanniapandi.com/services/fd-and-d/>> (last accessed 13 August 2017).

163. Insurance Companies (Legal Expenses Insurance) Regulations 1990 (SI 1990/1160), implementing Council Directive 87/344/EEC of 22 June 1987 on the Coordination of Laws, Regulations and Administrative Provisions relating to Legal Expenses Insurance, cited in HAZELWOOD and SEMARK, *P&I Clubs Law and Practice*, fn. 81, para. 26.2.

164. N. C. SCOTT, “Don’t Forget Me! The Client in a Class Action Lawsuit”, 15 *Geo J. Legal Ethics* (2002) p. 561 at pp. 573-583; D. L. SHAPIRO, “Class Actions: The Class as Party and Client”, 73 *Notre Dame Law Rev.* (1998) p. 913 at pp. 924, 929 and 939-940; J. KALAJDZIC, “Self-Interest, Public Interest, and the Interests of the Absent Client: Legal Ethics and Class Action Praxis”, 49 *Osgoode Hall L.J.* (2011) p. 1 at pp. 13-24 (discussing a similar issue under Canadian law).

VI. Overview of Definitions Used in Subsequent Chapters

As noted above, the Working Definition of the Task Force is intentionally broad to facilitate consideration of all types of third-party funding. For the purposes of discussion and study, this broad Working Definition facilitated analysis of functional similarities among different financing options, and their increasing overlap and integration in the market for litigation finance.

While comprehensive consideration of the range of options was important for discussion, such a broad definition is not necessarily helpful for assessing certain technical issues. For example, the insurance industry, insurance markets, and the participation of insurers in national court proceedings are already generally regulated through national insurance and financial regulations, through national procedural rules (in the litigation context), and through professional ethical regulations. Before the 2014 revisions to the IBA Guidelines, insurers were not subject to disclosure and analysis with respect to conflicts of interest with arbitrators. For reasons examined in greater detail in Chapter 4, insurance is included in the Task Force definition regarding arbitrator conflicts of interest, but it is not included in definitions in other chapters.

Notably, it would be superfluous for Chapter 5, which addresses privilege, to include insurance as part of the definition of third-party funding. Chapter 5 instead examines the so-called “common interest privilege” that exists for insurers in many jurisdictions and whether that privilege or the justifications for it should also extend to third-party funders.

Meanwhile, in Chapter 6, which addresses costs and security for costs, insurance is in some respects relevant to the analysis. For example, the existence of ATE insurance has, in at least one case, been the reason a tribunal denied a request for security for costs. Meanwhile, to the extent third-party funding may be considered in assessing whether to order security for costs, such funding does not raise any questions different from those implicated by contingency fee arrangements.

Chapter 7, which provides a compendium of best practices, addresses only modern third-party funding. As noted above, insurers’ relationships with their customers are already regulated through national legislation and attorney funding through contingency fees are regulated through domestic regulation of the legal profession.

For Chapter 8, which addresses issues in investment arbitration, once again it is important to use a broad definition of third-party funding, which comprehends not only modern non-recourse funding, but also respondent-side funding, including by non-governmental organizations, but also those types of insurance that operate as functional equivalents to modern funding and arguably raise similar issues.

VII. Conclusion

One of the challenges in recent debates about third-party funding, and related efforts to introduce related reforms, is that they often start with implicit assumptions about third-party funding, but without clear definitions of the phenomenon that is the focus of their attention. As demonstrated in the analysis of this Chapter, certain definitions either include or exclude certain forms of financing that may or may not be intended for inclusion or exclusion. Accidental inclusion or exclusion of related phenomena may raise questions about coherence and fairness.

It is hoped that the analysis in this Chapter, read together with Chapter 2, will illuminate aspects of the practice and market of third-party funding and facilitate deeper understanding, particularly in understanding the analysis in the chapters that follow.

Chapter 4[†]

Disclosure and Conflicts of Interest

PRINCIPLES¹⁶⁵

- A.1. A party and/or its representative should, on their own initiative, disclose the existence of a third-party funding arrangement and the identity of the funder to the arbitrators and the arbitral institution or appointing authority (if any), either as part of a first appearance or submission, or as soon as practicable after funding is provided or an arrangement to provide funding for the arbitration is entered into.
- A.2. Arbitrators and arbitral institutions have the authority to expressly request that the parties and their representatives disclose whether they are receiving support from a third-party funder and, if so, the identity of the funder.
- A.3. For the purposes of disclosure, the term “third-party funder” refers to any natural or legal person who is not a party to the dispute and is not a party’s legal counsel, but who enters into an agreement either with a party, an affiliate of that party, or a law firm representing that party:
 - a) in order to provide material support for or to finance part or all of the cost of the proceedings, either individually or as part of a specific range of cases, and
 - b) such support or financing is provided through a donation, or grant, or in exchange for remuneration or reimbursement wholly or partially dependent on the outcome of the dispute.
- A.4. In light of any disclosures made regarding the participation of any third-party funder or insurer, arbitrators and arbitral institutions should assess whether any potential conflicts of interest exist between an arbitrator and a third-party funder, and assess the need to make appropriate disclosures or take other appropriate actions that may be required under applicable laws, rules, or Guidelines.

† Primary contributors of this Chapter include Victoria Shannon Sahani, Mick Smith, Stavros Brekoulakis, Audley Sheppard, and Catherine Rogers. It should be noted that, for some issues on which Members of the Task Force disagreed, there was similar disagreement among the primary contributors to this Chapter. One of the most important areas of disagreement was with regards to whether disclosure should be mandatory and systematic, or ordered on an individual basis by the arbitrators.

165. In light of this Report’s carve out for maritime arbitration, see Chapter 1, pp. 9-10, the Principles in this Chapter are not intended to apply to maritime arbitrations or to other *ad hoc* or trade association arbitrations in which they may be inapposite. Nevertheless, there may be maritime arbitrations in which the parties or the arbitrator decide that the Principles and analysis in this Report are a useful resource.

I. Introduction

Potential arbitrator conflicts of interest were among the first and most prominent issues that attracted attention with respect to third-party funders' participation in international arbitration. More specifically, questions have arisen as to whether, how, to what extent and by whom disclosures should be made to allow arbitrators, parties, and institutions to assess potential conflicts of interest involving funders.

A number of factors contribute to increased interest in potential conflicts of interest due to the involvement of third-party funders. One frequently noted factor is that a number of leading arbitrators have taken positions within, or *ad hoc* consultant roles with, some funders.¹⁶⁶ Other factors include the increasing number of cases involving third-party funding, the highly concentrated segment of the funding industry that invests in international arbitration cases, the symbiotic relationship between funders and a small group of law firms, related links among elite law firms and some leading arbitrators, and what might fairly be characterized as general calls for increased transparency, including with respect to potential arbitrator conflicts.¹⁶⁷ Against this backdrop, the potential for conflicts of interest for arbitrators in funded cases can materialize out of several possible scenarios.

With such a complex and multi-faceted topic, it is not surprising that there was considerable disagreement on several issues, discussed later in this Chapter. Despite these competing viewpoints however, there were also several tenets on which there was general agreement. These, listed below, are the essential premises for the Task Force's discussion, for the Principles, and for the analysis that follows in this Chapter:

- (1) The existence of third-party funding or insurance in an international arbitral dispute can create the potential for an arbitrator conflict of interest with the funder or insurer;
- (2) Knowledge of the existence and identity of a third-party funder or insurer in international arbitral disputes is essential for arbitrators to assess and make necessary disclosures of potential conflicts of interest;
- (3) Disclosure of potential conflicts is important to avoid potential challenges to an arbitral award and to preserve the overall integrity of international arbitration;

166. It has also been reported by funders that they are occasionally approached directly by arbitrators or arbitration experts to provide such advice.

167. See M. J. GOLDSTEIN, "Should the Real Parties in Interest Have to Stand Up? – Thoughts About A Disclosure Regime for Third-Party Funding in International Arbitration", 8 *Transnational Dispute Management* (2011, Issue 4) p. 7. See also M. SCHERER, A. GOLDSMITH and C. FLÉCHET, "Third Party Funding of International Arbitration Proceedings – A View From Europe: Part II", *International Business Law Journal* (2012) p. 649 at pp. 651-653 (discussing third-party funder disclosure obligations in the context of potential arbitrator impartiality issues).

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- (4) Third-party funding may be provided through a variety of structures such that it is difficult to isolate a single definition of third-party funding;
- (5) Avoiding conflicts of interest is in the best interest of all parties and arbitrators, and is important for the legitimacy of international arbitration and the assured enforceability of arbitral awards; and
- (6) Disclosure should strike an appropriate balance between providing adequate information for arbitrators, parties, institutions, and appointing authorities to assess potential conflicts of interest, and reducing the potential for unnecessary delay, frivolous challenges to arbitrators, or unfounded applications for disclosure of financial information and funding agreements.

In light of these starting considerations, and based on analysis provided in greater detail below, broad agreement existed on the Task Force that disclosure by the funded party of the existence and identity of funders is necessary so that arbitrators could make appropriate disclosures and decisions regarding potential conflicts of interest. This view was regarded as in keeping with global trends in regulation of third-party funding, which increasingly requires disclosure of the existence and identity of the entity providing funding. There was also general agreement on the Task Force that, absent exceptional circumstances, no other information except the existence and identity of third-party funders was required for the purposes of analysing conflicts of interest.¹⁶⁸

Despite these points of agreement, some disagreement existed about whether insurance and insurers should be included within the definition of entities that should be disclosed for the purpose of assessing potential conflicts of interest. There was also disagreement about whether disclosure of the existence and identity of a funder should be as a matter of course in every case, or based on a request or order for disclosure by the arbitrators. Ultimately the Principles in this Chapter propose systematic disclosure.

This approach finds support in the results of the 2015 Queen Mary School of International Arbitration Survey, in which 76 per cent of survey respondents agreed that that disclosure of the existence of third-party funding should be mandatory, 63 per cent believed that disclosure of the identity of the funders should be mandatory, and 71 per cent that the full terms of the funding agreement should not be disclosed.¹⁶⁹ The

168. There was general agreement that maritime arbitration should, as noted in Chapters One and Three, be excluded from any Task Force recommendations or Principles.

169. Queen Mary, University of London and White & Case, “2015 International Arbitration Survey: Improvements and Innovations in International Arbitration” (2015) available at <https://www.whitecase.com/sites/whitecase/files/files/download/publications/qmul-international-arbitration-survey-2015_0.pdf> (last accessed 14 March 2018). Notably, the support for funding apparently expressed in the Queen Mary Survey may not necessarily be representative since only 39% of those surveyed had experience with third-party funding in practice, and 9% were not even aware of it.

Queen Mary Survey also revealed support for the notion that systematic disclosure may make the use of funding a more routine part of arbitral dispute resolution.¹⁷⁰

Some on the Task Force proposed that, instead of a general presumption of disclosure as a matter of course in every case, it should be more tailored to actual potential conflicts. Under this view, it was argued that the Principles should only confirm the authority of arbitrators and arbitral institutions to request disclosure of such information, as needed, and allow parties and funders to make disclosures of material facts that they agree arbitrators should consider.

Supporters of this view reasoned that parties and funders may disagree about the effect of disclosure requirements in non-binding soft-law instruments, as opposed to mandatory compliance with a procedural order issued by the tribunal. In the absence of mandatory obligations to disclose, such disagreements about whether to disclose can create tensions between funders and funded parties since both have mutual confidentiality obligations. Others suggested that systematic disclosure was not necessary because arbitrators know whether they have a potential conflict with funders when, for example, they advise or sit on a board of a funder. Still others commented that these approaches are not mutually exclusive, but should both be affirmed. These alternative approaches are explored in greater detail below.

While the Principles articulate the final consensus on the Task Force, arguments for and against the positions ultimately adopted and the reasons for adopting of the Task Force's final position are presented in detail below. The purpose of the extended analysis is to allow future reforms to understand the reasons for the final position adopted by the Task Force.

Finally, at the outset, it is important to emphasize that the Task Force does not propose any new or special rules or guidelines regarding how potential conflicts between funders and arbitrators should be analysed, or when such potential conflicts should lead to recusal or disqualification. Instead, the Principles in this Chapter address only the narrower issue of how, when, to what extent, and by whom the identity and existence of a funder should be disclosed to enable arbitrators to make relevant assessments (and necessary disclosures) regarding potential conflicts of interest. In this respect, this Chapter assumes that the scope of arbitrators' disclosure obligations and related disqualification standards will continue to be governed by existing applicable laws, standards, and guidelines. It thus leaves to other sources – the IBA Guidelines on Conflicts of Interest in International Arbitration (IBA Conflicts), arbitral rules, and national legislation, and case law – the substantive analysis of potential conflicts.

The Chapter proceeds in the following parts. After this introduction, it provides a general overview of the scope of the definition of third-party funding appropriate for

170. Notably, this survey, and related discussions in international arbitration, do not generally take account of practices in *ad hoc* and trade association arbitration, most notably in the maritime industry, which account for large numbers of arbitrations every year. These are among the reasons why this Report does not seek to address funding in maritime arbitration. See Chapter 1, pp. 9-10.

the purpose of disclosure with a focus on the definition in the IBA Guidelines on Conflicts [III], followed by an analysis of the definition adopted by the Task Force [III], and a survey of existing disclosure standards that have been adopted by institutions, national legislation, and trade and investment agreements [IV]. The Chapter then turns to questions about when and by whom disclosures should be made [IV], and concludes by addressing competing arguments regarding the effect of unknown conflicts [V].

II. Definition of Third-Party Funder for Purposes of Disclosure

Although the Task Force began in Chapter 2 with a broad Working Definition, for the purposes of analysing potential conflicts of interest, a narrower definition was deemed appropriate, given that not all entities captured within the Working Definition could give rise to a potential conflict of interest.

A. The Potential for Conflicts of Interest

Until relatively recently, there was debate about whether it was even possible for funders, or at least certain types of funding arrangements, to create conflicts of interest for arbitrators.¹⁷¹ Third-party funding, it had been argued, could not raise potential conflicts of interest because it is simply one among many possible forms of financial support for pursuing or defending a dispute. The source of financing for a dispute is irrelevant to the merits of the dispute, the argument went, and consequently there was no reason to treat third-party funding as subject to any special treatment that would not apply, for example, to a corporate loan taken out for the purpose of pursuing a claim.¹⁷²

171. See, e.g., C. BOGART, “Third Party Funding in International Arbitration” (taking as a “given” that “there is no legal, logical, or equitable basis for requiring disclosure of funding without also requiring the disclosure of other parties with economic interests in the outcome of a matter”) available at: <<http://www.burfordcapital.com/wp-content/uploads/2014/12/Burford-article-Third-Party-v1.2internal-no-symbol.pdf>>.

Arguably, this language could be interpreted to imply that no test for disclosure regarding funders could be valid unless it applied equally to all forms of economic interests, not only equity investors. This interpretation is consistent with his earlier assertions that “arbitration finance is really just specialty corporate finance”. See M. KANTOR, “Third-Party Funding in International Arbitration: An Essay About New Developments”, 24 ICSID Review – Foreign Investment Law Journal (2009, Issue 1) p. 65; M. STEINITZ, “Whose Claim Is This Anyway?” 11-13 University of Iowa Legal Studies Research Paper (2011) p. 1268 at p. 1292.

172. See M. MANIRUZZAMAN, “Third-Party Funding in International Arbitration – A Menace or Panacea?”, Kluwer Arbitration Blog (29 December 2012) available at <<http://kluwarbitrationblog.com/2012/12/29/third-party-funding-in-international-arbitration->

This line of argument has largely faded from public discussions,¹⁷³ but it did preview continuing challenges to define third-party funding in light of the expansion and evolution in funding models.

Opposition to disclosure is, some funders explain, is not so much related to maintaining their presence or identity as secret. It is instead a reaction to perceived procedural and strategic consequences of disclosure, such as allegedly frivolous challenges to arbitrators and unfounded requests for security for costs.¹⁷⁴ It was also suggested by some that these responses to disclosure may not simply be a matter of case strategy, but an intentional effort to drive up the cost of the case to make the funding model untenable.

The Task Force also considered one final argument against disclosure: that unknown conflicts of interest cannot be a basis for an effective challenge to an arbitrator or an award. Some, though not all, courts have found that unknown conflicts cannot be a basis for refusing enforcement of awards.¹⁷⁵ Even though a resulting award

a-menace-or-panacea/?doing_wp_cron=1503332583.8441140651702880859375> (last accessed 20 August 2017).

173. Notably, despite numerous third-party funders on the Task Force and extensive public comments received, only a few asserted that it was unnecessary or undesirable to require disclosure of the existence and identity of third-party funders. Several third-party funders commented on the potential for disruption that may result as a consequence of disclosure, but in similar numbers they also affirmed the importance of disclosure to insulate potential challenges to awards based on later-discovered arbitrator conflicts.
174. For an extended discussion of standards for granting security for costs, see Chapter 6. For an extended discussion of competing views in the underlying policy debate, see Chapter 8.
175. Globally, there is some disagreement about the effect of an arbitrator's lack of knowledge of a conflict. In the United States, the approach of U.S. courts is summarized in the Reporters' Notes to the Restatement:

“Some courts have taken the view that an absence of knowledge about a conflict per se precludes a finding of evident partiality. See *Gianelli Money Purchase Plan & Trust v. ADM Inv. Servs., Inc.*, 146 F.3d 1309, 1313 (11th Cir. 1998); see also Rev. Unif. Arb. Act § 12(e), 7 U.L.A. 43 (2005) (‘An arbitrator appointed as a neutral arbitrator who does not disclose a known, direct, and material interest in the outcome of the arbitration proceeding or a known, existing, and substantial relationship with a party is presumed to act with evident partiality under Section 23(a)(2).’). This approach – categorically excluding from consideration all conflicts regarding which an arbitrator has no actual knowledge – arguably discourages arbitrators from fulfilling their duty to investigate. It also imposes on the aggrieved party the unreasonable burden of having to prove actual knowledge about a conflict on the part of an arbitrator. The better view, and the one represented in the final factor of the test stated in the section, is that absence of knowledge is relevant to a court's analysis of the facts of a case, particularly as relates to the investigation undertaken by the arbitrator.” See *New Regency Prods., Inc. v. Nippon Herald Films, Inc.*, 501 F.3d 1101, 1107–8 (9th Cir. 2007). If the arbitrator has taken reasonable measures to investigate potential conflicts, a lack of knowledge about a particular conflict will generally weigh

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may not always be subject to set aside or refused enforcement, however, there are other potential costs to undisclosed conflicts.

A conflict of interest relating to a third-party funder may be initially unknown, but discovered later in the process, with the result being removal of an arbitrator or an effective challenge to the award that costs the parties and the funder waste time and money. An arbitrator may suffer the embarrassment of a public questioning of his or her integrity. And finally, the integrity and legitimacy of international arbitration may suffer generally. It is for these reasons that legal frameworks and practices regarding arbitrator conflicts are not based on a see-no-evil model, but instead on an affirmative duty for arbitrators to investigate potential conflicts.

Today the prevailing consensus in the international arbitration community is that that the existence of third-party funding can raise potential conflicts of interest for arbitrators, and therefore the identity of funders should be disclosed. As noted above, the potential for conflicts was one of the starting premises for the Task Force's work.

Despite consensus on the broader issues, disagreement remained on the Task Force regarding related questions about what kinds of dispute financing should be included in the definition of "funding" or "funder" for this purpose, and regarding how such disclosure should occur. This topic is taken up in greater detail below.

The sources that govern potential arbitrator conflicts of interest are numerous, and include arbitral rules, national law, and international soft law instruments, such as the IBA Guidelines on Conflicts. Given that modern third-party funding is a relatively recent phenomenon, however, many of these sources have not yet specifically addressed the issue of potential conflicts of interest involving third-party funding.

The IBA was the first organization to formally address issues relating to third-party funding conflicts by implementing the 2014 IBA Guidelines on Conflicts of Interest in International Arbitration. As examined in greater detail below, the IBA Guidelines define third-party funders and insurers as relevant to conflicts analysis if they have a "direct economic interest" in an award. This definition, however, still leaves unresolved some questions regarding the scope and application of the IBA Guidelines to certain types of dispute financing.

A definition similar to the IBA definition has subsequently been adopted by the Singapore International Arbitration Centre in its Practice Note¹⁷⁶ and the 2 February

significantly against a finding of evident partiality." (Restatement (Third) US Law of Int'l Comm. Arb, § 4-13, Reporters' Note *f* (2013)).

176. Singapore International Arbitration Centre Practice Note, PN – 01/17 (31 March 2017), Administered Cases under the arbitration rules of the Singapore International Arbitration Centre, On Arbitrator Conduct in Cases Involving External Funding (31 March 2017) available at <<http://www.siac.org.sg/images/stories/articles/rules/Third%20Party%20Funding%20Practice%20Note%2031%20March%202017.pdf>> (last accessed 29 August 2017).

2016 Guidance Note on conflict disclosures by arbitrators adopted by the ICC.¹⁷⁷ Other sources, such as recent legislative reforms in Hong Kong and Singapore, as well as proposed Bilateral Investment Treaties and trade agreements, have adopted different definitions. The scope and implications of these definitional differences are addressed below.

B. The IBA Definition

As noted in Chapter 3, the IBA was the first entity to address third-party funding, and hence to provide a formal definition of third-party funding in international arbitration. This Section provides a detailed analysis of that definition.

1. Elements of the Definition

The 2014 IBA Guidelines provide in General Standard 6(b) the following guidance with respect to the range of entities that should be considered in assessing potential conflicts of interest, which now includes reference to third-party funders:

“If one of the parties is a legal entity, any legal or physical person having a controlling influence on the legal entity, or a *direct economic interest in, or a duty to indemnify a party for*, the award to be rendered in the arbitration, may be considered to bear the identity of such party.”¹⁷⁸

This Guideline provides that any entity that has “a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration” may be treated as bearing the identity of the party for the purpose of assessing conflicts of interest.

The Explanation to General Standard 6(b) provides a definition, which includes additional details:

“For these purposes, the terms ‘third-party funder’ and ‘insurer’ refer to any person or entity that is contributing funds, or other material support, to the

177. See ICC Note to Parties and Arbitral Tribunals on the Conduct of the Arbitration under the ICC Rules of Arbitration (22 September 2016) p. 5, at para. 24; A. GOLDSMITH and L. MELCHIONDA, “The ICC’s Guidance Note on Disclosure and Third-Party Funding: A Step in the Right Direction”, Kluwer Arbitration Blog (14 March 2016) available at <<http://kluwerarbitrationblog.com/2016/03/14/the-iccs-guidance-note-on-disclosure-and-third-party-funding-a-step-in-the-right-direction/>> (last accessed 18 August 2017). Note to parties and arbitral tribunals on the conduct of the arbitration under the ICC Rules of Arbitration (1 March 2017) para. 24, available at <<https://iccwbo.org/publication/note-parties-arbitral-tribunals-conduct-arbitration>> (last accessed 29 January 2018).

178. IBA Guidelines on Conflicts of Interest in International Arbitration (2014), General Standard 6(b).

prosecution or defence of the case and that has a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration.”

The purpose of these provisions is to identify which entities are subject to the IBA Guidelines, and hence are implicated in assessing arbitrator conflicts.

General Standard 7, discussed below, indicates how and when a party or its counsel should disclose that the party has a third-party funder. Once the arbitrators are aware that a third-party funder is involved in the case, General Standard 6(b) explains that an entity that fits within this definition “may be considered to bear the identity” of a party for the purposes of assessing potential conflicts of interest with the funder. Thus, with respect to third-party funders, there are effectively two levels of disclosure in the IBA Guidelines: 1) disclosure *to the arbitrators* that a party has a funder (as defined in General Standard 6(b)’s Explanatory Note); and 2) disclosure *by the arbitrators* of any potential conflict of interest using the individually numbered Guidelines and in consideration of the fact that, for the purposes of such analysis, the funder “may be considered to bear the identity” of a party.

2. “Direct Economic Interest”

The elements of the definition in General Standard 6(b) and its Explanatory Note include the requirement that the funder be “contributing funds, or other material support, to the prosecution or defence of the case” in addition to the requirement that the funder have “a direct economic interest in, or duty to indemnify a party for, the award.”

Neither General Standard 6(b), nor its Explanatory Note, define “direct economic interest.” As a consequence, it is uncertain, for example, whether a “direct economic interest” would include payments that are conditioned on a particular outcome, such as in some forms of After-the-Event (ATE) insurance, but not payable from amounts recovered.¹⁷⁹ Some suggested that the phrase might also encourage corporate structures by funders that would arguably make their interest in an award more attenuated and therefore not a “direct” economic interest. As noted in Chapter 2, third-party funders often create special purpose vehicles to fund individual cases.¹⁸⁰

179. See Chapter 2, pp. 34-35 (describing ATE insurance).

180. Under this view, a third-party funder would not be excluded from the IBA Guidelines’ disclosure and conflicts analysis. IBA Guidelines make individual guidelines not only to parties, but also to “affiliates” of parties. General Standard 6 (b) provides that a third-party funder may “bear the identity of [a] party” and the term “affiliates” extends to entities in the same group of companies as a party, including parent companies. See IBA Guidelines, General Standard 6(b), and p. 21 n. 4. Consistent with these provisions, a third-party that established a special purpose vehicle would be an affiliate of an entity that bears the identity of a party, and thus be disclosable and subject to potential conflicts of interest.

On the other hand, a competing concern expressed on the Task Force was that the phrase “direct economic interest” was too broad and vague because it could refer to any range of entities, including some not intended to be addressed, such as shareholders. Under this view, it was suggested that instead the definition should be limited to an interest in proceeds or the prospect of making a profit in the event of success, and a definition should instead refer to a “return on investment.”

Apart from the interpretation of “direct economic interest”, the IBA definition may also exclude other types of funding that would seem to raise similar questions regarding potential conflicts of interest. For example, by focusing on “direct economic interests” in the award, the IBA Guidelines’ definition excludes funders that have an interest in the award, but whose interest may not be considered a “direct” interest.¹⁸¹

Particularly in the investment arbitration context, there are a number of examples of third-party funding provided for non-pecuniary interests. Non-profit organizations, third states, or other parties have provided funds or material support to a party. The purpose of these funds or support is to increase the likelihood that an award will further a particular policy, or provide meaningful precedent which may, indirectly, promote either broad policy interests, more specific legal interests, or create helpful precedent. For example, as Victoria Shannon Sahani explains:

“In *Quasar de Valores SICAV S.A. et al. v. The Russian Federation*, SCC Arbitration No. 24/2007, Award of 20 July 2012, para. 223, the funder, Group Menatep Limited, was a former majority shareholder in the Russian oil company Yukos, rather than a separate third-party funding company, and there was no contract in place requiring the claimant to reimburse Menatep. By funding the *Quasar de Valores* case, Menatep was seeking to create a favorable ‘precedent’ in hopes that such a precedent would be applied in its future, much larger, shareholder dispute against Russia under the Energy Charter Treaty.”¹⁸²

Such participation even in the absence of a direct economic interest has the potential to raise conflicts of interest with arbitrators in those arbitrations. The existence of such funding, however, would not be required to be disclosed under the IBA Guidelines’ definition because it is limited to a “direct economic interest” in the award.

181. An argument was raised that this definition would encompass non-for-profit funding because such funding would imply a “moral obligation” to reimburse for value received, and that moral obligation would be sufficient to constitute a “direct economic interest” in the award.

182. V. SHANNON SAHANI, “Revealing Not-for-Profit Third-Party Funders in Investment Arbitration”, available at <<http://oxia.ouplaw.com/page/third-party-funders>> (last accessed 18 February 2018).

3. *Portfolio Funding and Law Firm Finance*

The definition in the IBA Guidelines may also not be broad enough to extend to portfolio financing or law firm funding, where a loan is made to a law firm collateralized by anticipated income from identified cases.¹⁸³ In law firm financing, a funder provides financing directly to a law firm (not a party). The funding is provided usually based on a range of cases in which the law firm is counsel and the firm has a contingent or conditional fee arrangement. Portfolio financing may also be provided when a party has multiple claims.

In portfolio funding or law firm financing, third-party funders' compensation is not necessarily tied to the outcome of any individual arbitral award, but instead on the performance of a portfolio of cases. That portfolio, in turn, may only include cases for which funding was provided, or a separate portfolio that includes only some of the cases for which funding is provided. Such funding is usually on a non-recourse basis, meaning that the funder's recovery is still tied to the outcome of the arbitrations. As such, portfolio financing may be regarded as providing funders with an economic interest in the awards in the portfolio, but it is not certain that interest would be considered a "direct" (rather than an "indirect") economic interest in the award, such that portfolio funding would fall within the IBA Guidelines' definition.

Even if it is uncertain whether the definition in the IBA Guidelines extends to portfolio funding or law firm financing, it seems inescapable that an arbitrator might have a potential conflict of interest as a result of such financing. For example, if an arbitrator were a partner at a law firm that received significant financing from a funder based on a portfolio of the firm's cases, that arbitrator would have a disclosable potential conflict of interest.¹⁸⁴ The same might also be true if the arbitrator sat on the Board of Directors of that funder, or had been re-appointed in numerous cases in the same portfolio of funded cases.¹⁸⁵

As portfolio financing, and other forms of third-party funding, were not well known or widespread when the IBA undertook its 2014 revisions, the drafters were likely unable to fully consider the implications of their definition. The Task Force anticipates that with any future revisions to the Guidelines, the IBA may reconsider its definition. In the meantime, the Task Force's broader definition may be useful for determining the scope of disclosures to arbitrators, which may then be analysed under existing IBA Guidelines.

183. For a description of "portfolio funding" or "law firm financing", see Chapter 2, pp. 38-39.

184. A similar potential conflict seems to have arisen in S. PERRY, "Pakistan fights bid to revive treaty claims as funder is revealed", *Global Arbitration Review* (16 November 2017) available at <<http://globalarbitrationreview.com/article/1150573/pakistan-fights-bid-to-revive-treaty-claims-as-funder-is-revealed>> (last accessed 8 November 2017).

185. See V. SHANNON SAHANI, "Reshaping Third-Party Funding", 91 *Tulane L. Rev.* (2017) p. 405 (analysing in detail the conflicts of interest that may arise if the funder combines with a party or if the funder combines with a law firm).

4. Insurance

Finally, one topic of considerable interest on the Task Force was that the Explanatory Note for General Standard 6 expressly includes “insurers” as among those relevant for disclosure purposes. For reasons examined in Chapter 3¹⁸⁶ and elaborated below, for the purposes of analysing potential conflicts of interest, insurers (whether liability insurers or after-the-event insurers) can function similarly to funders. For this reason, the general consensus on the Task Force was that insurers may raise some of the same issues as funders with respect to potential conflicts of interest. Debate remained on the Task Force, however, regarding whether or to what extent insurers should be included in disclosure obligations.

As explained above in Chapter 3,¹⁸⁷ the wording in the IBA Guidelines may not extend to BTE insurers (because they arguably do not have a “direct economic interest” in the outcome as they received payment of a premium in advance). One view on the Task Force was that this definition would likewise not extend to ATE insurers since it was doubted that their policies could be said to be providing “material support.”¹⁸⁸

C. The Task Force Definition

As noted, the Working Definition adopted in Chapter 3 was useful to ensure that general discussions were as open as possible. However the full scope of the Working Definition is not necessary for consideration of potential arbitrator conflicts. Accordingly, the disclosure recommendations of this Chapter are applicable to third-party funders who fall within following, somewhat narrower, definition:

The term “third-party funder” refers to any natural or legal person who is not a party to the dispute and is not a party’s legal counsel, but who enters into an agreement either with a party, an affiliate of that party, or a law firm representing that party:

- a) in order to provide material support for or to finance part or all of the cost of the proceedings, either individually or as part of a specific range of cases, and**
- b) such support or financing is provided through a donation, or grant, or in exchange for remuneration or reimbursement wholly or partially dependent on the outcome of the dispute.**

Unlike the Working Definition, this definition is not intended to include BTE insurance. Nor does it extend to certain other types of funding that are within the Working Definition, but need not be subject to recommendations of this Chapter

186. See Chapter 3, p. 55.

187. See Chapter 3, pp. 63-64.

188. For a description of portfolio funding, see Chapter 2, p. 38.

because they are subject to separate bases for disclosure and conflicts assessment, as discussed below.

1. Scope of Definition

Although narrower than the Working Definition, this definition is intended to apply not only to traditional non-recourse claimant-side third-party funding, in which funding is provided in expectation of a return on investment, but also to respondent-side funding and to funding that is not based on pecuniary interest. For example, this definition would apply in the arbitration brought by Philip Morris against Uruguay, which the Uruguayan government's defence was funded on a pro bono basis.¹⁸⁹

Unlike the IBA definition, the definition adopted in this Chapter clearly extends to portfolio funding and law firm financing. Specifically, it applies when funds are extended to finance an arbitration "either individually or as part of a specific range of cases". The definition also attempts to avoid the ambiguity in the IBA Guidelines' definition between direct and indirect economic interests by referring to funding that is provided "in return for remuneration dependent on the outcome of the dispute". Thus, the definition would apply to law firm financing and as well as portfolio funding models in which a funder finances one portfolio of cases (portfolio A), but the funder's returns are linked to the outcomes of disputes in a separate portfolio (portfolio B).

2. Insurance

There was considerable debate on the Task Force about whether this definition should extend to insurers, including liability insurers, after-the-event (ATE), and before-the-event (BTE) insurers. For the reasons explained below, it was ultimately decided that for the purpose of assessing conflicts of interest, liability insurers and ATE insurers should be disclosed, but not BTE insurers.

As a starting point, it is indisputable that insurers, like third-party funders, can raise potential conflicts of interest for arbitrators. For example, an arbitrator may own significant stock in an insurance company or be a partner at a law firm that does significant work for an insurance company. Moreover, increasingly third-party funders and insurers (particularly ATE insurers) compete and/or operate in tandem within the same marketplace. It was also noted that some third-party funding entities offer ATE insurance or products that are virtually identical to ATE insurance, while some insurers are offering arrangements that are tantamount to third-party funding. Finally, insurers have interests in and, depending on the type of insurance and the jurisdiction, may

189. See Press Release by Uruguay's Counsel, Foley Hoag LLP, "Government of Uruguay Taps Foley Hoag for Representation in International Arbitration Brought by Philip Morris to Overturn Country's Tobacco Regulations" (8 October 2010) available at <<http://www.foleyhoag.com/news-and-events/news/2010/october/uruguay-taps-foley-hoag-for-representation>> (last accessed 22 August 2017).

exercise control over key aspects of a party's case that are functionally similar to the kinds of control exercised by modern third-party funders.¹⁹⁰

For the vast majority on the Task Force and among the public comments received, these similarities raised questions about the conceptual coherence and fairness of treating similarly situated entities differently with respect to disclosure. There was also significant support for the Task Force recommendations to include insurance in order to be consistent with the IBA Guidelines, which expressly include insurance and have already been followed by the ICC Note to Parties¹⁹¹ and Singapore International Arbitration Centre of 31 March 2017.¹⁹²

There was a separate debate about whether ATE insurance should be disclosable under the Task Force's recommendations. Unlike modern third-party funding, it was argued that ATE insurers are usually smaller divisions of larger insurance companies. As such, they are unlikely to have direct involvement of arbitrators (and hence less potential for conflicts) and may be subject to significant "commercial sensitivities" if their participation is disclosed, which could lead to negative consequences for the ATE market overall.¹⁹³

Apart from these few but respected views, clear majorities both on the Task Force and among those who submitted comments during the public comment period agreed that ATE insurance should be disclosable. In support of this view, some disagreed with concerns expressed about the potentially negative impact on the ATE market,¹⁹⁴ while others cited the increasing competition and interconnectedness of the markets for third-party funding and ATE insurance.¹⁹⁵

Ultimately, while BTE insurance is within the Task Force's Working Definition, and is often considered to be a type of litigation funding,¹⁹⁶ it was ultimately agreed that BTE insurance should not be included in the definition of this Chapter. The primary reason was practical – it is rarely if ever involved in large commercial

190. See Chapter 2, p. 28.

191. See ICC Note to Parties and Arbitral Tribunals on the Conduct of the Arbitration under the ICC Rules of Arbitration (22 September 2016), p. 5, at para. 24; GOLDSMITH and MELCHIONDA, "The ICC's Guidance Note on Disclosure and Third-Party Funding: A Step in the Right Direction".

192. See Practice Note of 31 March 2017, available at <<http://www.siac.org.sg/images/stories/articles/rules/Third%20Party%20Funding%20Practice%20Note%2031%20March%202017.pdf>> (last accessed 31 May 2017).

193. See Annex B.

194. In arguing in favour of inclusion of ATE insurance within the Task Force recommendations for disclosure, one set of comments received observed: "The ATE litigation market has shown itself to be adept to significant change in risk profile and the regulatory regime in the London market over a lengthy period, and there is nothing to suggest the arbitration market will react any differently."

195. Chapter 2, pp. 33-35.

196. L. BENCH NIEUWVELD and V. SHANNON SAHANI, *Third-Party Funding in International Arbitration*, 2nd edn. (Kluwer 2017) p. 4.

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arbitrations (apart from maritime arbitration arbitrations, which are expressly excluded from recommendations of this Report).

More generally, some members of the Task Force and a few among those who submitted feedback during the public comment period disagreed that any kind of insurance should be included in disclosure obligations. In support of this view, it was noted that various forms of insurance are ubiquitous in international arbitration, have existed for many years, and have not historically been considered subject to assessment with respect to potential arbitrator conflicts. It was also argued that exclusion of insurers from disclosure obligations was a structural feature of dispute settlement, which should not be tampered with and could be maintained as separate from the issue of third-party funding.

In particular, the view was expressed that insurance should not be considered in the absence of express and extensive consideration of the special market and regulatory issues that prevail in the insurance industry. In this vein, it was pointed out that the Task Force did not include among its Members any individuals currently employed in-house with an insurer.¹⁹⁷

It was also pointed out that the inclusion of insurance can raise some practical challenges. In any one case, there can be multiple insurers, either “horizontally” (because there are numerous underwriters of a single claim), or “vertically” (because of the existence of reinsurers and other means of diversifying risk). These market features raise some questions about the application of a disclosure obligation to insurers. If there are more than a few underwriters of a claim, do all need to be disclosed? If only some need to be disclosed, how should the disclosable insurers be identified? Do reinsurers need to be disclosed? If so, once again, what are the criteria for requiring disclosure? These are important questions that were not taken up by the Task Force, but that warrant future study.

Future study, including direct consultation with the insurance industry, would also be useful for reconciling regional and national differences regarding the uses of insurance in disputes, the markets for and industry practices of insurance, and national rules regarding disclosure of insurance. For example, in the United States, the availability of contingency fee representation makes BTE insurance largely unnecessary, while fee-shifting in other jurisdictions like England and Australia makes ATE insurance an important resource for disputing parties. In another example, in the United States Federal Rule of Civil Procedure 26(a)(1)(iv) requires that any insurance agreement that would be used to pay all or part of a court judgment must be disclosed

197. The Task Force did include some individuals with experience and expertise with insurance, and the Task Force sought out input from other experts in insurance during the public comment period. Notwithstanding this effort, as practice develops with respect to disclosure and assessment of potential conflicts with insurers, these issues will undoubtedly benefit from reconsideration and reassessment.

at the initiation of every case. No such disclosure is required in England and many other jurisdictions.¹⁹⁸

Despite questions that remain open, the Task Force’s inclusion of insurance is consistent with the approach taken by the IBA, and followed by the ICC and the SIAC. Moreover, the prevailing view among Task Force Members and among those who made contributions in the public comment period was that the omission of insurance from disclosure obligations was not the result of an intentional determination, but instead a historic oversight.

At the time this Report went to press, the IBA Guidelines had been in place for just over two years. As far as the Task Force was able to determine, there have been no public or anecdotal reports of objections to inclusion of insurers in their disclosure obligations. Meanwhile, experiences with disclosure of insurance under the IBA the Guidelines and the Principles in this Report will hopefully produce a track record of experience that will be useful to future efforts.

3. Exclusions from Definition

The definition in this Chapter is broad, but it does not extend to certain types of dispute funding. One reason is that certain types of dispute financing that fit within the Task Force’s Working Definition are subject to separate disclosure obligations.

a. Contingency Fees

For some purposes, contingency or conditional fee arrangements are included within the definition of third-party funding.¹⁹⁹ However, separate procedural rules require disclosure of lawyers and law firms involved in international arbitration.²⁰⁰ Based on these existing disclosure requirements, arbitrators already consider the potential for conflicts of interest with lawyers and law firms, and that analysis would not change if the law firm were providing representation on a contingent or conditional fee basis.

198. Notably, this rule is not for the purpose of assessing potential conflicts of interest with judges, but is instead aimed allowing both parties to appraise a case, particularly since in U.S. litigation, liability insurers may exercise complete control over a case. The rule does not extend to third-party funders. See Advisory Committee Note to Rule 26; see also V. SHANNON SAHANI, “Judging Third-Party Funding”, 63 UCLA L. Rev. (2016) p. 388 at p. 414.

199. See Chapter 3, p. 51.

200. See International Bar Association, “IBA Guidelines on Party Representation in International Arbitration” (2013) available at <<https://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0ahUKEwjqZCL4ejVAhUBKcAKHbS4CTsQFggmMAA&url=https%3A%2F%2Fwww.ibanet.org%2FDocument%2FDefault.aspx%3FDocumentUid%3D6F0C57D7-E7A0-43AF-B76E-714D9FE74D7F&usg=AFQjCNEh59hDXSao8TZVv7K5j4FnegIy7w>> (last accessed 20 August 2017).

b. Corporate Finance Models

The definition in this Chapter also does not necessarily extend to certain types of funding that are structured as corporate equity investments in a claimant, or debt instruments, such as a loan provided by a parent company. For dispute funding that is facilitated through equity and debt-based arrangements, however, disclosure may be required for other reasons.

For example, General Standard 7(a) of the IBA Guidelines provides that disclosure for the purpose of assessing conflicts applies not only to a party, but also to “another company of the same group of companies [as the party], or an individual having a controlling influence on the party in the arbitration”. A third-party funder that acquires sufficient shareholdings to influence corporate decision-making regarding management of a dispute would undoubtedly qualify as having a “controlling influence” and should therefore be disclosed. Meanwhile, if a related company provides funding, for example through inter-corporate loans, the identity of that related company would be disclosable as part of the same group of companies. The individual IBA Guidelines apply not only to parties, but also to “affiliates” of the parties, which are defined as those with the same “group of companies”.²⁰¹

Extending disclosure to related or controlling parties is not a complete solution. For example, the IBA Guidelines would benefit from greater specificity regarding how to determine when an influence is “controlling” or how “group of companies” is defined. Future revisions to the IBA Guidelines may address these issues, for example, by specifying specific percentage holdings, as provided in some domestic procedural and disclosure rules.²⁰² Such revisions taken up to clarify these corporate relationships should also consider corporate structures of and relationships among funders, for example to place a parent third-party funder of a special purpose vehicle more clearly within the provisions of General Standard 6(b).²⁰³

201. Footnote 6 of the IBA Guidelines provides: “Throughout the Application Lists, the term ‘affiliate’ encompasses all companies in a group of companies, including the parent company [...]”. International Bar Association, “IBA Guidelines on Party Representation in International Arbitration” (2013) available at <<https://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0ahUKEwjqZCL4ejVAhUBKcAKHbS4CTsQFggmMAA&url=https%3A%2F%2Fwww.ibanet.org%2FDocument%2FDefault.aspx%3FDocumentUid%3D6F0C57D7-E7A0-43AF-B76E-714D9FE74D7F&usg=AFQjCNEh59hDXSao8TZVV7K5j4FnegIy7w>> (last accessed 20 August 2017).

202. For example, Rule 29.6 of the Rules of Court of the U.S. Supreme Court requires disclosure of an ownership interest only when it exceeds 10%.

203. See Chapter 3, p. 51.

c. Maritime Arbitration

In addition, as explained in Chapter 1 (Introduction) and Chapter 3 (Definitions), the recommendations of this Report do not extend to maritime arbitration.²⁰⁴ It was recognized that funding provided through Shipowners' and Defence Clubs is similar to modern third-party funding,²⁰⁵ and hence raises some of the same concerns about potential arbitrator conflicts of interest. The Task Force did not study the existing practices in maritime arbitration, however, and therefore, expressly excludes maritime arbitration from any recommendations in this Report.

Finally, although the Task Force concluded that the presence and identity of a funder should be disclosed or disclosable to permit arbitrators to assess conflicts of interest, the potential for arbitrator conflicts should generally not be considered a basis for requiring disclosure of any additional details about the funding relationship or funding agreement. Such details are generally irrelevant to questions of arbitrator conflicts of interest.

This recommendation is made, however, in recognition that the need for transparency and avoidance of conflicts must be counterbalanced by meaningful responses to the attempts by opposing parties to exploit the participation of a funder to gain an unfair strategic advantage.²⁰⁶ Tribunals should remain mindful of potential dilatory requests or arguments to the tribunal based on unfounded assertions about the consequences of a funder's participation.²⁰⁷

d. Existing Standards for Disclosure

There was nearly universal agreement that disclosure of the identity of a funder is necessary for an arbitrator to undertake analysis of potential conflicts of interest. There was somewhat less consensus about how and when such disclosure should occur.

Some sources that have attempted to address the issue of disclosure and potential conflicts of interests nevertheless do not address precisely when and how disclosure about a third-party funder should be made. Nevertheless, these sources generally all suggest that potential conflicts of interest arising from the involvement of third-party funders should be considered by arbitrators. In general, national legislation and treaty-based obligations generally mandate early, systemic disclosure of third-party funding by parties, while some arbitral institutions have instead simply affirmed the authority of tribunals to order disclosure.

204. Chapter 1, pp. 9-10.

205. See Chapter 2 (Overview of Funding Market); Chapter 3 (Definitions).

206. *Ibid.*

207. *Ibid.*

i. Guidance from institutions

As examined in detail above, the first entity to promulgate guidelines regarding third-party funding was the International Bar Association (IBA) in its Guidelines on Conflicts of Interest in International Arbitration, last revised in 2014.²⁰⁸ Since that time, only a few institutions have specifically addressed the issue. Of those that have, the only one that appears to require expressly the systematic disclosure of third-party funding as a matter of course are the new CIETAC International Investment Arbitration Rules.²⁰⁹ Other institutions generally instead leave the issue to the discretion of arbitrators.

In December 2015, the ICC Commission on Arbitration issued a Report entitled “Decisions on Costs in International Arbitration” that provided some guidance to arbitrators regarding third-party funding.²¹⁰ Notably, the Commission provides a different definition of a third-party funder in footnote 44 of its report:

“A third-party funder is an independent party that provides some or all of the funding for the costs of a party to the proceedings (usually the claimant), most commonly in return for an uplift or success fee if successful.”

The Report does not suggest that the existence and identity of the funder must be disclosed as a matter of course, but instead provides as follows:

“The tribunal might also consider discussing with the parties, at the outset of the arbitration or during the proceedings (typically at the first case management meeting), other aspects of cost management, including... sensitive matters, such as whether there is third-party funding and ...whether the identity of the third-party funder (which could be relevant to possible conflicts of interest) should be disclosed.”

The Report also provides a worldwide survey of laws regarding disclosure of third-party funding (beginning on page 45) and a worldwide survey of cost provisions in all international arbitration rules (beginning on page 49).

208. International Bar Association, “IBA Guidelines on Conflicts of Interest in International Arbitration” (2014) available at <http://www.ibanet.org/Publications/publications_IBA_guides_and_free_materials.aspx> (last accessed 19 August 2017).

209. The CIETAC Investment Arbitration Rules, Article 27(2) (English Translation), available at <https://mp.weixin.qq.com/s/2kY_dw62_w-281QXua3yPA> (last accessed 14 March 2018).

210. See ICC Commission, “Arbitration report on Costs from December 2015”, available at <<http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2015/Decisions-on-Costs-in-International-Arbitration---ICC-Arbitration-and-ADR-Commission-Report/>> (last accessed 10 August 2017).

SIAC’s newly released Investment Arbitration Rules (IARs) specifically authorize arbitral tribunals to order disclosure of the existence of third-party funding and/or the identity of such funder (IAR 24(1)) and to take account of third-party funding when awarding costs (IAR 33.1).²¹¹ This complements Singapore’s legislative amendment (discussed below) to its Civil Law Act to allow for third-party funding. Similarly, proposed revisions to the HKIAC’s arbitration rules, contemplate disclosure of third-party funding.²¹²

The Secretariat of the ICC Court of Arbitration adopted a definition of third-party funding that appears to more closely resemble the IBA Guidelines than the ICC Commission’s Report. In its *Note to parties and arbitral tribunals on the conduct of the arbitration under the ICC Rules of Arbitration* (22 Sep. 2016 version), the ICC Court gives arbitrators the following guidance in Paragraph 24:

“Relationships between arbitrators, as well as relationships with any entity having a direct economic interest in the dispute or an obligation to indemnify a party for the award, should also be considered in the circumstances of each case.”²¹³

This instruction for arbitrators to consider relationships with third-party funders would seem to imply arbitrators have a duty to investigate the existence of a funder in an arbitration.²¹⁴

In July 2016, the President of CAM-CCBC issued Administrative Resolution No. 18 of 20 July 2016 (Resolution 18/2016), which provides in pertinent part:

“**Article 3** – The presence of a third-party funder can raise reasonable doubt as to the impartiality or independence of the arbitrators, due to possible past or current relationship between the arbitrator and the third-party funder.

Article 4 – In order to avoid potential conflicts of interest, CAM-CCBC recommends the parties to report the existence of third-party funding to CAM-

211. Investment Arbitration Rules of the Singapore International Arbitration Centre, “SIAC IA Rules”, 1st edn. (1 January 2017) available at <<http://www.siac.org.sg/our-rules/rules/siac-ia-rules-2017>> (last accessed 28 August 2017).

212. See Public Consultation Process on Proposed Amendments to the 2013 HKIAC Administered Arbitration Rules, available at <<http://www.hkiac.org/news/revision-2013-administered-arbitration-rules>> (last visited 14 March 2018).

213. See Secretariat of the ICC Court of Arbitration, “Note to parties and arbitral tribunals on the conduct of the arbitration under the ICC Rules of Arbitration” (2016) available at <<https://iccwbo.org/dispute-resolution-services/arbitration/practice-notes-forms-checklists/>> (last accessed 29 January 2018).

214. One commentator has elaborated specific guidelines about how such disclosures should be made. See J. TRUSZ, “Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration”, 101 *Geo. L.J.* (2013) p. 1649 at p. 1673.

CCBC at the earliest opportunity. The complete qualification of the funder should be included in this communication.

Article 5 – When this communication is received, CAM-CCBC shall inform the arbitrators and invite them to perform a conflict check and to reveal any information that may raise justifiable doubt as to their independence and impartiality. The third-party funding information shall also be provided to the other party.”²¹⁵

Resolution 18/2016 appears to take a unique approach, which requires systematic disclosure but by “reporting the existence of third-party funding to CAM-CCBC at earliest convenience.” CAM-CCBC then informs the arbitrators and invites them to conduct a conflicts check and make any necessary disclosure.

The last sentence of Article 5 provides that “third-party funding information shall also be provided to the other party.” It is uncertain from this language whether the opposing party is informed whenever a third-party funder is reported under Article 4, or only if arbitrators disclose a potential conflict of interest under Article 5.

More recently, in its new rules for investment arbitration, CIETAC addressed third-party funding. Its newly revised rules on investment arbitration expressly state in Article 27 that parties receiving funding “shall notify in writing, without delay” to the parties, the arbitral tribunal and the administering institution the “existence and nature” of the arrangement, together “with the name(s) and address(es) of the funder(s)”.²¹⁶ The tribunal may also specifically request such disclosure. When deciding on costs for the arbitration, the tribunal may take into consideration the existence of a third-party funding arrangement, and whether the concerned party complied with the disclosure requirements. The tribunal is also empowered to order disclosure of information related to third-party financing.²¹⁷ Meanwhile, CIETAC’s Hong Kong Arbitration Center has also recently published “Guidelines for Third Party Funding in International Arbitration”, which also require that “A party obtaining Funding should without delay disclose to the tribunal and other party any circumstances arising from that Funding that might give rise to any possible issues of conflict of interest under applicable laws and rules.”²¹⁸

215. CAM-CCBC Administrative Resolution 18/2016, available at <<http://www.ccbc.org.br/Materia/2890/resolucao-administrativa-182016/en-US>> (last accessed 2 January 2018).

216. The CIETAC Investment Arbitration Rules, Article 27(2) (English Translation), available at <https://mp.weixin.qq.com/s/2kY_dw62_w-281QXua3yPA> (last accessed 14 March 2018).

217. *Ibid.*

218. China International Economic and Trade Arbitration Commission, Hong Kong Arbitration Center, “Guidelines for Third Party Funding in Arbitration”, available at <<https://hkarbitration.files.wordpress.com/2016/05/cietac-draft-guidelines-17-may-16.pdf>> (last accessed 25 January 2018).

ii. National legislation

Few jurisdictions have specifically sought to regulate disclosure of third-party funding in international arbitration. The two exceptions are Hong Kong and Singapore, which recently enacted reforms to remove prohibitions that were regarded as previously prohibiting such funding in locally seated arbitrations. Notably, both these reforms mandate disclosure of the existence of funding and identity of the funder.

With respect to statutes, Singapore has recently introduced new legislation that allows third-party funding in international arbitration.²¹⁹ Amendments to the Legal Profession (Professional Conduct) Rules 2015 require that a legal practitioner must disclose “to the court or tribunal, and to every other party to those proceedings”²²⁰ the “existence of any third-party funding contract”²²¹ along with “the identity and address of any third-party funder involved in funding the costs of those proceedings.”²²² Disclosure must be made “at the date of commencement of the dispute resolution proceedings where the third-party funding contract is entered into before the date of commencement of those proceedings”²²³ or “as soon as practicable”²²⁴ after the third-party funding contract is entered into.²²⁵

Hong Kong has adopted legislation that is similar to that of Singapore with respect to its requirements for disclosure of third-party funding in international arbitration.²²⁶ Under the new Hong Kong law, a funded party must disclose “the fact that a funding

219. Civil Law (Amendment) Act 2017, §5(b)(2) “A contract under which a qualifying Third-Party Funder provides funds to any party for the purpose of funding all or part of the costs of that party in prescribed dispute resolution proceedings is not contrary to public policy or otherwise illegal by reason that it is a contract for maintenance or champerty.” Available at <<http://statutes.agc.gov.sg/aol/search/display/view.w3p;orderBy=date-rev,loadTime;page=0;query=Id%3Aae379db0-c3da-4abe-ad09-1d1518181ee9;rec=0#legis>> (last accessed 29 January 2018).

220. Legal Profession (Professional Conduct) Rules 2015, Part 5A Rules Applicable to Third-Party Funding, §49(A)(1), available at <<http://statutes.agc.gov.sg/aol/search/display/view.w3p;ident=dc37692e-e97b-4751-81bd-de82cd9bfd02;page=0;query=DocId%3Ae61bfe00-bda6-4ed2-8978535bf9ef5f27%20Depth%3A0%20Status%3Ainforce;rec=0#pr49A-he->>> (last accessed 30 August 2017).

221. *Ibid.* at §49(A)(1)(a).

222. *Ibid.* at §49(A)(1)(b).

223. *Ibid.* at §49(A)(2)(a).

224. *Ibid.* at §49(A)(2)(b).

225. See M. CHAN, M. SECOMB and P. TAN, “Third Party Funding: a New Chapter in Hong Kong & Singapore” (29 July 2016) available at <<http://www.jdsupra.com/legalnews/third-party-funding-a-new-chapter-in-40360/>> (last accessed 22 August 2017).

226. See S. JHANGIANI and R. COLDWELL, “Third-Party Funding for International Arbitration in Singapore and Hong Kong – A Race to the Top?”, Kluwer Arbitration Blog (30 Nov. 2016) available at <<http://kluwerarbitrationblog.com/2016/11/30/third-party-funding-for-international-arbitration-in-singapore-and-hong-kong-a-race-to-the-top/>> (last accessed 20 August 2017); Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016.

agreement has been made” and the “name of the third party funder”.²²⁷ Notice of the funding agreement must be given “before the commencement of the arbitration” or for a funding agreement made after commencement of the arbitration “within 15 days after” the funding agreement is made.²²⁸ Notice must be given to “each other party to the arbitration” and to the “arbitration body”.²²⁹ Similarly, a funded party must give notice to the other party and the arbitration body of the termination of a funding agreement within fifteen days after the funding agreement ends.²³⁰

iii. Trade and investment treaties

A few trade and investment treaties, and some proposed treaty provisions, have also recently sought to introduce disclosure obligations with respect to third-party funding. These instruments expressly require disclosure of funding arrangements.

The Comprehensive Economic and Trade Agreement (CETA), recently ratified by Canada and the European Union, contains the following provisions relating to third-party funding:

“Article 8.1: Definitions

third-party funding means any funding provided by a natural or legal person who is not a disputing party but who enters into an agreement with a disputing party in order to finance part or all of the cost of the proceedings either through a donation or grant, or in return for remuneration dependent on the outcome of the dispute.

Article 8.26: Third party funding

1. Where there is third party funding, the disputing party benefiting from it shall disclose to the other disputing party and to the Tribunal the name and address of the third party funder.
2. The disclosure shall be made at the time of the submission of a claim, or, if the financing agreement is concluded or the donation or grant is made after the submission of a claim, without delay as soon as the agreement is concluded or the donation or grant is made.”²³¹

227. Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016, §98T (1)(a)-(b), available at <<http://www.legco.gov.hk/yr16-17/english/bills/b201612301.pdf>> (last accessed 29 January 2018).

228. *Ibid.*, at §98T (2)(a)-(b).

229. *Ibid.*, at §98T (3)(a)-(b).

230. *Ibid.*, at §98U (1)-(3).

231. See “Comprehensive Economic and Trade Agreement” (CETA) available at <<http://data.consilium.europa.eu/doc/document/ST-10973-2016-INIT/en/pdf>> (last accessed 22 August 2017).

The EU has proposed including provisions regarding third-party funding in the Transatlantic Trade and Investment Partnership, negotiation of which is on hold at the time of writing. The EU's proposed language is as follows:

“Article 1, Scope and Definitions:

2. For the purposes of this Section: ‘Third Party funding’ means any funding provided by a natural or legal person who is not a party to the dispute but who enters into an agreement with a disputing party in order to finance part or all of the cost of the proceedings in return for a remuneration dependent on the outcome of the dispute or in the form of a donation or grant.

Article 8, Third party funding

1. Where there is a third party funding, the disputing party benefiting from it shall notify to the other disputing party and to the Tribunal, or where the division of the Tribunal is not established, to the President of the Tribunal, the name and address of the third party funder.

2. Such notification shall be made at the time of submission of a claim, or, where the financing agreement is concluded or the donation or grant is made after the submission of a claim, without delay as soon as the agreement is concluded or the donation or grant is made.”²³²

Some draft or model Bilateral Investment Treaties apparently include similar disclosure obligations. As of the date of publication of this Report, those drafts were not publicly available.

Several international investment arbitration cases, as well as a few international commercial arbitration cases and domestic court cases, have addressed the issue of disclosure of third-party funding.

Apparently the first, and most controversial, investment arbitration involving disclosure of third-party funding was *RSM Production Corporation v. Saint Lucia*, where disclosure was sought in relation to costs, not in relation to potential conflicts of interest. It resulted, however, in a challenge to one arbitrator as a result of strong language used to describe third-party funding in an Assenting Opinion.²³³ The claimant's principal grounds for the challenge were as follows:

232. See “Chapter II – Investment”, EU Draft, available at <http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc_153807.pdf> (last accessed 20 August 2017).

233. See *RSM Production Corporation v. Saint Lucia* (ICSID Case No. ARB/12/10), Decision on claimant's proposal for the disqualification of Dr Gavan Griffith QC, IIC 662 (23 October 2014).

“The description of third-party funders as ‘mercantile adventurers’ and the association with ‘gambling’ and the ‘gambler’s Nirvana: Heads I win and Tails I do not lose’ are, in Claimant’s view, radical in tone and negative and prejudice the question whether a funded claimant will comply with a costs award. Additionally, Claimant derives from [the arbitrator’s] determinations that his alleged bias against the funders extends to Claimant as the funded party as well. Claimant contends that the language used by [the arbitrator] cannot be qualified as a neutral discussion of the issues or a mere rhetorical emphasis.”²³⁴

The other two arbitrators rejected the challenge and articulated the following reasoning:

“The expressions used by [the challenged arbitrator] in his Assenting Reasons, such as ‘gambling,’ ‘adventurers’ and the reference to the ‘gambler’s Nirvana’ are strong and figurative metaphors. However, in our view, these expressions primarily serve the purpose of clarifying and emphasizing the point [the challenged arbitrator] purports to make, namely the paramount importance, in his opinion, of third-party funding of a party in connection with a request for security for costs. We do not regard it to be established that these terms reveal any underlying bias against third-party funders in general or Claimant in particular. The means of expressing a point of view or articulating an argument may vary from one arbitrator to another, and different arbitrators possess varied characteristics, including their habits of drafting decisions and the wording used. As long as such wording does not clearly reveal any preference for either party, it cannot serve as a ground for a challenge.... As we require an objective standard to be met, Claimant needs to establish facts indicating [the challenged arbitrator]’s lack of impartiality. However, in this case, the facts presented are that [the challenged arbitrator] issued his Assenting Reasons with the contents as described by Claimant. These facts, however, are as such not sufficient to constitute a lack of impartiality. The underlying arguments, as presented by [the challenged arbitrator] and the wording, in our view, do not cast reasonable doubt upon [the challenged arbitrator]’s capacity to issue an independent and impartial judgment in the present arbitration.”²³⁵

234. See *RSM Production Corporation v. Saint Lucia* (ICSID Case No. ARB/12/10), Decision on claimant’s proposal for the disqualification of Dr Gavan Griffith QC, IIC 662 (23 October 2014) para. 42.

235. See *RSM Production Corporation v. Saint Lucia* (ICSID Case No. ARB/12/10), Decision on claimant’s proposal for the disqualification of Dr Gavan Griffith QC, IIC 662 (2014) (23 October 2014) paras. 87, 90.

This case has been the subject of substantial discussion, in large part because of the strong language in the assenting opinion and the subsequent challenge to its author, as well as subsequent efforts to annul the award on the merits.²³⁶

In most cases when disclosure has been ordered, the arbitral tribunal orders disclosure of the identity of the third-party funder, but only rarely disclosure of the terms of the funding arrangement, and usually not for reasons related to arbitrator conflicts. For example, a dispute regarding termination of the funding arrangement in the ICSID case *S&T Oil Equipment & Machinery Ltd v. Romania* was litigated in the U.S. courts, which required disclosure of the terms of the funding arrangement in dispute.²³⁷ As a result of this dispute over the funding arrangement, the funder, Juridica, ceased paying S&T Oil's fees and costs in the ICSID case, and the ICSID tribunal ultimately terminated the proceedings due to this non-payment. In this case, the funding agreement was in dispute, so disclosure of its terms was appropriate.

In most cases, however, the funding agreement is not in dispute, so disclosure of its terms is not appropriate for the purposes of assessing potential conflicts of interest. For example, in the ICSID case *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic*, the tribunal ordered the claimant to reveal the identity of its third-party funder for the purposes of checking for arbitrator conflicts of interest, but did not require the claimant to disclose any of the terms of the funding arrangement.²³⁸ In that case, the claimant had previously voluntarily disclosed that it was funded by a Luxembourg-based funder, but the claimant did not disclose the identity of that funder until ordered to do so by the tribunal.

Muhammet Çap & Sehil İnşaat Endustri ve Ticaret Ltd Sti v. Turkmenistan, an ICSID case, provides an example of a tribunal ordering a claimant to disclose both the

236. See procedural history of *RSM Production Corporation v. Saint Lucia* (ICSID Case No. ARB/12/10) available at <<http://www.italaw.com/cases/2706>> (last accessed 3 August 2017).

237. See *S&T Oil Equipment & Machinery, Ltd, et al. v. Juridica Investments Limited, et al.*, 456 Fed. Appx. 481, 2012 WL (5 Jan. 2012) p. 2842 (requiring disclosure of funding arrangement to resolve a dispute between S&T and Juridica regarding termination of the third-party funding provided for the ICSID case *S&T Oil Equipment & Machinery Ltd v. Romania* (ICSID Case No. ARB/07/13), Order to Discontinue Proceedings (16 July 2010); B. M. CREMADES Jr., "Third Party Litigation Funding: Investing in Arbitration" 8 *Transnational Dispute Management* (2011, Issue 4) pp. 12-15 (discussing these two S&T cases); N. RAYMOND, "Litigation Funding Gone Wrong", *The American Lawyer* (25 April 2011) available at <<http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202492845664&slreturn=1law.com>> (last accessed 13 August 2017) (discussing the U.S. Fifth Circuit case, *S&T v. Juridica*).

238. See *EuroGas Inc and Belmont Resources Inc v. Slovak Republic* (ICSID Case No. ARB/14/14), Transcript of the First Session and Hearing on Provisional Measures (17 March 2015) p. 145 ("We think that the Claimants should disclose the identity of the third-party funder, and that third-party funder will have the normal obligations of confidentiality.").

identity of the funder and the terms of the funding arrangement.²³⁹ In doing so, the tribunal invoked its “inherent powers to make orders of the nature requested where necessary to preserve the rights of the parties and the integrity of the process.” In April 2014, Turkmenistan had requested the tribunal to order the claimant to disclose whether it had engaged the services of a third-party funder as well as the terms of that arrangement.²⁴⁰ In Procedural Order No. 2, the tribunal refused the request and listed several reasons why a tribunal could justifiably order disclosure of third-party funding.

“It seems to the Tribunal that the following factors may be relevant to justify an order for disclosure, and also depending upon the circumstances of the case:

- a. To avoid a conflict of interest for the arbitrator as a result of the third party funder;
- b. For transparency and to identify the true party to the case;
- c. For the Tribunal to fairly decide how costs should be allocated at the end of any arbitration;
- d. If there is an application for security for costs if requested; and
- e. To ensure that confidential information which may come out during the arbitral proceedings is not disclosed to parties with ulterior motives.”²⁴¹

One year later, Turkmenistan renewed its request for such disclosure to ensure that there were no conflicts of interests with the arbitrators or counsel in the case and to check whether the claimants were “still the actual owners of the claims in this arbitration”.²⁴² To bolster its renewed request, Turkmenistan also cited the newly enacted General Standard 7(a) and the Explanation to General Standard 7(a) of the International Bar Association (IBA) Guidelines on Conflicts of Interest in International Arbitration, which took effect in October 2014.²⁴³ Turkmenistan also stated that it was considering applying for security for costs in the case due to the presence of the third-party funder.²⁴⁴

In Procedural Order No. 3, the tribunal decided to grant Turkmenistan’s renewed request for the following reasons:

“First, the importance of ensuring the integrity of the proceedings and to determine whether any of the arbitrators are affected by the existence of a third-

239. See *Muhammet Çap & Sehil İnşaat Endustri ve Ticaret Ltd Sti v. Turkmenistan* (ICSID Case No. ARB/12/6), Procedural Order No. 3 (12 June 2015).

240. *Ibid.* at para. 1.

241. *Muhammet Cap & Sehil Insaat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan* (ICSID Case No. ARB/12/6), Decision on Jurisdiction (13 February 2015) para. 50 (quoting Procedural Order No. 2).

242. See Procedural Order No. 3, para. 2.

243. *Ibid.* at para. 2.

244. *Ibid.* at para. 2.

party funder. In this respect the Tribunal considers that transparency as to the existence of a third-party funder is important in cases like this. Second, although it has not yet done so, Respondent has indicated that it will be making an application for security for costs. It is unclear on what basis such application will be made, e.g., Claimants' inability to pay Respondent's costs and/or the existence of a third-party funder. There are two additional factors which the Tribunal considers support the conclusion it has reached. Claimants have not denied that there is a third-party funder for the claims in this arbitration. It would have been straight forward to do so, just as they denied having assigned any of their rights to another party. Furthermore, and this was not denied by Claimants, Respondent has alleged that the order for costs in favour of Respondent made by the Kılıç Tribunal²⁴⁵ has not been paid even though the claimant (Kılıç İnşaat İthalat İhracat Sanayi ve Ticaret Anonim Şirketi) has funded the annulment proceedings.²⁴⁶

It is important to note that the tribunal did not specify in its procedural order which of the terms of the funding arrangement were required to be disclosed and which could stay confidential.²⁴⁷ Some have expressed concern that this approach creates uncertainty regarding whether such disclosure may unfairly disadvantage the disclosing party or unfairly advantage the party receiving the information.

Similarly, in the PCA case *South American Silver v. Bolivia*, Bolivia "request[ed] the Tribunal to order the Claimant to 'disclose the identity of the funder of this arbitration, as well as the terms of the funding agreement signed with him.'"²⁴⁸ Like in the *Muhammet Cap* case, it would appear that the parent company of the claimant had earlier voluntarily disclosed the existence of the third-party funding, but not the identity of the funder or the terms of the agreement.²⁴⁹ Like Turkmenistan, Bolivia argued that it was seeking this disclosure and security for costs due to the economic difficulties of the claimant coupled with the existence of third-party funding.²⁵⁰ Bolivia also cited the 2014 IBA Guidelines for the proposition that "that third-party funders should be equated with the funded party to verify the existence of conflict of interests,

245. *Kılıç İnşaat İthalat İhracat Sanayi ve Ticaret Anonim Şirketi v. Turkmenistan* (ICSID Case No. ARB/10/1) Award (3 July 2013).

246. *Ibid.* at paras. 9-12.

247. See J. HONLET, "Recent decisions on third-party funding in investment arbitration", 30 ICSID Review (Fall 2015, Issue 3) pp. 699-712, available at <<https://doi.org/10.1093/icsidreview/siv035>> (last accessed 22 August 2017).

248. *South American Silver Limited v. Plurinational State of Bolivia* (PCA Case No. 2013-15), Procedural Order No. 10 (11 January 2016) para. 13.

249. *Ibid.* at para. 25.

250. *Ibid.* at para. 25.

and that the funded party is obliged to disclose any relationship that exists between her (including third-party funders) and the arbitrators.”²⁵¹

In its reply to Bolivia’s request, South American Silver (SAS) agreed to disclose the name of its funder but noted that “the terms of SAS’s funding agreement are irrelevant to the issues in dispute in this arbitration and that the terms of that agreement are confidential, commercially sensitive, and that SAS and the funder would incur prejudice if the Tribunal ordered SAS to disclose the terms of the funding agreement.”²⁵² With respect to Bolivia’s application for security for costs, the tribunal adopted the standard articulated by the majority of the tribunal in *RSM v. Saint Lucia* and *EuroGas v. Slovak Republic* that “the mere existence of a third-party funder is not an exceptional situation justifying security for costs.”²⁵³ In the end, the tribunal decided to order disclosure of the name of the funder “for purposes of transparency, and given the position of the Parties” but determined that there was no basis to order disclosure of the terms of the funding arrangement.²⁵⁴

The foregoing cases have all addressed cases involving for-profit third-party funding. There is another category of funders which may be termed “not-for-profit funders.”²⁵⁵ These funders are motivated to bring about a certain outcome in the case or a change in the law, rather than motivated by making a profit. The most widely known example of a “not-for-profit” funding arrangement is the arrangement whereby the Bloomberg Foundation and its “Campaign for Tobacco-Free Kids” donated US\$ 200,000 to Uruguay to help it fight against Philip Morris in the ICSID case *Philip Morris v. Uruguay* in which Philip Morris challenged state regulations requiring plain packaging of tobacco products.²⁵⁶

Bloomberg did not expect any monetary reimbursement of its investment or have any economic interest in the award. Instead it was seeking to bring about a certain outcome in the case, namely allowing Uruguay to successfully defend a suit challenging its laws regarding tobacco packaging.

It remains uncertain the extent to which not-for-profit funding will continue to grow. Particularly in investment arbitration, where awards are routinely relied on as a form of

251. *Ibid.* at para. 29.

252. *South American Silver Limited v. Plurinational State of Bolivia* (PCA Case No. 2013-15), Claimant Opposition to Respondent Request for Cautio Judicatum Solvi and Disclosure of Information (14 December 2015) paras. 38, 40.

253. *Ibid.* at para. 74 (citing *EuroGas Inc. & Belmont Resources Inc. v. Slovak Republic* (ICSID Case No. ARB/14/14), Procedural Order No. 3 – Decision on Requests for Provisional Measures (23 June 2015) para. 123.

254. *Ibid.* at paras. 79, 80 and 84.

255. See e.g., E. DE BRABANDERE and J. LEPELTAK, “Third-Party Funding in International Investment Arbitration”, 27 *ICSID Review* (2012, Issue 2) pp. 379-398, available at <<https://doi.org/10.1093/icsidreview/sis017>> (last accessed 22 August 2017).

256. See *Philip Morris Brand Sàrl (Switzerland), Philip Morris Products SA (Switzerland) and Abal Hermanos SA (Uruguay) v. Oriental Republic of Uruguay* (ICSID Case No. ARB/10/7).

soft precedent, it may become more common for states that are not a party in a particular case, or non-profit entities, to support responding parties in order to affect the development of the law or to protect their own rights indirectly.²⁵⁷ To date, it would appear that many not-for-profit funders and the parties they fund are inclined to voluntarily, and even publicly, announce their involvement in the case, perhaps to sway public opinion in their favour or to attract additional funding sources for the funded party.²⁵⁸

4. When and How Disclosure Should be Made, and by Whom?

A general principle that the presence and identity of funders should be disclosed raises separate questions about who bears the burden of such disclosure, to whom such disclosure should be made, and under what conditions. Because third-party funders are not, by definition, usually parties to the arbitration, they cannot be directly compelled by an arbitral tribunal or rules applicable within the arbitral proceedings to disclose their participation. Instead, disclosure is ordinarily effectuated through the parties, either on their own initiative or based on a request by individual arbitrators or on order by the tribunal.

This obligation is delineated in IBA General Standard 7(a), which requires parties to inform arbitrators, as follows:

“A party shall inform an arbitrator, the Arbitral Tribunal, the other parties and the arbitration institution or other appointing authority (if any) of any relationship, direct or indirect, between the arbitrator and the party (or another company of the same group of companies, or an individual having a controlling influence on the party in the arbitration), or between the arbitrator and any person or entity with a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration.”

At the end of General Standard 7(b), the provision states that “The party shall [make required disclosures] on its own initiative at the earliest opportunity.” In addition, General Standard 7(c) further states “In order to comply with General Standard 7(a), a party shall perform reasonable enquiries and provide any relevant information available to it.” As described below, there is room for different interpretations of General Standard 7’s obligations.

As noted above, there was less than complete unanimity among Task Force members about whether disclosure of funding should be made as a matter of course at

257. For example, it appears that Global Petroleum Group funded both Grenada and St Lucia in their efforts to defend against competing claims for access to oil reserves asserted by rival RSM. See HONLET, “Recent decisions on third-party funding in investment arbitration”, pp. 699-712, at fn. 30.

258. See e.g., E. DE BRABANDERE and J. LEPELTAK, “Third-Party Funding in International Investment Arbitration”, pp. 379-398.

the earliest possible opportunity (during the arbitrator selection process, in the filing of the request for arbitration, or at the initiation of funding if after constitution of the tribunal).²⁵⁹

Members of the Task Force disagreed about what relationships are required to be disclosed under General Standard 7, and how the reporting obligations in General Standard 7 relate to arbitrators' disclosure obligations under General Standard 6. Some members interpreted General Standard 7 as requiring only that parties disclose to arbitrators information that would constitute a disclosable "relationship" under General Standard 6 or the individual Guidelines in the Red and Orange lists.

Under this view, the presence and identity of a funder (or insurer) would only need to be disclosed in certain circumstances, namely if a funder might have a material relationship with an arbitrator that might give rise to a potential conflict of interest. A funder who had never had any contact or interaction with an arbitrator, or that has not funded numerous cases involving that arbitrator, would, according to this view, not need to have its presence and identity in the case disclosed.

The primary argument in favour of this view is that the party (and its funder) have the greatest interest in ensuring the enforceability of the award, and are therefore well-positioned to determine when disclosure is appropriate. In support of this view, it was pointed out that nothing precludes an arbitral tribunal from ordering disclosure.

Others on the Task Force disagreed both with this interpretation of the IBA Guidelines and expressed concern that this interpretation, as a practical matter, would effectively shift both the substance of the disclosure obligation and discretion in interpreting the IBA Guidelines (and other sources) not to parties, but effectively to funders, since not even the parties are in a position to evaluate potentially disclosable facts.

For example, parties know whether their current case is funded, but they do not and cannot know of every relevant contact or relationship that may exist as between a funder and an arbitrator. Unbeknownst to a party, its funder may have funded several cases in the past few years in which the same arbitrator was appointed, or may fund a portfolio of cases for a firm at which that arbitrator is a partner. In the absence of systematic disclosure, the arbitrator would likewise be unaware and unable to know of the repeated appointments or be able to check potential conflicts based on the firm's financing.

It is plausible that a party, as part of its duty under General Standard 7(c), could make reasonable enquiries to the funder about whether any such circumstances exist. However, not all of the IBA Guidelines are as straightforward as those that require the counting of cases and the counting of years, and in some instances, even those provisions involve nuanced assessments. If a party is only obliged to disclose the presence and identity of a funder when the funder has identified a relationship that is disclosable, then all the nuanced interpretation of what constitutes a disclosable

259. Similarly, the overwhelming majority of comments received agreed on the need for disclosure.

relationship or a potential conflict of interest rests with the funder. While sophisticated funders may be well-versed in the IBA Guidelines and related standards that govern arbitrators' conflicts of interest, as new funders constantly enter the market, such knowledge cannot be assumed.

The larger problem, for those Members who objected to the narrower reading of General Standard 7, is that arbitrators, not parties or funders, are obligated to determine and disclose particular facts that may give rise to a conflict of interest. This obligation to assess potential conflicts of interest also implies under many sources an affirmative duty to investigate. This duty, in turn, obliges arbitrators to make reasonable inquiries. Those on the Task Force who supported systematic disclosure at the beginning of cases relied in large part on this duty to investigate: arbitrators' duty to make reasonable inquiries presumably obliges them to request disclosure of the existence of funding and the identity of the funder in every case because, absent such disclosure, they may have conflicts that are not known.

Moreover, the duty to investigate is most appropriately exercised during the appointment process. A tribunal can only order disclosure after it is constituted, which as a practical matter occurs long after arbitrators should have fulfilled the obligation to disclose potential conflicts. For this reason, guidelines and rules that simply affirm tribunal powers to order disclosure miss the mark. Despite some dissenting views, the Principles in this Chapter do recommend disclosure as a matter of course as early as possible.

5. Unknown Conflicts of Interest

One argument considered but ultimately rejected by the Task Force is that relationships with funders need not be disclosed to arbitrators because unknown conflicts are not generally a basis for disqualifying arbitrators or successfully challenging an award. Unlike parties and law firms, third-party funders are not readily identifiable from the pleadings. In the absence of disclosure, this argument goes, the participation of a funder would remain unknown and unknowable and an arbitrator cannot be biased by unknown information.

This view was ultimately rejected by the Task Force, and by the standards for disclosure identified above. It is also inconsistent with basic premises that underpin conflicts of interest in other areas. Study of a particular example is helpful to illustrate the point.

Third-party funders can raise potentially serious conflicts that are distinct from those that arise with either law firms or parties. For example, a party may receive funding for a case in which *X* is the presiding arbitrator in one arbitral dispute (*A1*), but *X*'s partner also serves as counsel to a claimant in another unrelated second arbitration (*A2*), and the claim is funded by the same funder. The fact that the fees of *X*'s partner in *A2* are paid by *F* and that *X*'s partner is likely to have significant contacts with *F* on the basis of the funding agreement raises concerns beyond simple repeat appointments. The financial arrangement and ongoing contacts arguably raise questions about *X*'s

impartiality and independence with respect to the claimant in *AI* that would make it inappropriate for *X* to sit as an arbitrator in *AI*.²⁶⁰

The resolution to the problem illustrated in this example is self-evident, and generally should preclude the funder from taking on the case.²⁶¹ If a funder were somehow to undertake such funding, *X* would not be aware of the conflict because *X* would not know of the existence of a funding agreement. Absent an obligation to disclose the presence and identity of a funder, the funder's participation in an international arbitration case is otherwise usually unknown or unknowable. The nature of funders' relationships with attorneys and funded parties is generally unknown.

Even if unknown at the initial stages, the existence of the funding agreement may be discovered later. A number of circumstances create the possibility of disclosure: if a dispute arises between the client or the law firm and the funder; if financing is suspended or funding caps are reached that require explanations from a party about their financial situation; or if the need arises to respond to a challenge by an opposing party that a claim of financial distress is unfounded because of a suspected funding arrangement.²⁶² Disclosure can also be accidental. For example, Jonas von Goeler reports, "[i]n the ICC case *X v. Y and Z*, for example, the claimant transferred a litigation funding agreement to the respondents without further explanation, leading counsel for the respondents to the assumption that '[t]his agreement was sent maybe by mistake'".²⁶³ Any of these scenarios can lead to disclosure about the presence of a funder.

In addition, as von Goeler summarizes, rules governing publicly traded companies may also oblige disclosures: "Importantly, the presence of a third-party funder may need to be disclosed for reasons *not linked to the arbitration proceedings*, namely to comply with public disclosure requirements imposed upon listed companies, and following disputes between the parties to the funding agreement ending up in state courts."²⁶⁴

Later discovery of a third-party funder whose links with an arbitrator should have been disclosed may require that the arbitrator step down or risk rendering an award that

260. This hypothetical and analysis was developed by Maxi Scherer in M. SCHERER, "Out in the open? Third-party funding in arbitration", CDR News (26 July 2012) available at <<http://www.cdr-news.com/categories/expert-views/out-in-the-open-third-party-funding-in-arbitration>> (last accessed 3 August 2017).

261. Calunius Capital, "IBA Guidelines on Conflicts of Interest – how should we interpret the Third Party Funding disclosure principles?" (March 2015) available at <<http://www.calunius.com/media/10902/iba%20guidelines%20on%20conflicts%20of%20interest.pdf>> (last accessed 10 August 2017).

262. GOLDSTEIN, "Should the Real Parties in Interest Have to Stand Up?", p. 7.

263. *X v. Y and Z* (ICC Case), Procedural Order (3 August 2012), published in P. PINSOLLE, "Third Party Funding and Security for Costs", Cahiers de l'arbitrage/Paris J. Int'l Arb. (2013, No. 2) pp. 399-416; J. VON GOELER, *Third-Party Funding in International Arbitration and Its Impact on Procedure* (Kluwer 2016) p. 127.

264. VON GOELER, *ibid.*, p. 128 (italics in originally).

may be set aside or refused recognition and enforcement as a result of the conflict. Even if discovered after the close of proceedings, a conflict that should have been disclosed can still be a potential ground for attacking an award, even if the arbitrator was ostensibly unaware of the funding arrangement.²⁶⁵

Eventually, it might not be proven that the arbitrator knew about the participation of the funder, and the conflict would be treated therefore as an “unknown conflict”. An absence of specific knowledge about a particular conflict is not, however, universally recognized as negating allegations of bias. It is a question of proof during challenge to an arbitral award. Moreover, particularly when circumstances create inappropriate financial relationships from which an arbitrator benefitted, challenges to an award may be effective, even if the alleged financial relationship was unknown.

Another, final reason for rejecting arguments based on unknown conflicts is that arbitrators are generally understood as having a “duty to investigate” or to take reasonable steps to inform themselves of potential conflicts of interest. For example, in General Standard 7(d), the IBA Guidelines provide (d): “An arbitrator is under a duty to make reasonable enquiries to identify any conflict of interest, as well as any facts or circumstances that may reasonably give rise to doubts as to his or her impartiality or

265. There is some disagreement among arbitrators and courts about the effect of an arbitrator’s lack of knowledge of a conflict. Under U.S. law, the Restatement explains:

“There is some disagreement among courts about whether an arbitrator’s lack of knowledge of a conflict precludes a finding of evident partiality. Some courts have taken the view that an absence of knowledge about a conflict per se precludes a finding of evident partiality. See *Gianelli Money Purchase Plan & Trust v. ADM Inv. Servs., Inc.*, 146 F.3d 1309, 1313 (11th Cir. 1998); see also Revised Uniform Arbitration Act, § 12(e), 7 U.L.A. 43 (2005) (‘An arbitrator appointed as a neutral arbitrator who does not disclose a known, direct, and material interest in the outcome of the arbitration proceeding or a known, existing, and substantial relationship with a party is presumed to act with evident partiality under Section 23(a)(2).’). This approach – categorically excluding from consideration all conflicts regarding which an arbitrator has no actual knowledge – arguably discourages arbitrators from fulfilling their duty to investigate. It also imposes on the aggrieved party the unreasonable burden of having to prove actual knowledge about a conflict on the part of an arbitrator. The better view, and the one represented in the final factor of the test stated in the section, is that absence of knowledge is relevant to a court’s analysis of the facts of a case, particularly as relates to the investigation undertaken by the arbitrator. See *New Regency Prods., Inc. v. Nippon Herald Films, Inc.*, 501 F.3d 1101, 1107–8 (9th Cir. 2007). If the arbitrator has taken reasonable measures to investigate potential conflicts, a lack of knowledge about a particular conflict will generally weigh significantly against a finding of evident partiality.”

Restatement of the U.S. Law of International Commercial Arbitration, Section 4-13, Reporters’ Note *f* (2013).

independence. Failure to disclose a conflict is not excused by lack of knowledge, if the arbitrator does not perform such reasonable enquiries.”²⁶⁶

Some on the Task Force view an inquiry by an arbitrator about the existence and identity of funding as part of an arbitrator’s fulfilment of this duty. Indeed, it would be difficult to argue that asking parties about whether they are funded does not fall within the duty to “make reasonable enquiries”. Under the IBA Guidelines, a failure to make a reasonable enquiry would mean that a failure to disclose is not “excused”. Under other authorities, an arbitrator’s failure to investigate a potential conflict may also be a factor to be considered in assessing the consequences of an undisclosed, unknown conflict of interest.²⁶⁷

As a practical matter, in an effort to protect their reputations and ensure effective handling of the dispute, most arbitrators do undertake to investigate unknown potential conflicts of interest. A request that parties disclose the existence and identify of a funder would normally be a part of that effort.

III. Conclusion

Although several efforts have been made to facilitate disclosure for the purpose of assessing potential conflicts, there remain several important differences among the various approaches. Some require systematic disclosure, while others simply affirm arbitrators’ power to order disclosure. The new Hong Kong and Singapore legislation reforms both require systematic disclosure, while Article 4 of CAM-CCBC Administrative Resolution 18/2016 “recommends” the parties to report the existence of third-party funding to CAM-CCBC at the earliest opportunity. The IBA Guidelines, under the interpretation endorsed by a majority of the Task Force, appear to contemplate systematic disclosure. Other sources, perhaps in an effort to start with small steps, either affirm the authority of arbitrators to order disclosure (the SIAC Investment Arbitration Rules) or simply suggest that arbitrators consider making inquiries about potential funders. It is hoped that this Chapter’s recommendations, and more importantly its analysis of the relevant issues, will be a useful resource as other future reforms are implemented.

266. See IBA Guidelines on Conflicts of Interest in International Arbitration, General Guideline 7(d).

267. IBA, “Code of Ethics” (1988) available at <https://www.trans-lex.org/701100/_iba-rules-of-ethics-for-international-arbitrators-1987/> (last accessed 15 August 2017).

Chapter 5[†]

Privilege and Professional Secrecy

PRINCIPLES

- B.1. The existence of funding and the identity of a third-party funder is not subject to any legal privilege.
- B.2. The specific provisions of a funding agreement may be subject to confidentiality obligations as between the parties, and may include information that is subject to a legal privilege; as a consequence, production of such provisions should only be ordered in exceptional circumstances.
- B.3. For information that is determined to be privileged under applicable laws or rules, tribunals should not treat that privilege as waived solely because it was provided by parties or their counsel to a third-party funder for the purpose of obtaining funding or supporting the funding relationship.
- B.4. If the funding agreement or information provided to a third-party funder is deemed to be disclosable, the tribunal should permit appropriate redaction, or take other appropriate measures, and limit the purposes for which such information may be used.

I. Introduction

Obtaining third-party funding and the maintenance of a funding relationship generally requires disclosure of information that would otherwise be privileged, either because it involves communications between a client and its counsel, or analysis by a client's counsel in preparation for legal proceedings. However, when confidential or privileged information is shared with a third party, confidentiality and privilege are generally deemed waived.²⁶⁸ In the context of third-party funding, the tension between these two premises raises questions about whether otherwise privileged information disclosed to funders may result in a waiver of privilege. If so, that information could be susceptible to disclosure requests in the arbitration proceedings or related national court proceedings.

Related to this issue, some have noted that a third-party funder, once in possession of a client's confidential information, is not bound by the same obligations as attorneys

[†] Primary contributors to this Chapter included: Ania Farren, Nikolaus Pitkowitz and Catherine Rogers, with significant assistance from Sarah Breckenridge.

268. This Chapter focuses on primarily on legal privileges, and related professional duties of confidentiality and professional secrecy. Separate from evidentiary privileges and professional duties, third-party funding agreements often include contractual obligations of confidentiality. These contractual confidentiality obligations are not directly addressed in this Chapter, but instead are primarily addressed as best practices in Chapter 7.

with respect to confidentiality/professional secrecy or conflicts of interest. The concern is that third-party funders are not prohibited from using such information in another funded matter for a different client, even if that matter may raise a potential conflict with the interests of the original client. Funders, in their capacity as funders, are not generally regarded as bound by professional ethical rules regarding treatment of confidential information and conflicts of interest rules in the same way lawyers are.²⁶⁹

Despite the importance of these issues, international Conventions, and most national arbitration law and arbitral rules are silent about issues of privilege (and related questions of conflicts of interest).²⁷⁰ The rise of third-party funding has added new complexities to existing ambiguities about privilege in international arbitration.

An important starting point is that most national arbitration law, arbitral rules and the 2010 IBA Rules on the Taking of Evidence in International Arbitration (the IBA Rules on the Taking of Evidence) largely leave such issues to arbitrator discretion.²⁷¹ Arbitrators enjoy broad discretion to control the proceedings before them, which includes determining when to order document production, whether any privileges apply to requested documents, and whether such privileges may have been waived.

The Principles in this Chapter are predicated on arbitrators' broad authority over procedural issues, and the need to exercise that authority in light of conflicting national standards regarding privilege, and a general absence of clear standards that apply when otherwise privileged information is shared with third-party funders. This Chapter begins by outlining the scope of privileges [A], analysing the treatment of privilege and waiver in international arbitration [B], and summarizes the results of an international survey on privilege conducted by the Task Force [C]. It then examines the laws that might apply to determine privilege [D], and existing national heads of privilege and the rules that affect their applicability to funded parties [E].

A. Scope of Privilege Issues

There are three categories of information that are implicated in discussions of privilege and third-party funding.

The first category involves privileged information that may be provided to a third-party funder in the following situations:

- (1) during the initial due diligence phase (where funding is first requested and the third-party funder requires information in order to decide whether or not to provide financing); and

269. In fact, many funding agreements expressly state that the funder is not providing legal services and that the agreement does not create an attorney-client relationship.

270. See G. BORN, *International Commercial Arbitration*, 2nd edn. (2014) p. 2376.

271. VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure* (Kluwer Law International 2016) p. 166.

- (2) once the third-party funder has already committed to funding a party's participation in a pending dispute and the party and/or its counsel is sharing information about developments as well as documents being submitted in those proceedings.

Second, there are questions about whether the funding agreement itself, or specific provisions in it, are privileged.

Finally, there is a separate category of documents produced and held by the funder such as (i) the funder's own evaluation of the case; (ii) documents relating to the negotiation of the funding agreement (the terms may give away thoughts on the strength of the case); and (iii) separate legal opinions from independent counsel on the strength of the case.

The first two categories of information (privileged documents shared with a party and the funding agreement itself) have been sought in international arbitrations. With respect to the third category (legal documents created internally by the funder), these documents are unlikely to be sought in the arbitration since the funder is not a party to the arbitration proceedings.

With regard to all three categories, however, there may be circumstances in which such information is sought in the context of arbitration-related litigation (parallel proceedings, or set aside or enforcement actions). In the United States, such documents could be sought in an action to obtain document production under 28 U.S.C. § 1782. When production of this information is sought, important questions arise regarding whether production can be opposed based on an assertion of privilege.

B. Privilege in International Arbitration

According to leading international arbitration commentators, there has been "limited authority concerning the appropriate treatment of privileges",²⁷² in international arbitration, and international sources generally provide little guidance.²⁷³ As a result, considerable disagreement exists regarding both the sources and application of legal privilege in international arbitration.²⁷⁴

272. BORN, *International Commercial Arbitration*, p. 2375.

273. V. SCHLABRENDORFF and A. SHEPPARD, "Conflict of Legal Privileges in International Arbitration: An Attempt to Find a Holistic Solution", in G. AKSEN ET AL., eds., *Global Reflection in International Law, Commerce and Dispute Resolution: Liber Amicorum in Honour of Robert Briner* (2005) pp. 743, 763.

274. D. KUITKOWSKI, "The Law Applicable to Privilege Claims in International Arbitration", 32 J. Int'l Arb. (2015) p. 65 at pp. 65-66 (noting that "legal issues regarding privilege determinations in international arbitration are diverse, complex and often disputed due to several factors"); O. MEYER, "Time to Take a Closer Look: Privilege in International Arbitration", 24 J. Int'l Arb. (2007) p. 365 at pp. 365-366 (emphasizing inconsistency and lack of predictability).

In the absence of prevailing international rules or standards, arbitrators often look to national sources to determine the existence of a privilege, either as a category or as applied to particular documents. Most commentators are of the view that the weight of authority and the better view is that domestic privileges should apply, rather than international standards.²⁷⁵ The justification for this approach is that national law provides the basis for privileges in the first instance. Under this approach, the applicable national rule is determined through conflict of laws analysis.

Arbitrators have considerable discretion in undertaking a conflict-of-laws analysis to determine applicable privileges. Some commentators have suggested that consensus exists regarding the factors to take account of in determining applicable national law that relies considerably on national law and conflict of laws analysis to select as between potentially applicable national laws.²⁷⁶ Other scholars have instead identified an emerging trend toward the internationalization of privilege rules.²⁷⁷ In addition to traditional conflict of laws factors, it is generally understood that “arbitral tribunals should do justice to the legitimate expectations of the parties”.²⁷⁸

These basic premises are reflected in in the IBA Rules on the Taking of Evidence. Article 9(2) authorizes arbitrators to “exclude from the evidence or production any

275. BORN, *International Commercial Arbitration*, pp. 2383-2384.

276. K. P. BERGER, “Evidentiary Privileges: Best Practice Standards Versus/and Arbitral Discretion”, 22 *Arb. Int’l* (2006), p. 501 at pp. 514-515:

“This pragmatic consensus is based on four key observations: (1) Privilege issues must be qualified as substantive law issues. (2) The parties’ standard choice of law clause in the contract usually does not extend to the issue of evidentiary privileges. (3) In determining the law applicable to a certain privilege issue, the tribunal shall apply the law of the jurisdiction with which the relevant communication is most closely connected, i.e., the law where the party has its place of business. (4) The tribunal may exclude evidence from both sides which is privileged under the law of one party but not under the law of the other based on compelling considerations of fairness or equality.”

Notably, however, the first factor (qualification of privilege as a substantive law issue) is not universally recognized, as research by the Task Force has demonstrated. See the online Annex (Annex A) at p. 50 (Hong Kong); see also fn. 284, below.

277. In a forthcoming article, Susan Franck tracks development of international standards and argues that current practice is not based on an analysis of applicable national laws/conflict of laws. See “Attorney Client Privilege and International Arbitration – Considering the Value of a Conflicts of Law Approach” (on file with Task Force).

278. P. SHAUGHNESSY, *Dealing with Privileges in International Commercial Arbitration*, 792 *PLI/LIT* 257, 257 (2009) (in ruling on issues of privilege, arbitrators “frequently have to balance the demand for promoting efficiency and controlling obstruction with the requirement of providing the right to be heard and equal treatment”); K. P. BERGER, “Evidentiary Privileges: Best Practice Standards vs./and Arbitral Discretion”, in: M WIRTH, ed., *Best Practices in International Arbitration*, ASA Swiss Arbitration Association Special Series No. 26 (July 2006), para. 502.

document because of legal impediment or privilege under legal or ethical rules determined by the tribunal to be applicable”.²⁷⁹ Under this provision, a tribunal would first determine what law applies to the issue of legal privilege, and then apply that law to determine whether the relevant information is subject to a privilege.

As examined in greater detail below and in the online Annex, national laws differ significantly with respect to the “heads of privilege” they create, and the scope of such privileges. Most national laws do not clearly or specifically address, however, whether provision of privileged documents to a third-party funder would constitute a waiver. Different national treatment of privileges is not, however, unique to third-party funding.

In recognition that the identification of a national privilege, or a determination that no national privilege exists, may not always produce a fair or reasonable outcome as between the parties, Article 9(3) provides a list of factors that a tribunal can take into account as it evaluates the existence of legal impediment or privilege under Article 9.2(3), and can apply the factors only “insofar as permitted by any mandatory legal or ethical rules that are determined by it to be applicable”.

Several of the factors in Article 9(3) support the notion that information shared with a funder should generally not be ordered to be disclosed. Under Article 9(3)(a), a tribunal may take into account the need to protect the confidentiality of communications made in connection with and for the purpose of producing or obtaining legal advice. Article 9(3)(b) refers to similar protections for communications made in connection with settlement negotiations. Under Article 9(3)(c), arbitral tribunals are advised to consider the parties’ expectations at the time privilege is said to have arisen, and thus presumably most often apply the approach to privilege in the parties’ home jurisdictions.

In undertaking this analysis, another provision in the IBA Rules on the Taking of Evidence is helpful. Apart from privileges established by national law, arbitral tribunals are separately authorized under Article 9(2)(e) to decline to order production on “grounds of commercial or technical confidentiality that the Arbitral Tribunal determines to be compelling.” Documents provided subject to the types of non-disclosure agreements typically entered into between funders and parties would seem to establish commercial confidentiality. Protection against disclosure would seem to be particularly compelling when disclosure would involve otherwise privileged documents.

Other provisions in Article 9 also instruct tribunals to consider more fairness-related issues. Under Article 9(3)(e), the arbitral tribunal is urged to maintain fairness and equality between the parties, particularly relevant where different rules of privilege apply to each party so that one party appears able to shield documents from disclosure while the other does not. The considerations emphasized in Article 9(3) may counsel in favour of applying the broadest standard of protection available to all parties to the arbitration.

279. *Ibid.* at Art. 9.2(b).

While the IBA Rules on the Taking of Evidence are not binding on arbitral tribunals, they are frequently a point of reference. To the extent they support the notion that the provision of privileged documents to a third party does not necessarily constitute waiver of privilege, the Task Force concluded they provide a firm basis for informing Principle B.3 in this Chapter.

Institutional rules are generally less specific than the IBA Rules. The various institutional rules generally do not specify the criteria a tribunal may wish to consider when determining issues of privilege and confidentiality.²⁸⁰ Many of the main arbitral institutions simply state in their rules that the tribunal has the final say as to the admissibility of any evidence, including whether or not to apply strict rules of evidence (which will include legal privilege). For example:

(i) The UNCITRAL Model Law (2006):

“Article 19. Determination of rules of procedure

(1) Subject to the provisions of this Law, the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings.

(2) Failing such agreement, the arbitral tribunal may, subject to the provisions of this Law, conduct the arbitration in such manner as it considers appropriate. The power conferred upon the arbitral tribunal includes the power to determine the admissibility, relevance, materiality and weight of any evidence.”

(ii) The UNCITRAL Rules (2010):

“Article 27. Evidence

...

3. At any time during the arbitral proceedings the arbitral tribunal may require the parties to produce documents, exhibits or other evidence within such a period of time as the arbitral tribunal shall determine.

4. The arbitral tribunal shall determine the admissibility, relevance, materiality and weight of the evidence offered.”

(iii) The ICC Arbitration Rules (2017):

“Article 22: Conduct of the Arbitration

2) In order to ensure effective case management, the arbitral tribunal, after consulting the parties, may adopt such procedural measures as it considers appropriate, provided that they are not contrary to any agreement of the parties.

280. See C. TEVENDALE and U. CARTWRIGHT-FINCH, “Privilege in International Arbitration: Is it Time to Recognize the Consensus?”, 26 *Journal of International Arbitration* (2009, Issue 6) pp. 825-826.

3) Upon the request of any party, the arbitral tribunal may make orders concerning the confidentiality of the arbitration proceedings or of any other matters in connection with the arbitration and may take measures for protecting trade secrets and confidential information.”

(iv) LCIA Rules (2014):

“Article 22 Additional Powers

22.1 The Arbitral Tribunal shall have the power ...

(vi) to decide whether or not to apply any strict rules of evidence (or any other rules) as to the admissibility, relevance or weight of any material tendered by a party on any issue of fact or expert opinion; and to decide the time, manner and form in which such material should be exchanged between the parties and presented to the Arbitral Tribunal...”

Accordingly, arbitral rules generally affirm that arbitrators are afforded considerable discretion in shaping and applying rules of privilege. In this respect, they provide additional support for the power of international arbitrators to follow the relevant Articles of the IBA Rules on the Taking of Evidence and Principle B.3, above, to conclude that sharing documents with third-party funders does not constitute waiver.

C. Task Force Survey on National Practices

To assess existing practices and governing law in various jurisdictions, the Task Force collected reports on privilege from over twenty jurisdictions.²⁸¹

Each report considers the following four questions:

- (i) Please describe, with brief reference to case law, legislation or legal writings, the privileges or other rules (e.g., professional secrecy) on which a party or its counsel may rely in order to resist disclosure in national court proceedings of communications between the lawyer and the client (or between lawyers) that would otherwise have to be disclosed. In each case, please identify who may claim the benefit of the privilege or other rule (e.g., the client, the lawyer).
- (ii) Please describe, with brief reference to case law, legislation or legal writings, the privileges or other rules (e.g., professional secret) on which a party or its counsel may rely in order to resist disclosure in arbitral proceedings (with their seat in your jurisdiction) of communications between the lawyer and the client

281. Jurisdictions covered are: Australia, Brazil, China, England and Wales, Germany, Hong Kong, India, Japan, Netherlands, Portugal, Russia, Scotland, Singapore, South Korea, Spain, Sweden, Switzerland, Turkey, United States (California), Ukraine, United Arab Emirates. These reports will be made available at <http://www.arbitration-icca.org/projects/Third_Party_Funding.html>.

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(or between lawyers) that would otherwise have to be disclosed. In each case, please identify who may claim the benefit of the privilege or other rule (e.g., the client, the lawyer).

- (iii) Please describe the circumstances in which the benefit of the privilege or other rule may be lost in national court proceedings or arbitration. In particular, please describe the possible effect of disclosure to a third party of a communication that would ordinarily have been protected from disclosure to a court or arbitral tribunal by reason of the privileges or similar rules described in questions 1 and 2.
- (iv) Please identify the circumstances in which disclosure of an otherwise-protected communication to a third-party funder will result in loss of the benefit of the privilege or other rule, in national court proceedings or arbitration. Please identify any circumstances where the benefit of the privilege or other rule will continue to attach to the communication, notwithstanding the disclosure. Please make brief reference to case law, legislation or legal writings relevant to this question, if such exist. Where there is little or no authority on privilege and how it applies to third-party funders, please look instead at situations analogous to the third-party funder relationship e.g., with insurers.

The following additional questions were posed to reporters for consideration:

- (i) What law applies to privilege in litigation in your jurisdiction/in arbitration with its seat in your jurisdiction?
- (ii) Are documents held by the funder protected, i.e., the funder's own evaluation of the case; separate legal opinions; negotiation of the funding agreement?
- (iii) In relation to documents transferred by the lawyer/party to the funder, does the use of a confidentiality/non-disclosure/common interest agreement work to protect privilege/secretcy in your jurisdiction?

Based on this research, the Task Force concluded that in most jurisdictions, there is no clear answer as to whether documents and information provided to a funder will be definitively protected – in a nascent industry, lawyers may be able to advise by analogy but in many (indeed most) jurisdictions, there are no well-established precedents or rules (only limited and under-developed sources) dealing with the point.

The responses from the national lawyers who responded to the Task Force's questionnaire demonstrate the need to take local advice on a case by case basis as treatment of "privileged" documents varies from jurisdiction to jurisdiction.

The main distinction in the treatment of information shared with funders appears between civil and common law systems, although many nuances exist even among jurisdictions on each side of this divide.

There can be some confidence that in common law jurisdictions where funding is allowed at all (notably it is prohibited in Ireland; recent reforms allow it for international arbitration and supporting litigation in Hong Kong and Singapore) an exchange of information with a funder will be protected, in particular where an

appropriate contract is in place to manage confidentiality, limit waiver of privilege, assert a common interest and/or assert the application of an appropriate form of privilege.

However, caution must be exercised and advice taken in each case.²⁸² There has been at least one case in the US where the discovery of documents provided to a funder has been ordered. We are also aware of two cases before the English courts in which the disclosure of funding documents was ordered.²⁸³

The approach of civil jurisdictions is based on the concept of “professional secrecy” according to which lawyers (but often not extending to in-house lawyers) are bound by professional duties and rights not to reveal confidential information, even if – for example- ordered by a court to testify. Whether those rights and duties could be extended to a funder with whom such information is shared depends on the rules in a particular jurisdiction. In certain jurisdictions there is no protection afforded to documents not in the lawyer’s possession or control. One can take some comfort, however, from the fact that a party is not generally required to “disclose” documents at the request of an opposing party in civil law systems, so there will be limited scenarios in which disclosure of otherwise confidential case documents becomes a real issue.

Parties and funders in practice (hope to) protect against problems by entering into appropriate confidentiality agreements before sharing information.

D. Applicable Laws and Rules That Determine Privilege

Privilege may be regarded as a matter of substance or procedure, but its status as either varies from jurisdiction to jurisdiction, and is often unclear.²⁸⁴ The existence and scope

282. See the discussion in M. N. ALRASHID, J. WESSEL and J. LAIRD “The Impact of Third Party Funding on Privilege in Litigation and International Arbitration”, 6 *Dispute Resolution International* (October 2012, No. 2), p. 109. *Bray & Gillespie Mgmt LLC v. Lexington Ins. Co.* 2008 2008 WL 5054695 M.D. Nov 17, 2008.

283. See e.g., *Leader Technologies, Inc. v. Facebook, Inc.*, 719 F.Supp.2d 373 (D.Del. 2010) (holding that common interest privilege did not exist between patentee and litigation financing companies and ordering disclosure of "limited technical documentation" that had been shared with litigation funder); *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711 (N.D. Ill. 2014) (upholding protection under the work product doctrine for documents disclosed to the funder due to a pre-existing confidentiality agreement between the client and the funder, but not upholding protection under the attorney-client privilege, because the court did not view the funder as falling within the “common interest” exception to waiver). In England, see *Excalibur Ventures LLC v. Texas Keystone Inc. and others* [2012] EWHC 2175; and *Re Edwardian Group* [2017] EWHC 2805.

284. In England and Wales, legal professional privilege is usually considered a substantive common law right. However there is still some ambiguity as to whether or not it is also a procedural right. In a landmark English case, Lord Scott held that “the debate [as to whether the right to legal advice privilege is a procedural right or a substantive right] is sterile. Legal advice privilege is both”. *Three Rivers District Council and others v.*

of privilege may be determined or affected by a range of sometimes overlapping domestic laws, professional ethics rules, and arbitral rules.

The various domestic laws that may be relevant include (i) the law of the jurisdiction where communications took place or the relevant document was created; (ii) the law of the jurisdiction where the document is physically located or held; (iii) the law of the jurisdiction where the counsel of each party is licensed and/or practises; (iv) the law of the jurisdiction where each party resides; (v) the law of the jurisdiction in which disclosure is sought; (vi) the law of the seat of the arbitration; (vii) the law governing the substance of the dispute or the law in relation to which the legal advice was provided; (viii) the law governing the arbitration agreement and/or (ix) the law of the country with the “closest connection” to the events.²⁸⁵

International arbitral tribunals may need to conduct a conflict-of-laws analysis to determine which applicable law governs the existence and scope of any claimed legal privilege. In practice, tribunals often apply a “closest connection” test to avoid this complex analysis.

In addition to the rules and laws that may be formally applicable, tribunals may also take into consideration more practical considerations, such as the materiality of the documents in question, or the equality between the parties, to ensure that the same protection is afforded to documents of both parties, or in other words that the broadest standard of protection is applied to all privileged documents concerned.²⁸⁶

The professional/ethical obligations of a lawyer are also relevant to determinations about how information or evidence may be protected within certain jurisdictions, particularly in civil law jurisdictions. Documents in civil law jurisdictions are not protected as a matter of “privilege”, as in common law jurisdictions. Rather, a lawyer in a civil law jurisdiction is bound by rules of “professional secrecy”, which will dictate the manner in which he or she must treat information given to him by the client.

Governor and Company of the Bank of England (No 4) [2004] UKHL 48, Lord Scott at 26. See also, for example, the Australia report for a discussion of the status of privilege as a part of substantive law rather than a procedural rule. This leads to tensions where a matter has international elements and so a tribunal may have to apply conflict of laws principles to decide which privilege laws apply. Contrast this with the position in civil law jurisdictions, such as The Netherlands, where the concepts of professional secrecy are derived from the Code on Civil Procedure and would appear to apply by virtue of the office of the professional instructed. Where a tribunal’s analysis of conflict of laws principles is at odds with the professional’s duties and rights with regards to secrecy this may lead to difficulty.

285. ALRASHID, WESSEL and LAIRD “The Impact of Third Party Funding on Privilege in Litigation and International Arbitration”, p. 126.

286. See sub-section B above.

While this distinction in the origins of protections often produces similar results, it can also result in some different treatments, particularly with respect to issues of waiver.²⁸⁷

E. National Privileges Applicable to Funded Parties

The protections afforded to information (confidential or otherwise) passing between a lawyer and his/her client vary substantially across jurisdictions. The clearest distinction to be made is whether or not the jurisdiction concerned applies or requires a process of documentary “discovery” or “disclosure” (the sharing between opposing parties of documentary evidence) as a stage in the conduct of a dispute.

Discovery or disclosure processes most usually occur in the progress of a dispute within common law jurisdictions – England and Wales, Hong Kong, Australia and the US for example. The inevitable result of the requirement that parties share information and documentation is that the rules or laws around legal privilege – in respect of information and documents which can legitimately be withheld from that sharing process – have developed extensively. Broadly the starting point is that all relevant information and communications must be shared with opponents save for any information which is legitimately protected because it is privileged.²⁸⁸

Many civil law jurisdictions have a very limited or no process of discovery/disclosure in the course of a dispute. Nevertheless, the concept of “professional secrecy” has developed in order to protect from subsequent use or exposure confidential information which passes to a lawyer when a client seeks advice or instructs a lawyer on a dispute. The starting point is the opposite from that in common law jurisdictions: no information and communications need be or can be shared with opponents or other parties unless the prohibition is lifted (by client, lawyer, or authority,²⁸⁹ depending on the circumstances and the rules of the jurisdiction concerned).

287. Compare and contrast for example the treatment of waiver or its equivalent in France (Annex A, p. 40), Germany (Annex A, p. 43), Japan (Annex A, p. 56), Netherlands (Annex A, p. 61).

288. See the national reports in the online Annex (Annex A) for Australia (p. 1); England and Wales (p. 30); Hong Kong (p. 48) and USA (p. 104) which show broadly common approach to disclosure/discovery – and withholding documents from disclosure/ discovery – in common law jurisdictions.

289. The annexed reports reveal that the nature of professional secrecy, and the manner in which secrecy might be waived or lifted, varies widely. For example, it may be that the client has the right to lift the veil on secrecy and ask his lawyer to communicate secret information (Japan, Ukraine); the lawyer may have rights to lift of his own volition, for example where his/her life or honour is at threat or where imminent commission of a crime is suspected (Brazil, Portugal, Spain, Sweden) and this may be an automatic right, or one where permission of the local bar council, the court or other authority is required (Spain, Portugal). In many jurisdictions, disclosure of otherwise secret information to a

Despite this fundamental difference in approach, the broad policy behind protecting lawyer and client information and communications is the same across jurisdictions. A client must be able to take advice and do business, having been candid about all of the applicable facts. Without the protection of law or legal doctrines like privilege and professional secrecy preventing the information from being released to the wider world, that process would not occur freely and openly.²⁹⁰

II. Common Law Heads of Privilege

Across the common law jurisdictions, litigation privilege and common interest are the “heads” which are most applicable to considerations of supplying information to funders, both during a funder’s due diligence to decide whether or not to invest, as well as in ongoing communications following an investment. Of course, the precise treatment and categorization of privilege across common law jurisdictions does vary.

Many common law jurisdictions divide the concept of legal privilege into legal advice privilege and litigation privilege. The US is an exception, with no concept of litigation privilege but instead a “work product doctrine” which covers lawyers’ work done in anticipation of litigation, or may be extended still further in some US states, such as California.²⁹¹ Broadly, documents passing between a client and his lawyer forming part of the chain of information in order to seek and receive advice are protected by advice privilege²⁹²; documents passing between client and lawyer or

third party will result in a loss of confidentiality and waiver of the right to secrecy unless attempts have been made through a confidentiality agreement to preserve secrecy.

290. Privilege “is a fundamental human right long established in the common law. It is a necessary corollary of the right of any person to obtain skilled advice about the law. Such advice cannot be effectively obtained unless the client is able to put all the facts before the adviser without fear that they may afterwards be disclosed and used to his prejudice.” *R (Morgan Grenfell & Co Ltd) v. Special Commissioner of Income Tax* [2002] UKHL 21, per Lord Hoffman at 7.

291. In California, work product doctrine applies to any document prepared by an attorney in connection with his or her work as an attorney; there is no requirement that litigation be in contemplation. Conversely, the concept of attorney-client privilege in California is derived from statute and thus the Californian courts cannot expand upon the protection provided.

292. Legal advice/ attorney-client privilege is not analysed in any more detail here as litigation privilege (or work-product privilege) is the more relevant head for communications with a funder. Indeed, whilst we understand that some US cases have held that there is no waiver of privilege when documents subject to advice privilege or attorney-client privilege are provided to a funder, this is still an area where funders themselves may exercise caution. See for example Burford Capital’s blog post, “Litigation Finance and attorney work product” of 18 September 2013, which states “we do not yet encourage disclosure to us of material that is not work product but is privileged; we’d rather be conservative in this

involving a third party, for the dominant purpose of proceedings (which may be litigation or arbitration) are covered by litigation privilege (and may, in the US context, count as “work product”).²⁹³

A. Litigation or Work Product Privilege

Litigation privilege protects communications with third parties, broadly where the dominant purpose of the communication is to further a litigation which is pending, reasonably contemplated or existing. Whilst largely untested in common law courts, it should be possible to argue that sharing privileged information with a potential funder in order for it to decide whether to invest in the dispute meets that dominant purpose test, if it is the case that without funding the matter may not be pursued, or would be approached differently.

In the United States, there is a growing body of federal and state case law which suggests that the court will uphold the confidentiality (and thus privilege) of information passed to a funder. Documents prepared “because of” the litigation should be protected by work product privilege, thus documents prepared for funders, may still be privileged – even though a “dominant purpose” test might not be met. This is particularly where there is a confidentiality agreement in place.²⁹⁴

In the United States, there have also been cases in which work product privilege was found to apply to documents created “with the intention of coordinating potential investors to aid in future possible litigation”.²⁹⁵ That would suggest that documents created for approaches to multiple funders, most of whom will not, as a matter of logic, ultimately invest in a case, could meet the appropriate test for work-product privilege/litigation privilege. However, one might argue that the privilege status of documents created solely for and provided to a funder who does not subsequently invest is more

area”. Clearly it is neither in the interest of the party, nor the proposed/ invested funder to risk loss of privilege and potential exposure of information to the party’s opponent.

293. A funder currently engaged in funding a case would fall within the US version of the work product doctrine under federal Rule of Civil Procedure 26(b)(3)(A) for documents or tangible things created by the funder in anticipation of litigation or for litigation purposes. Federal Rule of Civil Procedure 26(b)(3)(A) states that “Ordinarily, a party may not discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative (including the other party’s attorney, consultant, surety, indemnitor, insurer, or agent)” unless there is a substantial need or undue hardship in obtaining information within the scope of discovery. A funder most likely falls within one of the categories “consultant, surety, indemnitor, insurer, or agent.” Thus, the documents would be protected. If a funder declines to fund a case, however, then Rule 26 does not apply to the information that the funder had already obtained about the case, which means that this information remains unprotected in the US.

294. *Miller v. Caterpillar*, 10 C 3770, 6 January 2014, United States District Court, N.D. Ill.

295. *Mondis Technology Ltd v. LG Electronics Inc* No. 2: 07-CV-565-TJW-CE2011 WL1714304.

vulnerable to challenge;²⁹⁶ whereas once a funding relationship is in place and a claimant could not pursue the matter without the continued investment by that funder, arguments as to the dominant purpose or reason for creating further communications are considerably stronger.²⁹⁷

That is on the basis that a funder is unlikely to agree to continue funding proceedings without progress updates; indeed funding agreements may well include a right of termination if the funder is not kept updated in the manner and frequency agreed. Thus the continued provision of information to the funder is crucial as it allows the proceedings to continue. Nevertheless, the contrary is plainly arguable,²⁹⁸ so there must still remain a risk, particularly in jurisdictions deploying the dominant purpose test, that no privilege will apply.²⁹⁹

Based on research by the Task Force, it appears that the scope of litigation privilege has been tested in the English Courts twice by virtue of application by the defendants for funding-related documents (including those evidencing the funding terms), in the matter of *Excalibur Ventures LLC v. Texas Keystone & Ors* and, more recently, *Re*

296. We are unaware of common law decisions which make a clear distinction between the privilege status of communications with a funder who does invest, and one who does not. In *Bray & Gillespie Mgmt LLC v. Lexington Ins. Co.* 2008WL 5054695 M.D. Nov 17, 2008, arguments that a deponent could withhold answers to questions about discussions held with a funder (which did not subsequently invest) by arguing both attorney-client and work product privilege, failed. However, those claims failed because of procedural mistakes during the deposition so this would appear to be an area of risk where there is no clear position.

297. Federal Rule of Civil Procedure 26(b)(3)(A) explicitly protects work product once a funder is on board with funding the case.

298. For the position in England and Wales, see *Winterthur Swiss Insurance Company and other v. AG (Manchester) Limited and others* [2006] EWHC 839, in particular paragraphs 85 and 86 of the judgment. Counsel for the claimants argued that litigation privilege could not apply during the insurer's due diligence period when deciding to cover or not, as obtaining insurance was a condition precedent to litigating. Thus no litigation could be contemplated until insurance was effected. On the other hand, counsel for the defendants saw the due diligence process to obtain insurance as an "intrinsic" part of the unified purpose of working towards litigation, such that litigation privilege should apply.

299. The Task Force did not locate any case law in England and Wales that deals with the funder position, so again assumptions may only be drawn by examining analogous situations. In *Winterthur Swiss Insurance Company and other v. AG (Manchester) Limited and others* [2006] EWHC 839 the court considered whether litigation privilege applied to preliminary claim information prepared in order to decide whether or not an ATE insurer would cover a claim: "If the policy was not issued, then there would be no litigation." There was no conclusive result: it was found either that litigation privilege did not apply, or that if it did it was in the hands of the insurer. However, it was clear that documents prepared after the inception of the policy did have litigation privilege.

Edwardian Group.³⁰⁰ In an unreported judgment, Mr Justice Popplewell held that not all documents brought into existence for the purposes of actual or contemplated litigation will be protected by litigation privilege. The Judge refuted the wider formulation of litigation privilege advanced by Excalibur – that the funding documents were covered by litigation privilege because they were made for the dominant purpose of litigation – and said that if that were the case, “where a litigant buys a new suit in order to appear as a witness...all documents and information in relation to that purchase [would be] privileged because its dominant purpose was the conduct of the litigation”.

The judge agreed with previous authorities that it is the “use of the document or its contents in the conduct of the litigation which is what attracts the privilege” and endorsed the principle stated in *Dadourian Group*³⁰¹ that “Litigation privilege...can include a communication between a client and his lawyer or between one of them and a third party which comes into existence after litigation is commenced or contemplated for the dominant purpose of obtaining information or advice in connection with such litigation or of obtaining evidence (or information which might lead to evidence) for use in the conduct of such litigation.”

The defendants were granted copies of Excalibur’s funding agreements that were found not to be privileged, and also to be directly relevant to the claims and defences pleaded in that case. It may be that the reasoning was based on the specific facts that meant the funding arrangement was found to be directly relevant to the merits of the dispute. The Court was content, however, for certain terms (including the success fee, settlement and termination provisions) to be redacted in response to the Excalibur’s contention that knowledge of a party’s funding arrangements might provide a “tactical advantage in relation to various aspects of the conduct of the litigation.”³⁰²

Two other English high court cases (*Arroyo* and *RBS*) examine whether communications with ATE insurers, and the resultant policies, could be subject to legal

300. *Excalibur Ventures Llc v. Texas Keystone Inc & Ors* [2013] EWHC 2767 (Comm) (the application was heard in 2012). A full analysis of the *Excalibur* case is available in the England and Wales report. See Annex A, at p. 38.

301. *International Inc. & Ors v. Paul Simms & Ors* [2008] EWHC 1784 (Ch) (which cross referred to the House of Lords’ decision in *Waugh v. British Railways Board* [1980] AC 521) at para. 86.

302. *Excalibur Ventures Llc v. Texas Keystone Inc & Ors* [2013] EWHC 2767 (Comm). The more recent High Court judgment of *Re Edwardian Group* [2017] EWHC 2805 puts a gloss on the *Excalibur* decision. There is a clear distinction to be drawn between aspects of a funding agreement which are privileged (because they properly betray or evidence the substance of a privileged communication) and aspects which are merely “sensitive” in that they may give a tactical advantage if disclosed, but are not privileged. In the latter instance disclosure must be made unless the court orders otherwise.

advice or litigation privilege.³⁰³ As discussed elsewhere in this Report, under some definitions, ATE insurance may be considered a type of third-party funding, and in any event it is a close analogy.

Nevertheless, with respect to application of privilege to ATE insurance, as examined in the jurisdictional report for England and Wales, those judgments are conflicting, leaving the position under English law unclear. In *Arroyo*, the court found that an ATE policy is likely covered by litigation and legal advice privilege.³⁰⁴ By contrast, in *RBS*, the court found that only those parts of an ATE policy may be privileged that would allow one to work out what legal advice had been given.³⁰⁵ In fact, the *RBS* court stated clearly that “it is unlikely that privilege attaches to an ATE policy as such on either ground (litigation or advice), except to the extent... that parts of a policy (such as, possibly, the amount of premium...) may attract legal advice privilege, and require redaction on the basis that the relevant part might allow the reader to work out what legal advice has been given...”³⁰⁶

The *Arroyo* and *RBS* judgments demonstrate that English courts are aware of the potential tactical advantage to a party who successfully obtains disclosure of an ATE policy (or, by analogy, a third-party funding agreement). Based on this awareness, careful consideration is warranted before making any such order. Arbitral tribunals should be similarly mindful.

Despite the existence of clear and controlling precedents, there are persuasive arguments to be made by parties resisting disclosure both on the grounds that they are not relevant to the substantive case in issue, and that the contents of documents may betray legal advice, for example, the premium, termination provisions, and procedure for consideration of settlement offers. These privileged provisions should be redacted prior to disclosure as those discrete aspects are likely to attract legal advice privilege. It is for these reasons that the Task Force recommends that, if the terms of a third-party funding agreement are ever deemed relevant and disclosable, the tribunal should either order redaction, or take other appropriate measures to protect privileged information in the funding agreement. Such other measures may include restricting disclosure to specified individuals, such only to the arbitral tribunal, to parties’ counsel or to a neutral third party.

303. See *Arroyo v. RBSV. BP Exploration Co (Columbia) Ltd (unreported)* approved judgment of 6 May 2010, and *RBS Rights Issue Litigation* [2017] EWHC 463 (Ch). There is an examination of both judgments in the national report for England & Wales.

304. *Arroyo v. RBSV. BP Exploration Co (Columbia) Ltd (unreported)* approved judgment of 6 May 2010, para. 59.

305. *Arroyo v. RBSV. BP Exploration Co (Columbia) Ltd (unreported)* approved judgment of 6 May 2010.

306. *Arroyo v. RBSV. BP Exploration Co (Columbia) Ltd (unreported)* approved judgment of 6 May 2010, para.112.

B. Common Interest Privilege

Each of England and Wales, Australia, Hong Kong, Singapore and some – but not all – US states³⁰⁷ also recognize the concept of “common interest” as a species of privilege (or more specifically as an exception to the rule that to pass privileged material to a third-party constitutes a waiver of privilege).

Where privileged documents are disclosed to a third-party who has a common interest with the party entitled to the privilege, the document remains privileged. In England and Wales common interest privilege is not a freestanding form of privilege. It allows a party to share material that already has the protection of legal advice or litigation privilege with a third party who has a “common interest without waiving or losing that privilege.”

The common interest privilege is well established as between insureds and insurers.³⁰⁸ For example, in the English *Winterthur* case it was found that an insurer held a common interest in the policy holder’s litigation. Mr Justice Aikens explained that:

“where a communication is produced by or at the instance of one party for the purpose of obtaining legal advice or to assist in the conduct of litigation, then a second party that has a common interest in the subject matter of the communication or the litigation can assert a right of privilege over that communication as against a third party. The basis for the right to assert this ‘common interest privilege’ must be the common interest in the confidentiality of the communication.”³⁰⁹

Importantly, in the English *Winterthur* case, a distinction was made between documents created during the insurer’s due diligence (the “pre-ATE documents”) and

307. See also the decision of *Miller v. Caterpillar (ibid.)* which, in the context of sharing documents with a third party funder, decided that common interest did not apply, as the interest shared between the parties must be a legal interest rather than a commercial one. Funders may wish to ensure the manner in which a common interest is drafted is not solely a commercial one, but funders should be careful not to manufacture a substantive interest in the underlying subject matter of the dispute merely to obtain shelter under the common interest privilege. A court would likely see straight through such an attempt.

308. See *Winterthur Swiss Insurance Company & Anor v. AG (Manchester) Ltd & Ors* [2006] EWHC in which an insurer was able to assert a common interest with an insured claimant at least for the post-ATE period. The Australian courts have treated the insurer-insured relationship similarly. See Section 3 of the Australian jurisdictional report which refers to *Spotless Group Ltd v. Premier Building and Consulting Group Pty Ltd* [2006] VSCA 201 and *Asahi Holdings (Australia) Pty Ltd v. Pacific Equity Partners Pty Limited (No. 2)* [2014] FCA 481.

309. *Winterthur Swiss Insurance Company & Anor v. AG (Manchester) Ltd & Ors* [2006] EWHC 839 at para. 78.

those created after the inception of the policy (the “post-ATE documents”). The applicability of litigation privilege was unclear in respect of the pre-ATE documents but accepted for the post-ATE documents. Consequently, the finding of common interest between insured and insurer was confined to the post-ATE period.

If seeking to assert that the claimant-funder relationship is analogous, then the periods of time – pre- and post- investment – may be similarly categorized. A similar analysis appears to have applied in the Australian *Asahi* case in which common interest was found not to apply, as at the time a confidential report was provided to the insurer there was no basis to say the insurer would cover the claim.³¹⁰

By analogy, where a funder has invested in a case and is provided with privileged information in order to monitor that investment, it may well follow that a common interest with the party can be asserted. Commentators have opined that the third-party funder would share a common interest in the confidentiality of a communication provided to it by a party to a litigation “as it has the common interest of pursuing litigation or arbitration in much the same way an insurer does”.³¹¹ However, there is more doubt over whether a common interest can be applied during a pre-investment due diligence phase.

In addition to limitations on the common interest exception, there are also questions about whether the reasoning from the insurance context necessarily extends to the third-party funding context. The insurer’s rights of subrogation (and indeed express contractual rights) may contribute both to securing the insurer’s rights to otherwise privileged documents and to emphasizing a community of interest. For these reasons, it is not necessarily the case that jurisdictions that have adopted a common interest privilege for insurers would necessarily extend it by analogy to third-party funding. In fact, extension by analogy appears to be largely untested in the courts of many common law jurisdictions.

Some jurisdictions, however, have expressly considered the issue. In the United States, privilege is treated as a state law issue, and judicial decisions among the states is varied. For example, in Illinois under the *Miller v. Caterpillar* case,³¹² “common interest” applies to third-party funding relationships. On the other hand, in *Leader Technologies v. Facebook*, a Delaware court determined that a funder does not fall

310. See the Australian jurisdictional report, and reference therein to *Asahi Holdings (Australia) Pty Ltd v. Pacific Equity Partners Pty Limited (No2)* [2014] FCA 481.

311. ALRASHID, WESSEL and LAIRD, “The Impact of Third Party Funding on Privilege in Litigation and International Arbitration”, p. 108.

312. In *Miller v. Caterpillar* (17F. Supp. 3d 711 (N.D. Ill. 2014)) the United States District Court held that common interest does not apply and thus any attorney-client privilege protection which applied to documents was lost when those documents were passed to a third-party funder. This was on the basis that the interest between sender and recipient must be a legal as opposed to a purely commercial one. As treatment of privilege and indeed the doctrine of common interest varies by US state, specific local advice must be taken.

within the common interest exception.³¹³ The relevant distinction appears to lie on whether the interest between party and funder is determined to be only commercial, in which case a communication will not be protected. The parties must be able to demonstrate a common interest in the legal aspects of the matter, and should consider potentially applicable state law as it may vary.

C. Confidentiality Agreements/Limited waiver

Where a common interest is in doubt or does not apply, a limited waiver may be another basis for protecting information shared with a funder. To assert that any such waiver was limited, confidentiality agreements typically include wording as to intended limited waiver. Notably, however, if no common interest exists, only the party to whom a limited waiver of privilege is made can assert privilege. Contrast this with common interest where the privilege is one which both common parties are entitled to assert.³¹⁴

Under English law, a party is able to share privileged material with a limited number of third parties pursuant to an express agreement to keep that material confidential, and thus preserve its privileged status. Documents shared without a general intention to waive privilege as against the world at large, but instead subject to a limited waiver with respect to an identified third party, are described as subject to a “limited waiver”. Whether a waiver is limited is a matter of fact and degree, so caution must be taken in terms of parties (and their number) to whom a waiver is intended.³¹⁵

Parties intending to make a limited waiver should expressly state the basis on which a disclosure is being made in order to minimize the risk of a wider (unintended) loss of privilege. Nevertheless, even without clear wording, the courts of England and Wales have been prepared to impose limits and rescue a waiver after the event.³¹⁶

Similarly, in the United States, in those jurisdictions in which third-party funding is permissible, courts have protected as privileged documents where: (i) appropriate confidentiality agreements are in place; (ii) there is an underlying privilege in the documents; and (iii) the sharing is “reasonably necessary” to advance the purpose for which the lawyer was consulted. This should be the case even where a common interest cannot be found to apply. Clients must provide privileged information under a limited

313. *Leader Technologies v. Facebook*, 719 F. Supp. 2d 373 (D. Del. 2010).

314. See C. PASSMORE, *Privilege*, 3rd edn. (Sweet and Maxwell 2013) para. 7-038 and its footnote 76.

315. *Ibid.*, para. 7-043 which discusses the issue of the point at which an intended limited waiver becomes too wide to preserve confidentiality and thus privilege as against the rest of the world.

316. *Ibid.*, para. 7-038.

waiver which is clearly worded, and in circumstances which protect the confidentiality of the information.³¹⁷

Whilst privilege is waived as against the funder, it remains enforceable against the rest of the world. Nevertheless, clients and funders should be forewarned that the law in this respect varies from state to state, and most states do not explicitly protect information shared with funders. There are three states, however, that explicitly protect information shared with funders via statute – Indiana, Nebraska, and Vermont – although those statutes were enacted in the context of consumer litigation funding rather than commercial funding or international arbitration.³¹⁸

III. Civil Jurisdictions – Heads of “Privilege”

“Privilege” is not a concept commonly adopted in civil jurisdictions. Instead the relationship between lawyer and client is seen as one of confidence and information passing between them is protected by a “professional secrecy” doctrine that applies with respect to both contentious and non-contentious work (and in some jurisdictions even includes pre-existing information or documents given to a lawyer in order for him to advise).

The secrecy concept, set out in professional rules, statutes, and civil procedure rules or otherwise, means that information relayed between lawyer and client cannot be revealed to the court, authorities or the wider world. In some civil law jurisdictions, such as South Korea, Turkey and the Netherlands, this doctrine forms part of counsel’s ethical obligations and in general cannot be waived by the client. In other jurisdictions, client consent or permission from a regulator/bar association may allow the lawyer to reveal information, for example in order to defend himself or herself, or to make disclosures to a regulator or authority. In other jurisdictions (such as Russia, Ukraine and Brazil), a client may expressly or impliedly consent to his or her lawyer passing

317. For a discussion of standards for waiver, see J. M. GLOVER, “Alternative Litigation Finance and the Limits of the Work-Product Doctrine”, 12 N.Y.U. J. L. Bus (2016), p. 911; M. DESTEFANO, “Claim Funders and Commercial Claim Holders: A Common Interest or a Common Problem?”, 63 DePaul L. Rev. (2014) p. 305.

318. See 2016 Ind. Acts 1557 (providing an exception to waiver of the attorney-client privilege and work product doctrine for communications between parties and funders in Indiana); VT. STAT. ANN. tit. 8, § 2255 (2016) (providing that “communication between a consumer’s attorney and the [funding] company shall not be discoverable” and providing an exception to waiver of the attorney-client privilege and work product doctrine for communications with funders in Vermont); NEB. REV. STAT. § 25-3306 (2010) (providing an exception to waiver of the attorney-client privilege and work product doctrine for communications with funders in Nebraska).

information on to a third-party (an insurer or funder for example) but otherwise the information retains its “secret” status.³¹⁹

The release, with or without client consent, of information to funders may pose a risk to the inherent secrecy of the information, however. In some jurisdictions (such as Turkey, Portugal and Sweden) the information in the hands of a funder (as opposed to a lawyer) will not be subject to professional secrecy, so a funder may be obliged, for example by court order, to reveal that information. Alternatively, passing information to a funder will be seen as a waiver of the secrecy otherwise afforded to the information, and it may therefore be admissible as evidence or susceptible to disclosure to authorities on request. That risk may be alleviated by use of an appropriately worded confidentiality agreement.³²⁰

In advance of sharing information, then, funders and potential funded parties should take considered advice on whether and how some level of protection over the information may be maintained. As in common law jurisdictions, the role of the funder and the protections that may be afforded information passing to them is largely untested.

Likewise, some civil law jurisdictions are developing methods for extending privilege protections to third-party funders. Principally this includes the use of confidentiality agreements when releasing information to third-party funders in order to retain maximum control over the use of the information³²¹. Consideration may also be given to whether it is the lawyer or client who passes on the information and/or whether the funder is simply copied into communications between lawyer and client in

319. As noted above, in many civil jurisdictions a lawyer’s right and obligation to keep secret matters communicated by his client is derived from procedural rules but also professional obligations or the constitution of his/her jurisdiction, and is thus inviolable, save for limited policy exceptions and in some instances the ability of a client to lift such a restriction. Tribunals may need to allow for the assertion by a civil lawyer of his professional obligations with regards to secrecy of information, and ensure that decisions on the parameters of discovery do not violate that assertion. Moreover, civil lawyers must be careful to consider the mechanics of releasing secret information to a funder to ensure that the lawyer is not inadvertently breaching his obligations to keep client matters secret. See for example the reports in relation to The Netherlands, Germany, Turkey, Ukraine, Russia.

320. The effectiveness of a confidentiality agreement may vary across jurisdictions, and between litigation and arbitration. In Russia, for example, whilst a confidentiality agreement may protect secrecy from third parties, this may be irrelevant if a court makes an order that documents should be disclosed and used in evidence in court proceedings. Within arbitration, the sensible approach in order to ensure that secrecy remains intact is that the advocate retains custody over relevant documents; alternatively that the funder instructs its own advocate who holds the documents.

321. The use of confidentiality agreements appears to offer effective protection for secret information in the hands of the funder in jurisdictions such as the Netherlands, Russia, Germany and Japan.

order to preserve secrecy. In some jurisdictions whilst the lawyer's duty and right to assert professional secrecy may protect the communication with a third-party, the same will not apply to the client.³²²

It should nevertheless be noted that in certain civil jurisdictions information transferred by the lawyer to a third party will lose its confidential status regardless of the existence of a confidentiality agreement: once in the funder's hands, the secrecy in the information itself is considered waived.³²³ This outcome may depend, however, on whether or not the client has expressly waived the secrecy.

IV. To Whom Does Any Privilege Belong?

Issues of waiver often depend on related questions about whom the privilege belongs to in the first place.

A. Common Law Jurisdictions

In common law jurisdictions any privilege belongs to the client and is for the client alone to waive. No adverse inference can be drawn (for example by a court) from a client's refusal to waive his right to assert privilege. Even where it may be in professional interests of an adviser to be able to waive privilege, it is for the client alone to waive. For example if the adviser is facing criticism or legal action by a third-party and would wish to deploy the privileged information in order to defend himself/herself, without permission of the client (or former client, as the privilege is permanent even after a case or matter is closed) the lawyer may take no steps to deploy or disclose the privileged information. Where the client himself/herself brings a claim against his/her lawyer, then he/she is regarded as having waived the privilege and confidence to the extent required for the lawyer to defend himself/herself.

322. In Germany for example, whilst a communication (with a client's permission) between a lawyer and a funder would be protected as long as an appropriate confidentiality agreement was made, a direct communication from the client to the funder could not be protected in any way. Contrast with Japan, Sweden and Spain where it would appear that either a lawyer or client could communicate with a funder without risk of waiver or loss of the confidential status of information. Interestingly, in the Ukraine, a communication by lawyer to funder without express permission from a client would be inadmissible evidence and thus it is preferable for communications to come at all times from lawyers.

323. See for example the jurisdictional reports for Turkey and Portugal.

B. Civil Law Jurisdictions

The balance between the rights and duties of lawyers and their clients is different in civil jurisdictions from that in common law jurisdictions where the client is in complete control; in addition there are differences of approach according to jurisdiction.

Where professional secrecy applies, it may be regarded both as a duty of the lawyer to keep matters secret, but also a right to be exerted, for example in order to resist giving testimony on the matters which are subject to the secrecy for example. Generally, unless the secrecy is waived by the client, or there is permission from the lawyer's regulating body (such as a local bar council) the lawyer is able to resist all requests for disclosure.

C. Documents Held by the Funder

There are additional questions about whether documents created and/or held by the funder are protected. Again, the problem must be analysed both in the context of common law jurisdictions and civil law jurisdictions.

In common law jurisdictions, when a funder consults its own external lawyers in order to make a decision about whether to fund a particular case, it naturally follows that the flow of information seeking and obtaining that advice is covered by advice privilege or its equivalent across common law jurisdictions such as attorney-client privilege. The situation where a funder consults its own employees who are lawyers for that same advice requires additional consideration. If properly consulted in his or her capacity qua lawyer (rather than as a commercial adviser) then most common law jurisdictions would recognize that the resultant documentation was equally covered by advice privilege or its equivalent.³²⁴ This does highlight, however, the need for funders themselves to consider privilege issues carefully in the structure of their business and the way they deploy employees with a legal qualification.

Any other documents generated by a funder – but not by lawyers – would be unlikely to attract the protection of advice privilege, but would likely be covered by litigation privilege/work-product privilege³²⁵, if its production can be argued to meet the dominant purpose test (or the less onerous “because of” test for the US) discussed above.³²⁶ However, this may be susceptible to challenge, for example in situations

324. See the report on England and Wales in the online Annex at p. 35.

325. For example, in the US under Federal Rule of Civil Procedure 26(b)(3)(A).

326. See the analysis by G. M. GIESAL in “Alternative Litigation Finance and the Work-Product Doctrine”, 47 Wake Forest Law Review (2012) pp. 1083-1140, in particular at pp. 1124-1125 in which there is an examination of analogous cases of evaluation of ongoing litigation by an independent company auditor. Where those evaluations included and recorded the thoughts and impressions of lawyers advising the company, the court was prepared to find that work-product privilege applied. (*United States v. Deloitte LLP*, 610 F 3d 129 (D.C. Cir 2010)). The court in that case was able to apply the less stringent

where a funder does not ultimately make an investment in the proposed litigation or where it is asserted that the information was passing for a commercial rather than a legal purpose, as may well be the case with a funder.³²⁷

The situation is much less clear in civil jurisdictions as the precise structure of the professional secrecy rules vary across jurisdictions and depends on: the professional status of the person to whom information is given; the rights of the client to circulate information; and the ability of either professional or client to lift the secrecy obligation/right in certain circumstances. Many civil jurisdictions will not view a funder as belonging to a profession which of itself attracts the status which confers professional secrecy rights and obligations, so this may mean that the only chance of asserting secrecy is for the funder to appoint its own lawyers to consider the case and proposed investment and thus take advantage of the secrecy status of those lawyers.³²⁸ Other jurisdictions, for example Brazil, recognize certain financial institutions as structures which may attract professional secrecy, so it may be that a funder could incorporate itself as a particular type of financial entity in order to take advantage of the additional status this would confer on communications.

There is a further concern that the funder itself should keep the information confidential and does not share information it has obtained from one party/client with another party/client without consent. In England and Wales, where many of the major funders are self-regulated under the Association of Litigation Funders, comfort can be taken from Article 7 of the ALF Code of Conduct which provides that “A funder will observe the confidentiality of all information and documentation relating to the dispute to the extent the law permits, and subject to the terms of any confidentiality or non-disclosure agreement agreed between the funder and the funded party. For the avoidance of doubt, the funder is responsible for the purposes of this code for preserving confidentiality on behalf of any Funder’s Subsidiary or Associated Entity.”³²⁹ Equivalent provisions can be added to the confidentiality agreement entered into with the funder.

“because of” test and found that the documents recorded information “... prepared by the company and its lawyers because of the prospect of the litigation.” This may be seen as a judgment at the limits of the because of test, and such protection may not be forthcoming in other courts of common law jurisdictions, but nevertheless the case highlights the policy motivations of courts to protect the confidentiality of the adversarial litigation or arbitration process, even if that is to go as far as to protect documents created by a funder.

327. Professional ethics rules would usually currently prohibit a lawyer from using or revealing any information gleaned from a prospective client even if that lawyer does not take the client’s case. See, e.g., the American Bar Association’s Model Rules of Professional Conduct, Rule 1.18(b). A similar rule would be useful with respect to funders.

328. See for example the treatment in the Netherlands, described in the online Annex at p. 63.

329. Association of Litigation Funders Code of Conduct (November 2016), available at <<http://associationoflitigationfunders.com/wp-content/uploads/2014/02/Code-of-conduct-Nov2016-Final-PDF-1.pdf>> (last accessed 29 December 2017).

A related question is whether a funder can refer to otherwise confidential information in its possession to defend itself in a suit by the funded party. The answer is presumably yes in most circumstances.³³⁰ Again, English insurance cases can provide a helpful analogy.

In *Formica*³³¹ ECGD had guaranteed 90 per cent of the loss arising out of a contract between Formica and a Swedish company. The latter went into liquidation and Formica called on the guarantee. ECGD resisted on the basis that it was not kept apprised of the litigation developments which they had initiated overseas to try and recover some of the debt in breach of a condition of the guarantee. The court held that Formica could not claim legal professional privilege in relation to those documents in the litigation since ECGD was contractually entitled to see them at the time the guarantee was active.³³² Their contractual relationship meant that both parties had a common interest in recovering the outstanding debt from the Swedish company.³³³

330. But see, for example, the most recent Court of Appeal authority, *Berezovsky v. Hine & Ors* [2011] EWCA Civ 1089, the Court held that Mr Berezovsky could assert privilege in his draft witness statement in the context of later, separate proceedings despite having given it to the Defendant in earlier unrelated proceedings. Importantly, when the document was initially disclosed, there was no express restriction as to the purpose for which the privileged document could be used and the court inferred this restriction from the “*obvious intentions of the parties*”. The Court held that privilege could be retained by the claimant in respect of a different set of (unrelated) proceedings if: (i) the court is satisfied that the disclosure to the third party was limited to a particular purpose and that party is now seeking to use them for another purpose without the consent of the holder of privilege or (ii) where such use will damage the privilege holder or (iii) where it will involve the documents being disclosed to a third party.

331. *Formica Ltd v. Secretary of State* (acting by the Export Credits Guarantee Department) [1995] 1 Lloyd’s Rep. 692

332. *Ibid.* The court held that “where such documents never were transferred, but, if they had been, would have been transferred for such a joint interest purpose, the applicant for discovery can show that had he been supplied with the documents at the time, he would have held them subject to the mutual obligations of confidence attributable to legal professional advice. He is thus entitled to say that he would then have been within the ambit of confidentiality protected by the law and that therefore privilege does not attach to the documents which he now seeks on discovery.”

333. Similarly, in other insurance cases like *Commercial Union Assurance Co v. Mander and Winterthur*, [1996] 2 Lloyd’s Rep 640, the Courts have shown that the insured cannot use privilege to prevent his insurer from accessing privileged documents (given its contractual entitlement to them) and neither can an insurer withhold such documents from a reinsurer on the grounds of privilege. *Cia Barca de Panama SA v. George Wimpey & Co Ltd* [1980] 1 Lloyd’s Rep 598, 615, involved the scenario where privileged material existed in connection with a case in which A and B were both involved in at the same time. Lord Bridge said that if “A and B have a common interest in litigation against C and if at that point there is no dispute between A and B then if subsequently A and B fall out and litigate between themselves and the litigation against C is relevant to the disputes between

D. Documents Sought in Litigation Proceedings

Even when the parties have agreed to arbitrate their dispute, some aspects of their dispute may nevertheless still be subject to court proceedings. For example, the parties may seek to compel arbitration (or object to a dispute being subject to an arbitration agreement), seek interim relief in courts, or seek to set aside or recognize and enforce an arbitration award. In each of these contexts, factual questions may arise and, in some jurisdictions, document production may be sought in support of a party's position. Particularly in the United States, 28 U.S.C. § 1782(a) provides in relevant part:

“The district court of the district in which a person resides or is found may order him to give his testimony or statement or to produce a document or other thing for use in a proceeding or a foreign or international tribunal, including criminal investigations conducted before formal accusation. The order may be made pursuant to a letter rogatory issued, or request made, by a foreign or international tribunal or upon the application of any interested person and may direct that the testimony or statement be given, or the document or other thing be produced, before a person appointed by the court. . . . The order may prescribe the practice and procedure, which may be in whole or part the practice and procedure of the foreign country or the international tribunal, for taking testimony or statement or producing the document or other thing. To the extent that the order does not prescribe otherwise, the testimony or statement shall be taken, and the document or other thing produced, in accordance with the Federal Rules of Civil Procedure.”

There are divergent authorities among U.S. courts regarding whether this section can be used in support of international arbitration proceedings.³³⁴ Nevertheless, it has been successfully invoked in some international arbitrations and hence there is a risk that a party could use the statute to seek documents directly from a funder.

A and B then in litigation between A and B neither A nor B can claim legal professional privilege for documents which came into existence in relation to the earlier litigation against C.”

334. See the discussion by J. BLACKMAN and P. FOX in “Discovery in Aid of Arbitration under 28 USC 1782”, *Global Arbitration Review* (16 August 2016), in particular the discussion on the cases of *NBC v. Bear Stearns & Co* 165 F.3d 184, 191 (2nd Cir. 1999); *Republic of Kazakhstan v. Biedermann International* 168F 3d 880 (5th Cir 1999) against such use, and *Intel* 542 U.S. 198 (2004) in support. In the First, Third, Eighth and DC Circuits, district courts have held that at least some types of private arbitral tribunal are within the ambit of the statute, while their counterparts in the Fifth, Seventh, Ninth and Tenth Circuits have held that at least some types of private arbitral tribunal are not covered. In one instance, the same arbitration proceeding has produced conflicting decisions in different district courts.

THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION

In deciding whether to order production under § 1782, U.S. courts do not generally order production of privileged documents. In international cases, however, it may be uncertain what law applies to determine whether a privilege exists. It is beyond the scope of this Report to survey the approaches of U.S. courts in determining privilege in international cases. The potential for protecting documents against such disclosure, however, is presumably enhanced if the documents sought would be considered privileged in other jurisdictions, for example under a conflict of laws analysis, or under the standards determined to apply in the relevant arbitration proceeding. Under the latter of these bases, particularly in the absence of any express ruling from an arbitral tribunal on the issue, the Principles in this Chapter may be cited as a source that articulates party intent or international arbitration practice regarding disclosure of third-party funding.

Chapter 6[†]

Costs and Security for Costs

PRINCIPLES

Principles on Final Award (Allocation) of Costs:

- C.1. Generally, at the end of an arbitration, recovery of costs should not be denied on the basis that a party seeking costs is funded by a third-party funder.
- C.2. When recovery of costs is limited to costs which have been “incurred” or “directly incurred”, the obligation of a party to reimburse the funder in the event of a successful outcome is generally sufficient for a tribunal to find that the costs of a funded party comes within that limitation.
- C.3. The question of whether any of the cost of funding, including a third-party funder’s return, is recoverable as costs will depend on the definition of recoverable costs in the applicable national legislation and/or procedural rules, but generally should be subject to the test of reasonableness and disclosure of details of such funding costs from the outset of or during the arbitration so that the other party can assess its exposure.
- C.4. In the absence of an express power, in applicable national legislation or procedural rules, a tribunal would lack jurisdiction to issue a costs order against a third-party funder.

Security for Costs:

- D.1. An application for security for costs should, in the first instance, be determined on the basis of the applicable test, without regard to the existence of any funding arrangement.
- D.2. The terms of any funding arrangement, including ATE, may be relevant if relied upon to establish that the claimant (or counterclaimant) can meet any adverse costs award (including, in particular, the funder's termination rights).
- D.2. In the event that security turns out not to have been necessary, the tribunal may hold the requesting party liable for the reasonable costs of posting such security.

[†] Primary contributors to this Chapter included: Stavros Brekoulakis, Audley Sheppard, Susan Dunn, Mick Smith and Jonas von Göler.

I. Introduction

The purpose of this Chapter is to provide guidance regarding the impact of third-party funding on allocation of costs and applications for security for costs. The analysis in this Chapter focuses on non-recourse funding arrangements. Where relevant, however, ATE, BTE and contingency fee arrangements are discussed for purposes of comparison.

It should be noted from the outset that the principles articulated in this Chapter are not intended to articulate a normative position; rather, they reflect the current state of the law that emerges from review of cases and scholarly commentary. Policy considerations are of course included in the analysis of this Chapter, but they are developed in more detail in Chapter 8, especially for investment arbitration. In this respect, sections of this Chapter that discuss issues in the context of investment arbitration should be read together with the policy analysis in Chapter 8.

The Chapter first examines issues on awarding of costs, and then issues on security for costs applications. Unless a tribunal establishes the likelihood that costs could in principle be awarded against an unsuccessful claimant, it cannot make a decision on a security for costs application.³³⁵

In respect of third-party funding, four principal questions arise and are addressed below:

- (1) Should third-party funding affect the recoverability of its legal costs by the successful claimant?
- (2) Should the costs of funding be recoverable?
- (3) Can the third-party funder be ordered to contribute to the costs of the successful respondent?
- (4) How should third-party funding affect the ordering of security for costs?

II. Awarding of Costs

When asked to make an award of costs at the end of the proceedings, an arbitral tribunal has to address a number of issues. First, the tribunal must decide whether it can and should reallocate costs and on what basis (e.g., costs follow the event). Second, if it decides to make a costs award against the unsuccessful party, the tribunal must determine which of the prevailing party's costs are recoverable from the other side,

335. Typically it is the claimant that has third-party funding, but the same principles are applicable to the award of costs to a respondent that has third-party funding. Also, typically a respondent seeks security for cost against a claimant, but occasionally a claimant seeks security for costs against a counter-claimant. For convenience, in this Chapter it is assumed that successful claimant seeks an award of costs, and a respondent seeks security for its costs.

including the type and amount of recoverable costs (i.e., (i) tribunal/institution costs and/or (ii) parties' legal and other costs). Third, the tribunal must determine which and how much of those costs should be awarded against the unsuccessful party in the circumstances.

An arbitral tribunal's decisions on these issues will generally be framed by the applicable arbitral laws and rules [A], but are often informed by litigation practice [B]. Below some arbitral practices in relation to third-party funding are summarised [C]. Finally, key observations and suggestions are set out [D].

A. Arbitral Laws and Rules

1. Arbitral Laws

As the award of costs originates from English law and practice, that is a useful place to begin.

English arbitration law contains comparatively detailed provisions on costs allocation. Section 61 English Arbitration Act 1996 provides that:

- “(1) The tribunal may make an award allocating the costs of the arbitration as between the parties, subject to any agreement of the parties.
(2) Unless the parties otherwise agree, the tribunal shall award costs on the general principle that costs should follow the event except where it appears to the tribunal that in the circumstances this is not appropriate in relation to the whole or part of the costs.”

As regards the amount of recoverable costs, Section 63 English Arbitration Act 1996 states:

- “(3) The tribunal may determine by award the recoverable costs of the arbitration on such basis as it thinks fit.
If it does so, it shall specify –
(a) the basis on which it has acted, and
(b) the items of recoverable costs and the amount referable to each.
(4) If the tribunal does not determine the recoverable costs of the arbitration, any party to the arbitral proceedings may apply to the court (upon notice to the other parties) which may –
(a) determine the recoverable costs of the arbitration on such basis as it thinks fit, or
(b) order that they shall be determined by such means and upon such terms as it may specify.
(5) Unless the tribunal or the court determines otherwise –

- (a) the recoverable costs of the arbitration shall be determined on the basis that there shall be allowed a reasonable amount in respect of all costs reasonably incurred, and
- (b) any doubt as to whether costs were reasonably incurred or were reasonable in amount shall be resolved in favour of the paying party.”

Default rules on costs shifting can also be found in the arbitration laws of other common law systems such as Hong Kong,³³⁶ as well civil law systems such as Germany, Spain, Brazil and Portugal.³³⁷

While jurisdictions that have adopted the UNCITRAL Model Law (or close to it), such as France, Switzerland, and the United States, are silent on the issue of costs allocation, it is generally understood that tribunals sitting in these jurisdictions have the power to render awards on costs.³³⁸

No national arbitration laws of which the Task Force is aware include substantive provisions regarding the effect of third-party funding on cost awards.

2. *Arbitral Rules*

Many widely used arbitral rules also provide for the award of costs and for cost shifting and set a presumption that costs should follow the event, or should be allocated based on the degree of success, unless particular circumstances call for a different approach.³³⁹ Other rules simply provide for wide arbitrator discretion.³⁴⁰

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- 336. Hong Kong Arbitration Ordinance (2011), s. 74(2) (written offer to settle as a particularly relevant factor).
 - 337. German Code of Civil Procedure (2013), s. 1057(1) (outcome of the case as a particularly relevant factor); Spain: Law 60/2003, Art. 37; Portugal: Law 63/2011, Art. 42; Brazil: Law 13.129 (26 May 2015), Art. 27.
 - 338. G. BORN, *International Commercial Arbitration*, 2nd edn. (Kluwer 2014), Vol. III, p. 3089.
 - 339. UNCITRAL Rules (2010), Art. 42 (“costs of the arbitration shall in principle be borne by the unsuccessful party”); LCIA Rules (2014), Art. 28(4) (“costs should reflect the parties’ relative success and failure in the award or arbitration or under different issues, except where it appears to the Arbitral Tribunal that in the circumstances the application of such a general principle would be inappropriate under the Arbitration Agreement or otherwise”); DIS Rules (1998), s. 35(2) (“[i]n principle, the unsuccessful party shall bear the costs of the arbitral proceedings”, but the tribunal may order each party to bear its own costs or apportion the costs between the parties, in particular, where each party is partly successful and partly unsuccessful); WIPO Rules (2014) Art. 74.
 - 340. ICSID Convention 1965, Art. 61(2) (“the Tribunal shall, except as the parties otherwise agree, assess the expenses incurred by the parties in connection with the proceedings, and shall decide how and by whom those expenses, the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the Centre shall be paid”); SIAC Rules (2016), Art. 35(1) (“[u]nless the parties have agreed otherwise, the Tribunal shall determine in the award the apportionment of the costs of the arbitration among the

The UNCITRAL Rules are representative. Article 40(1) provides that the arbitral tribunal shall fix the costs of arbitration in the final award and, if it deems appropriate, in another decision. Article 42 then provides:

- “1. The costs of the arbitration shall in principle be borne by the unsuccessful party or parties. However, the arbitral tribunal may apportion each of such costs between the parties if it determines that apportionment is reasonable, taking into account the circumstances of the case.
2. The arbitral tribunal shall in the final award or, if it deems appropriate, in any other award, determine any amount that a party may have to pay to another party as a result of the decision on allocation of costs.”

Similar formulations can be found, for instance, in the ICC Rules,³⁴¹ the LCIA Rules,³⁴² and the CIETAC Rules.³⁴³

The only provision in arbitral rules that specifically address the issue of third-party funding with respect to costs awards is Article 35 of the 2017 SIAC Investment Arbitration Rules, which provide:

“The Tribunal shall have the authority to order in its Award that all or a part of the legal or other costs of a Party be paid by another Party. The Tribunal may take into account any third-party funding arrangements in ordering in its Award that all or a part of the legal or other costs of a Party be paid by another Party.”

B. Litigation Practice

Given that the award and allocation of costs has its genesis in court practice, especially in common law jurisdictions, for comparative purposes, this section provides a brief overview of the status of recoverability of funding costs in litigation in some of the most popular jurisdictions for international litigation.

In England and Wales, conditional fees and the premium for ATE insurance were made recoverable under the Courts and Legal Services Act 1990 as amended by the

parties”); ICC Rules (2017), Art. 38(5) (“[i]n making decisions as to costs, the arbitral tribunal may take into account such circumstances as it considers relevant, including the extent to which each party has conducted the arbitration in an expeditious and cost-effective manner”).

341. ICC Rules 2017, Art. 38(1) (“reasonable legal and other costs incurred by the parties for the arbitration”).

342. LCIA Rules (2014), Art. 28(3) (“legal or other expenses incurred by a party ... The Arbitral Tribunal shall decide the amount of such Legal Costs on such reasonable basis as it thinks appropriate”).

343. CIETAC Rules 2014, Art. 52(2) (winner entitled to “the expenses reasonably incurred by it in pursuing the case”).

Access to Justice Act 1999. Section 58A(6) stated that costs orders made in any proceedings might include success fees. Section 58A(4) made it clear that the term ‘proceedings’ included arbitration proceedings. Section 29 Access to Justice Act 1999 provided that ‘[w]here in any proceedings a costs order is made in favour of any party who has taken out an insurance policy against the risk of incurring a liability in those proceedings, the costs payable to him may, subject in the case of court proceedings to rules of court, include costs in respect of the premium of the policy.’ The success fee element could only be based on fees incurred after the conditional fee agreement had been disclosed to the other side. This regime was subsequently changed with the Legal Aid, Sentencing and Punishment of Offenders Act 2012, which abolished the recoverability of conditional fees and ATE insurance premiums for agreements entered into after 1 April 2013, on the ground that such premiums and fees were key drivers behind the escalating costs of civil litigation.

Section 58B also permitted litigation funding agreements and provided that a costs order made in any proceedings may, subject in the case of court proceedings to rules of court, include provision requiring the payment of any amount payable under a litigation funding agreement. This provision was unaffected by the 2012 reforms.

In the United States – where parties typically bear their own costs – the Supreme Court has clarified that if a federal fee shifting statute applies and the prevailing party seeks to recover its contingency fees, only reasonable hourly fees (lodestar-method) are recoverable.³⁴⁴

In Germany, interest charged on a loan used to pay litigation expenses is not recoverable under section 91 German Code of Civil Procedure, since the interest cost is not directly related to the conduct of the proceedings.³⁴⁵ Accordingly, recovery of other funding costs (such as an ATE insurance premium) would likely be impossible from the perspective of German procedural law.

As regards the question of whether a third-party funder may be ordered to pay adverse costs should the funded claim fail, there is judicial authority from the UK³⁴⁶

344. *City of Burlington v. Dague*, Supreme Court of the United States, Judgement of 24 April 1992, 505 U.S. 557.

345. A. SCHULZ, in *Münchener Kommentar “ZPO § 91”* (2016), para. 205 (with further references); HERGET, in *Zöller*, § 91 (2016), para. 13.

346. *Excalibur Ventures LLC v. Texas Keystone Inc. & Ors v. Psari Holdings Limited & Ors*, English High Court (Queen’s Bench, Commercial Court), (Case No. 2010 Folio 1517), Order of 23 October 2014, [2014] EWHC 3436, paras. 4, 161 confirmed by the Court of Appeal in *Excalibur Ventures LLC v. Texas Keystone Inc & Ors* [2016] EWCA Civ 1144; *Arkin v. Borchard Lines Ltd. & Ors*, English Court of Appeal, Judgement of 16 May 2005, [2005] EWCA Civ 655, para. 36 (“[w]here ... the non-party not merely funds the proceedings but substantially also controls or at any rate is to benefit from them, justice will ordinarily require that, if the proceedings fail, he will pay the successful party’s costs”). Further, the *Arkin* case is also considered authority to the effect that the funder’s maximum liability for the respondent’s costs is capped at twice the amount loaned.

and the US³⁴⁷ to the effect that costs can be awarded against third-party funders if they have obtained a sufficient degree of economic interest and control in relation to the claim.

C. Arbitration Practice

Since the procedural matrix established by the arbitration law and rules typically allow tribunals wide discretion regarding costs allocation, it is not always easy to predict how an arbitral tribunal will ultimately approach the issue in a given case. The award of substantial costs based on the case's outcome – notably of legal costs based on counsel's hourly fees – constitutes an approach that is especially prevalent in court litigation in England and other common law jurisdictions. Nevertheless, it is one that appears to be increasingly applied in international arbitration as well, not least since, as discussed above, many widely used arbitral rules provide that the prevailing party is presumptively entitled to its costs, while authorizing the tribunal to adopt a different standard if appropriate in the particular case.³⁴⁸

As Gary Born has noted:³⁴⁹

“As a practical matter, arbitrators in international cases routinely award the costs of legal representation, usually without discussing questions of applicable law or detailed substantive analysis. Most arbitral awards either rely exclusively on grants of discretion (or other standards) pursuant to the applicable institutional rules, or simply award a ‘reasonable’ or ‘appropriate’ amount.”

This section looks at the body of arbitral case law dealing with the awarding of costs in the context of third-party funding. There are very few reported cases. We start with commercial arbitrations, but most of the examples are found in non-confidential investment treaty cases.

347. *Mohammed Abu-Ghazaleh et al. v. Gerard Martin Demerutis Chaul et al.*, Florida Third District Court of Appeal, (Nos. 3D07–3128, 3D07–3130) Decision of 2 December 2009, 36 So. 3d 691. Whereas parties litigating in front of US courts typically have to bear their own costs *Mohammed Abu-Ghazaleh et al. v. Gerard Martin Demerutis Chaul et al* presents special circumstances in that a fee shifting statute applied.

348. ICC Commission on Arbitration and ADR Report, “Decisions on Costs in International Arbitration” (2015), paras. 12-19, available at: <<http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2015/Decisions-on-Costs-in-International-Arbitration---ICC-Arbitration-and-ADR-Commission-Report/>> (last accessed 18 August 2016).

349. BORN, *International Commercial Arbitration*, p. 3095 (footnotes excluded).

1. ICC Case No. 7006

In 1992, an ICC tribunal noted (*obiter*) that the legal costs of a respondent that had been paid by a third party (insurer) would have been recoverable had the respondent succeeded:

“I believe that they are [recoverable], at least from the point that Defendants rather than the [indemnifier], mandated counsel to represent them in the arbitration. By so doing, they incurred the primary obligation to pay such counsel’s fees and expenses – one not negated by the fact that someone else, through prior arrangement, paid them on their behalf. The counterpart to this determination is that Defendants would be obliged to reimburse their indemnifier any costs they recovered from the arbitration.”³⁵⁰

2. Essar Oilfield Services

In *Essar Oilfield Services Ltd v. Norscot Rig Management Pvt Ltd* (as described in the subsequent court proceedings),³⁵¹ the arbitrator ordered Essar to pay costs on an indemnity basis, including a substantial amount which the claimant had paid to a third-party funder. The arbitrator held that the concept of "other costs" in the English Arbitration Act was not merely limited to legal costs, but extended to any other reasonable costs incurred by parties, including funding costs. The arbitrator further held that the respondent in the arbitration had exhibited egregious conduct in deliberately putting the claimant in a position where it could not fund the arbitration out of its own resources and it was therefore reasonable for the claimant to obtain funding from a third party on usual market terms for funding costs, namely 300 per cent of the amount advanced or 35 per cent of the amount recovered.

Essar sought to set aside the award. The English High Court confirmed the award, holding that it was within the arbitrator’s discretion to construe the phrase “other costs” in s.59(1)(c) of the Arbitration Act 1996 and “costs of the arbitration” in s.63(3) as including costs of funding. The court stated that the correct approach was to take a functional approach to the term “other costs” and “costs of the arbitration”, and consider what other costs were incurred in bringing or defending the claim. The court noted that as a matter of language, context and logic “other costs” could include third-party funding costs.³⁵²

350. *Supplier v. First distributor, Second distributor* (ICC Case No. 7006), Final Award (1992), 4 *ICC Bull.* (May 1993) 49.

351. *Essar Oilfields Services Ltd v. Norscot Rig Management Pvt Ltd*, Queen’s Bench Division (Commercial Court) 15 September 2016, [2016] EWHC 2361 (Comm).

352. *Ibid.*, paras. 56, 68 and 69.

3. *Kardassopoulos v. Georgia*

In *Ioannis Kardassopoulos & Ron Fuchs v. Georgia*,³⁵³ the investors were successful in an arbitration funded by German company Allianz Litigation Funding in a claim against Georgia for compensation for the unlawful termination of a concession to build and maintain a pipeline. The claimants requested that they be awarded their costs of proceedings including legal costs, arguing that there is a trend of outcome-based recovery in investment-treaty arbitration. The respondent argued, *inter alia*, that claimants' legal costs were excessive, and further claimed that they might have been borne (at least in part) by a third-party funder and therefore not properly recoverable. The Tribunal held that:

“The Tribunal knows of no principle why any such third-party financing arrangement should be taken into consideration in determining the amount of recovery by the Claimants of their costs.”³⁵⁴

This passage has been adopted by the ICSID annulment committees in *RSM v. Grenada*³⁵⁵ and *ATA v. Jordan*.³⁵⁶

4. *Siag and Vecchi v. Egypt*

In *Siag and Vecchi v. Egypt*,³⁵⁷ the claimants' law firm had acted on a contingency fee basis. Nonetheless, the claimants requested recovery of a specified amount of normal (hourly) fees, without the corresponding invoices or other details. The tribunal accepted this. Prof. Orrego Vicuña dissented, albeit not on the issue of substantiation of costs, but more generally on the allocation of costs stating:

“In respect of the costs of this arbitration I believe that a more adequate approach would be to require each party to pay one half of such costs, particularly taking into account the fact that the Claimant agreed to pay attorney's fees only on a successful recovery. While there is nothing unusual in such arrangement, it entails the acceptance of the Claimant of a degree of risk

353. *Kardassopoulos and Fuchs v. The Republic of Georgia* (ICSID Case Nos. ARB/05/18 and ARB/07/15), Award (3 March 2010).

354. *Ibid.*, para. 691.

355. *RSM Production Corporation v. Grenada* (ICSID Case No. ARB/05/14), Annulment Proceeding, Order of the Committee Discontinuing the Proceeding and Decision on Costs (28 April 2011) para. 68.

356. *ATA Construction, Industrial and Trading Company v. The Hashemite Kingdom of Jordan* (ICSID Case No. ARB/08/2), Annulment Proceeding, Order Taking Note of the Discontinuance of the Proceeding (11 July 2011) para. 34.

357. *Siag and Vecchi v. The Arab Republic of Egypt* (ICSID Case No. ARB/05/15), Award (1 June 2009).

that should not entirely be shifted to the Respondent, particularly in view of the amounts involved.”³⁵⁸

5. *Quasar de Valores v. Russia*

In *Quasar de Valores v. Russia*,³⁵⁹ the tribunal denied the prevailing claimants (Spanish portfolio investors in Yukos) recovery of their costs because the funder (Menatep, ex-majority shareholder in Yukos) had funded the entirely the costs of the proceedings and had no contractual right vis-à-vis the claimants for reimbursement of these costs. The tribunal held that:

“The usual arguments about the recoverability of costs where a party’s representation in a case has been financed by a third party are inapposite here, because such third-party financing is typically part of a legally enforceable bargain under which the prevailing party in the arbitration has given up something in return for that support. Here, it is conceded that there is no legal duty on the part of the Claimants to hand over any recovery on account of costs to Menatep.”³⁶⁰

While the tribunal refused to award claimants recovery of their costs in *Quasar de Valores*, it must be noted that the circumstances in this case were quite unusual in that the funded party had no obligation whatsoever to reimburse the funder for the costs advanced, effectively giving the funded party a ‘total free ride’.”³⁶¹

D. Key Observations and Suggestions

For the purposes of this Report it is assumed that, as is typically the case, a party funded by a third-party funder assumes an obligation to reimburse the funder for the costs advanced, in case of successful recovery. It is also assumed that the tribunal is generally willing to allocate costs based on the outcome of the case. This raises the following questions in relation to third-party funding.

358. *Siag and Vecchi v. The Arab Republic of Egypt* (ICSID Case No. ARB/05/15) Dissenting Opinion of Francisco Orrego Vicuña, (11 May 2009) p. 6.

359. *Quasar de Valores SICAV S.A. et al. v. The Russian Federation* (SCC Arbitration No. 24/2007), Award (20 July 2012) para. 223.

360. *Ibid.*, para. 223.

361. The funder, Group Menatep Limited, a former majority shareholder in the Russian oil company Yukos, had a strategic, indirect financial interest in the outcome of the case, namely to create a favourable “arbitral precedent” for its own, much larger majority shareholder claims filed against Russia under the Energy Charter Treaty.

1. Should a Funded Party That Has Prevailed in the Arbitration Be Able to Recover Party Costs Where These Costs Have Been Funded by a Third Party?

a. Amount of costs: did a funded party “incur” costs?

Although the answer to this question will depend on the billing structures adopted by the third-party funder for each case, when a party is funded by a third-party funder, it typically assumes an obligation to reimburse the third-party funder for the costs advanced by that third-party funder to its lawyers and others. The obligation to reimburse a third-party funder should be sufficient for tribunals to accept that a funded party has incurred costs.

Specifically, the usual practice in funded arbitration claims is that the invoices of lawyers and others are issued in the funded party’s name (with whom the law firm has the lawyer-client relationship), but are payable by the funder pursuant to the terms of the funding agreement (as between third-party funder and client). The funded party’s lawyers would usually send the invoice to the funder (along with a monthly report). If the funded party and third-party funder are satisfied that the invoice is consistent with the pre-agreed budget, the third-party funder will pay the invoice directly to the lawyer. Thus, the involvement of a third-party funder does not change the funded party’s primary liability to the law firm to discharge the bill. The funded party incurs the obligation to reimburse the third-party funder for the costs so advanced in case of successful recovery (plus a return to the third-party funder as per the funding agreement). In these cases, the third-party funder covers the legal fees of the funded party with a view of recovering its investment, including the legal fees, and making a profit, if the funded party is ultimately successful in the arbitration.

It is therefore suggested that legal costs that the funded party is contractually obliged to repay to the third-party funder be considered as legal costs incurred by the funded party.³⁶² Equally, and for illustrative purposes, other types of third-party funding, including traditional funding on a recourse basis, may not be considered a basis for denying an award of costs for the successful funded party.

For example, a P&I and FD&D Club will be responsible for paying the party’s legal expenses albeit they will not appear on the record. P&I and FD&D are a form of liability insurance.³⁶³ They operate on a “pay to be paid” principle, i.e., the member must incur a liability first and then the club will reimburse such expenses. In both cases the funded party pays the invoices to the legal representatives and then the club reimburses. Therefore, again the party on the record incurs the costs, and P&I and

362. ICC Commission on Arbitration and ADR Report, “Decisions on Costs in International Arbitration” (2015), paras. 87-89, available at: <<http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2015/Decisions-on-Costs-in-International-Arbitration---ICC-Arbitration-and-ADR-Commission-Report/>> (last accessed 18 August 2016).

363. See Chapter 3 for definitions of P&I and FD&D.

FD&D arrangements should not be considered a basis for refusing a costs award in favour of the successful funded party.

The same applies for conditional (or contingency) fee arrangements (“CFAs”).³⁶⁴ CFAs typically provide that the successful party will have to pay the law firm's invoices determined on the basis of the amount of time spent at its normal hourly rates (or often a discounted rate) plus an uplift in the event of success (i.e., a success fee). Recoverability of the amount of the fees at the applicable rate (standard or discounted) for the time spent by the law firm should be possible as an essential part of the legal costs incurred by the successful party. Recoverability of any uplift or success fee is more problematic (see [2] below).

On the other hand, obtaining an ATE³⁶⁵ policy may not include any funding of the legal costs of an arbitration,³⁶⁶ and therefore the question of whether an ATE insurer pays the insured party its arbitration costs does not arise in the first place. ATE policies typically meet adverse costs awards only,³⁶⁷ and therefore the claimant will have to obtain funding from elsewhere or fund the arbitration itself. If it is successful, a party with ATE policy will have incurred legal costs, which should be recoverable.

b. Allocation of costs: should a tribunal deviate from otherwise applicable outcome-based methods of costs allocation if the prevailing party’s costs have been funded?

The fact that a party’s costs have been paid by a third-party funder will not generally be regarded as a relevant factor in determining whether or not costs are to be allocated based on the outcome of the case. As explained in the previous section, these costs are incurred vis-à-vis the law firm by the funded party, who typically is obliged, under the funding agreement, to repay the funder if it is successful in the claim. Otherwise, the funded party would be left uncompensated for the costs it has incurred, which it would have recovered had it not been funded.

In this respect, as discussed above, the Task Force agrees with the decision in *Ioannis Kardassopoulos & Ron Fuchs v. Georgia*.³⁶⁸

2. What Amount and Type of “Costs” Can a Prevailing Funded Party Recover?

Funding arrangements will typically require the funded party not only to reimburse the funder for the actual arbitration costs covered, but also to pay for the cost of that

364. See Chapter 3 for definition of CFAs.

365. See Chapter 3 for definition of ATE.

366. Although see above Chapters 2 and 3 for implications of ATE in potential funding or material support of an arbitration.

367. *Ibid.*

368. *Kardassopoulos and Fuchs v. The Republic of Georgia* (ICSID Case Nos. ARB/05/18 and ARB/07/15), Award (3 March 2010).

capital, i.e., the funding costs (such as a conditional fee, or a litigation funder's return) over and above normal legal costs.

Depending on the circumstances, the successful funded party might be able to claim funding costs charged by the third-party funder as damages against the unsuccessful party in a separate claim. However, the requirements for causation and foreseeability would be difficult tests to meet under most national substantive laws.³⁶⁹

It would seem more attractive for the successful funded party to attempt to recover funding costs from the unsuccessful party as part of the costs allocation exercise at the end of the arbitration, although the question whether an arbitrator can and should allocate funding costs is disputed.

In a survey of practice of arbitral tribunals under the ICC Rules, the 2015 ICC Report on Costs in International Arbitration states that funding costs, including the third-party funder's success fee, may be recoverable in certain circumstances.³⁷⁰

As noted above, in *Essar Oilfield Services Ltd v. Norscot Rig Management Pvt Ltd*³⁷¹ the tribunal ordered the unsuccessful party to pay a substantial amount which the claimant had paid to a third-party funding as the cost of funding. This was upheld by the English High Court.

For the purposes of this Report, the issue of whether the funded party should be able to recover funding costs, including success fees, attracted a large number of comments during the public consultation period. A number of comments suggested that allowing a third-party funder to recover funding costs in exceptional circumstances only, typically when the respondent's conduct has been "egregious", was setting the bar too high, especially in investment arbitration. Under this view, other types of conduct, which may not readily fall within the scope of "egregious", may justify an award of funding costs, subject to overriding principles of reasonableness. On the other hand, other comments suggested that awarding funding costs as part of arbitration costs would substantially and unfairly increase the amounts owed by the losing party³⁷² and would unreasonably impose a huge risk of an adverse costs award on the respondent.

369. See J. VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure*, (Kluwer 2016) pp. 414-415.

370. ICC Commission on Arbitration and ADR Report, "Decisions on Costs in International Arbitration" (2015) paras. 92-93, available at: <<http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2015/Decisions-on-Costs-in-International-Arbitration---ICC-Arbitration-and-ADR-Commission-Report/>> (last accessed 18 August 2016).

371. *Essar Oilfield Services Ltd v. Norscot Rig Management Pvt Ltd*, Queen's Bench Division (Commercial Court) 15 September 2016, [2016] EWHC 2361 (Comm).

372. See VON GOELER, *Third-Party Funding in International Arbitration and Its Impact on Procedure*, pp. 387-396; M. BÉRARD, "'Other Costs' in International Arbitration" in J. C. BETANCOURT, ed., *Defining Issues in International Arbitration: Celebrating 100 Years of the Chartered Institute of Arbitrators* (OUP 2016) 27.44; D. WEHRLI, "Contingency Fees/Pactum de palmario 'Civil Law Approach'", 26 *ASA Bull* (2008, Issue 2) p. 241 at p. 253; M. O'REILLY, "Costs in Arbitration Proceedings", 2nd edn., (Informa Law 1997) pp. 67-68; B. HANOTIAU, "The Parties' Costs of Arbitration" in

As discussed above, under the majority of the rules, a party may recover costs which it has “reasonably” incurred in the arbitration. Accordingly, the question of whether a claimant can recover funding costs, assuming that such costs are found by the tribunal to qualify as arbitration costs, should be treated under the test of reasonableness. While the decision as to whether a claimant in seeking funding from a third-party funder has reasonably incurred funding costs which are recoverable will largely depend on the factual circumstances of the case and is eventually left, under almost all rules, to the tribunal’s discretion, important factors for tribunals to take into account would be: first, whether the respondent’s conduct has caused the impecuniosity of the claimant; second, whether the claimant had no other option but to seek funding from a third-party funder in order to pursue its arbitration claim; and third, whether the respondent knew that the claimant had funding. As is further explained below under the security for costs section, while for some impecunious claimants the only way to access justice is by seeking external funding to pursue their arbitration claims, an increasing number of solvent companies now seek third-party funding as a way to share risk associated with the outcome of the arbitration and not to impair cash flow. Thus, a tribunal may find that in the specific circumstances, it was reasonable for a claimant, who was made impecunious by the respondent’s conduct, to have sought external funding from a third-party funding under standard market rates, in which case funding costs might be recoverable. Conversely, a tribunal may find that it was not reasonable for a claimant to recover funding costs in circumstances where it sought third-party funding simply to hedge the costs risk from the arbitration. Indeed, tribunals have occasionally dealt with similar issues on the basis of reasonableness, and have either included the funders’ return in the allocation of costs³⁷³ or not, depending on their assessment of the case as a whole.

The above observations should be subject to three caveats: first, that the tribunal may not have the power under the applicable rules and laws to award funding costs in the first place. For example, as already discussed, the English court in *Essar* held that funding costs can be recoverable under the English Arbitration Act, on the basis that such costs fall within the meaning of the term “other costs” in s.59(1)(c) and “costs of the arbitration” in s.63(3) of the Arbitration Act of 1996. Similarly, the ICC Report on “Decisions on Costs in International Arbitration” considers that funding costs are

R. H. KREIDLER and Y. DERAÏNS, eds., *Evaluation of Damages in International Arbitration* (Dossier IV of the ICC Institute of World Business Law 2006) p. 219; J. WAINCYMER, *Procedure and Evidence in International Arbitration* (Kluwer 2012), p. 1246.

373. Compare *Adem Dogan v. Turkmenistan*, (ICSID Case No. ARB/09/9), Award (12 August 2014) not public, reported by Peterson, IA Reporter (19 August 2014) (where the tribunal awarded the claimant two thirds of the actual sums owed to its counsel under a contingency fee arrangement, which included a 20% share in the final award).

recoverable under the ICC Rules.³⁷⁴ However, the language employed by other arbitration laws or arbitral rules may not permit arbitrators to treat funding costs as arbitration costs and therefore recoverable costs.³⁷⁵

Second, in all cases, the amount of funding costs that might be recovered should be reasonable. This is the second aspect of the general requirement of reasonableness, the first being whether the costs “have been reasonably incurred” (discussed above). In all cases, the requirement that costs must be reasonable provides the necessary assurances that the parties will be treated fairly and equally in terms of costs and that third-party funding will not enjoy unjustified windfalls.³⁷⁶ What exactly constitutes “reasonable” amount of funding costs will again depend on the factual circumstances of the case, including in particular the financial situation of the claimant in seeking costs to fund its arbitration and the applicable standard market rates at the time the claimant sought funding.

It is not for this Report to set the standards for what constitutes reasonable funding rates. By way of example only, having reviewed a large amount of evidence on this point, the English court in *Essar* found that a return rate of 300 per cent reflected, in that case, “standard market rates”. Other tribunals can, if necessary, hear evidence as to what constitutes “standard market rates” for a specific case.

Third, in case a tribunal decides to award funding costs to the funded party, this should ordinarily be possible only if details on the funding costs, which the funded party will have to incur if it is successful in the arbitration, are disclosed from the outset of the arbitration or at an early stage. Ordering an unsuccessful respondent to pay funding costs constitutes a significant shift in the risk associated with the outcome of the arbitration. It is reasonable to suggest that if the respondent is held to assume this risk at the end of the arbitration, the respondent should be aware of it from the outset of the arbitration proceedings, or be liable for a proportion of third-party funding costs relative to such time as it is made aware of such funding.

The above observations should also apply to CFAs as they essentially constitute funding of a party’s participation in an arbitration by a law firm, subject however to the fact that in a number of jurisdictions recoverability of lawyers’ success fees is typically capped.³⁷⁷

374. ICC Commission on Arbitration and ADR Report, “Decisions on Costs in International Arbitration” (2015) paras. 92-93, available at: <<https://iccwbo.org/publication/decisions-on-costs-in-international-arbitration-icc-arbitration-and-adr-commission-report>> (last accessed 18 August 2016).

375. For example, in its recent public consultation report (August 2017), HKIAC recently sought views as to whether an express provision should be added in the new edition of the HKIAC Rules to allow tribunals to award costs of third party funding as part of costs of arbitration; see Articles 34.1(d), 44 and 45.3(e).

376. ICC Commission on Arbitration and ADR Report, see fn. 374 above.

377. See, e.g., *City of Burlington v. Ernest Dague et al*, Supreme Court of the United States, Judgement of 24 April 1992, 505 U.S. 557 (only reasonable hourly fees recoverable instead of contingency fees); British Courts and Legal Services Act (1990), s. 58A(6) (as

While the same analysis and considerations are applicable to recourse based funding costs, including for example BTE and ATE premiums, it will typically be difficult to classify such costs as costs of the arbitration even under the broader meaning of the term, given by the English court in the *Essar* case. Indeed, ATE does not typically fund the claim; rather it is there to meet any adverse costs award.³⁷⁸ Similarly, P&I and FD&D Clubs and other forms of mutual insurance, “calls” (i.e., premiums) are offered, usually annually, by members in advance of the dispute and are paid even if a dispute never arises for one of the members for the duration of the call. This may explain why there is no reported case of which the Task Force is aware awarding a party funded by a P&I and FD&D club its membership call as part of costs, and that ATE premiums are generally considered irrecoverable in arbitral proceedings.³⁷⁹

3. Can Arbitral Tribunals Render Costs Orders Directly Against Third-Party Funders?

As regards the question whether a third-party funder may be ordered to pay adverse costs should the funded claim fail, courts in England³⁸⁰ and the United States³⁸¹ have

changed by virtue of section 44(4) Legal Aid, Sentencing and Punishment of Offenders Act 2012) provides that “[a] costs order made in proceedings may not include provision requiring the payment by one party of all or part of a success fee payable by another party under a conditional fee agreement”.

378. Although see above Chapters 2 and 3 for implications of ATE in potential funding or material support of an arbitration.
379. M. BERARD, “‘Other Costs’ in International Arbitration” in J. C. BETANCOURT, ed., *Defining Issues in International Arbitration: Celebrating 100 Years of the Chartered Institute of Arbitrators* (OUP 2016) 27.35 *et seq.* In the context of English litigation, from April 2013, ATE costs are no longer recoverable; see Lord R. JACKSON, “Review of Civil Litigation Costs” (2009) Foreword, available at <<https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf>> (last accessed 19 August 2016).
380. *Excalibur Ventures LLC v. Texas Keystone Inc. & Ors v. Psari Holdings Limited & Ors*, English High Court (Queen’s Bench, Commercial Court), (Case No. 2010 Folio 1517), Order of 23 October 2014, [2014] EWHC 3436, paras. 4, 161 confirmed by the Court of Appeal in *Excalibur Ventures LLC v. Texas Keystone Inc & Ors* [2016] EWCA Civ 1144; *Arkin v. Borchard Lines Ltd. & Ors*, English Court of Appeal, Judgement of 16 May 2005, [2005] EWCA Civ 655 (“[w]here ... the non-party not merely funds the proceedings but substantially also controls or at any rate is to benefit from them, justice will ordinarily require that, if the proceedings fail, he will pay the successful party’s costs”). See also the most recent case about a non-party costs order against insurers *Legg and others v. Sterte Garage Ltd and another* [2016] EWCA Civ 97, where the Court of Appeal held that a costs order against the insurers was warranted because “(1) the insurers determined that the claim would be fought; (2) the insurers funded the defence of the claim; (3) the insurers had the conduct of the litigation; (4) the insurers fought the claim exclusively to defend their own interests; (5) the defence failed in its entirety”.

ruled, in the context of litigation funding, that costs can be awarded against third-party funders if they have obtained a sufficient degree of economic interest and control in relation to the claim. In the context of litigation funding, courts have emphasized that the third-party funders seek to gain financially from claims as much as the funded parties and that “the derivative nature of a commercial funder’s involvement should ordinarily lead to his being required to contribute to the costs” on the same basis as the funded claimant.³⁸²

The rationale behind these cases is clear and straight-forward: a funder who benefits financially if the client wins should not be able to walk away without any responsibility for adverse costs if the client loses. The important question, however, is whether the considerations underlying these cases can be transferred into the framework of international arbitral procedures.

Unlike state courts, which may be endowed with the power to order third parties to bear procedural costs by virtue of statutory procedural law, arbitral tribunals will typically lack jurisdiction to issue a costs order against a third-party funder because of the consensual nature of arbitration. The third-party funder is not normally party to the arbitration agreement and has no formal participation in the underlying arbitration proceedings between the two parties.³⁸³ While a number of non-signatory theories have been relied upon by national courts and arbitral tribunals to find that a non-signatory party is bound by an arbitration agreement, most of these theories will not apply to a typical third-party funding scenario. Given the typical one-off and arm’s length commercial relationship and the lack of corporate links between a third-party funder and a funded party, nor any involvement in the performance of the underlying contract or its termination, it would be difficult to envisage factual circumstances under which a third-party funder might be brought within the jurisdiction of an arbitration tribunal as the third-party beneficiary of the arbitration agreement between the funded party and the respondent, or the principal or alter ego of the funded party, or the assignee of the funded party’s claim (albeit one can envisage the partial assignment concept being developed). Equally, while funders, in certain circumstances, might be involved (occasionally actively) in the arbitration proceedings, this will not usually be sufficient to establish implied consent to the arbitration agreement by conduct.³⁸⁴ The test for treating a non-signatory as a party in arbitration is demanding, and courts, particularly in common law jurisdictions, have noted that there is a strong presumption that it is only the signatory parties (in this case, the funded claimant and the respondent) who

381. *Mohammed Abu-Ghazaleh et al. v. Gerard Martin Demerutis Chaul et al*, Florida Third District Court of Appeal, (Nos. 3D07–3128, 3D07–3130) Decision of 2 December 2009, 36 So. 3d 691.

382. *Excalibur Ventures LLC v. Texas Keystone Inc & Ors* [2016] EWCA Civ 1144.

383. Compare S. BREKOULAKIS, *Third Parties in International Commercial Arbitration* (OUP 2010) paras. 1.76-1.84.

384. See VON GOELER, *Third-Party Funding in International Arbitration and Its Impact on Procedure*, pp. 419-420.

should normally be considered as parties in an arbitration and subject to the tribunal's jurisdiction.³⁸⁵

However, shifting focus of the inquiry from whether a third-party funder *can* be brought within the jurisdiction of an arbitration tribunal to whether it *should*, the issue has interesting, and potentially important, policy implications which were the subject of a large number of comments received during the period of public consultation. On the one hand, some comments sought to challenge the idea behind the proposition that funders should be liable for adverse costs. As it was noted, a funder cannot be equated to a party, as it does not have the same degree of control over the conduct of the dispute or knowledge of all the facts (for example, which might lead to the claim being dismissed). On the other hand, the majority of the comments suggested that it would be fair for a funder whose investment might turn out to be very profitable in the event of a successful claim, to be directly liable for adverse costs in case its investment turns out to be unsuccessful.

The latter comments are in line with the “substantial majority” of the submissions received by the Hong Kong Law Reform Commission during its public consultation, which supported the position that tribunals should be “given the power to make Third Party Funders directly liable for adverse costs awards in appropriate circumstances”.³⁸⁶ As the HK Law Reform Commission’s further noted, “there is no evidence that full liability [of funders] for adverse costs would stifle third party funding or inhibit access to justice”,³⁸⁷ if a third-party funder has confidence in the matter it is funding, it will not be concerned with its potential liability.

There is force in the argument that a third-party funder, who stands to profit if the arbitration outcome is successful for the funded party, should be held directly liable for costs awarded against the funded party or at least for costs which are awarded as a consequence of the outcome of the case.³⁸⁸ By contrast, for any costs incurred as a result of the funded party’s conduct in the arbitration, third-party funders should not typically be held accountable, especially when they exercise limited control over the way the funded party and its counsel conduct themselves in the arbitration.

Further considerations would militate in favour of according tribunals the power to award costs directly against funders. For example, the ability of a tribunal to make direct costs orders against a third-party funder would provide counterparties in

385. See for example, the decisions of the English Supreme Court in *Dallah Real Estate and Tourism Holding Company v. The Ministry of Religious Affairs, Government of Pakistan*, [2010] UKSC 46, and the decision of the English High Court in *Peterson Farms Inc v. C&M Farming Ltd* [2004] 1 Lloyd’s Rep 603, the decision of the Court of Singapore in *PT First Media TBK v. Astro Nusantara International BV and others* [2013] SGCA 57, the decision of the Swiss Federal Tribunal, Decision 4A_450/2013 7 April 2014.

386. Hong Kong Law Reform Commission’s Final Consultation Paper, (2015).

387. Hong Kong Law Reform Commission’s Final Consultation Paper, (2015) para. 4.70 citing Jackson LJ.

388. Hong Kong Law Reform Commission’s Final Consultation Paper, (2015).

arbitration with appropriate certainty that any adverse costs orders will eventually be paid, if not by the funded party then by the third-party funder itself. Importantly too, the eventuality that funders may be held accountable for costs awards would offer further disincentive for funders to fund proceedings which are not clearly meritorious. This risk to third-party funders is often addressed by them by requiring the funded party to take out ATE.

Eventually, however, this issue can be better addressed by binding rules either in national law or arbitration rules, expressly granting tribunals the power to order, if necessary, costs against third-party funders. For example, as noted above, the 2017 SIAC Investment Arbitration Rules provide in Article 35 that “The Tribunal may take into account any third-party funding arrangements in ordering in its Award that all or a part of the legal or other costs of a Party be paid by another Party.” Whether any such award would be enforceable outside Singapore is an open question.

The position does not differ in the case of recourse based funding. Both ATE insurers and P&I and FD&D clubs will typically assume the contractual obligation to pay adverse costs, although such contractual obligation is vis-à-vis the insured, i.e., the funded party. The level of control of BTE and ATE insurers over the claim differs. For example, a FD&D club will typically exert a high degree of control over the claim as is often permitted by its rules. Whether such control can allow tribunals in practice to decide that a FD&D club has effectively become a proper party to the arbitration on the basis of any of the known non-signatory theories will depend on the factual circumstances of the case. In the context of English litigation, and for comparative purposes, the Court of Appeal held in the recent *Legg and others v. Sterte Garage Ltd and another* [2016] EWCA Civ 97, that a costs award against a third party insurer that first ran the case and then withdrew support was warranted. While the level of control by the funder in this case was significant, the difference with arbitration is the compulsory jurisdiction enjoyed by the court as opposed to the arbitration tribunal’s reliance on consent for its jurisdiction.

III. Security for Costs

If a claimant might not be able to pay an adverse costs award, English and other Commonwealth jurisdictions have typically allowed the respondent to apply for security for costs. While originating in English litigation practice, and expressly prescribed in, for example, the English Arbitration Act 1996 and the LCIA Rules; historically, arbitral tribunals have been sceptical about awarding security for costs, but more recently, international tribunals have been willing to entertain such requests.³⁸⁹

389. BORN, *International Commercial Arbitration*, p. 2494.

This Section begins with reference to applicable arbitral laws and rules [A], as well as summarizes some arbitral practices in relation to ordering security for costs [B]. Finally, key observations and suggestions are set out [C].

A. Arbitral Laws and Rules

1. Arbitral Laws

Because the award of security for costs again originates from English law and practice, those sources are summarized first.

Section 38(3) of the English Arbitration Act 1996 provides that “The tribunal may order a claimant to provide security for the costs of the arbitration.”

Various civil law countries include general provisions on interim measures,³⁹⁰ which, as is generally accepted, include security for costs orders.

No national arbitration laws of which the Task Force is aware address the implications of third-party funding on security for costs orders.³⁹¹

2. Arbitral Rules

Various arbitral rules also provide for the award of security for costs. For example, Article 25.2 of the 2014 LCIA Rules provides:

“The Arbitral Tribunal shall have the power upon the application of a party, after giving all other parties a reasonable opportunity to respond to such application, to order any claiming or cross-claiming party to provide or procure security for Legal Costs and Arbitration Costs by way of deposit or bank guarantee or in any other manner and upon such terms as the Arbitral Tribunal considers appropriate in the circumstances. Such terms may include the provision by that other party of a cross-indemnity, itself secured in such manner as the Arbitral Tribunal considers appropriate, for any costs and losses incurred by such claimant or cross-claimant in complying with the Arbitral Tribunal’s order. Any amount payable under such cross-indemnity and any consequential relief may be decided by the Arbitral Tribunal by one or more awards in the arbitration. In the event that a claiming or cross-claiming party does not comply with any order to provide security, the Arbitral Tribunal may stay that party’s claims or cross-claims or dismiss them by an award.”

390. See, e.g., French Code of Civil Procedure (2011), Art. 1468; Swiss Private International Law Act (2017), Art. 183(1); German Code of Civil Procedure, (2013) Art. 1041(1).

391. For a recent example of a security for costs award made against a third-party funder in English litigation, see *In the Matter of RBS [Rights Issue Litigation]* 2017 EWHC 1217 (Ch.).

This provision recognizes that security for costs is an interim measure, and as is often the case in England where interim measures is sought, the requesting party must provide a cross-indemnity.

Various other arbitral rules include general provisions on interim measures,³⁹² which, likewise, are generally accepted to include security for costs orders.³⁹³ This is also referred to as *cautio judicatum solvi*.

No arbitral rules address the implications of third-party funding on security for costs orders.

B. Arbitral Practice

In international commercial arbitration, no uniform test for security for costs applications exists at this point. International commercial tribunals will thus have to decide security for costs applications on the basis of the relevant standards under the applicable national law.

1. Commentaries

Derains and Schwartz, commenting on the previous version of the ICC Rules (but worded in identical terms), state:³⁹⁴

“... those drafting the 1998 Rules were reluctant to mention security for costs expressly because they did not wish to encourage the proliferation of such applications, which, apart from being rare, are generally disfavoured in ICC arbitration, while nevertheless possibly justified in exceptional circumstances”.

Likewise, Craig, Park and Paulsson have commented that:³⁹⁵

“It may be concluded that security for costs is not usually granted in ICC arbitration; nevertheless, the power exists and in some circumstances may be justified.”

392. See, e.g., ICC Rules, (2017) Art. 28(1); ICDR Rules, (2014) Art. 21(1); ICSID Convention, Art. 47.

393. E.g., J. FRY, S. GREENBERG and F. MAZZA, *The Secretariat's Guide to Arbitration* (ICC Services, 2012), para. 3-1035.

394. Y. DERAIS and E. SCHWARTZ, *Guide to the ICC Rules of Arbitration* (Kluwer, 2005) p. 297.

395. L. CRAIG, W. PARK and J. PAULSSON, *International Chamber of Commerce Arbitration*, 3rd edn. (Oceana Publications 2000) p. 469.

Sandrock has written.³⁹⁶

“Again, all legal authors who acknowledge such power [under the ICC Rules], as well as the few arbitral tribunals which have already made use of it, agree that the issuance of an order for a *cautio judicatum solvi* is not permissible unless special circumstances require it for the protection of the defendant. The following instances are recognised as special circumstances justifying a *cautio judicatum solvi*:

- the claimant is already insolvent or he is just about to slide into a state of insolvency;
- the claimant is too poor to finance the advance deposit for the fees of the arbitrators out of his own pocket, but must avail himself of the financial aid of a third person;
- the principle of the equality of the parties may require, however, that the duty to furnish a *cautio judicatum solvi* is imposed not only on the claimant, but likewise on the defendant.”

This exceptional nature of orders for security for costs is not particular to ICC arbitration, but is applicable generally in international arbitrations. It is based on policy considerations.³⁹⁷ Lew, Mistelis and Kroll write:³⁹⁸

“On what conditions should the tribunal exercise this power? There are few cases where arbitrators have ordered security for costs. This may be an indication that tribunals are reluctant to exercise this power. One reason is the strong view that orders for security for costs are not appropriate in arbitration. There are good arguments that a higher standard should be applied than in court proceedings. Arbitration generally requires that the respondent agreed to arbitrate with the claimant. Furthermore the burden placed on the claimant by the obligation to pay an advance on costs under the institutional rules or to the arbitrators in respect of their fees is considered to be a sufficient safeguard to exclude any abusive and extravagant claims. Since the lack of sufficient funds is often due to the actions or contractual non-performance of the respondent it is feared that in those cases parties may abuse requests for additional security to prevent underfunded claimants from pursuing their rights. ...”

396. O. SANDROCK, “The *Cautio Judicatum Solvi* in Arbitration Proceedings”, 14 *Journal of Int. Arb.* (1997, Issue 2).

397. J. WAINCYMER, *Procedure and Evidence in International Arbitration*, pp. 642-651.

398. J. LEW, L. MISTELIS and S. M. KROLL, *Comparative International Commercial Arbitration* (Kluwer 2003) pp. 601-602.

The position is no different where an international arbitration is seated in London. Merkin and Flannery note that there is no real guidance at all as to what principles a tribunal ought to apply and what facts and matters may be relevant when applying Section 38(3), but in relation to international arbitrations in particular, the granting of security for costs is a rarely exercised power, and the authors further comment:³⁹⁹

“We suggest that the low number of cases reflects the principle that an order should be made only in the most exceptional of circumstances, and not just because there is a likelihood (even a strong likelihood) that the claimant will not be able to meet any costs order. The availability of a remedy is one thing; its appropriateness, particularly in an international context, quite another.”

And:

“Where the respondent has brought a counterclaim in the same arbitral proceedings, arising out of the same facts as the claim, a tribunal ought to be less inclined to make an order that the claimant provide security for costs.”

2. Chartered Institute of Arbitrators

In 2016, the Chartered Institute of Arbitrators published a report on “Applications for Security for Costs”,⁴⁰⁰ in which it sets out “current best practice in international commercial arbitration in relation to applications for security for costs”. It stated, inter alia:

“2. When deciding whether to make an order for security for costs, arbitrators should take into account the following matters:

- i) the prospects of success of the claim(s) and defences
- ii) the claimant’s ability to satisfy an adverse costs award and the availability of the claimant’s assets for enforcement of an adverse cost award ...; and
- iii) whether it is fair in all of the circumstances to require one party to provide security for the other party’s costs

3. This list is not exhaustive and arbitrators should also take into account any other additional considerations that they may consider relevant to the particular situation of the parties and the circumstances of the arbitration.”

399. R. MERKIN and L. FLANNERY, *The Arbitration Act 1996*, 5th edn, (Informa, 2014) pp. 147 and 150.

400. See CI Arb’s International Arbitration Practice Guidelines on Applications for Security for Costs available at: <<https://www.ciarb.org/docs/default-source/practice-guidelines-protocols-and-rules/international-arbitration-guidelines-2015/2015securityforcosts.pdf?sfvrsn=16>> (last accessed 29 December 2017).

3. Key Criteria

The starting point for any tribunal faced with an application for security for costs is at least *prima facie* evidence that the claimant is unlikely to be able to pay an adverse costs award (having regard to the likely quantum of such award).

In deciding security for costs applications, the majority of commercial arbitration tribunals appear to adopt, to the extent that this is possible under the applicable national law, a consent-based approach, looking into whether a material and unforeseeable change of circumstances has occurred since the conclusion of the arbitration agreement.⁴⁰¹ Such an approach is based on the consensual nature of commercial arbitration and the fact that the parties to an international commercial arbitration have agreed to arbitrate their disputes in the first place. In this respect, it is generally accepted that if the financial circumstances of the claimant have not materially and unforeseeably changed since the conclusion of the arbitration agreement, the claimant's inability to satisfy an adverse costs award may be taken to have been accepted by the respondent as part of the business risk at the inception of the parties' relationship.⁴⁰² For example, if a party contracts with a special purpose vehicle, without obtaining a parent company guarantee, it cannot later complain that the counterparty lacks funds to pay an adverse costs award.

As discussed below, some investment treaty tribunals also introduce a requirement of bad faith or abuse on the part of the claimant.

C. Key Observations and Suggestions

Both in commercial and investment arbitrations, arbitral tribunals will typically have the power to order security for costs, either pursuant to arbitration laws and/or rules explicitly providing for such power, or general provisions on interim measures. When an arbitral tribunal is faced with a security for costs application, it must balance the claimant's interest in having access to arbitral justice and the respondent's interest in recovering its costs if it wins. Assuming that an arbitral tribunal will shift costs to the losing party (see previous section), the question arises as to how third-party funding arrangements may affect whether an arbitral tribunal should grant security for these – potentially recoverable – costs.

401. See, e.g., *XXX INC., incorporée dans une île des Caraïbes v. YYY S.A., incorporée dans un pays d'Amérique latine*, (ICC Case No. 15951/FM), Procedural Order No. 2 (29 May 2009), 28 ASA Bulletin (2010, Issue 1) p. 75.

402. See CIARB's International Arbitration Practice Guidelines on Applications for Security for Costs 2015, Article 3, available at: <<https://www.ciarb.org/docs/default-source/practice-guidelines-protocols-and-rules/international-arbitration-guidelines-2015/2015securityfor-costs.pdf?sfvrsn=16>> (last accessed 29 December 2017).

Two questions arise here: first, whether tribunals *can* award security for costs. Second, assuming that tribunals have the power to award security for costs, whether they *should* award security for costs when the claimant is funded by a third party.

At the outset, it must be emphasized that it is not the aim of this Chapter to prescribe the required standards for security for costs applications, either for commercial or investment arbitrations. Rather, the analysis here is based on what different arbitration tribunals have found to be the standards for security for costs applications in both commercial and investment arbitration. It is further noted that security for costs applications will be decided under the standards set by the applicable national law or applied by courts or tribunals in that jurisdiction; in this respect, various national laws may lay down differing standards for security for costs applications. Accordingly, any reference to the term “impecunious” in this Report should be taken as a reference to the meaning that the term has under the appropriate test laid down by the applicable national law.⁴⁰³

1. Whether Tribunals Have the Power to Award Security for Costs

As noted above, certain national laws and arbitral procedural rules expressly prescribe that the arbitral tribunal may order security for costs. The test for awarding security can usually be found in case law and published arbitral decisions and commentaries.

Where the applicable arbitration law or arbitral rules contain a general clause providing for interim measures, rather than specifically permitting security for costs orders, it is generally accepted that arbitrators will typically have the power to award security for costs orders even under the general provisions for interim measures.⁴⁰⁴ In such a case, the party requesting security for costs will have to prove the requirements for interim relief set out in the applicable national law, which often include *prima facie* jurisdiction, necessity and urgency and no prejudice.⁴⁰⁵ Relatedly, an ICSID tribunal noted that one of the reasons why the general clause on interim measures contained in Article 47 ICSID Convention should cover security for costs is that, when the ICSID Convention was drafted in 1965, “issues such as third party funding and thus the shifting of the financial risk away from the claiming party were not as frequent, if at all, as they are today”.⁴⁰⁶

403. See CIArb’s International Arbitration Practice Guidelines on Applications for Security for Costs available at: <<https://www.ciarb.org/docs/default-source/practice-guidelines-protocols-and-rules/international-arbitration-guidelines-2015/2015securityforcosts.pdf?sfvrsn=16>> (last accessed 29 December 2017).

404. BORN, *International Commercial Arbitration*, pp. 2494-2495.

405. Compare *South American Silver Limited v. Bolivia*, (PCA Case No. 2013-15) Procedural Order No. 10 (11 January 2016), para. 57.

406. *RSM Production Corporation v. Saint Lucia*, (ICSID Case No. ARB/12/10) Decision on Saint Lucia’s Request for Security for Costs (13 August 2014) para. 55. Whether the explanation offered by the Tribunal in this case is accurate or supported by the history of

It is arguable whether a tribunal will have the power to grant security for costs when there is no express legal rule to that effect nor any general clause on interim measures exists that could serve as a basis for the tribunal's power to order security for costs. According to some commentators, a tribunal will still have the power to order security for costs on the basis of its inherent power to preserve the integrity of the proceedings.⁴⁰⁷

2. Does the Fact that a Party is Funded by a Third Party affect the Tribunal's Decision on Security for Costs?

While tribunals normally apply different tests depending on the applicable laws and on whether the case is a commercial or investment arbitration, one essential consideration they take into account is the claimant's ability to satisfy an adverse costs award.⁴⁰⁸ The following sections provide an overview of the circumstances which international arbitration tribunals have found to be relevant in deciding security for costs applications in commercial and investment arbitration. The analysis concludes with general observations applying to both types of arbitration.

a. Commercial Arbitration

There is an argument to the effect that the existence of third-party funding is relevant to an application for security for costs, as it implies that the funded party is impecunious *per se*. Further, there have been cases where arbitral tribunals have found that entering into of an arbitration funding agreement did constitute "a fundamental change of circumstances which would justify granting security for costs".⁴⁰⁹

drafting the ICSID Convention is questionable, and the question of the propriety and jurisdiction to order a State to post security for costs is much more complex.

407. CRAIG, PARK and PAULSSON, *International Chamber of Commerce Arbitration*, p. 467 (who report that even when the ICC Rules did not yet contain a general clause for granting interim measures, 'ICC tribunals had found that they had the power to grant security for costs as part of their inherent powers in connection with the conduct of arbitral proceedings') (with further references); *Commerce Group Corp. & San Sebastian Gold Mines, Inc. v. the Republic of El Salvador*, (ICSID Case No. ARB/09/17), Annulment Proceeding, Decision on El Salvador's Application for Security for Costs (20 September 2012), para. 45.

408. BORN, *International Commercial Arbitration*, p. 2495. See also CI Arb's International Arbitration Practice Guidelines on Applications for Security for Costs available at: <<https://www.ciarb.org/docs/default-source/practice-guidelines-protocols-and-rules/international-arbitration-guidelines-2015/2015securityforcosts.pdf?sfvrsn=16>> (last accessed 29 December 2017).

409. Although the tribunal in this case seems to have applied a broader fairness test (see discussion under *i. on p. 171*): *X v. Y and Z*, (ICC Case) Procedural Order (3 August 2012), published in P. PINSOLLE, "Third Party Funding and Security for Costs" Cahiers

On the other hand, however, there is rising concern that non-funded parties are using the “impecuniousness assumption” to justify routinely submitting security applications as a means of delaying and deliberately increasing the costs of the resolution of meritorious claims.

Overall, the position adopted by the Task Force is that obtaining funding from a third party should not be taken to suggest material deterioration of the claimant’s finances, since, as has been discussed in detail above,⁴¹⁰ funding is widely used by financially stable parties in order to share risk and maintain liquidity.

i. Broader fairness concerns

The situation looks quite different if one applies a broader fairness test to third-party funding scenarios, which is essentially what an ICC tribunal did in an order dated 3 August 2012. The terms of the funding agreement were on the record because the claimant had previously transferred the agreement to the respondent, without indicating any reasons for this. The tribunal therefore examined in great detail the terms of the funding agreement and ultimately granted the security order, essentially because (1) the claimant was a holding company based in Cyprus that was unlikely to be able to pay adverse costs; (2) the funding agreement did not cover adverse costs; and (3) in the tribunal’s view the funder’s termination rights under the funding agreement meant that the funder was “empowered to terminate the Agreement at any time, entirely at its discretion”.⁴¹¹

The tribunal pointed out that the claimant engaged in an unfair “cherry-picking”: the funding agreement enabled the claimant to arbitrate as if it was solvent while not assuming the economic risk of this arbitration due to its impecuniosity. In addition, the arbitrators’ view was that there was a risk of the funder walking out at any time, leaving the claimant without means to continue with the arbitration or pay adverse costs. Some may even want to go a step further and argue that the asymmetric situation of a claimant being able to arbitrate while not running economic risks as to the arbitration is in itself sufficient to grant security for costs.

Certainly, there are valid counter-arguments: the claimant here was impecunious from the start, so that the respondent could never have really expected to recover its costs. If a tribunal indeed wishes to take into account broader fairness considerations and ask whether it would be unfair for the funded party to proceed without security in

de l’arbitrage/Paris J. Int’l Arb. (2013, No. 2), p. 399 at paras. 28, 33. For a critique of this decision, see E. A. SCHWARTZ, *Security for Costs and Third-Party Funding, a Bridge Too Far, Liber Amicorum William Laurence Craig*, Lexis Nexis (2016), pp. 371-388.

410. See Chapter 2, p. 20.

411. *X v. Y and Z*, (ICC Case), Procedural Order (3 August 2012), published in P. PINSOLLE, “Third Party Funding and Security for Costs”, para. 43. It should be pointed out here that this type of termination rights in a funding agreement would be anomalous in the third-party funding market today (see also: CI UK Code of Conduct).

light of all the circumstances, this will require an analysis of the precise terms of the funding agreement, which might in turn be used as an argument in favour of disclosure of such agreement.

Another important aspect for arbitrators to be aware of and take into account are arrangements between the funder and the funded party as to whether the former has undertaken to finance any adverse costs. Where the funder is liable to the funded party to cover an adverse costs order and the capital adequacy of the funder to meet an adverse costs award is shown, an order for security for costs may be seen as dispensable.

While looking into broader fairness considerations is an interesting approach, it clearly remains a minority view with tribunals in commercial arbitration normally adopting a consent-based approach to security for costs applications and applying a “material change of circumstances” test.⁴¹²

b. Investment Arbitration

Investment arbitration raises some unique issues with respect to security for costs.⁴¹³

i. Do states have a protected right to security for costs under ICSID arbitration?

While the ICSID Convention provides that each party must abide by and comply with the terms of the award,⁴¹⁴ execution of the award is left to the national applicable law.⁴¹⁵ Accordingly, because the ICSID Convention is not concerned with execution or collection of awards, including the collection of a possible costs award, some tribunals and arbitrators have questioned whether a defendant state has a “right” to security for costs which is protected under the ICSID regime. In *Maffezini v. Spain* for example, the tribunal noted that there was no present right of the respondent state to be preserved.⁴¹⁶ In *Grynberg v. Grenada*, the dissenting arbitrator stated that “the use of the words ‘preserve’ and ‘preserved’ in [ICSID] Article 47 and Rule 39 presupposes that the right to be preserved exists. Because Respondent has no existing right to an ultimate award of costs, the Tribunal is thus without jurisdiction”.⁴¹⁷

412. No other case than the *ICC X v. Y and Z*, (ICC Case), *ibid.*, has been reported as taking a broader fairness approach.

413. See C. SIM, “Security for Costs in Investor-State Arbitration”, *Arbitration International* (2017) p. 427.

414. ICSID Article 53(1).

415. ICSID Article 54(3).

416. *Emilio Agustín Maffezini v. Kingdom of Spain*, (ICSID Case No. ARB/97/7) Procedural Order No. 2 (28 October 1999) para. 15.

417. *Rachel S. Grynberg, Stephen M. Grynberg, Miriam Z. Grynberg and RSM Production Company v. Grenada*, (ICSID Case No. ARB/10/6), Tribunal’s Decision on Respondent’s Application for Security for Costs (14 October 2010), para. 5.16, in fn. 9.

Other ICSID tribunals, such as the tribunal in *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic*⁴¹⁸ and the majority decision in *Grynberg v. Grenada*, accepted that states have a right in a security for costs application, which is protected under the ICSID regime, even if under the circumstances of the case, the requested security for costs was rejected.

In this regard, the tribunal in the recent, *Eskosol S.P.A. in Liquidazione v. Italian Republic*,⁴¹⁹ noted that “there is something analytically curious about the notion that an ICSID tribunal, while not empowered to protect a claimant’s ability to collect on a possible merits award, nonetheless should intervene to protect a State’s asserted “right” to collect on a possible costs award”. While the tribunal in the *Eskosol* case decided not to address this matter as the respondent had failed to demonstrate that the security for costs request was urgent even assuming that the state had a protectable right, it went on to observe that:

“The Tribunal accepts that respondent States have genuine concerns about their ability to enforce an eventual costs award against unsuccessful claimants, and some States are starting to raise the possibility of reforms to the ICSID system to protect themselves more systematically. But at the same time, such States would be unhappy to see a similar argument about a right to effective relief used against them, for example by claimants worried about collection risk associated with any final merits award of compensation.”⁴²⁰

Ultimately, this is still an emerging matter, which is included here for the sake of completeness. The Task Force does not wish to take a position on this matter at this stage.

ii. Relevant considerations

The issue of whether security for costs applications should be granted against investors is predicated on larger policy debates about the legitimacy of investment arbitration more generally, and the role of third-party funding in that debate. A detailed discussion of this larger debate in investment arbitration, including underpinning policy considerations, is provided in Chapter 8. As already mentioned, the primary aim of this Chapter is to state the current position of the law, as this emerges from analysis of the relevant investor-state cases, and capture the more technical considerations in relation to security for costs applications.

418. *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic* (ICSID Case No. ARB/14/14), Procedural Order No. 3 (23 June 2015).

419. *Eskosol S.P.A. in Liquidazione v. Italian Republic*, (ICSID Case No. ARB/15/50) Procedural Order No. 3 (Decision on Respondent’s Request for Provisional Measures), (12 June 2017) para. 35.

420. *Ibid.*, para. 34.

From a review of a growing number of cases dealing with this matter, it appears that tribunals in ICSID arbitration tend to adopt a stricter test than the claimant's impecuniosity to order security for costs: they usually require evidence of abusive conduct or bad faith on the part of the claimant,⁴²¹ such as evidence that the claimant has a track record of deliberately failing to comply with costs awards.

While this appears to be an increasingly accepted test for investment arbitration tribunals, it is questionable whether such a high threshold is warranted. It can reasonably be argued that, if the respondent state was subject to an unsuccessful claim, it should be able to recover costs at the end of the arbitration regardless of whether the claimant is acting in bad faith or not.

On the other hand, an investor may claim that it would be unreasonable for a tribunal to order an investor to meet a security for costs order, because the state's unlawful conduct (assuming that the state's conduct in question is indeed unlawful) has diminished or even expropriated their investment in the first place, and has left the investor with limited or no available funds to conduct a usually costly investor-state arbitration. This can be a powerful argument, not least because it raises, from the investors' perspective, issues of access to justice.⁴²²

In practice however, when investor-state tribunals decide security for costs requests, usually at an early stage of the arbitration process, they tend not to presume that the state's conduct has actually left an investor with limited available funds to avoid prejudging the merits of the dispute and thus violating fundamental principles of procedural fairness.

This explains why investment tribunals tend to focus on other considerations, which are not directly related to the merits of the dispute, but nevertheless set a high threshold for a claimant to be subject to a security for costs order in investment arbitration, including for example the requirement that the claimant has exhibited abusive conduct by repeatedly failing to comply with costs orders or deliberately dissipating its assets.

Against this background, it is perhaps unsurprising that investment arbitration tribunals have consistently dismissed applications for security for costs in the past. In doing so, these tribunals have relied on a range of different arguments, such as the following:

421. See, e.g., *South American Silver Limited v. The Plurinational State of Bolivia*, (PCA Case No.2013-15), Procedural Order No. 10 (11 January 2016), para. 59; *RSM Production Corporation v. Saint Lucia*, (ICSID Case No. ARB/12/10), Decision on Saint Lucia's Request for Security for Costs (13 August 2014), para.75 and the cases cited therein.

422. See similar concerns expressed in commercial arbitration by E. SCHWARTZ, "Security for Costs and Third-Party Funding, a Bridge Too Far", in *Liber Amicorum William Laurence Craig*, (LexisNexis 2016) 371-388.

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- impropriety of prejudging the claimant’s case on the merits;⁴²³
- failure on the part of the respondent to establish concrete risk of non-payment;⁴²⁴
- there is nothing unusual in the fact that the claimant is a vehicle or has no assets and this does not justify a security for costs award;⁴²⁵
- a security for costs award would limit claimant’s access to justice;⁴²⁶
- the rejection of the security for costs application does not pose a threat to the integrity of the proceedings.⁴²⁷

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423. *Emilio Agustín Maffezini v. Kingdom of Spain*, (ICSID Case No. ARB/97/7), Procedural Order No. 2 (28 October 1999), para. 21; *Libananco Holdings Co. Limited v. Republic of Turkey*, (ICSID Case No. ARB/06/8), Decision on Preliminary Issues (23 June 2008), para.59; *Guaracachi America, Inc. (U.S.A.) and Rurelec plc (United Kingdom) v. Plurinational State of Bolivia*, (PCA Case No. 2011-17), Procedural Order No.14 (11 March 2013), para. 8.
424. *Victor Pey Casado and President Allende Foundation v. Republic of Chile*, (ICSID Case No. ARB/98/2), Decision on Provisional Measures (25 September 2001), para. 89; *Burimi S.R.L. and Eagle Games S.H.A. v. Republic of Albania*, (ICSID Case No. ARB/11/18), Procedural Order No. 2 (3 May 2012), para. 39; *Alasdair Ross Anderson et al. v. Republic of Costa Rica*, (ICSID Case No. ARB(AF)/07/3), Award (19 May 2010), para. 9; *Abaclat and others v. The Argentine Republic*, (ICSID Case No. ARB/07/5), Procedural Order No. 10 (18 June 2012); *Rachel S. Grynberg, Stephen M. Grynberg, Miriam Z. Grynberg and RSM Production Company v. Grenada*, (ICSID Case No. ARB/10/6) Tribunal’s Decision on Respondent’s Application for Security for Costs (14 October 2010), para. 5.21; *Libananco Holdings Co. Limited v. Republic of Turkey*, (ICSID Case. No. ARB/06/8), Decision on Preliminary Issues (23 June 2008), para.59; *Guaracachi America, Inc. (U.S.A.) and Rurelec plc (United Kingdom) v. Plurinational State of Bolivia*, (PCA Case No. 2011-17), Procedural Order No. 14 (11 March 2013), para. 7, *Dawood Rawat v. Republic of Mauritius*, (PCA Case No. 2016-20), Order Regarding Claimant’s and Respondent’s Requests for Interim Measures (11 January 2017), para. 144.
425. *BSG Resources Limited v. Republic of Guinea*, (ICSID Case No. ARB/14/22), Procedural Order No. 3 (25 November 2015), para.78; *Libananco Holdings Co. Limited v. Republic of Turkey*, (ICSID Case. No. ARB/06/8), Decision on Preliminary Issues (23 June 2008), para.59; *Rachel S. Grynberg, Stephen M. Grynberg, Miriam Z. Grynberg and RSM Production Company v. Grenada*, (ICSID Case No. ARB/10/6) Tribunal’s Decision on Respondent’s Application for Security for Costs (14 October 2010), para. 5.19.
426. *Burimi S.R.L. and Eagle Games S.H.A. v. Republic of Albania*, (ICSID Case No. ARB/11/18), Procedural Order No. 2 (3 May 2012), para.41; *Gustav F W Hamster GmbH & Co KG v. Republic of Ghana*, (ICSID Case No. ARB/07/24), Award (18 June 2010), para.17; *Commerce Group Corp. & San Sebastian Gold Mines, Inc. v. the Republic of El Salvador*, (ICSID Case No. ARB/09/17), Annulment Proceeding, Decision on El Salvador’s Application for Security for Costs (20 September 2012), para. 52.
427. *Commerce Group Corp. & San Sebastian Gold Mines, Inc. v. Republic of El Salvador*, (ICSID Case No. ARB/09/17), Annulment Proceeding, Decision on El Salvador’s Application for Security for Costs (20 September 2012), para. 49.

iii. Third-party funding as abuse or bad faith?

Some have argued that third-party funding should in itself be a reason for ordering security against the funded party, or at least shift the burden of proof to the effect that the funded party must make a case why security should not be granted.⁴²⁸ However, assuming that the test in investment arbitration is that the respondent must demonstrate exceptional circumstances in the form of an element of bad faith or abuse on the claimant side, the question is whether a claimant's recourse to third-party funding affects the decision on security for costs.

An argument frequently raised by respondents in order to demonstrate an element of bad faith is that the simple fact of recourse to funding would necessarily or at least probably result in situations where the claimant's expenses are being covered by a third party who stands to gain if the claimant wins, but would not be liable to meet any award of costs that might be made against the claimant if it lost.

The growing body of arbitral case law on this question in response to such argument has been quite consistent in holding that mere recourse to third-party funding is not generally considered to carry an element of bad faith or abuse, which is typically required by investment tribunals to award security for costs. Thus, the existence of a funding agreement alone has not been found by arbitration tribunals to be sufficient to grant security for costs.

The first case to explicitly address the issue was *Guaracachi America Inc. and Rurelec plc v. Bolivia*, in which the tribunal refused to order security for costs.⁴²⁹ Given the controversy that the question generated in the wake of *RSM Production Corporation v. St Lucia*, discussed below, it is worth citing the tribunal's reasoning *in extenso*: "[a]lthough investment treaty tribunals clearly hold the power to grant provisional measures, an order for the posting of security for costs remains a very rare and exceptional measure. (...) The Respondent has not, however, been able to supply evidence to justify the extraordinary measure that it requests. As a factual matter, the Respondent has not shown a sufficient *causal link such that the Tribunal can infer from the mere existence of third party funding that the Claimants will not be able to pay an eventual award of costs rendered against them, regardless of whether the funder is liable for costs or not.* The Respondent's analysis of Rurelec's balance sheet and other related financial documents also does not sufficiently demonstrate that Rurelec will lack the means to pay a costs award or to obtain (additional) funding for that purpose. To the contrary, Rurelec appears to be an ongoing concern with assets beyond those involved in this arbitration and the Claimants have promptly paid all the requested deposits of costs with no suggestion that they have had trouble finding the necessary funds to do so."⁴³⁰

428. See notably *RSM Production Corporation v. Saint Lucia*, (ICSID Case No. ARB/12/10), Assenting Reasons of Gavan Griffith (12 August 2014).

429. *Guaracachi America Inc. and Rurelec plc v. Plurinational State of Bolivia* PCA Case No. 2011-17, Procedural Order No. 14 (11 March 2013).

430. *Ibid.*, paras. 6-7.

In *RSM Production Corporation v. St Lucia*, where an ICSID tribunal – for the first time ever in investment treaty arbitration – issued a security for costs order.⁴³¹ The respondent argued that, while no ICSID tribunal had ordered security before, such measure would be justified here, pointing out that the claimant had failed to pay ICSID’s advance on costs, had not honoured costs awards rendered against it in a number of previous ICSID arbitrations, and that “the proceedings initiated by Claimant are funded by third parties”. Claimant’s counsel had admitted this already at a hearing on ICSID’s advance on costs. The respondent further claimed that these third parties would not be liable for adverse costs, enabling the claimant to engage in “arbitral hit and run”. The claimant contested the tribunal’s jurisdiction to order security and additionally argued that a difficult financial situation would not be sufficient to justify a grant of security payment against claimants in ICSID proceedings. Additionally, claimant challenged whether its current conduct would give reason to doubt about its willingness to pay adverse costs.

In reaching its decision to order security, the RSM tribunal did take into account that the claimant was impecunious and was funded by a third-party that could presumably not be made responsible for any adverse costs award. Notably, the tribunal pointed out that it would be “unjustified to burden Respondent with the risk emanating from the uncertainty as to whether or not the unknown third party will be willing to comply with a potential cost award”. Yet, the decisive factor for the tribunal to grant the requested security for costs was the fact that the claimant had a proven history of not complying with costs awards rendered against it. The fact that the third-party funder was not revealed (and was therefore unknown) to the tribunal was incidental in the tribunal’s reasoning.⁴³²

In *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic*,⁴³³ the respondent advanced strikingly similar arguments, arguing not only that it had a good case on the merits, but also that the claimants “‘have a history of engaging in fraud and renegeing on payment obligations’ and that they do not have the means to pay for the costs of the arbitration proceedings, which are entirely funded by third parties”. The claimants contested the tribunal’s power to order security for costs, argued that ordering security would unduly restrict their access to justice, and that their financial difficulties were “in large part attributable to acts and omissions of Respondent”. The arbitrators explicitly distinguished the case before them from *RSM Production Corporation v. Saint Lucia* and denied the respondent’s security request, pointing out that “the underlying facts in [the RSM] arbitration were rather exceptional since the claimant was not only impecunious and funded by a third party, but also had a proven history of not

431. *RSM Production Corporation v. Saint Lucia*, ICSID Case No. ARB/12/10, Decision on Saint Lucia’s Request for Security for Costs (13 August 2014).

432. *Ibid.*, para. 86. It is worth noting that on fifteen pages of reasons, only one paragraph is in truth devoted by the tribunal to third-party funding.

433. *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic*, (ICSID Case No. ARB/14/14), Procedural Order No. 3 (23 June 2015).

complying with cost orders. As underlined by the arbitral tribunal, these circumstances were considered cumulatively.” The tribunal went on to note that the respondent had failed to establish that the claimants had defaulted on their payment obligations in the present proceedings or in other arbitration proceedings. It concluded by making it clear that “financial difficulties and third-party funding – which has become a common practice – do not necessarily constitute per se exceptional circumstances justifying that the Respondent be granted an order of security for costs”.

In *South American Silver Limited v. The Plurinational State of Bolivia*, the respondent argued that the claimant was an impecunious shell company which was funded by a third party, which in combination, according to some arbitrators, would create “a prima facie case for granting the *cautio judicatum solvi*”, meaning that the burden of proof is transferred to the funded party, who must prove why the *cautio judicatum solvi* should not be ordered.⁴³⁴ Referring to *RSM v. St. Lucia*, the claimant pointed out that “the only investment tribunal that has ever issued security for costs did so primarily because of the claimant’s notorious history of failing to pay prior cost awards”, and that the position that “the mere uncertainty as to the existence of a third-party funder’s obligation to reimburse constitutes ‘compelling grounds for security for costs’ correspond[s] to a minority view”, while “[t]he majority of international tribunals have stated the contrary in recent decisions, and on the contrary, the existence of a funder indicates that the claim is plausible on the merits”. The PCA tribunal transferred the “extreme and exceptional circumstances-test” favoured by ICSID tribunals into the framework of Article 26 of the applicable UNCITRAL Arbitration Rules, concluding that “Bolivia’s mere analysis of SAS’ or SASC’s balances and other related accounting documents, or the mere existence of a third-party funder do not meet the high threshold set forth by investment tribunals.”⁴³⁵ In reaching this conclusion, the tribunal explicitly referred to the two previously mentioned cases, and confirmed that “the mere existence of a third-party funder is not an exceptional situation justifying security for costs”, explaining that:

“[i]f the existence of these third-parties alone, without considering other factors, becomes determinative on granting or rejecting a request for security for costs, respondents could request and obtain the security on a systematic basis, increasing the risk of blocking potentially legitimate claims.”⁴³⁶

434. *South American Silver Limited Bolivia v. The Plurinational State of Bolivia*, (PCA Case No.2013-15), Procedural Order No. 10 (11 January 2016), para. 27, citing *RSM Production Corporation v. Saint Lucia*, (ICSID Case No. ARB/12/10), Assenting Reasons of Gavan Griffith (12 August 2014).

435. *South American Silver Limited Bolivia v. The Plurinational State of Bolivia*, (PCA Case No.2013-15), Procedural Order No. 10 (11 January 2016), paras. 59, 83.

436. *Ibid.*, para. 77.

In a procedural order issued in April 2017 in the case *Eskosol S.P.A. v. Italy*,⁴³⁷ the tribunal rejected the respondent's request for an order that the claimant post a bank guarantee of US\$ 250,000 or prove it had obtained an undertaking from its third-party funder to pay any costs awards against it, notwithstanding the fact that the claimant had been declared insolvent and placed under receivership in 2013. In its security for costs application the respondent argued that the claimant's insolvency made it unlikely that it would be able to meet any adverse costs, if the claim was declined. The respondent further argued that a security for costs order was necessary and urgent because it had "a suspicion" that the claimant was funded by a third-party funder, which –according to the respondent- increased the risk that the claimant would not comply with a costs order. Responding to the security for costs application, the claimant confirmed that it had been funded by a third-party funder which had assisted the claimant to purchase an ATE insurance policy protecting the company against adverse costs of up to Euro 1 million. While accepting that the claimant's insolvency meant that the claimant would be unable to meet an adverse costs award from its own funds, the tribunal stated that the ATE insurance policy was sufficient to cover the amount of costs requested by the respondent. The tribunal thus concluded that the respondent had failed to demonstrate that it was either necessary or urgent to grant the security for costs application.

However, in two recent procedural orders issued in July 2017 in relation to the same investment dispute in the parallel cases of *Luis Garcia Armas v. Venezuela* and *Manuel Garcia Armas et al. v. Venezuela*,⁴³⁸ the tribunal (sitting in both cases) ordered the funded claimants to provide evidence on their solvency before deciding a request for security for costs made by the respondent state.

In these two cases, the claimants had voluntarily disclosed the existence of a third-party funding agreement. In response to a request by the respondent state, the tribunal had subsequently ordered the claimants to disclose the actual terms of their funding arrangements. Because the funding agreement included a provision that the funder did not undertake to finance any adverse costs related to the arbitration, the respondent requested the tribunal to order the claimants to post a US\$ 5 million bond as security for adverse costs.

Before deciding on the request for security, the tribunal asked the claimants to provide reliable evidence of their solvency, including asset valuations. The claimants were also directed to inform the tribunal of the jurisdictions where those assets were located, in order to assess the enforceability of any future adverse costs order. While these proceedings were still ongoing, at the time this Report was finalized, and the

437. *Eskosol S.P.A. in Liquidazione v. Italian Republic*, (ICSID Case No. ARB/15/50) Procedural Order No. 3 (Decision on Respondent's Request for Provisional Measures), (12 June 2017). See also above p. 173.

438. *Luis Garcia Armas v. Venezuela and Manuel Garcia Armas et al. v. Venezuela*, (ICSID AF Case No. ARB(AF)/16/1) Procedural Order (7 July 2017) administered by ICSID's Additional Facility Rules; PCA Case No. 2016-08, administered by the Permanent Court of Arbitration, (Both with the seat in The Hague, The Netherlands).

decision on the respondent's security for costs application was still pending, the tribunal's request that the claimants provide evidence of their solvency appears to have shifted the burden of proof of impecuniosity from the respondent to the claimants.

c. Concluding Analysis for Both Commercial and Investment Arbitration

As the preceding analysis shows, a key aspect in any security for costs analysis will usually be the financial situation of the party against which security is requested. Subject to the security for costs test under the applicable national law, tribunals tend to require sufficient evidence to conclude that the current financial circumstances of the claimant are such that it will not be able to pay the respondent's costs at the end of the proceedings.

What can, then, be the relevance of a third-party funding agreement in determining whether the claimant is impecunious? On the one hand, it could be argued that the fact that a claimant is actively seeking external funding to pursue its claim is evidence (or at least an indication) of the claimant's difficult financial circumstances. It might even be said that the existence of third-party funding arrangements should set a rebuttable presumption of the claimant's impecuniosity.⁴³⁹ However, the assumption that a funded party is impecunious misconprehends the current state of third-party funding. Most of the funders, including in the Task Force, suggest and arbitration practitioners confirm that third-party funding is increasingly used by large, solvent companies that simply wish to share risk and maintain liquidity. As has been pointed out, "companies that want to maintain sufficient cash flow to continue their regular business while the arbitral proceedings are ongoing, or that simply want to share the risk of the arbitration with a third party" may "seek financing to pursue a meritorious claim."⁴⁴⁰ As has been noted "third-party financing is increasingly a tool of choice, not of necessity. Some of the world's largest companies are regular users of outside financing."⁴⁴¹

These observations provide one explanation as to why arbitration tribunals, as discussed in the preceding sections, tend to reject security for costs applications which are mainly or exclusively based on the grounds that the claimant is funded by a third-party funder. It is thus suggested that applications for security for costs in international arbitration should be determined irrespective of any funding arrangement, and on the basis of, among other reasons, impecuniousness. In the first instance, the burden should

439. See for example, *RSM Production Corporation v. Saint Lucia*, (ICSID Case No. ARB/12/10), Assenting Reasons of Gavan Griffith, (12 August 2014). Mr Gavan Griffith reiterated this view by providing feedback to the Draft Report at the period of public consultation.

440. See V. FRIGNATI, "Ethical Implications of Third Party Funding in International Arbitration", 32 *Arbitration International* (2016, Issue 3) p. 506.

441. C. P. BOGART, "Third-party financing of international arbitration", *The European Arbitration Review 2017* (GAR Special Report) (14 October 2016) p. 10, available at <<http://globalarbitrationreview.com/insight/the-european-arbitration-review-2017/1069316/third-party-financing-of-international-arbitration>> (last accessed 19 August 2016).

be on the moving party, and it is suggested that no party should have to defend a motion for security unless and until the moving party makes a *prima facie* showing of impecuniousness. If no such showing is made, then the motion should be denied outright.

If a party is found to be impecunious, that party should then be given the opportunity to present additional evidence of funding or have a security for costs award imposed. If the party has third-party funding arrangements in place, in which the funder agrees to pay any costs award, it could then be submitted to the tribunal as evidence that no security need be posted.

At that stage, a request for disclosure of third-party funding agreements should normally be accepted as the moving party and the tribunal should be able to examine the relevant parts of the third-party funding agreement in the context of the security for costs application against an impecunious party. In this regard, ordering disclosure of the third-party funding agreements in their entirety may have a negative effect on the arbitration proceedings. Tribunals are thus encouraged to limit disclosure orders to the provisions that are strictly necessary to assess the extent to which the funder may cover (or not) an adverse costs order. Another approach could be to allow the funded party, its counsel or even the funder to provide the tribunal with a witness statement or affidavit stating its identity and whether under the third funding party agreements it can be held liable for adverse costs.

As already indicated, one important provision in a third-party funding agreement, which the tribunals should review, will be the provision about whether the funder has agreed to cover adverse costs, including an order for security for costs. The funding agreement should normally clearly set out whether the funder will pay a defined sum to the claimant in the event of an adverse award of costs, whether that promise endures if the funding agreement has been breached or otherwise terminated, and whether the funder will pay any order of security for costs. And if the party is impecunious, both the funder and party should be aware that a funding agreement in which a funder is not obligated to irrevocably pay an award of costs may cause the tribunal to order security for costs. In all cases, where a funder has agreed with the funded party to finance any adverse costs, the capital adequacy of that funder to meet an adverse costs award, whether in its own right or by virtue of an ATE policy, is clearly relevant in assessing whether adequate security has been provided.

Another relevant provision in the context of a security for costs application will be the provision in a third-party funding agreement about the funder's termination rights. Where a third-party funder has agreed to finance adverse costs, whether and under which conditions a funder can discontinue funding may be a relevant consideration for tribunals to take into account. Most professional funders have very clear termination provisions which set out, in circumstances where they have agreed to be liable for adverse costs, when they are liable for such costs, which typically is for the duration of their funding. Where a funder is a member of the Association of Litigation Funders of England and Wales (ALF), its funding agreements must comply with the ALF Code of Conduct for Litigation Funders (ALF Code, January 2014). Article 13.2 ALF Code requires that, in case of a dispute over termination, "a binding opinion shall be obtained

from a Queen’s Counsel who shall be instructed jointly or nominated by the Chairman of the Bar Council”. Only if the Queen’s Counsel agrees with the funder that it is lawful to terminate, will the Termination Notice be valid. Funders operating in other jurisdictions may have internal codes that set out their practice in respect of whether and under which circumstances they can terminate funding. In all cases where the defendant has previously knowingly proceeded on the basis that the funder would meet the adverse costs, it is suggested that third-party funders or funded parties should notify the defendant if funding is discontinued.

The form of security for costs order was the subject of a large number of comments at the public consultation period. For example, comments were received to the effect that a bank guarantee is typically costly and therefore it may not be the most cost-efficient way of providing security for costs. Under this view, it would be preferable for tribunals to require evidence of “a credit worthy third party” or order payment into escrow account.

Other comments addressed alternatives. One comment suggested that a deed poll executed by the third-party funder in favour of the respondent and the tribunal would be a reasonable alternative form of security. Another comment noted that in circumstances where a party is impecunious and calls upon a third-party funder, it will generally be impossible for that party to obtain a bank guarantee, because the bank will ask for collateral that the impecunious party will precisely be unable to give. In such a situation, the only way to post security would be to increase the amount committed by the third-party funder, which however would increase the ultimate amount that the party posting security will have to return to the funder, in case it prevails in the arbitration.

The Task Force concluded, while the question of the appropriate form that security for costs should be given should be left to the tribunal’s discretion, tribunals should take into account the existing arrangements between the funded party and external funders in this regard. For example, the existence of an ATE insurance policy or any other form of evidence of indemnification arrangements, including with a third-party funder, should generally be considered as adequate evidence that the claimant will meet an adverse costs award.⁴⁴² By way of comparison, in cases where the claimant is funded by a P&I and FD&D club or an ordinary insurer, security for costs can be provided by way of a club letter of guarantee or an insurer’s bond. Typically, the club and insurer have a contractual obligation to indemnify the member or insured for any

442. See also Victorian Supreme Court in *DIF III Global Co-Investment Fund LP & Anor v. BBLP LLC & ors* [2016] VSC 401 and *Australian Property Custodian Holdings Ltd v. Pitcher Partners* [2016] VSC 399 where it was held that a Deed of Indemnity provided by ATE insurer directly to a defendant constituted adequate security for the defendant’s costs. However, see also *Petersen Superannuation Fund Pty Ltd v. Bank of Queensland Limited* [2017] FCA 699, where the Court held that ATE Deed of Indemnity was not considered, in the circumstances, sufficient form of guarantee, including because the respondents were not made parties to the Deed and that the ATE in question included a number of potentially important exclusion.

liability incurred, including costs awards. In the absence of an ATE policy or other form of evidence of indemnification arrangements, tribunals could well consider ordering security for costs by way of a parent company guarantee, a bank guarantee or, as in exceptional circumstances, a payment into a bank account.⁴⁴³

Finally, when a security for costs application is lodged, an arbitral tribunal should consider indicating to the respondent (the requesting party) that, should the claimant prevail on the merits of the case, the respondent will be held liable for the costs reasonably incurred by the claimant (funded party) in posting security. It should be for the claimant (funded party) to substantiate the amount of costs it reasonably incurred in posting security. This seems desirable from a policy perspective, as it provides a legally fair and financially risk neutral solution to granting security for costs. At the beginning of the proceedings, the tribunal can at best perform a *prima facie* assessment of the respondent's chances of succeeding on the merits. If the tribunal denies the respondent's application for security it risks evaluating the merits in a way that *ex post* may prejudice the respondent, should the respondent ultimately prevail and be unable to recover costs. At the same time, if the tribunal grants the respondent's security request and the claimant ultimately prevails, the security application would turn out to be a win-win option for the respondent, as there would be no downside for having requested (as it turned out unnecessary) security. By granting security payment on the premise that the respondent must contribute towards the cost of the security should the claimant prevail on the merits, the tribunal can restore the financial balance between the parties, both of which continue to run risks in relation to the money posted. This approach avoids prejudging the case in favour of either side. The tribunal may even order the requesting party to provide counter-indemnity and its own security.

IV. Conclusion

In conclusion, the principles articulated in this Chapter are based on analysis of existing sources and reported investment arbitration cases. The Task Force concluded that these principles are a sound reflection of the existing legal framework, including standards set by investment arbitration cases. The Task Force nevertheless recognizes that these issues can also implicate larger macro-economic and structural debates in investment arbitration, such as those discussed in detail in Chapter 8. If the policies and considerations underpinning third-party funding, which continue to evolve particularly in investment arbitration, change in the future, this change may affect the legal analysis and principles articulated in this Chapter.

443. See also 2015 CI Arb's International Arbitration Practice Guidelines on Applications for Security for Costs, Article 5, available at: <<https://www.ciarb.org/docs/default-source/practice-guidelines-protocols-and-rules/international-arbitration-guidelines-2015/2015securityforcosts.pdf?sfvrsn=16>> (last accessed 29 December 2017).

Chapter 7[†]

Best Practices in Third-Party Funding Arrangements

I. Introduction

As noted in Chapter 1, in its early work, the Task Force engaged in considerable debate about what form its final work product should take. Early suggestions ranged from drafting a code of conduct for third-party funders in international arbitration, similar to the Association of Litigation Funders Code of Conduct in England and Wales, to abstaining from producing any form of guidance. Against the backdrop of these discussions, the Task Force ultimately agreed on two general objectives for the Task Force's work: (1) to promote greater understanding about what third-party funding is and the issues it raises in international arbitration; and (2) to facilitate greater consistency and more informed decision-making in addressing issues relating to third-party funding. In pursuing these objectives, the Task Force also decided to limit its work to those issues that: (1) directly affect international arbitration proceedings; and, (2) are capable of being addressed at an international level.

The issues addressed in the preceding chapters largely fulfil these objectives and limitations. Chapter 4 addresses issues relating to disclosure and arbitrator conflicts of interest; Chapter 5 addresses issues relating to privilege; and Chapter 6 addresses issues relating to costs and security for costs.

While those chapters provide extensive analysis of the issues they address, the Task Force sought to address the major practical questions that funders, the parties, their counsel and tribunals involved in third-party funding issues often encounter. Within these issues the Task Force deemed important to include certain best practices to provide further guidance for tribunals and parties faced with the issues of disclosure, privilege or costs.

In general, the Task Force considered that many of the Principles in previous chapters rely on certain fundamentals being effectively addressed either in the funding agreement or in the parties' negotiations. For example, the Principles regarding privilege in Chapter 5 rely on, or at least are most effective when, the funder and the party have entered into a non-disclosure agreement.

This Chapter aims to provide general guidance in the form of articulation of what constitute good and responsible practices for parties, their counsel and tribunals to consider when entering into or deciding on matters related to third-party funding arrangements. Also, this Chapter includes a checklist for parties and counsel to consult when considering funding options. To that end, the Chapter proceeds as follows: it first provides some general background about funding in national legal systems [III]; it then

[†] Primary contributors to this Chapter were John Roesser, Alain Grec, Michael McIlwrath, and Ralph Sutton.

collects the Principles articulated in other Chapters of this Report and articulates additional best practice norms [III], and finally provides a due diligence checklist that parties (and their counsel) can use as they consider entering into a funding agreement [IV].

II. Background

In offering these proposals, the Task Force recognizes the difficulty of suggesting principles and/or guidelines that apply across myriad jurisdictions, forms of funding transactions and lawyering norms. The Task Force treads especially carefully in its proposals to avoid excessive intrusion upon parties' freedom of contract, recognizing that so long as parties are well represented, they may enter into a wide range of bargains. The availability and sustainability of funding practices is a worthy and important goal for the systemic and long term use of funding. Given the rapid evolution of funding trends, as well as differences among national contracting and lawyering traditions, the issues addressed in this Chapter describe general principles, even if the Task Force recognizes that such distillation has inherent limitations.

Many common law jurisdictions have historically prohibited the funding of litigation (and other forms of dispute resolution) by parties other than those directly involved in the dispute. And some still do. Although such prohibitions have come in many forms over the years, in common law jurisdictions they usually appear as laws prohibiting maintenance and champerty. In plain terms, maintenance is the support of litigation by a stranger without just cause. Champerty, a form of maintenance, is the support of litigation by a stranger in return for a share of the proceeds.

In some of those jurisdictions where such laws still exist, third-party funding is still prohibited. In Ireland, for example, maintenance and champerty are both criminal offences and civil torts, and have been since the 1600s. As recently as 2017, the Supreme Court of Ireland held that third-party litigation funding violated its maintenance and champerty laws.⁴⁴⁴ In the *Persona* decision, the High Court confirmed – consistent with a long line of authority – that the provision of financial assistance to support litigation by a third party in return for a share of the proceeds is both contrary to public policy and an abuse of process, unless that third party has a genuine interest in the litigation. Although an appeal has been accepted by the Supreme Court of Ireland, for now, third-party funding in litigation is prohibited in Ireland.

Other jurisdictions that historically prohibited third-party funding under maintenance and champerty laws have recently introduced reforms to expressly permit third-party funding in international arbitration. Notably, Hong Kong recently enacted legislative reforms to permit third-party funding arrangements that were previously

444. See *Persona Digital Telephony Ltd & ors v. The Minister for Public Enterprise & ors* [2017] IESC 27.

prohibited. The new legislation expressly provides that the doctrines of maintenance and champerty do not apply to domestic or international arbitrations.⁴⁴⁵ The proposed amendments also establish certain disclosure obligations for funded parties, as well as ethical and other standards for counsel and third-party funders.

Singapore has also recently amended its laws to allow for third-party funding in arbitration. As in Hong Kong, the new Singapore law makes clear that the use of third-party funding in international arbitration is not prohibited by existing maintenance and champerty laws, nor is it contrary to public policy.⁴⁴⁶ The new law also provides certain disclosure obligations for funded parties and imposes certain regulations and financial standards on third-party funders.

The purpose of these Best Practices is not to identify the various legal permutations that may affect the ability of a party to obtain third-party funding in a particular jurisdiction. But parties should be aware that third-party funding remains prohibited in some jurisdictions and should generally seek the advice of local counsel before engaging a third-party funder.

The questions on the Checklist included at the end of this Chapter are designed to help parties, counsel, and third-party funders identify the kinds of questions that should be considered when deciding whether to enter into third-party funding arrangement. In particular, this Checklist seeks to identify the key questions that may assist a potential user of third-party funding in determining whether (i) the potential funder is financially able to fund the case in accordance with a state of the art funding agreement, (ii) the potential funder's interests are compatible with those of the potential party, and (iii) the potential funder offers adequate assurances in relation to the integrity and conduct of the case.

The main purpose of the Checklist is to prompt consideration and inquiries that may assist in identifying important details for inclusion in a proposed funding agreement in order to reduce the likelihood of potential misunderstandings due to incompleteness and/or lack of clarity.

III. Principles and Best Practices

This Part of the Chapter collects [A] the Principles provided for in other Chapters along with Best Practices gathered by the Task Force, and articulates [B] several additional matters for consideration by parties, funders, counsel, and arbitrators as well as the Best Practices applicable thereto.

445. See M. CHAN, M. SECOMB and P. TAN, "Third Party Funding: a New Chapter in Hong Kong & Singapore", (29 July 2016) available at <<http://www.jdsupra.com/legalnews/third-party-funding-a-new-chapter-in-40360/>> (last accessed 22 August 2017).

446. See Civil Law (Amendment) Act 2017, §5(b)(2), available at <<http://statutes.agc.gov.sg/aol/search/display/view.w3p;orderBy=date-rev,loadTime;page=0;query=Id%3Aae379db0-c3da-4abe-ad09-1d1518181ee9;rec=0#legis>> (last accessed 28 August 2017).

A. Principles (as set forth in Chapters 4, 5 and 6) and Related Best Practices

This section collects those Principles articulated in other Chapters of the Report.

1. Principles Regarding Disclosure and Conflicts of Interest

- A.1. A party and/or its representative should, on their own initiative, disclose the existence of a third-party funding arrangement and the identity of the funder to the arbitrators and the arbitral institution or appointing authority (if any), either as part of a first appearance or submission, or as soon as practicable after funding is provided or an arrangement to provide funding for the arbitration is entered into.
- A.2. Arbitrators and arbitral institutions have the authority to expressly request that the parties and their representatives disclose whether they are receiving support from a third-party funder and, if so, the identity of the funder.
- A.3. For the purposes of disclosure, the term “third-party funder” refers to any natural or legal person who is not a party to the dispute and is not a party’s legal counsel, but who enters into an agreement either with a party, an affiliate of that party, or a law firm representing that party:
 - a) in order to provide material support for or to finance part or all of the cost of the proceedings, either individually or as part of a specific range of cases, and
 - b) such support or financing is provided through a donation, or grant, or in exchange for remuneration or reimbursement wholly or partially dependent on the outcome of the dispute.
- A.4. In light of any disclosures made regarding the participation of any third-party funder or insurer, arbitrators and arbitral institutions should assess whether any potential conflicts of interest exist between an arbitrator and a third-party funder, and assess the need to make appropriate disclosures or take other appropriate actions that may be required under applicable laws, rules, or Guidelines.

Best Practices Regarding Disclosure and Conflicts of Interest⁴⁴⁷

1. In all jurisdictions, a Party seeking funding and its counsel should ensure that a robust non-disclosure agreement (“NDA”) is entered into before any substantive discussions with a Funder to protect against the disclosure of confidential communications.

447. In general, the Principles and Best Practices in this Chapter are designed for arrangements where third-party funding is provided in return for a remuneration dependent on the outcome of the dispute. For this reason, some sections of this Chapter may not apply to arrangements such as donations or grants.

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2. No transaction details or funding arrangement provisions should be ordered to be disclosed for purposes of determining potential conflicts of interest.

2. Principles Regarding Privilege and Professional Secrecy

- B.1. The existence of funding and the identity of a third-party funder is not subject to any legal privilege.
- B.2. The specific provisions of a funding agreement may be subject to confidentiality obligations as between the parties, and may include information that is subject to a legal privilege; as a consequence, production of such provisions should only be ordered in exceptional circumstances.
- B.3. For information that is determined to be privileged under applicable laws or rules, tribunals should not treat that privilege as waived solely because it was provided by parties or their counsel to a third-party funder for the purpose of obtaining funding or supporting the funding relationship.
- B.4. If the funding agreement or information provided to a third-party funder is deemed to be disclosable, the tribunal should permit appropriate redaction, or take other appropriate measures, and limit the purposes for which such information may be used.

Best Practices Regarding Privilege

1. In all jurisdictions, a Party should seek legal advice regarding the doctrines of privilege, professional secrecy, work product and waiver, under the law applicable to funding arrangements.
2. Arbitral tribunals should generally treat as privileged and not order production of any information that: (1) is determined to be subject to a privilege under either national law or international arbitration standards, and (2) has been provided by a party or its counsel to a funder for the purpose of obtaining funding or supporting the funding relationship during the pendency of arbitral proceedings;
3. The strength and applicability of the privilege described in paragraph a) may be evidenced by, but is not strictly dependent on, an existing agreement between the party and the funder that contains provisions addressing confidentiality and/or non-disclosure; and
4. In those rare instances when documents provided to a funder by a party or its counsel may be relevant and the presumptive privilege applicable to such documents may be deemed to have been waived, tribunals should exercise caution in ordering their production. If production is deemed to be appropriate because of waiver or otherwise, tribunals should limit the purposes for which such documents or the information contained in such documents may be used.

3. Principles Regarding Costs and Security for Costs

Principles on Final Award (Allocation) of Costs

- C.1. Generally, at the end of an arbitration, recovery of costs should not be denied on the basis that a party seeking costs is funded by a third-party funder.
- C.2. When recovery of costs is limited to costs which have been “incurred” or “directly incurred”, the obligation of a party to reimburse the funder in the event of a successful outcome is generally sufficient for a tribunal to find that the costs of a funded party comes within that limitation.
- C.3. The question of whether any of the cost of funding, including a third-party funder’s return, is recoverable as costs will depend on the definition of recoverable costs in the applicable national legislation and/or procedural rules, but generally should be subject to the test of reasonableness and disclosure of details of such funding costs from the outset of or during the arbitration so that the other party can assess its exposure.
- C.4. In the absence of an express power, in applicable national legislation or procedural rules, a tribunal would lack jurisdiction to issue a costs order against a third-party funder.

Principles on Security for Costs

- D.1. An application for security for costs should, in the first instance, be determined on the basis of the applicable test, without regard to the existence of any funding arrangement.
- D.2. The terms of any funding arrangement, including ATE, may be relevant if relied upon to establish that the claimant (or counterclaimant) can meet any adverse costs award (including, in particular, the funder's termination rights).
- D.3. In the event that security turns out not to have been necessary, the tribunal may hold the requesting party liable for the reasonable costs of posting such security.

B. Best Practices Referring to Additional Matters for Consideration by Parties, Funders, Counsel, and Arbitrators

As a starting point, there are considerable difficulties in articulating best practices that would be relevant and applicable across a range of jurisdictions, forms of funding transactions, and lawyering norms. Moreover, parties’ freedom of contract and the need for flexibility in structuring arbitral proceedings counselled against any rigid formulation. This Section provides a series of considerations that comprise best practices with respect to the funding agreement and the funding relationship.

These best practices focus on addressing those issues that arise most typically in third-party funding of claims in individual cases, and may not directly apply to other forms of funding.

1. Basic Funding Agreement Terms

- (a) Funding agreements should be in writing, and their terms should be clear, unequivocal, and reflect the intentions of the parties;
- (b) Funding agreements should state the amount of funding to be provided, the return to the third-party funder and how the proceeds of an award are to be distributed among the parties;
- (c) Funding agreements should provide a fair, transparent, and independent dispute resolution process; and
- (d) Funding agreements should include a recommendation that a party obtain independent legal advice.

Parties to the agreement

Ordinarily, a third-party funder and a party should be the sole parties to the funding agreement in order to avoid any potential attorney conflicts of interest should the party and the funder disagree on a material issue during the arbitration. In the United States, and perhaps in other jurisdictions, the inclusion of lawyers as parties could raise concerns regarding counsel's duty of undivided loyalty to the client.

Terms of funding

With respect to the funding itself, a party and the third-party funder must consider and address in the funding agreement the scope and extent of the funding; i.e., whether the third-party funder will fund the arbitration through the end of the proceedings (or through enforcement), will fund up to a specific amount, will fund a specific piece of or milestone in the arbitration, or will fund the arbitration in some other fashion.

A party and the third-party funder should consider the consequences of any limitation on funding, including the cost to a party of continuing to fund the arbitration in the absence of the third-party funder's participation, as well as the cost of enforcing any award. One key aspect that a party should consider is whether the third-party funder is basing its internal calculations on the occurrence of a certain event, such as the potential for an early settlement, thereby possibly underestimating the budget required.

A party and the third-party funder should also address which of them will be responsible for fees and costs for any related or ancillary claims, including counterclaims, and who will be financially responsible for an adverse award of costs (addressed in greater detail below).

Division of proceeds from award

Any agreement to fund an arbitration should specify how a future recovery will be divided between the third-party funder and a party, as noted. In general, a well-crafted funding agreement should afford a party the opportunity to retain a majority of the expected recovery (above and beyond the subject of fees and costs), based on the

likeliest projected outcome. But any allocation will need to be proportionate to the measure of risk and costs assumed by a party and the third-party funder, respectively.

For example, the risk incurred by the third-party funder to pursue a successful US\$ 10 million claim will be very different from the risk on a US\$ 1 billion claim; the third-party funder's return will also likely be different. Similarly, a third-party funder that undertakes to pursue a claim from the filing of the request for arbitration through the enforcement of the award will have considerably higher costs than a third-party funder that undertakes only to pursue enforcement of an arbitral award that has already been rendered. A third-party funder's return may be in a fixed dollar amount, a fixed percentage, a multiple of deployed or committed capital, or a structure involving a greater of a multiple or a percentage. Any such return may also include a time-based element, and may provide a greater return to the third-party funder for longer-term recoveries.

The funding agreement should reflect the intention of both a party and the third-party funder as to the priority of the distribution of proceeds: i.e., who should be first to receive what amount, followed by the next recovery, etc. For example, third-party funders typically seek priority recovery of their principal deployed in the case before all other recoveries. Thereafter, depending on the return structure, the third-party funder, counsel and the parties may share *pro rata* their respective per cent returns. At times, the parties may choose to establish a separate escrow account specifically created for the purpose of distributing the proceeds of an arbitration award.

Termination of agreement or withdrawal

Provisions for termination and withdrawal are some of the most important issues to consider in any funding agreement. In considering such terms, the parties should clearly address the following:

- i. When either or both parties can terminate the agreement and on what bases, including the impact on funding already provided, any future funding, and returns due to the third-party funder, if any;
- ii. Whether notice of intent to terminate or withdraw must be provided and whether it must be in writing;
- iii. Whether there is a point in the proceedings after which termination of the agreement is precluded;
- iv. How any amendments or modification of the terms of the agreement will be handled;
- v. How differences of opinion between the third-party funder and a party concerning strategy for the conduct of the case, cooperation by the party in the case or settlement are to be resolved; and
- vi. What further obligation of confidentiality is owed by the third-party funder to a party should the agreement be terminated.

Dispute resolution provision

In entering into a funding agreement, a party and a third-party funder should include a provision in the agreement governing how any potential disputes between the third-party funder and a party will be resolved expeditiously and efficiently. At their option, they may incorporate a mediation or conciliation step before proceeding to binding adjudication, typically private arbitration.

Transparency

A number of additional topics fall under the topic of transparency. It may be useful to consider the following in the funding agreement negotiations:

- i. Whether the third-party funder is audited annually by a reputable firm;
- ii. Whether the third-party funder will periodically provide a statement of the invested capital during the pendency of the case, the percentage of the budget consumed, and the risk, if any, that the budget may be exhausted;
- iii. A clear expression in the funding agreement that only a party can terminate the agreement with its legal counsel, but only after notice to the third-party funder;
- iv. The third-party funder should provide accurate and non-misleading information, particularly regarding its financial conditions, and its intended funding commitment; and
- v. Whether and in what circumstances the third-party funder will manage a party's litigation itself or the litigation expenses of the case.

2. Day-to-Day Case Management and Strategic Decisions (Party Control)

- (a) The scope of a third-party funder's involvement or control of day-to-day management and on all key issues such as strategy and settlement is an issue generally determined by a party and the third-party funder in the funding agreement; and
- (b) The funding agreement should clearly and unequivocally reflect the intentions of the parties with respect to the scope of involvement or control on all such issues and the procedures, rights, and duties that apply when an unresolved dispute over management and strategy arises.

A key issue in any funding arrangement is determining the appropriate level of third-party funder control. Put another way, what happens when the third-party funder and a party or the third-party funder and a party's counsel fundamentally disagree over strategy or settlement (for example, whether to accept a settlement offer or whether to add additional claims)? Some third-party funders have no interest in controlling strategy or settlement, while others believe they can meaningfully add value by contributing to or even controlling certain aspects of the case.

Some commentators contend that funding arrangements pose risks to the international arbitration process through excessive control because “the funded party becomes a proxy for the funder’s interests.”⁴⁴⁸ Although perhaps put in extreme terms, some argue that the third-party funder “may pressure the funded party to accept certain short-cut procedures to save costs[,]” including by circumscribing pre-hearing information exchange, insisting on shortened pre-hearing written submissions or accelerated hearings, etc.⁴⁴⁹

Other commentators argue along similar lines that, although the interests of the third-party funder and a party are typically aligned to maximize the award proceeds, the arbitral process may become “flawed if not substantially corrupted” if the needs of the third-party funder mask or override those of a party.⁴⁵⁰ Still others have raised the related concern that disagreements between a party (and/or its counsel) and the third-party funder could potentially create untenable conflicts of interest for a party’s counsel where the third-party funder has been retained to manage the arbitration, or retains excessive control over the proceedings.⁴⁵¹

On the other hand, a number of commentators have noted the extensive history of parties ceding control over litigation in both tort and insurance law contexts. According to these writers, “courts and policymakers should be skeptical of arguments that use party control as a justification to block [Third-Party Funding]”.⁴⁵² One scholar, Sebok, observes: “in the context of insurance law, courts have permitted strangers to take total control over a party’s litigation”.⁴⁵³ Others have similarly noted that insurance agreements already give the insurers the right to select counsel, decide litigation strategy, consider settlement opportunities, and impose expense audits on counsel.⁴⁵⁴ Still other commentators go further, suggesting that third-party funders should affirmatively exercise extensive control over the proceeding.⁴⁵⁵

Although insurers can “make it very expensive for the insured to regain the freedom to tell her attorney to do things to which the funder is opposed [,] ... this is an artifact of the terms of the contract between the client and the investor[.]”⁴⁵⁶ And as Silver

448. E. CHAN, “Proposed Guidelines for the Disclosure of Third-Party Funding Arrangements in International Arbitration”, 26 *Am. Rev. Int’l Arb.* (2015, no. 2) p. 281 at p. 308.

449. *Ibid.*, at p. 309.

450. M. J. GOLDSTEIN, “Should the Real Parties in Interest have to Stand Up? – Thoughts About a Disclosure Regime for Third-Party Funding in International Arbitration”, 8 *Transnational Dispute Management* (2011, Issue 4), p. 1.

451. A. J. SEBOK, “Should the Law Preserve Party Control? Litigation Investment, Insurance Law, and Double Standards”, 56 *Wm. & Mary Law Rev.* (2015) p. 833 at p. 853.

452. *Ibid.*, at pp. 833-834, p. 859.

453. *Ibid.*, at p. 838.

454. C. SILVER, “Litigation Funding versus Liability Insurance: What’s the Difference?”, 63 *DePaul L. Rev.* (2014) p. 617 at p. 623.

455. *Ibid.*, n. 20.

456. See A.J. SEBOK, “Should the Law Preserve Party Control? Litigation Investment, Insurance Law, and Double Standards”, p. 856.

succinctly summarizes, “[t]hat the client may feel pressure from the funder to follow a particular course should have no bearing on the result. Clients reject lawyers’ recommendations for all sorts of reasons, including expense, and must often make unpleasant trade-offs when doing so.”⁴⁵⁷ (In such cases, a party and the third-party funder’s dispute will be governed by the funding agreement and should not implicate the attorney).⁴⁵⁸

Beyond commentators, there is practical experience. In Australia, for example, there exists High Court authority (and over a decade of subsequent funding experience) to support the proposition that claimants should have the right to freely choose the level of control ceded to a third-party funder, provided there is no prejudice to the court or tribunal’s process.⁴⁵⁹

Given the historical judicial acceptance of contractual arrangements in which parties transfer control in the insurance and subrogation contexts, the Task Force takes the position that a third-party funder’s control should be an issue decided by the parties during the negotiations of the funding agreement, subject to applicable law. Because there is a dearth of decisional law on point in the arbitration and litigation contexts, the parties should focus on the potential risks and concerns raised by excessive control by third-party funders during contract negotiations.

Regardless of the amount of control retained by a party and/or the third-party funder, the funding agreement should clearly reflect the parties’ understanding of who has final say on management and strategy for the funded dispute, and what happens when there is an unresolved dispute over management and strategy.

457. See C. SILVER, “Litigation Funding versus Liability Insurance: What’s the Difference?”, at p. 638.

458. Some argue that the comparison to insurers is not apt because insurance is a highly regulated industry. However, national regulation of insurance does not always extend to the insurers’ conduct of litigation. In the United States, insurers’ control third-party fund counsel, strategy, tactics and settlement within policy limits is typically absolute. Chapter 3 of the Report discusses control because it is often references in debates about definitions. References to control do not, however, suggest that third-party funders could not nor should not be able to contract for control over certain aspects of a funded dispute.

459. The experience in Australia in the last 10 years since the High Court’s decision in *Campbells Cash and Carry Pty Limited v. Fostif Pty Limited NSW* [2006] HCA 41 [Aust.]; 229 CLR 386 suggests that initial concerns that third-party funders would subvert the civil justice system there if they were allowed “control” over proceedings were unfounded. The typical provisions in Australian funding agreements enabling funded parties to override instructions given by third-party funders to the lawyers, and instigate a highly expedited dispute resolution process, can be described as a system of efficient checks and balances, rather than outright control.

IV. Due Diligence Checklist

This final section of the Chapter provides a due diligence checklist of questions and issues that funders and funded parties should consider before entering into a funding agreement.

1. Concerning the Third-Party Funder's Legal and Financial/Capital Structures

- a. Is it publicly listed?
- b. Is the funder regulated and/or bound to comply with official and/or publicly published guidelines, whether having the force of law or merely by way of recommendations? Is it subject to the control of any regulating authority?
- c. Is it a limited liability company and, if so, what is its:
 - (i) paid-up capital;
 - (ii) objects clause;
 - (iii) indebtedness and leverage level (indebtedness vs. equity capital)?
- d. Is it an investment fund and, if so;
 - (i) where is it established?
 - (ii) is it regulated and if so, by whom?
 - (iii) what is its duration?
 - (iv) what is its indebtedness and leverage level (indebtedness vs. equity capital)?
- e. Did the third-party funder take any steps to ensure that there are no actual or potential conflicts of interest between any shareholder/investor and a party, arbitrator(s), and/or opposing parties?
- f. How and when does the third-party funder raise the funds necessary to fund the case? Are these funds kept in segregated accounts? If funds are subject to successive capital calls, have precautions been taken to ensure that the committed equity capital is available for the successive calls?
- g. Is the third-party funder regularly reviewed by an external auditing company?
- h. Does the third-party funder raise funds on a case by case basis ("pledge fund": investors decide which case they are funding)?

2. Concerning the Third-Party Funder's Specific Obligations to a Party

- a. Is the funding agreement intended to provide for the funding of the arbitration proceedings up to the stage of the rendering of an award (lawyers' and expert(s)' fees, arbitrators' and arbitral institution's fees), up to the collection of the proceeds, or up to a different milestone?
- b. Is there a selective budget? Which types of costs are not included? Which precise costs/expenses are funded by the third-party funder?
- c. Which aspect of the arbitration or of the enforcement is possibly not included?

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- d. Does the funding agreement provide for funding in respect of a potential annulment proceeding (by the respondent, by the claimant)?
- e. Does the third-party funder intend to bear the costs related to enforcement of the award or related judgment resulting from the funded proceedings?
- f. Does the funding agreement cover fees or costs related to ancillary claims, including third-party fund against counterclaims?
- g. Does the funding agreement address the issue of security for costs?
- h. If the decisions of the third-party funder are taken by an investment (or similar) committee, does a professional arbitrator or a legal counsel specialized in arbitration participate in the decisions of the investment committee?
- i. If so, how is the risk of an actual or potential conflict of interest between such person, a party, the opposing party and/or any of the arbitrators dealt with?

3. The Third-Party Funder's Professional Responsibilities

- a. Does the third-party funder have an internal code of conduct or does it adhere to an external (e.g., industry) one?
- b. Is the third-party funder's code of conduct compatible with the party's own ethical principles, and those of the lawyers representing the party?

4. The Funding Agreement

- a. Who are the parties to the funding agreement?
- b. Has a separate non-disclosure agreement been signed or does the funding agreement deal with confidentiality-related issues?
- c. If the funding agreement sets out a pre-established budget for the proceedings, does it also provide a solution in case this budget is exceeded?
- d. Does the funding agreement specify the conditions for and degree of control the funder may exercise over case strategy?
- e. Does the funding agreement deal with situations of disagreement between the parties with respect to the strategy to be implemented or pursued? In particular, does it address the issue of resolution of disagreements between the third-party funder and a party concerning settlement proposals?
- f. What remuneration will the funder be entitled to, and how will it be calculated?
- g. Does the funding agreement include provisions regarding a potential adverse costs award against the funded party?
- h. Does the funding agreement include provisions regarding who will bear the costs for enforcing the award?
- i. Does the funding agreement provide for whether and under what conditions it can be terminated?
- j. Does the funding agreement include provisions for modification?
- k. Does the funding agreement provide for a dispute resolution mechanism in case disagreements cannot be solved amicably?

Chapter 8

Third-Party Funding in Investment Arbitration

I. Introduction

The Principles and analysis in the preceding chapters reflect the current state of the law that emerges from review of publicly available cases and related scholarly commentary regarding existing standards and practices. They apply to both international commercial and investment arbitration, and do not aim to prescribe future directions for third-party funding, but instead primarily to summarize and analyse the current state of the law based on existing precedent.

In investment arbitration, third-party funding has drawn particular attention, which often extends beyond the existing legal frameworks and decisions in individual cases. Because investment arbitration involves states, it necessarily implicates a range of policy issues more deeply, more regularly, and (in some cases) differently than private commercial disputes. Investment arbitration is, and is expected to be, more transparent than international commercial arbitration and factors that affect the incentives, viability, and scope of investment claims are subject to more intensive scrutiny and to more rigorous assessments of related policy issues.

These policy issues arise within a larger political context, and within the larger policy debates about the purpose, function, and legitimacy of the laws governing foreign investment and investment arbitration more generally. For example, stakeholders who see fundamental problems with many of the substantive and procedural aspects of investment arbitration, and are therefore critical of the nature and scope of claims brought by investors, inevitably regard third-party funding as exacerbating the basis for their concerns.⁴⁶⁰ Meanwhile, those who regard investment arbitration as an important means for foreign investors to enforce their rights regard third-party funding as a valuable resource to facilitate investor claims against states.

Another factor that complicates discussion of policy issues regarding third-party funding in investment arbitration is that key elements of these debates are often premised on factual assumptions. The contours and accuracy of these assumptions, however, cannot readily be assessed because relevant empirical data is not generally available. For some, this lack of transparency and information is itself a cause for alarm and scepticism about some of the asserted benefits of third-party funding.

This Chapter does not, particularly in light of the absence of empirical evidence and the often uncertain state of investment arbitration case law, seek to resolve the existing policy questions. Instead, the primary aim of this Chapter is to identify broader policy issues that relate to analysis in earlier chapters, to provide an account of competing,

460. The various viewpoints presented in this Chapter are drawn from written and oral comments received during the public comment period, and from the Roundtable co-hosted by CCSI, the discussion from which is summarized in greater detail in Annex C.

viewpoints on the relevant policy issues, and to identify considerations for future inquiry and research. This effort benefitted significantly from a roundtable discussion convened during the public comment period, and co-hosted by the Columbia Center on Sustainable Investment.⁴⁶¹

Even with these more modest goals, the process of drafting this Chapter, even more than other chapters in the Report, presented many challenges. One of the primary challenges was linguistic. The language used by different stakeholders in debates about investment arbitration can be particularly stark. Terminology that is part of the basic lexicon of one group of stakeholders is often regarded by those with competing views as inherently biased or unduly inflammatory. Despite these challenges, this Chapter aims to provide a full-throated presentation of competing viewpoints in a manner that both respects particular stakeholders' frame of reference, but also facilitates meaningful discussion.

Toward that aim, after this introduction, this Chapter will first explore general policy issues that inform specific debates about third-party funding [III], followed by discussion of political risk insurance, and how it compares and contrast with third-party funding and inter-relates with some policy issues raised regarding third-party funding [III]. The Chapter then [IV] revisits topics examined in earlier chapters namely disclosure and potential conflicts of interest [A], and security for costs [B] to examine policy issues regarding those topics in the context of investment arbitration. The Chapter ends with a final conclusion to the Report.

II. Systemic Policy Issues

Neutral but meaningful analysis of policy issues in investment arbitration can be difficult. Various stakeholders take as their starting point very different underlying assumptions about the effects of third-party funding on structural aspects of the investment arbitration regime and on the rights of investors within that regime.

Under one view, investment arbitration may be regarded as a legitimate process only to the extent it facilitates and promotes investment seen as an engine for sustainable economic and social development.⁴⁶² Under this view, certain categories of

461. A summary of discussions at that roundtable, prepared by the CCSI, is attached as Annex C.

462. In fact, proponents of this view challenge whether investment arbitration is at all necessary for investors' access to justice, pointing instead to other mechanisms, such as resort to domestic national courts, State-to-State dispute resolution or diplomatic protection, political risk insurance, contract-based dispute resolution, or even (in egregious cases) human rights courts. From this perspective, the legitimacy and efficacy of investment arbitration can only be evaluated in light of its ability not only of investors' claims, but also the social and political costs, which are borne by States, their internal political processes, and other stakeholders. For a more comprehensive discussion of these concerns, see L. JOHNSON and L. SACHS, "The Outsized Costs of Investor-State Dispute

cases are considered directly objectionable. In particular, claims predicated on what are considered vague treaty provisions, such as fair and equitable treatment or indirect expropriation, are regarded as inappropriately constraining governments' ability to achieve legitimate political, social, and regulatory objectives. Such claims are perceived as a means of challenging actions taken by governments undertaken for legitimate, non-discriminatory purposes, and in good faith, but that also have an impact on investor profits or expected profits.

Such claims are also regarded as objectionable because only foreign investors have a procedural and substantive avenue to bring claims, often for damages that are not available under domestic law or to non-covered investors. Even those who are sceptical of investment arbitration can agree that it is reasonable or even valuable in cases of direct expropriation and when covered investors have been denied justice through domestic judicial avenues, and as a consequence are not necessarily opposed to third-party funding in such cases. They argue, however, that the vast majority of investment arbitrations do not fit in that category. As a result, they question both the social value of investment arbitration in such cases, as well as the additional opportunities to bring such cases facilitated by third-party funding.

With these starting points, the increase in the number of cases⁴⁶³ – sometimes attributed to third-party funding – is regarded as an independent cause for concern. Even apart from the rise of third-party funding, some scholars and commentators have argued that investment arbitration may over-deter states from enacting socially valuable regulatory measures that may have a negative impact on foreign investors.⁴⁶⁴ From this perspective, if the increase in caseloads were attributable to funding, that would be an even more serious cause for concern.

More directly, the profit incentive of third-party funders is regarded by some as inherently incompatible with the policy objectives of an investment regime by which arbitral awards are paid from public funds. Under this view, in circumstances outside of direct expropriations or denials of justice, third-party funding is regarded by some as exacerbating the transfer of wealth from public sectors (particularly in developing countries) to the private sector, particularly when these awards are based on non-discriminatory regulation and other actions taken in the public interest. The notion that

Settlement”, 16 AIB Insights (2016, No. 1) p. 10, available at <<http://ccsi.columbia.edu/files/2016/02/AIB-Insights-Vol.-16-Issue-1-The-outsized-costs-of-ISDS-Johnson-Sachs-Feb-2016.pdf>>.

463. For a listing of the number of investment cases filed annually, see <<http://investmentpolicyhub.unctad.org/ISDS/FilterByYear>> (last accessed 28 January 2018).

464. See J. BONNITCHA, “Outline of a Normative Framework for Evaluating Interpretations of Investment Treaty Protections”, in C. BROWN and K. MILES, eds., *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press 2011) p. 117 at p. 134 (footnotes omitted) (describing the potential for regulatory chill and the difficulties in proving chilling effects “because they require counterfactual evidence about the regulations that would have existed in the absence of the purported chilling”).

some amounts recovered from states would go to third-party funders, instead of solely to aggrieved investors, is considered inherently inconsistent with the underlying goal of promoting sustainable development, particularly when such funding is supporting the kinds of claims that they regard as inconsistent with that goal.⁴⁶⁵

Others regard investment arbitration as an essential means of recourse for foreign investors when governments act in ways that violate applicable treaty-based protections for their investments. Under this view, broad protection against expropriation and discrimination is essential, as are protections to ensure fair and equitable treatment or full protection and security. Consistent with these starting premises, third-party funding is regarded a critical tool for facilitating access to investment arbitration in order to seek justice on such claims.⁴⁶⁶ The value of third-party funding is particularly important, under this view, for that class of investors that, as a result of the alleged wrongful expropriation by a host state, lack the means to pursue an investment claim in the absence of third-party funding.

Even for those claimants whose investments have not been expropriated, the argument goes, investor-claimants should not have to forego business opportunities by using their own capital to pursue recourse for harms allegedly caused by the wrongful conduct of a state. Alternative means of financing claims allow claimants to minimize continued harm from the alleged misconduct, and strategically reduce the risks of pursuing the claims. It is also argued, more generally, that modern third-party funding is not functionally or economically different from alternative means of financing claims, such as contingency fees, corporate loans, and certain types of insurance. For this reason, proponents of this view argue that modern third-party funding should not be singled out for different treatment particularly with respect to security for costs.

While these opposing views continue to animate discussion on specific topics relating to third-party funding, as a practical matter they have not as yet led to any specific reforms. Those who are most sceptical of third-party funding continue to believe that the practice could be (and should be) prohibited in investment arbitration. In support of this view, they note that only a few jurisdictions have to date addressed third-party funding directly, and consequently recent reforms remain in relative infancy.

As noted in Chapter 1,⁴⁶⁷ however, all recent reforms the Task Force is aware of are, instead, expressly acknowledging and permitting third-party funding, but also ensuring greater transparency and focusing on the balance of the potential costs of third-party funding to the system. As explored in earlier chapters, under existing precedents, questions remain about the extent and limits of such transparency, and

465. L. JOHNSON and B. SKARTVEDT GUVEN, “Third Party Funding in Investor-State Dispute Settlement: A Public Policy Perspective” (forthcoming) (on file with Task Force).

466. D. G. HENRIQUES, “Third Party Funding: a Protected Investment?”, 30 *Spain Arbitration Review* (2017) pp. 122-127.

467. See Chapter 1, fn. 8.

there are competing concerns about the potential for procedural abuses and the protection of confidential information.

With third-party funding now regularly involved in investment arbitration, additional questions are being raised about its effect on caseloads and settlement rates, costs and costs awards, and investor rights. One of the most common arguments from those concerned about the effects of third-party funding in investment arbitration is that it supports or encourages the bringing of claims that would otherwise not be brought. This critique falls into two categories.

The first area of concern is that third-party funding increases the overall number of investment arbitration claims brought against states. This argument ties into related concerns that, as damages are the primary remedy in investment cases, the effect of alleged expansion would disrupt the balance between investor protection and state interests.⁴⁶⁸ For those sceptical of investment arbitration, an increase in the absolute number of cases means an increase in the number of cases they find objectionable as a matter of substance. Moreover, some argue that the structure of investment arbitration, which typically permits investors not states to initiate claims, will over time necessarily result in an expansion of the rights and protections enjoyed by investors.⁴⁶⁹

A separate but related concern is that third-party funding could lead an increase in number of speculative, marginal, or frivolous investor claims. Proponents of this view point to the high recoveries sought by claimants,⁴⁷⁰ which they argue may create an incentive to fund even cases with a low probability of success and which may promote inflation of estimated case values in an effort to attract funding. A favourable award, they argue, in any one sizable case could offset the cost of other unsuccessful cases.

Under this view, the development of portfolio funding, in which the range of claims in a particular portfolio vary in terms of likelihood of success, may encourage the bringing of more speculative or risky claims. In a related vein, some argue that if claimants and funders are not compelled to pay the respondent state's costs when they lose, they have an incentive to bring risky claims.⁴⁷¹

468. See Public Statement on the International Investment Regime – (31 August 2010), available at <<http://www.osgoode.yorku.ca/public-statement-international-investment-regime-31-august-2010/>> (last accessed 29 August 2017).

469. L. SACHS and L. JOHNSON, “Investment Treaties, Investor-State Dispute Settlement and Inequality: How International Rules and Institutions Can Exacerbate Domestic Disparities” (2017), available at <<http://ccsi.columbia.edu/files/2017/11/ISDS-and-Intra-national-inequality.pdf>> (last accessed 29 January 2018).

470. L. Y. TAN and A. BOUCHENAKI, “Limiting Investor Access to Investment Arbitration: A Solution without a Problem?” in J. E. KALICKI and A. JOUBIN-BRET, *Reshaping the Investor-State Dispute System* (Brill 2015) p. 250 (identifying perceptions that some investment arbitration decisions “award unrealistic and unfair damages to claimants with insufficient regard to public interest, national security or other extenuating circumstances”).

471. *RSM Production Corporation v. Saint Lucia*, (ICSID Case No. ARB/12/10), Assenting Reasons of Gavan Griffith (12 August 2014).

Others respond to such concerns by pointing out that speculative cases, such as *Philip Morris v. Uruguay* and *Philip Morris v. Australia*, are examples of the investment arbitration regime working as intended because those tribunals ultimately rejected the claims. They note that funders carefully vet cases and conduct independent assessments to determine both likelihood of success and an accurate estimate of expected damages.

Notably, there is no empirical evidence regarding whether recent increases in investor claims or high damages claims are indeed related to third-party funding. There is also no evidence regarding the more specific question about whether funding is increasing the number of speculative, marginal, or frivolous cases. The absence of such evidence is, as noted above, itself a basis for objection for some: they object to allowing a practice that may have the potential to distort investment arbitration caseloads, process, and frequency of settlement, but whose actual effects are unknown.⁴⁷²

They also note that empirical evidence is exceptionally difficult to develop given the lack of transparency regarding funding, and that even a single case can have important negative consequences for a particular state. For example, when even a single investment arbitration case is brought against a state, it can have a negative impact on that state's reputation as a safe place for investment.⁴⁷³

In the absence of empirical data in the investment context, some have pointed to arguments and research regarding litigation funding in national courts. For example, in the United States, a petition written by the U.S. Chamber of Commerce and signed by the International Association of Defense Counsel, advanced the argument that third-party funding would result in an "expected ... increase [in] the filing of ill-considered cases".⁴⁷⁴ A recent study examining the effects of third-party funding in litigation in Australian courts has also been cited. That study concluded that third-party funding leads to an overall increase in the number of claims being brought.⁴⁷⁵ That same study also concluded that third-party funders have funded cases that raise novel issues and involve riskier, more uncertain claims, and that decisions in funded cases were particularly influential in developing the law as they were reversed less and cited more than non-funded cases.⁴⁷⁶

472. See L. JOHNSON and B. SKARTVEDT GUVEN, "The Settlement of Investment Disputes: A Discussion of Democratic Accountability and the Public Interest", *Investment Treaty News* (13 March 2017), available at <<http://ccsi.columbia.edu/files/2017/03/ITN-The-Settlement-of-Investment-Disputes-Mar-13-2017.pdf>>.

473. T. ALLEE and C. PEINHARDT, "Contingent Credibility: The Impact of Investment Treaty Violations on Foreign Direct Investment", 65 *International Organization* (2011) p. 401.

474. *Ibid.*

475. See D. L. CHEN, "Can Markets Stimulate Rights?", 46 *RAND Journal of Economics* (2015, No. 1), p. 23 at p. 42.

476. *Ibid.* at p. 35.

Several responses are offered to these critiques. First, it is argued that that many concerns are premised on a misunderstanding of the criteria and processes by which funders select cases. As described in Chapter 2, before deciding to fund a case, a funder engages in a rigorous assessment of the claimant's likelihood of success on the merits. The result of this rigorous review, funders report, is that they decide to fund only those cases that are deemed to be highly likely to succeed. As a result, funders only finance a tiny fraction of cases in which funding is sought. Anecdotally, the funders on the Task Force and those queried in preparing this Report suggest they fund only about one in ten cases for which funding is sought and that then avoid cases that appear uncertain.⁴⁷⁷

Of the cases that qualify for and receive funding, funders report that many of those cases could not be brought in the absence of funding. As a result, they argue, third-party funding operates to allow legitimately aggrieved parties to pursue claims they might otherwise be unable to.⁴⁷⁸ Relatedly, funders report even claims that are assessed as having a high likelihood of success on the merits do not necessarily get funded. In addition to an assessment on the merits, a claim will only qualify for funding if it also presents a sufficient potential return on investment.⁴⁷⁹

Under this view, even if third-party funding raises the overall number of investment arbitration claims, that increase involves only presumptively meritorious claims. The overall increase in claims, it is argued, is most likely attributable to other causes (increases in the number of BITs, the amount of foreign investment, and the instances of unlawful behaviour by states, etc.).⁴⁸⁰

Funders are also able to point to national court statistics in response to the concerns expressed. For example, a study of funded personal injury claims in The Netherlands suggests that the greater availability of funding does not lead to an increase in the overall number of claims filed.⁴⁸¹

477. See Chapter 2, pp. 24-25.

478. This argument is often characterized as permitting "access to justice", but as noted below, that characterization itself is highly contested by opponents to third-party funding in investment arbitration.

479. Notably, anecdotal reports describe an emerging market for funding smaller cases and funding cases with a smaller return for funders. These developments raise additional questions, which are difficult to assess in the absence of empirical data.

480. Some who are concerned about the increased number of investment arbitrations also attribute the rising caseloads to overly investor-friendly interpretations by arbitral tribunals, particularly on jurisdictional issues. See, e.g., G. VAN HARTEN, "Arbitrator Behaviour in Asymmetrical Adjudication: An Empirical Study of Investment Treaty Arbitration", 50 *Osgoode Hall L.J.* (2012, Issue 1) p. 211 at p. 226.

481. M. G. FAURE, T. HARTLIEF and N. J. PHILIPSEN, "Funding of Personal Injury Litigation and Claims Culture: Evidence from the Netherlands", 2 *Utrecht L. Rev.* 1 (2006) (finding that Between 1999 and 2003, the number of policies for legal expenses insurance increased by over 30%, but the number of personal injury claims remained stable).

Further they argue that studies of trends in domestic litigation do not necessarily translate into investment arbitration. Several features distinguish investment arbitration from typical domestic litigation, including: 1) the high values for relief sought; 2) the high cost of pursuing claims in investment arbitration; 3) the fact that states are generally responding parties, and do not bring counter-claims or affirmative claims; and 4) the open-textured procedures and evolving legal standards that apply. As noted above, these features of investment arbitration are precisely the bases for concerns that third-party funding is problematic if it increases the overall number of claims (whether frivolous or not) in investment arbitration.

The increase in the investment arbitration caseload over the past fifteen years is itself a hot button issue. The causes of this increase are hotly debated in various contexts. For this reason, it is not surprising that the effect of third-party funding on caseloads has attracted attention. It is exceedingly difficult to identify and measure the exact causes, but precisely for this reason it is an area that would benefit from deliberative empirical research about the effect, if any, of third-party funding on investment arbitration caseloads.

Beyond the empirical questions, another challenge in attempting to sort through competing arguments about third-party funding is that they arise in the context of larger debates about the legitimacy of investment arbitration. For example, almost all agree that “access to justice” as a general matter is an important goal from a legal and public policy perspective. However, differences immediately begin to surface about what qualifies as “access” or what constitutes “justice”.

Proponents of third-party funding often point to Lord Jackson’s remarks in his Final Report on the Review of Civil Litigation Costs, where he states: “it is now recognised that many claimants cannot afford to pursue valid claims without third-party funding... and that third-party funding has a part to play in promoting access to justice.” Lord Jackson emphasized that “access to justice entails that those with meritorious claims (whether or not ultimately successful) are able to bring those claims before the courts for judicial resolution or post-issue settlement, as the case may be.”⁴⁸² Although Lord Jackson appears to have focused on claimants that are “unable to afford” to pursue their claims, as noted above, many argue that the “affordability” of pursuing a claim is not a literal prerequisite; instead, by facilitating the bringing of claims despite competing financial interests, third-party funding promotes access to justice.

Not everyone agrees with the applicability of these views to investment arbitration. For example, some argue that justice for one party can lead to injustices for others, and that these balances and interests must be accounted for in any assessment of overall justice. They note that in many cases foreign investors have an option of pursuing a claim either through domestic courts or investment arbitration. The absence in investment arbitration of doctrines such as impleader or interpleader, which are

482. Lord Justice JACKSON, “Review of Civil Litigation Costs: Preliminary Report” (2009) (n. 97) p. 41.

generally available in domestic litigation, precludes adequate consideration of these others' interests in investment arbitration.⁴⁸³

Under this view, arguments that the inability to access investment arbitration is itself a denial of justice, or the only means of accessing justice, is a "false narrative".⁴⁸⁴ Proponents of this view do not regard investment arbitration outcomes as providing access to true "justice" because they do not take into account the rights and interests of stakeholders who are not represented in arbitral proceedings, but who would be represented as part of larger political regimes in which domestic courts exist.⁴⁸⁵

Similarly strong disagreement exists about what constitutes a frivolous, marginal or speculative claim. Those concerned with policy implications of expanding number of investment arbitrations point out that at least some claimants supported by third-party funding have brought claims that tribunals determined were frivolous, or otherwise implicated questionable conduct. Building on this background, the concern is that the risks are particularly acute in investment arbitration because the standards of protection in investment treaties, especially fair and equitable treatment and indirect expropriation, remain vague. As these standards have been broadly developed, they

483. While these claimants could, in theory, bring claims in other fora for wrongs, access to justice against foreign corporations and/or governments is notoriously difficult. See G. SKINNER, R. McCORQUODALE and O. DE SCHUTTER, *The Third Pillar: Access to Judicial Remedies for Human Rights Violations by Transnational Business* (2013). Therefore, providing a remedy to investors which remedy can itself implicate the rights of other stakeholders when they are not joined in the proceeding can be problematic.

484. Many object to these and related arguments as a return to the Calvo doctrine. See W. SHAN, "From North-South Divide to Private-Public Debate: Revival of the Calvo Doctrine and the Changing Landscape in International Investment Law", 27 *Nw. J. Int'l L. & Bus.* (2006-2007) p. 631 at p. 655 (illustrating the resurgence of the Calvo Doctrine while stating that it will remain in a new, modernized, form that is less restrictive than its original formulation); C. N. BROWER and S. MELIKIAN, "'We Have Met the Enemy and He is US!' Is the Industrialized North 'Going South' on Investor-State Arbitration?", *Arb. Int'l* (2015) p. 31 at pp. 19-26 (arguing against the 'neo-NIEO' trend of developed States fighting to eliminate or narrow the very investor-State arbitration system that they fought for); see also B. M. CREMADES, "Disputes Arising Out of Foreign Direct Investment in Latin America: A New Look at the Calvo Doctrine and Other Jurisdictional Issues", *Dispute Resolution Journal* (May-July 2004) p. 80 (explaining that the resurgence of the Calvo Doctrine would be an unfavourable trend).

485. For a general background on investment arbitration debates, see M. WAIBEL, ET AL., eds., *The Backlash Against Investment Arbitration* (Kluwer 2010). For contrasting views about investment arbitration and national legal regimes, compare B. CHOUDHURY, "Recapturing Public Power: Is Investment Arbitration's Engagement of the Public Interest Contributing to the Democratic Deficit?", 41 *Vand. J. Transnat'l L.* (2008) p. 775, and G. VAN HARTEN and M. LOUGHLIN, "Investment Treaty Arbitration as a Species of Global Administrative Law", 17 *Eur. J. Int'l L.* (2006) p. 121, with C. BROWER and S. SCHILL, "Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?", 9 *Chi. J. Int'l L.* (2009) p. 471 at p. 479.

argue, the system is endangered not only by frivolous claims, but also by claims that are speculative or seek to expand jurisdiction or the bases for liability for states beyond the originally intended meanings in investment and trade agreements.⁴⁸⁶

Those concerned about potentially frivolous claims query whether third-party funding contributes to inflated damages claims and increases costs of pursuing such claims. They also argue that third-party funding could increase the potential for settlement, which is of concern for two reasons. First, they argue that states may have structural incentives to settle even when a claim is speculative, marginal, or frivolous. Second, they argue that settlements raise public policy concerns, including lack of transparency and related issues that arise with non-monetary settlements.⁴⁸⁷

In response to concerns about potentially frivolous or speculative claims, others argue that determination of what constitutes a frivolous claim to for arbitral tribunals, through rejection on jurisdictional grounds or on the merits. Under this view, the dismissal of unmeritorious claims is an affirmation of a healthy adjudicatory system, and not something that can be prejudged based on one particularly viewpoint.

Another response is that funders' process for assessing claims and the typical terms and provisions in funding agreements reduces or eliminates the risks identified. As a starting point, it is noted that third-party funders engage in rigorous due diligence to avoid funding frivolous cases and that a funder could not long survive by funding high-risk cases. In support of these views, funders report that they generally fund only one out of every ten cases in which funding is sought.⁴⁸⁸ These views have been articulated publicly by many funders and attorneys who have worked with funders,⁴⁸⁹ and were underscored in Task Force discussions. Typical funding agreements also include provisions about how settlement, including non-monetary settlements, are to be managed. Finally, funders often both set and monitor budgets that they argue function to contain, not increase, costs.

Another possible basis for continued scepticism is that there are no set criteria (apart from a few jurisdictions such as Hong Kong and Singapore) for what entities can offer funding or for the terms of funding agreements. For this reason, arguments that

486. See generally, L. JOHNSON, L. SACHS and J. SACHS "Investor-State Dispute Settlement, Public Interest and US Domestic Law" Vale Columbia Center on Sustainable Investment (Policy Paper, May 2015).

487. See L. JOHNSON and B. SKARTVEDT GUVEN, "The Settlement of Investment Disputes: A Discussion of Democratic Accountability and the Public Interest".

488. See Chapter 2, pp. 24-25.

489. S. REISMAN, "Critics Pushing Back on 3rd-Party Funding Disclosure Rule", (21 June 2017) available at <<https://www.law360.com/articles/935786/critics-pushing-back-on-3rd-party-funding-disclosure-rule>> (last accessed 28 August 2017), (quoting a partner at a major international law firm as saying "From my experience working with third-party funders, considering the extensive diligence they do on cases, it is unlikely that the existence of litigation funding would increase the number of frivolous lawsuits"); B. M. CREMADES Jr., "Third Party Litigation Funding: Investing in Arbitration", 8 *Transnational Dispute Management* (2011, Issue 4), pp. 12-15.

are based on industry practice among the leading commercial funders do not necessarily apply to all funding arrangements or all funders. Notably, since constitution of the Task Force, the number of funders has increased significantly, with new venture capitalists and in some instances banks announcing they are interested in financing investment arbitration claims. Concerns have been expressed that not all new funders are necessarily staffed with legal expertise, let alone expertise in investment arbitration. As a result, some are concerned that funding in investment arbitration has potential to be disruptive and damaging to a system whose legitimacy is already being questioned.

There have been at least some examples (both public and anecdotal) of questions about funders' roles raised in certain individual cases. To those concerned about the potential effects of third-party funding, these cases are taken as exemplars of all their worst fears about third-party funding. Moreover, they highlight that even outlier cases can do significant harm in specific cases, particularly for least-developed countries.

The Task Force does not undertake to make normative recommendations about how to resolve these complex issues. At one of the spectrum, some maintain that third-party funding could and should still be prohibited in investment arbitration. Theoretically that prohibition could be implemented by having investment agreements both preclude the use of funding and impose an obligation on parties or their representatives to affirm expressly that no third-party funding is involved.

As noted above, however, most recent investment and trade agreements do not aim to preclude or even limit the use of third-party funding. Instead, current efforts, typified by the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union⁴⁹⁰ and some draft model investment treaties that were presented during Task Force discussions,⁴⁹¹ appear to focus on increasing transparency regarding the participation of funders, primarily by imposing an obligation that the existence and identify of funding be disclosed.

As this Report is going to press, ICSID is currently considering revisions to its rules, and UNCITRAL's Working Group III is considering including third-party funding in its work on reforms to investment arbitration. It is hoped that the Report, and this Chapter's discussion of policy issues, can contribute to those efforts.

III. Political Risk Insurance

As examined in Chapters Two and Three, under some definitions, third-party funding may be considered to include, be analogous to, and compete in the same market as

490. See Article (8.1) of the revised version of the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union, (29 February 2016), available at: <http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf> (last accessed 26 October 2016).

491. See Chapter 4, pp. 103-104.

other forms of dispute financing, including certain types of insurance.⁴⁹² In the investment context, in addition to traditional forms of private insurance, political risk insurance or “PRI” is also relevant as a point of comparison with third-party funding, both at a larger policy level and with respect to some doctrinal issues regarding the effects of subrogation. As Willem van Boom has suggested, if “international investment practice would not find offensive the involvement of subrogated Political Risk Insurance (PRI) insurance companies, why would they take issue with TPF?”⁴⁹³

The answer to this query, as it turns out, is not quite as straightforward as the question seems to suggest.⁴⁹⁴ This section provides an outline of issues relating to the relationship between PRI and investment arbitration and, in turn, third-party funding in investment arbitration.

While third-party funding is relatively new to investment arbitration, PRI has long been regarded as a valuable tool for increasing the flow of foreign investment to developing and emerging economies that need such investment.⁴⁹⁵ For example, MIGA, as a member of the World Bank Group, specifically aims to encourage mutual prosperity and reduce global poverty.⁴⁹⁶

For many who oppose investment arbitration more generally, PRI is considered a means of providing protection for foreign investors that is superior in many respects. PRI covers political events and the direct and indirect actions of host governments in many of the same areas as investment treaty protections. PRI, like treaty-based protections, can help encourage investment that would have otherwise been deterred due to concerns about risk. Unlike investment arbitration, however, some regard PRI as

492. See Chapter 4, pp. 93-94.

493. W. H. VAN BOOM, “Third-Party Financing in International Investment Arbitration” (31 December 2011) p. 50, available at <<https://ssrn.com/abstract=2027114>> or <<http://dx.doi.org/10.2139/ssrn.2027114>> (last accessed 14 March 2018).

494. Some PRI insurance is provided through national governments (for example, the U.S.’s Overseas Private Investment Corporation or OPIC), through international financial institutions (for example the World Bank Group’s Multilateral Investment Guarantee Agency or MIGA), and private insurance companies and syndicates such as Zurich Re and PRI provide on the Lloyd’s market. M. KANTOR, “Chapter 34: Comparing Political Risk Insurance and Investment Treaty Arbitration”, in B. SABAHI, N. J. BIRCH, I. A. LAIRD and J. A. RIVAS, eds., *A Revolution in the International Rule of Law: Essays in Honor of Don Wallace, Jr.* (Juris 2014) p. 455 at p. 457.

495. OPIC, “New OPIC Political Risk Insurance Will Cover Investments by Private Equity Funds”, “PRI coverage can significantly mitigate the risks posed to emerging market private equity investors, and thereby increase their appetite to pursue the opportunities available in the developing world.” OPIC, “New OPIC Political Risk Insurance Will Cover Investments by Private Equity Funds”, available at <<https://www.opic.gov/press-releases/2011/new-opic-political-risk-insurance-will-cover-investments-private-equity-funds>> (last accessed 29 August 2017).

496. MIGA, *Annual Report 2016*, pp. 6-7.

effectively a form of “free” political risk insurance, which requires the investor to internalize the cost of the risk that it is taking based on a market-based analysis.

Under this view, because PRI insurers are a more structural feature and become involved at the time of investment, they have a greater interest in promoting the rule of law than third-party funders. Furthermore, PRI insurers often require investors to comply with other desirable sustainable development norms (e.g., anti-corruption and human rights). To the extent that PRI may not cover the full gamut of claims covered by investment treaties and arbitration, those claims may more often be the kinds of claims are not considered desirable from a sustainable development perspective. Proponents of this view are concerned that, in contrast to PRI, third-party funding relies on a business model that favours increases in the number of claims, the scope of potential liability for states, the damages models used to calculate that liability, and ultimately the amount of damages awarded against states.

Some aspects of PRI are also regarded as more favourable for investors. PRI is an actual promise to pay by a creditworthy third-party. A successful investment arbitration claim produces an award that must still be reduced to payment through negotiation or, often, expensive and uncertain judicial enforcement proceedings.⁴⁹⁷

Despite these comparisons, some commentators dispute that PRI is or can be a meaningful substitute for investment arbitration.⁴⁹⁸ Several factors are pointed to in support of the view that PRI is not able to fully compensate investors. Such limitations include caps on the scope of coverage, risk-sharing provisions, ceilings on the amounts and types of sums recoverable, and what is sometimes characterized as the high cost of PRI premiums (which are payable regardless of whether a dispute ever arises and which also tend to be priced into the costs of the investment may therefore be shifted over to a state that is a counterparty).⁴⁹⁹ Moreover, once a PRI insurer pays a claim under the insurance policy, the insurer is subrogated to the rights of the insured investor and is entitled to pursue the claim against the host state itself or through the investor (usually in arbitration). Therefore, a successful claim under PRI insurance does not necessarily preclude an arbitration of the underlying claims; it instead shifts the identity of the claimant from the investor to the PRI insurer.

497. KANTOR, “Comparing Political Risk Insurance and Investment Treaty Arbitration”, p. 474.

498. *Ibid.*

499. Kantor provides a detailed examination of limitations on PRI coverage, including lack of coverage for certain types of alleged harms, such as alleged violations of fair and equitable treatment and discriminatory conduct, limitations on reimbursement to invested capital (not market value), the application of subrogation and related arbitration provisions and other “limits exclusions, covenants and conditions” that limit coverage. M. KANTOR, “Are You in Good Hands with Your Insurance Company? Regulatory Expropriation and Political Risk Insurance Policies”, in T. MORAN and G. WEST, eds., *International Political Risk Management* (World Bank Group 2008).

Political economists point out that, in theory, PRI does nothing to “alter the pay-offs” of expropriation for a state or to change the economic detriment of expropriation for investors since, assuming insurance is actuarially fair, the risk of expropriation is simply priced into the cost of insurance.⁵⁰⁰

Other arguments, and the history of investment instruments, suggest that PRI and investment arbitration are synergistic, not simply alternatives. PRI and investment arbitration are considered part of one package intended to address both costs and risk allocation. For example, OPIC does not offer insurance to foreign investors who invest in states which do not have any BITs or related instruments with the United States.⁵⁰¹ Similarly, MIGA offers insurance only where the host state is a party both to a bilateral agreement between itself and the host state,⁵⁰² as well as a party to the MIGA Convention, and has a limit of up to US\$ 250 million in coverage per project.⁵⁰³

Under this view, investment treaties are regarded as complementing PRI and ultimately both reducing the cost of PRI and creating positive incentives for states to refrain from expropriation. For example, when Chile ratified the ICSID Convention, the president of Chile noted that joining ICSID and entering BITs would reduce PRI insurance costs for foreign investors and therefore put Chile in “an advantaged position in order to attract foreign investment.”⁵⁰⁴ Meanwhile, the IMF insistence on BITs as a condition of loans to developing states reinforces this on the other side of the fence, such that international organizations bolster the investment treaty regime and accommodate PRI as a supplement, rather than an alternative, to that regime.⁵⁰⁵

Another perceived advantage of PRI over third-party funding is that the disclosure and transparency issues that have attracted so much attention with third-party funders do not apply, or apply with much less force, to either public or private PRI insurers. To take a prominent example, following an award in favour of three insured investors in

500. J. BONNITCHA, ET AL., *The Political Economy of the Investment Treaty Regime* (OUP 2017) p. 146.

501. M. SORNARAJAH, *The International Law on Foreign Investment*, 4th edn. (Cambridge 2017) p. 205. OPIC will insure investments in countries that do not have BITs or FCN treaties with the US. However, as a condition to issuing any PRI policies in a host State, OPIC first requires the host State to enter into a bilateral agreement directly with OPIC that inter alia confirms OPIC’s subrogation and arbitration rights. All of those bilateral agreements are public. OPIC will insure investments in countries that do not have BITs or FCN treaties with the US. However, as a condition to issuing any PRI policies in a host State, OPIC first requires the host State to enter into a bilateral agreement directly with OPIC that inter alia confirms OPIC’s subrogation and arbitration rights.

502. R. DOLZER and C. SCHREUER, *Principles of International Investment Law*, pp. 229-230.

503. MIGA, Investment Guarantees, Terms and Conditions, available at <<https://www.miga.org/investment-guarantees/overview/terms-and-conditions/>> (last accessed 6 November 2017).

504. BONNITCHA, ET AL., *The Political Economy of the Investment Treaty Regime*, pp. 208-209.

505. M. SORNARAJAH, *The International Law on Foreign Investment*, p. 205.

India,⁵⁰⁶ the United States through its government agency, OPIC, was named as the claimant against India in an *ad hoc* arbitration contemplated by the bilateral agreement between OPIC and India under which OPIC issues all PRI policies for investments in India.⁵⁰⁷ Whereas third-party funders fund the named party, a subrogated PRI insurer effectively serves as a party and, to the extent the arbitration is public, the PRI insurer's participation is publicly identifiable.

The process for arbitrating political risk insurance claims is not transparent, however, even among public PRI insurers. Some observers point to so-called "shadow claims", meaning claims that were initiated but never finally determined, because they were withdrawn or otherwise resolved without a final public determination (i.e., settled).⁵⁰⁸ In addition, most private PRI insurers do not disclose detailed information about claims, which means information would only be available to the extent such information is provided by public insurers⁵⁰⁹ or to the extent that such information is disclosable through otherwise applicable disclosure obligations, such as national securities regulations or corporate compliance guidelines related to disclosure.⁵¹⁰

This general comparative market-based analysis of PRI and investment arbitration provides background for more practical comparisons regarding claims covered by PRI and financed by third-party funders. PRI providers require the claimant to subrogate that claim to the insurer.⁵¹¹ As Mark Kantor explains:

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506. *Bechtel Enterprises International (Bermuda) Ltd; Ben Dabhol Holdings, Ltd; and Capital India Power Mauritius I v. Overseas Private Investment Corporation*, AAA Case No. 50 T195 00509 02 (3 September 2003).
507. Request for Arbitration under the Investment Incentive Agreement between the Government of the United States of America and the Government of India 19 November 1997 (4 November 2004) para. 3.
508. R. C. O'SULLIVAN, "OPIC's Shadow Claims History" in G. VERHEYEN and E. QUINTRELL, eds., *Old Risks, New Solutions, or Is It the Other Way Around?* (World Bank 2013) p. 13.
509. M. SUNDBERG, F. QURAIISHI and S. CHOUDHURY, "Linking Political Risk Insurance Pricing and Portfolio Management with Economic Capital Modeling: A Multilateral Perspective?" in K. W. LU, G. VERHEYEN and S. M. PERERA, eds., *Investing with Confidence: Understanding Political Risk Management in the 21st Century* (World Bank 2009) p. 90 at p. 97.
510. E. COPPOLA, "Issues Affecting Pricing in the Political Risk Insurance Market, and a Probabilistic Approach to Measuring Country Risk in a Political Risk Insurance Portfolio" in LU, VERHEYEN and PERERA, eds., *Investing with Confidence: Understanding Political Risk Management in the 21st Century*, p. 115 at p. 116.
511. J. VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure* (Kluwer Law International 2016) p. 226 ("[i]f international commercial practice and international investment practice would not find offensive the involvement of subrogated Political Risk Insurance (PRI) insurance companies, why would they take issue with third-party funding?") (quoting VAN BOOM, "Third-Party Financing in International Investment Arbitration", at p. 50).

“[B]y operation of the doctrine of subrogation and the express terms of the PRI programs operated by public insurers like OPIC and MIGA, the insurance provider automatically steps into the shoes of the investor and succeeds to the investor’s claim against the state upon payment under the PRI policy. The subrogated PRI provider is then entitled to pursue that claim against the expropriating state directly.”⁵¹²

As a subrogated party, a PRI provider would seem to potentially raise questions that are similar to those, examined below, about the status of investors when their claims are wholly or partially [payable to] third-party funders. Typically, however, subrogated claims in the PRI context are pursued through separate arbitration proceedings, and in some instances under separate agreements, which generally avoid these issues.⁵¹³

For example, many BITs include a provision recognizing, to quote a representative example, “the assignment of all the rights and claims of the indemnified investor to the former Contracting Party or its designated agency ... and the right of the former Contracting Party or its designated agency to exercise by virtue of subrogation any such right to same extent as the investor”.⁵¹⁴ This language creates a separate basis for arbitral jurisdiction over a subrogee. The United States and some other states instead typically conclude separate PRI agreements, for example between OPIC and the host state.⁵¹⁵ Some point out that the “explicit recognition of assignment or subrogation by a contracting state [in the context of PRI agreements] may be seen as a first hint that, *a contrario*, treaty claims might not be as readily assignable as claims arising out of commercial contracts”.⁵¹⁶ Others point out that there is substantial jurisprudence on the

512. KANTOR, “Comparing Political Risk Insurance and Investment Treaty Arbitration”, p. 474.

513. To the extent the insured investor retains losses (e.g., scope, ceilings, risk-sharing, exclusions) that are not indemnified, the investor can still bring its own claim for the uncovered losses. Moreover, most PRI policies grant the PRI insurer the right to decide whether to bring the recovery claim in its own name or to compel the insured investor to bring the claim in its name under the control of the PRI insurer and for the benefit of the insurer. Thus while PRI generally obviates a separate investment arbitration, it is not necessarily always the case.

514. *Agreement between the People’s Republic of China and the Federal Republic of Germany on the Encouragement and Reciprocal Protection of Investments*, signed 1 December 2003 (entered into force 11 November 2005) Art. 7.

515. See KANTOR, “Comparing Political Risk Insurance and Investment Treaty Arbitration”, pp. 461-462 (describing *ad hoc* and non-transparent arbitrations brought by the United States against India and Indonesia to recover on subrogated claims insured under OPIC).

516. VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure* (Kluwer 2016) p. 227; see also R.D. SOOPRAMANIEN, “Mind the Gap: Tailoring the Form and Substance of Political Risk Insurance in Order to Bridge the ‘Enforcement Gap’ in Investment Arbitration”, 50 *Int’l Law* (2017) p. 585 at p. 588.

transferability of investment arbitration claims to entities other than third-party funders, and this jurisprudence may suggest assignments to funders will not be a basis for effectively challenging admissibility or jurisdiction.⁵¹⁷

As discussion and debate about third-party funding continues, analysis in the investment context will likely refer to PRI as a point of comparison and contrast, both at a broader policy and structural level and potentially with reference to more specific issues, such as the potential for assignment of claims and its effect on questions of jurisdiction and admissibility.

IV. Doctrinal Issues

In addition to structural questions about the effect of third-party funding on investment arbitration, policy issues are also intertwined in several doctrinal issues. The first set of issues, examined in Section A, relate to questions of jurisdiction and admissibility. For certain purposes and in some funding arrangements, a third-party funder may share the interests and (particularly in the case of subrogation) the identity of the party. For these reasons, the participation of third-party funders has raised questions definitional and jurisdictional questions.

A second set of issues relate to the doctrinal matters examined in earlier chapters, such conflicts of interest and costs and security for costs. These narrower doctrinal matters are often in themselves implicated in larger policy debates about the legitimacy of investment arbitration. It is not surprising, therefore, that when these matters are examined in the context of third-party funding, they similarly implicate some unique policy issues in investment arbitration. Section B below reconsiders briefly disclosure and conflicts (Chapter 4), and Section C reconsiders costs and security for costs (Chapter 6) in light of some of the policy issues that are implicated by these issues.

A. Jurisdictional and Admissibility Questions

There are interesting and important questions about arbitral jurisdiction over and admissibility of claims in relation to third-party funding issues, even if to date mostly limited to policy and academic discussions. This section considers only questions regarding the effect of third-party funding on issues of jurisdiction and admissibility. Other potentially important questions, such as whether arbitral tribunals have the

R. HARFOUCHE and J. SEARBY, “Third-Party Funding: Incentives and Outcomes”, in *European, Middle Eastern and African Arbitration Review 2013* (GAR Special Report) p. 10 at pp. 10-14; A. GOLDSMITH and L. MELCHIONDA, “Third Party Funding in International Arbitration: Everything You Ever Wanted to Know (But Were Afraid to Ask) – Part II”, 2 *Int’l Bus L. J.* (2012) p. 221 at pp. 221-230.

517. See, e.g., M. KANTOR, “Nationality and Control Issues in ICSID Arbitrations”, in *ADR & the Law*, 18th edn. (2002).

power over third-party funders, who by definition are not parties to the arbitration, and whether third-party funders can, under the terms of investment treaties, be parties to an investment arbitration. These questions, while interesting, are not included in this Chapter, but may be of interest for future study.

Jurisdiction and admissibility in investment arbitration is premised on requirements that the claimant “be a covered ‘investor’, carry the nationality of one of the contracting parties, and hold a protected ‘investment’ in the territory of the host state”.⁵¹⁸ Out of these requirements, with respect to third-party funders, the question has been raised whether the participation of a funder may change the status of, and therefore disqualify, a claimant from qualifying as an “investor”.

Several cases have addressed various respondent states’ objections to the jurisdiction of the tribunals and admissibility of claims in relation to the existence of third-party funding. One case that has addressed jurisdictional issues with respect to a modern commercial funder is *Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanos del Sur S.A. v. The Argentine Republic*.⁵¹⁹ In that case, the claimants concluded a funding agreement, which conferred a percentage of any successful recovery to the funder in exchange for funding of costs for pursuing the arbitration. The respondent state argued that, having transferred their rights to a third-party funder, the claimants were no longer the real parties in interest and that the funder would be “the only party that would seem to potentially benefit [] in the case of a hypothetical award against Argentina”.⁵²⁰ According to this argument, claimant did not qualify either as an investor in Argentina or as a company organized in Spain, and as such was outside the jurisdiction of the Spanish-Argentine BIT under which the case was brought.⁵²¹

In assessing these arguments, the tribunal concluded that jurisdiction is generally assessed as of the date the case is filed.⁵²² Because the relevant events relating to funding all occurred after the case was filed, the tribunal concluded, the funding agreement did not affect the claimant’s standing or, consequently, its jurisdiction over the case.

By effectively assuming that the provision of funding is an assignment of the claim, and by limiting its analysis to issues of timing, the tribunal’s decision in *Teinver*, and the related line of cases,⁵²³ did not definitively resolve jurisdictional and admissibility

518. VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure*, p. 224.

519. *Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanos del Sur S.A. v. The Argentine Republic*, ICSID Case No. ARB/09/1, Decision on Jurisdiction of 21 December 2012, para. 254.

520. *Ibid.*, para. 245.

521. *Ibid.*, para. 246.

522. *Ibid.*, para. 255.

523. See generally, *RosInvestCo UK Ltd v. The Russian Federation*, SCC Case No. V079/2005, Final Award (12 September 2010); *Abaclat and others v. The Argentine Republic*; ICSID

issues relating to modern commercial third-party funders. Many funding arrangements are, in fact, entered into prior to filing of an investment claim, which means the reasoning of *Teinver* would not directly apply. Meanwhile, under the terms of most agreements, third-party funders are entitled only to a percentage of any potential recovery, while claimants typically retain a significant (and most often majority) stake in potential proceeds. As such, funding agreements do not generally constitute either a transfer of 100 per cent of the proceeds of a potential award or an “assignment” of a claim, as that term is generally understood.

While *Teinver* left unanswered some questions by addressing only commercial third-party funding and by conditioning its decision on features of that third-party funding, several other cases have considered similar objections in relation to different types of claims financing. None of these cases concluded that the funding or an interest in the final award has any impact on jurisdiction or admissibility.⁵²⁴

In *RosInvestCo UK Ltd v. The Russian Federation*,⁵²⁵ an SCC tribunal addressed claims by a purchaser of shares of the Yukos company which alleged an expropriation of those shares and a right to compensation under the United Kingdom–Russia BIT. The Claimant was a member of the “Elliott Group”. Russia alleged that the Elliott Group was “a fund whose modus operandi” consisted of “buying lawsuits and securities not because they offer the prospect of a reasonable return” but because they furnish “a pretext to threaten legal action”. Russia asserted that, in light of “Participation Agreements” entered into between the Claimant and a company of its group, the Claimant was not an “investor” under the BIT. The Tribunal rejected the contention based on the “plain meaning of the definition”.

In *Abaclat and others v. Argentine Republic*, a type of third-party funding financed the claims of 60,000 Italian bondholders against Argentina. In that case, there was no commercial funder, but instead an entity called Task Force Argentina (TFA), which was created by and funded by the Italian banks that had sold Argentinean bonds to Italian citizens. TFA initiated and managed the ICSID arbitration on claimants’ behalf.

Case No. ARB 07/5; *Ambiente Ufficio SpA and others v. The Argentine Republic*, ICSID Case No. ARB 08/9; *Giovanni Alemanni and others v. The Argentine Republic*; ICSID Case No. ARB/07/8; *Quasar de Valores and others v. The Russian Federation*, SCC Case No. 24/2007.

524. For an analysis of these cases, see J. C. HONLET, “Recent decisions on third-party funding in investment arbitration”, ICSID Review 30 (Fall 2015, Issue 3) pp. 699-712, at fn. 30 <doi: 10.1093/icsidreview/siv035> (last accessed 29 January 2018); see also VON GOELER, *Third-Party Funding in International Arbitration and its Impact on Procedure*, pp. 225-251. For a more sceptical perspective, see A. CRIVELLARO “Chapter 11: Third-Party Funding and ‘Mass’ Claims in Investment Arbitrations” in B. M. CREMADES SANZ-PASTOR and A. DIMOLITSA, eds., *Third-Party Funding in International Arbitration* (ICC Dossier) (Kluwer 2013), p. 137 at p. 148 (“A respondent State needs to be protected from the risk of defending itself against a puppet claimant.”).

525. *RosInvestCo UK Ltd v. The Russian Federation*, SCC Case No. V079/2005, Final Award (12 September 2010), paras. 5, 322-323, and 381-383.

Preliminary objections were raised by Argentina based on the TFA mandate. A first objection, to jurisdiction, dealt with the existence of consent by the Claimants.

That third-party funding was not for Argentina in itself a question going to jurisdiction or admissibility became particularly clear in the second of the Italian bondholders ICSID arbitrations to give rise to a decision on jurisdiction. In *Ambiente Ufficio and others v. Argentine Republic*,⁵²⁶ a smaller group of Italian bondholders (approximately 120 initially) commenced arbitration against Argentina, alleging violations of the same BIT. The case was funded by a Luxembourg entity called NASAM, which was the basis for Argentina's objection:

“According to Respondent’s submission, the problem is not NASAM’s funding arrangement as such, but rather the fact that genuine third party funding deals with the provision of funds by individuals and companies having no other connection with the litigation. NASAM does not fall in this definition, however, as its control goes as far as making NASAM a real party in interest in the present case.”⁵²⁷

The Tribunal dismissed the objection. As one commentator explains, “The point of note is that the lack of objection by Argentina regarding the mechanism of third-party funding, which was implicit in *Abaclat*, became explicit in *Ambiente Ufficio*.”⁵²⁸

In another case, *Giovanni Alemanni and others v. Argentine Republic*,⁵²⁹ NASAM was the entity funding a group of approximately 180 claimants initially in the third of the Italian bondholders, ICSID arbitrations against Argentina. In that case, Argentina also did not challenge the existence of third-party funding as such, but rather other aspects of the NASAM mandate related to the power of attorney and related allegation that consent was lacking. In finding adequate consent, the Tribunal noted that:

“Individual views may differ as to whether third-party funding is or is not desirable or beneficial, either at the national or at the international level, but the practice is by now so well established both within many national jurisdictions and within international investment arbitration that it offers no grounds in itself for objection to the admissibility of a request to arbitrate.”⁵³⁰

In *Quasar de Valors and others v. The Russian Federation*,⁵³¹ an SCC tribunal was presented with a more direct challenge to third-party funding. The arbitration was

526. *Ambiente Ufficio SpA and others v. Argentine Republic*, ICSID Case No. ARB 08/9.

527. *Ibid.*, at para. 186s 275-278 (references omitted).

528. HONLET, “Recent decisions on third-party funding in investment arbitration”, p. 701.

529. *Giovanni Alemanni and others v. Argentine Republic*, ICSID Case No. ARB/07/8.

530. *Giovanni Alemanni and others v. Argentine Republic*, ICSID Case No. ARB/07/8, Decision on Jurisdiction and Admissibility (17 November 2014) para. 278.

531. *Quasar de Valors and others v. The Russian Federation*, SCC Case No. 24/2007.

brought by holders of American Depositary Receipts (ADRs) in the Yukos company, who argued that they had been expropriated of their investment in violation of the Spain–Russia BIT. The claimants were funded by Group Menatep, which had its own separate arbitration against the Russian Federation in respect of its former Yukos shareholding.

In *Quasar de Valors*, Russia alleged an abuse of process, which it said deprived the tribunal of jurisdiction, because claimants allowed the arbitration to be filed in their names when the only real party-in-interest was Menatep, an entity with no rights under the Spain/Soviet bilateral investment treaty. The Tribunal rejected the objection, stating

“[T]here is no reason of principle why [the Claimants] were not entitled to pursue rights available to them under the BIT, and to accept the assistance of a third party, whose motives are irrelevant as between the disputants in this case”.⁵³²

In each of these cases, the tribunals appear reluctant to find that conferral of economic rights to non-parties in exchange for financing raises compelling questions about jurisdiction or admissibility. If states sought to limit or preclude modern third-party funding, they would most likely have to implement more restrictive treaty language that directly and expressly precludes external financing in cases, rather than relying on existing (or even modified) definitions of “investor” and “investment”.

As noted above, however, to date most attention by states has not aimed to prohibit third-party funding of investment claims, but instead to expressly acknowledge it and require disclosure and greater transparency, and to reconsider (in light of the Panama letter to ICSID) issues relating to security for costs.⁵³³ In addition to states addressing these issues in investment agreements, as noted below, these topics are also currently being considered by ICSID and potentially UNCITRAL.

B. Potential Conflicts of Interest

Disclosure and potential conflicts of interest are taken up in Chapter 4. To date, there have been a few known cases in which disclosure of third-party funding has been ordered by tribunals: *Muhammet Çap & Sehil İnşaat Endustri ve Ticaret Ltd Sti v. Turkmenistan*,⁵³⁴ and *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic*.⁵³⁵

532. *Quasar de Valors and others v. The Russian Federation*, SCC Case No. 24/2007, Award (20 July 2012) para. 33.

533. See Chapter 1, at fn. 8.

534. See *Muhammet Çap & Sehil İnşaat Endustri ve Ticaret Ltd Sti v. Turkmenistan* (ICSID Case No. ARB/12/6), Procedural Order No. 3 (12 June 2015).

535. See *EuroGas Inc and Belmont Resources Inc v. Slovak Republic* (ICSID Case No. ARB/14/14), Transcript of the First Session and Hearing on Provisional Measures (17 March 2015) p. 145 (“We think that the Claimants should disclose the identity of the third-party funder, and that third-party funder will have the normal obligations of confidentiality.”).

These cases and the basis for requiring disclosure are discussed extensively in Chapter 4.⁵³⁶

While disclosure of the identity of funders has been ordered to check for potential arbitrator conflicts, there are no known investment arbitrations in which an arbitrator has been disqualified or an award challenged based on conflicts of interest involving a third-party funder.⁵³⁷

As discussed in Chapter 4, two competing approaches have developed under existing rules and guidelines about how disclosure and potential conflicts should be managed. Some sources simply empower arbitrators to order disclosure about third-party funders or advise that they consider potential conflicts with funders.⁵³⁸ The other approach, which is adopted by the Principles in Chapter 4⁵³⁹ and the IBA Guidelines, is to oblige parties and their counsel to disclose the presence and identity of funders as a matter of course at the earliest possible stage. The justification for obliging systematic disclosure is that arbitrators are often not in a position to know and evaluate whether there is a potential conflict unless they are informed of the presence and identity of a funder in a particular case. In addition, tribunal-ordered disclosure would necessarily occur after constitution of the tribunal, and therefore after initial arbitrator disclosures occur in the ordinary course of arbitrator appointments. A full discussion of the reasons for, and costs and benefits of, these competing approaches is discussed in Chapter 4.⁵⁴⁰

Notably, whichever approach is adopted, most sources proposing disclosure obligations are not mandatory. Neither the IBA Guidelines nor the Principles in Chapter 4 are formally binding on parties or their counsel. The ICC Guidance Note is similarly an advisory,⁵⁴¹ not mandatory, instrument. Meanwhile, the SIAC Investment

536. See Chapter 4, at pp. 106-108. For another detailed analysis of these cases, see HONLET, “Recent decisions on third-party funding in investment arbitration”, pp. 708-710.

537. In one case, it seems there may have been concerns raised, but they became moot before ever being formally addressed. See S. PERRY, “Pakistan fights bid to revive treaty claims as funder is revealed”, available at <<https://globalarbitrationreview.com/article/1150573/pakistan-fights-bid-to-revive-treaty-claims-as-funder-is-revealed>> (last accessed 18 January 2018).

Notably, the issue never became ripe because the dispute in which the issue arose was transferred to another tribunal comprised of different arbitrators.

538. This approach is adopted by the ICC Commission in its “Note to parties and arbitral tribunals on the conduct of the arbitration under the ICC Rules of Arbitration” (22 February 2016) available at <<http://www.iccwbo.org/Products-and-Services/Arbitration-and-ADR/Arbitration/Practice-notes,-forms,-checklists/>> (last accessed 10 August 2017).

539. See Chapter 4, p. 81.

540. See Chapter 4, pp. 83-84.

541. See ICC Note to Parties and Arbitral Tribunals on the “Conduct of the Arbitration under the ICC Rules of Arbitration” (22 September 2016), p. 5, at para. 24, available at <<https://iccwbo.org/publication/note-parties-arbitral-tribunals-conduct-arbitration/>> (last accessed 29 August 2017); A. GOLDSMITH and L. MELCHIONDA, “The ICC’s Guidance Note on Disclosure and Third-Party Funding: A Step in the Right Direction”,

Arbitration Rules 2017 expressly authorize arbitral tribunals to require disclosure of third-party funding, but they do not require such disclosure.⁵⁴² The only mandatory disclosure requirements that apply to international arbitration appear to be the national legislative reforms in Hong Kong and Singapore, and the new CIETAC International Investment Arbitration Rules, and a few provisions in what are to date draft investment treaties.⁵⁴³

ICSID has recently announced that it will be considering rules governing disclosure of third-party funding as part of its process of updating its rules and regulations.⁵⁴⁴ It remains to be seen, as of publication of this Report, whether ICSID and other institutions will mandate systematic disclosure of the existence of funding and the identity of funders or, consistent with the approach of the SIAC Investment Arbitration Rules, simply authorize arbitrators to order such information.

C. Security for Costs

The legal frameworks and practical considerations developed through existing case law addressing costs and security for costs, in both investment and international commercial arbitration, are analysed in Chapter 6. The conclusions there, based on analysis of existing sources and reported investment arbitration cases is that the existence of third-party funding is generally irrelevant to either a determination of a request for security for costs or a final allocation of costs at the end of the case.⁵⁴⁵ The Task Force concluded that the principles articulated are a sound reflection of existing standards and economic principles that affect analysis in particular cases. It nevertheless recognized that these issues can also implicate larger macro-economic and

Kluwer Arbitration Blog, (14 March 2016) available at <<http://kluwerarbitrationblog.com/2016/03/14/the-iccs-guidance-note-on-disclosure-and-third-party-funding-a-step-in-the-right-direction/>> (last accessed 18 August 2017); See also “Standard 6” of the IBA Guidelines on Conflicts of Interest in International Arbitration, and Explanation to Standard 6 (b), available at <https://www.ibanet.org/ENews_Archive/IBA_July_2008_ENews_ArbitrationMultipleLang.aspx> (last accessed 15 July 2017).

542. M. MANGAN and H. DEFRIEZ, “SIAC Investment Arbitration Rules 2017”, available at <<http://oxia.ouplaw.com/page/siac-ia-rules>> (last accessed 28 August 2017) (stating that “The new rules are the first of any major arbitral institution to grant tribunals the express authority to require the disclosure of any third-party funding arrangements”).

543. See Chapter 4, pp. 101-104.

544. M. KINNEAR, “ICSID Secretary General’s Top Priorities for Reform”, *Global Arbitration Review* (3 May 2017), available at <<http://globalarbitrationreview.com/article/1140847/icsid-secretary-generals-top-priorities-for-reform>> (last accessed 28 August 2017).

545. For a discussion on existing standards for allocating costs and granting security for costs, see Chapter 6.

structural debates in investment arbitration, which are reflected on briefly in this Section.

The purpose of such awards regarding costs is to deter frivolous claims and make a prevailing respondent whole at the end of a case. Those purposes, however, assume that a losing claimant will be able to pay the adverse costs award.⁵⁴⁶ These concerns were historically also accompanied by assumptions that the provision of third-party funding necessarily implied a funded party was impecunious or would otherwise be unable to satisfy a potential adverse costs award.

Today, as described in Chapter 2, the assumption that funding *necessarily* signals an impecunious claimant is no longer sustainable.⁵⁴⁷ As noted above, it can provide resources for a respondent state, and is sometimes also being undertaken not out of financial necessity, but as a means of allocating corporate resources and risks. Nevertheless, there are still many cases in which claimants seek funding because they do not otherwise have the resources to pursue those claims. In this category of cases, however, third-party funding can enable a party that has had all of its assets wrongfully expropriated to nevertheless pursue a remedy. In such a case, an order for security for costs would penalize a party for not having resources, even though its lack of resources was caused by the responding state's allegedly improper expropriation of its assets.

On this issue, the prevailing view among respondent states and related stakeholders is that it would be particularly unfair, now that the trend is for costs to follow the event, if a prevailing state cannot collect costs against an impecunious claimant or be reimbursed by the third-party funder that was prepared at the outset to share in the risk of making a potential gain. As noted by Panama in its recent letter to ICSID, prevailing states have pursued costs awards not voluntarily paid by investors, and in a significant percentage of cases, states have been unable to collect on costs awards.⁵⁴⁸

Third-party funding has also raised (or resurrected) structural issues regarding increasing investment arbitration caseloads and the potential financial strain on

546. See Memorandum of 12 June 2016 from I. A. ZARAK, Acting Minister of Economy and Finance of Panama, to Meg Kinnear, International Centre for Settlement of Investment Disputes, available at <http://res.cloudinary.com/lbresearch/image/upload/v1477064514/rop_memorandum_to_icsid_administrative_council_re_effective_protection_english_version_2_219116_1641.pdf> (last accessed 27 August 2017).

547. See Chapter 2, pp. 20-24; 33-37 (describing why parties seek funding, and different types of financing or insurance that can provide for satisfaction of an adverse costs award).

548. Reporting on a recent survey, the letter notes that "Responses to the survey also indicated that, among the twenty-two costs awards in favor of respondent states that had been paid either in full or in part, fourteen awards were paid voluntarily (64%), two awards were paid pursuant to a settlement (9%), and six awards were paid through enforcement (27%)." *Ibid.* at 3 (citing J. GILL QC and M. HODGSON, "Costs Awards – Who Pays?", 10 *Global Arbitration Review* (15 September 2015, Issue 4), available at <<http://globalarbitrationreview.com/article/1034757/costs-awards-%E2%80%93-whopays>> (last accessed 29 January 2018)).

states.⁵⁴⁹ This concern stems from the fact that in investment treaty arbitration, states are always respondents and are not generally able to bring counter-claims.⁵⁵⁰ As a consequence, even when a state prevails, it generally does not receive compensation and will have to pay for the costs of its own defence. Thus, to the extent the availability of funding may increase the overall number of cases brought, some are concerned that an overall increase in the number of investment arbitration cases will pose a unique burden on states, particularly small states and states facing domestic economic challenges.

A nascent market for funding of states seems to be emerging. One of the most prominent examples of pro bono third-party funding of a respondent state is the financial support for Uruguay in the *Philip Morris v. Uruguay* case.⁵⁵¹ In addition, there are reports of funding that is structured akin to ATE insurance and available for states is from a commercial funder, as well as funding for states' counterclaims or claims pursued against investors in alternative fora. The availability of such commercial funding would arguably encourage states to pursue claims or counterclaims (typically in other fora) that they might otherwise not forego for budgetary reasons. Some commentators, however, raise policy concerns about a portion of potential recovery awarded to a state to remediate local harms instead going to a third-party funder, and also note that under most investment treaties the ability to bring a counter-claim is extremely narrow. The development of commercial funding for states still appears to be in its infancy, but will broaden the range of policy questions to be considered.

On the other side of the spectrum, some argue that the monitoring of fees and expenses by third-party funders may generally reduce the overall cost of obtaining a successful award. Given their incentive to keep legal costs within predicted budget projections, the argument is that third-party funders may be more focused on efficiency

549. M. MORPURGO, "A Comparative Legal and Economic Approach to Third-Party Litigation Funding", 19 *Cardozo Journal of International and Comparative Law* (2011) p. 352; and M. STEINITZ, "Whose Claim Is It Anyway? Third-Party Litigation Funding", 95 *Minn. L. Rev.* (2011) p. 1267.

550. For an overview of State counter-claims, see, A. VOHRZYK-GRIEST, "State Counterclaims In Investor-State Disputes: A History of 30 Years of Failure", 15 *Int'l L.: Revista Colombiana de Derecho Internacional* (2009) p. 83.

551. "The Anti-Tobacco Trade Litigation Fund", available at <http://global.tobaccofreekids.org/en/about_us/trade_litigation_fund/> (last accessed 27 August 2017) ("The fund will support low- and middle-income countries that have been sued by tobacco companies in arbitration under international trade agreements. Managed by the Campaign for Tobacco-Free Kids, the fund will provide financial and technical assistance to governments committed to defending their laws to reduce tobacco use."). While that case was funded on a pro bono basis, there are reports that viable funding models are being developed both for States as respondents.

than law firms that operate based on an hourly rate.⁵⁵² While it is ultimately funders' self-interest that motivates them to control costs, the effect of lower costs expended by claimants would arguably carry some potential incidental benefits for states, particularly if a successful claimant is awarded costs against a state.

In a related vein, funders raise cost-related concerns regarding disclosure. They argue that when the presence and identity of a funder is revealed, respondents often use that disclosure as a basis for bringing challenges to arbitrators, requests for further disclosure, and requests for security for costs. These reactions to disclosure of funding arrangements can slow arbitral proceedings, funders complain, and consequently significantly increase the costs of an arbitration. Funders and funded parties argue that many of these efforts are substantively unfounded and are instead simply tactics to delay proceedings and increase the costs of proceedings to make the funding model untenable.⁵⁵³ In fact, the potential for such challenges is the primary reason why funders express reluctance at having their presence and identity disclosed.

Debates about security for costs, and the existing standards articulated in Chapter 6, are being challenged based on larger macro arguments about structural incentives and disincentives. Some funders have argued that security for costs does not have a place in arbitration generally. Under this view, the risk of an unenforceable award (including an unenforceable award for costs) is like any litigation risk, and should not be treated differently in the investment context. Systematic issuance of security for costs orders will simply raise the cost of third-party funding for investors, which will translate into reduced recovery margins for funders or a restriction on the availability of funds. Either scenario, it is argued, will reduce the ability of genuinely aggrieved investors to seek redress for alleged wrongs through investment arbitration.

Other funders have stated that, as a general matter, *ex ante* they are relatively ambivalent about the imposition of security for costs because that amount can be factored into a funding agreement. The greater problem, under this view, is the uncertainty about whether security for costs will be granted, and the time and delay that often accompanies the request for costs. In light of this observation, some proposals have been made to make security for costs more generally available.

One proposal made during the public comment period, and discussed specifically at the Roundtable discussion hosted by CCSI, is adoption of a presumption that security for costs would be posted in every case, and a parallel presumption that the costs of that security (i.e., the cost of funding, the cost of ATE insurance premiums, or the cost

552. Funders' cost-monitoring function has raised some questions about attorneys' independent professional judgments. These issues are generally the province of national ethical rules and the funding agreement, and for these reasons not considered directly in this Report, other than generally in Chapter 7 in a discussion of Best Practices. See Chapter 2, pp. 29-30; Chapter 7.

553. Unforeseen delays or increases in legal costs can change the assumptions on which funding was provided and make otherwise potentially meritorious claims unprofitable from the funder's perspective. See Chapter 2, pp. 29-30.

for a bank guarantee) would be shifted at the end of the case, along with other costs. Under this proposal, each party would be made financially whole at the conclusion of the case – if the state prevails it would be sure to recover on any costs award, and if the investor prevails it would recover not only its legal costs, but also costs associated with security. Arguably, however, each side would also benefit by the reduction or elimination in the often costly and time-consuming process for applying for and resisting an order for security for costs.

This proposal seems to enjoy at least tentative support from both funders and counsel who routinely represent states. Some pointed out, however, that several details would have to be addressed to make this idea into a workable proposal.

One potential concern with this proposal is that the cost of security is likely to be much higher than interest on the amount. An impecunious claimant does not likely have cash on hand to put in escrow, or have the option of obtaining a traditional loan from a bank. As a consequence, that party might seek the amount for security of costs through a conventional third-party funder. In that instance, from the state’s perspective, the cost of that security would be exceptionally high. As one commentator explains,

“if a claimant is ordered to post USD 500,000 as security for costs by a tribunal, the cost of that security for the claimant (if the claimant is impecunious and has to require that additional amount from the third-party funder, which will often be the case) may be USD 1,000,000 or more, that will come in deduction of the claimant’s entitlement if it prevails in the arbitration. Should states that do not prevail in arbitration bear that additional cost?”⁵⁵⁴

A bank guarantee may be an alternative to a cash deposit, but can be similarly expensive. Yet another option may be ATE insurance, which is already often procured together with third-party funding, and which may be a lower cost alternative. As described in Chapter 2, the purpose of this type of insurance is to provide for coverage in the event a claimant is liable for adverse costs.⁵⁵⁵ In *Eskosol S.p.A. v. Italy*,⁵⁵⁶ the tribunal found that Italy’s request for security for costs was not urgent because the claimant had purchased ATE insurance that would cover a potential adverse award of costs.⁵⁵⁷ Claimants in financial difficulties may not be able to afford the premiums for ATE insurance.

Finally, another possibility that was suggested during the public comment period was that funders undertake a “deed of submission” to the jurisdiction of the tribunal,

554. See HONLET, “Recent decisions on third-party funding in investment arbitration”, p. 712 and n. 76.

555. See *Eskosol S.p.A. v. Italy*, ICSID Case No. ARB/15/50.

556. *Eskosol S.P.A. in Liquidazione v. Italian Republic*, (ICSID Case No. ARB/15/50) Procedural Order No. 3 (Decision on Respondent’s Request for Provisional Measures) (12 June 2017).

557. For a more detailed discussion of the case, see Chapter 6, p. 179.

similar to how some funders in Australia submit to a court's jurisdiction for the purpose of the court to make adverse costs orders directly against the funder should that become necessary.⁵⁵⁸ This proposal could provide an alternative source of assurance to states and avoid the need for applications for security for costs. It should be noted, however, that general agreement on the Task Force and from external commentators was that under the current state of the law, absent such a submission, arbitral tribunals generally lack the jurisdiction to order costs directly against a funder.⁵⁵⁹

IV. Conclusion

As noted in the introduction, this Chapter does not aim to provide concrete answers to the larger considerations and policy debates in which third-party funding issues are often raised. Instead it aims to provide a fair-minded presentation of competing viewpoints in the larger political debates, sharpen the focus of such debates and suggest some possible areas for future research and work.

Discussion of investment arbitration specifically comes at the end of the Report not because it is less important. Instead, it comes at the end because the policy issues and questions raised in this context are more open-ended and thus even more forward-looking than discussions in earlier chapters.

As described in Chapter 1,⁵⁶⁰ the central purposes of the Task Force included promoting a clearer understanding of issues relating to third-party funding and engaging a range of stakeholders in meaningful dialogue about those issues. From this view, the Task Force's means were an end in themselves. In the work of the Task Force itself, Members shared generously from their experiences and distinct perspectives, but also listened and engaged in dialogue that, at least in some instances, changed otherwise settled minds. This effort was dramatically enhanced by the tremendous outpouring of ideas and comments received from innumerable advisors beyond the Task Force.

It is hoped that this Report will contribute to better composite understandings of the issues and greater appreciation of the reasons for differing viewpoints. Dialogue alone will not, of course, necessarily produce consensus. In fact, even after extensive discussions, many areas of disagreement remained among Task Force Members.

Particularly as the number of third-party funders and funded cases increase, and the pace of related reforms quickens, and as public scrutiny remains trained on investment arbitration, the need for constructive dialogue has never been greater. Meaningful and engaged dialogue can help identify more clearly areas of actual agreement and

558. See *Traderight Pty Ltd v. Bank of Queensland Ltd* [2010] NSWSC 1502 at [95] per Ward J.

559. See Chapter 6, pp. 160-163.

560. See Chapter 1, p. 3.

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disagreement, sharpen focus and analysis, and aid in collectively distinguishing between what are priorities and what is background noise. It is also hoped that, particularly for investment arbitration, the Report helps identify the critical issues for independent empirical research. Such research is needed to meaningfully assess some of the factual assumptions that animate various arguments and positions.

As noted in the introduction, in light of how rapidly international arbitration practice and funding models are evolving, this Report will not be either definitive or permanent. It is hoped, however, that the conceptual frameworks and detailed analysis it provides be a foundation for future work in the area.

Annex B

Summary of Roundtable Discussion on the ICCA-Queen Mary Task Force Draft Report on Third-Party Funding in International Arbitration

12 October 2017, at The Law Society

Introduction

On 12 October 2017, the Law Society of England and Wales and the ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration co-hosted a roundtable discussion on issues of insurance and maritime arbitration that are implicated in the draft report. The purpose of the roundtable was to facilitate direct engagement between the Task Force Members and maritime insurers, maritime arbitration institutional representatives, arbitrators, attorneys, barristers, third-party funders, and brokers. A complete list of attendees is attached.

Discussion at the roundtable was organized around two questions:

- (1) For the purposes of disclosure of the existence of third-party funders to facilitate assessment of potential arbitrator conflicts of interest, the current draft includes “insurance” (other than that provided by P&I and FD&D Clubs) in its definition of “third-party funding”. Is it reasonable and appropriate to include “insurance” within the definition of third-party funding for this purpose?
- (2) For the purposes of disclosure of the existence of third-party funders to facilitate assessment of potential arbitrator conflicts of interest, the current draft of the Task Force Report carves out “maritime arbitration.” Is this carve out reasonable and workable?

The major points from the roundtable discussion are summarized below.

Question 1: Insurance

Discussion in the first part of the roundtable focused on whether the inclusion of “insurance” in the definition of “third-party funding” is reasonable and appropriate. It was noted at the outset that inclusion was limited to the existence and identity of funders and for the limited purpose of facilitating conflicts of interest checks by arbitrators. It was also noted that the draft report included two alternative definitions in the Principles set out at the beginning of Chapter 4 (one that included insurance and

one that did not), and that the Task Force would be deciding as between these alternatives as it finalized the draft and after it took account of public comments submitted at the public consultation period which ends on 31 October 2017.

It was noted at the outset that although non-maritime insurers were not in attendance, but that both the Task Force and the roundtable included a number of individuals who have expertise with and prior experience in the insurance industry. All participants agreed that the Task Force would benefit from additional outreach to non-maritime insurers and those with expertise in insurance.

The roundtable participants first took up the topic of ATE insurance, identifying similarities and differences between ATE and third-party funding. Some of the most important differences identified between ATE and conventional third-party funding are that ATE insurers do not provide “funding” but insurance by way of an indemnity against the risk of an adverse cost award; they typically receive a contingent premium based on a percentage of the amount indemnified; and have been involved in litigation and arbitration for longer than the new funders, notably in the UK market.

With respect to the market structure, participants noted that ATE insurers are generally more passive in case management than funders, including being generally less concerned with the constitution of the arbitral tribunal. Unlike funders, ATE insurers do not generally have any investment committees or advisory boards that may include arbitrators or arbitration specialists (which is one potential source of conflicts identified with respect to funders). ATE insurers tend to be a very small division of a very large insurance company, with a handful of employees and a very small portion of the insurer’s total business.

Given these differences, questions were raised about whether ATE insurers raise the same concerns about potential conflicts of interest, and whether imposing a disclosure obligation could raise internal concerns regarding their own internal potential business conflicts, particularly if a client with a significant business relationship with an insurer were to find out that the ATE branch of the insurer was providing coverage for adverse costs against its opposing party in an arbitration. One concern expressed was a risk that insurers could be pressured into abandoning ATE business because of commercial sensitivities or conflicts with other clients of the insurer, thereby reducing access to justice.

It was noted that there may be an argument in favour of disclosure of the involvement of an ATE insurer if there is thought to be a risk that a court in the place of enforcement would take a strict view of conflicts (thereby putting the effectiveness of any resulting award at risk).

Discussion then turned to some of the reasons why insurance was proposed to be included in the draft report’s definition of third-party funding. One reason is that third-party funders compete directly with ATE insurers in the same market, and that market is increasingly integrating ATE insurance with other forms of third-party funding, and some individual entities are offering both products. Based on the integration of markets and convergence of forms, third-party funders on the Task Force raised questions of fairness: if they are similar in function, and operate in the same market and sometimes

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in the same transaction, why are ATE insurers and funders subject to different treatment with respect to their disclosure?

The roundtable participants found general consensus around the idea that the main goal of the Task Force's proposals surrounding disclosure was to enable arbitrators to decide for themselves whether there is a conflict of interest in any given situation.

However, it was also noted that insurance had not traditionally been treated as causing "mischief" and therefore historically not be disclosed to allow arbitrators to assess potential conflicts of interest with arbitrators.

As the discussions shifted towards BTE insurance, it was argued that the wording of the definition on page 39 of the Report does not seem to cover BTE insurance simply because the definition suggests that a dispute will have already arisen at the time of entering into a funding agreement. It was acknowledged that the definition should be revised to avoid this implication.

It was also suggested that BTE insurance could not logically be covered by the current version of the definition because BTE insurance is provided in return for a premium that is usually paid annually and BTE insurers do not receive any "profit" from the case in the same way that funders do.

This view was countered with the observation that a BTE insurer can recover from an award of costs in favour of the insured, and the issue was not "profits" from an award so much as an interest in the final outcome and award. Under this view, the prospect of recovering costs could be seen as sufficient to make BTE similar enough to third-party funding that it could and should be within the scope of the Task Force definition for disclosure purposes.

It was also noted that a partial recovery of costs would only be available in those arbitrations in which costs shifting was permissible. Under some arbitration rules and at some seats, costs recoveries don't happen but BTE insurers fund such arbitrations.

It was noted that some innovations in BTE insurance may be a result of an effort to compete with third-party funding and, given the increased prevalence of third-party funding, parties may in the future be more likely to opt to obtain third-party funding after the dispute arises rather than pay for BTE insurance premiums.

Roundtable participants largely agreed that ATE insurance is conceptually very close to third-party funding. There was less consensus about the functional similarities with BTE insurance. For some, the potential for recovering costs in the event of a favourable costs award was sufficient to create an interest in the award, and thus potentially relevant for an arbitrator considering conflicts of interest, whereas such potential recovery was not regarded by others as sufficient to raise the potential of conflicts of interest between arbitrators and BTE insurers.

It was noted that a definition for purposes of disclosure of participation by a funder or an insurer should take into account a reasonable limit on the participation that would be subject to disclosure – for example, whether the identity of a re-insurer or of a backer of a third-party funder would be subject to disclosure or not.

Roundtable participants were invited to submit further comments and suggestions to assist in refining the definition of third-party funding so that is fair, commercially reasonable, and addresses the practical realities of potential conflicts of interest.

Question 2: Maritime Arbitration

Discussion then turned to maritime arbitration and focused on the carve out in the Task Force's draft report for "maritime arbitration." The issue discussed was whether this carve out was reasonable and workable.

It was noted that the carve out was mentioned in the introductory chapter, but it did not appear in later in the Principles, an omission would be corrected in the Report.

Discussion began with the appropriateness of entirely carving out maritime arbitration from the Task Force's recommendations. It was suggested that the existing language for the maritime arbitration carve out inaccurately implied that the industry was perhaps parochial. It was pointed out that in some cases maritime arbitration is indistinguishable from other types of large commercial arbitrations, such as in relation to the construction of vessels, and indeed maritime arbitration cases are brought in arbitral institutions like the HKIAC, ICC, SCC, and SIAC.

One question raised was whether the Task Force carve out should include language more similar to that employed in the IBA Guidelines on Conflict of Interest ("IBA Guidelines") to identify an exception for maritime arbitration. In response, it was emphasized that, although "disclosure" is discussed in both contexts, the purpose of the IBA Guidelines' exception was different than the Task Force carve out. In the IBA Guidelines, the exception is with respect to disclosure to be made *by arbitrators* to parties as part of arbitrators' duty to disclose potential conflicts of interest. The Task Force carve out, on the other hand, concerns the need for disclosure *by funder or insurers* of their existence and identity to the arbitrators, which disclosure would enable the arbitrators, in turn, to determine whether they have any potential conflicts that need to be disclosed to the parties.

In discussing justifications for the Task Force's maritime carve out, it was suggested that the main focus should not be on the idea that maritime arbitration conducts itself differently, but rather that the circumstances of the industry make it such that conflicts are not a problem. In particular, it was noted that maritime arbitration's culture of transparency allows the parties to know with which club a ship is entered. Whether a club is, in fact, covering a claim (which is a matter of discretion) may not, however, be disclosed and it may not become known to an arbitrator until, for example, a club representative appears at the hearing. In addition, maritime arbitrators do not generally have commercial conflicts because they are usually independent, full-time arbitrators and not lawyers in law firms, and that clubs take an active role in the management of the proceedings.

There was significant debate about whether the maritime carve out should be based on a range of factors and special features that define the field of maritime arbitration, or whether it should be more categorical, particularly in light of the fact that some types

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of maritime arbitration may be funded by third-party funders (not P&I or FD&D Clubs). Additionally, the participants largely agreed to consider changing the carve out's reference from "London Maritime Arbitration" to something more inclusive to account for the global nature of maritime arbitrations and the administration of maritime arbitrations by other arbitral institutions.

Roundtable participants were invited to submit further comments and suggestions to assist in refining the maritime carve out to take account of the points raised and suggestions offered during the roundtable discussion.

Annex C

Third-Party Funding in Investor-State Dispute Settlement

Roundtable Discussion of the ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration

Draft Report for Public Discussion*

17 October 2017

Introduction

On October 17, 2017, the Columbia Center on Sustainable Investment (CCSI) and the ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration (Task Force) co-hosted a roundtable discussion at Columbia University in New York City to discuss the “Draft Report for Public Discussion of The ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration”, dated 1 September 2017 (“Draft Report”).

The roundtable was convened to specifically address the use, and public policy impacts, of third-party funding in Investor-State Dispute Settlement (ISDS). When third-party funding is used in ISDS it raises myriad policy questions, some of which are debated in the context of third-party funding generally, and some of which are unique to ISDS. For example, because of the involvement of a respondent-state, which has innumerable, and sometimes competing, obligations to its citizens, policy concerns arise that are not present when a dispute is between two private parties. Similarly, under nearly all existing treaties, treaty-based claims must be initiated by a claimant, and other than in the extremely limited number of circumstances in which a counterclaim may be possible, only the claimant, and not the respondent-state, has the potential to be awarded financial compensation. This reality means that the economics of third-party funding will necessarily look different as between claimants and states.

Furthermore, the debate over third-party funding cannot be decoupled from with the larger, ongoing debate over the propriety of investor protection provisions and the inclusion of ISDS mechanisms in international investment treaties. This roundtable took place at a time when ICSID, UNCITRAL, UNCTAD, the European Union as well as many states are reconsidering their approach to, and/or the rules surrounding, ISDS,

* CCSI and the Task Force express their thanks to the rapporteurs for the roundtable whose contributions made this outcome document possible: Vladislav Djanic, Nathan Lobel, Neeraj R. S. and Charlotte Skerten.

exists and third-party funding is being used, this roundtable sought to allow participants to better understand how third-party funding, and different approaches to governing it, impact issues including, for example: the use of ISDS, outcomes of cases for litigants and non-parties, development of the law, and ethical obligations of arbitral professionals.

This roundtable provided an opportunity engage various stakeholders with diverse perspectives and experiences to discuss the issues raised in the Draft Report regarding the use of third-party funding in ISDS. This roundtable sought not only to ask what is happening, but to dig deeper by considering the impacts of third-party funding, whether the impacts are desirable or undesirable from a policy perspective, and what mechanisms are available, or should be available, to manage the impacts. It also sought to identify information gaps that prevented adequate analysis of third-party funding and its policy implications.

The roundtable discussion proceeded under Chatham House Rules and this outcome document is therefore drafted on a basis of non-attribution. Present at the roundtable were representatives of the following: states, funders, lawyers who represent states, lawyers who represent claimants, academics, and members of civil society. A list of participants is included at the end of this summary report.

Roundtable Discussion

The discussion started with a general round of introductions and a brief overview of the Task Force, including a review of chapter topics for the final report. The introduction also clarified the objective of the roundtable, which was to generate an informed dialogue about the public policy issues surrounding third-party funding in ISDS.

Session 1: Third-Party Funding and Public Policy

Recent years have seen significant increases in third-party funding in ISDS. While it is understood that the number of funded cases is increasing, diverse opinions exist on how third-party funding is impacting ISDS, whether third-party funding is useful or desirable in this context, and what may be the short- and long-term public policy impacts of third-party funding. The roundtable's first session considered questions about potential structural impacts of third-party funding (for both claimants and respondents), including how of standards in the Task Force's draft report regarding disclosure, cost allocation and security for costs may affect these structural issues.

Specific questions that roundtable participants were asked to address included:

- Does third-party funding promote “access to justice”? From the perspective of claimants? States? Third parties? What do we mean by “access to justice”? Is third-party funding necessary for “access to justice”?

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- Does the use of third-party funding as a way to manage funds and a corporate balance sheet, as opposed to funding impecunious claimants, change the public policy issues surrounding third-party funding? Why or why not?
- Does third-party funding impact the number of cases? The quality? Does third-party funding increase or decrease frivolous cases? What is meant by a “frivolous” case?
- Does third-party funding ameliorate or exacerbate systemic power imbalances? How?
- What are policy arguments for permitting, and for not permitting, third-party funding in ISDS?
- How does third-party funding ameliorate or exacerbate concerns about ISDS as a general matter?

To facilitate comprehensive deliberation over a wide range of issues the discussants split into four sub-groups for one hour and then reconvened into a plenary group.

Small Group Discussions:

Small Group I

In discussing whether third-party funding increases access to justice, participants in this group began by asking what exactly is meant by the word “justice?”

One participant, conceiving of “justice” as ability to have one’s day in court, asserted that third-party funding undeniably increased access to justice. Some participants reasoned, however, that third-party funding does not generally provide access to the ISDS system for all claimants. For example, even impecunious small claimants may have claims that are not financially large enough to entice third-party funders, so these claimants still have no greater access to the ISDS system. Rather, third-party funding seems to be more likely to lower the cost of entry for potential claimants that, without funding, may have been hesitant to bring a claim but are not impecunious. To support this position, participants pointed to the recipients of third-party funding, who, based on anecdotal evidence and the Draft Report, as well as knowledge of the ISDS system generally, seem to be mostly large multinational corporations. While third-party funding may be useful in managing their balance sheets and how these corporations choose to allocate resources or which opportunities may be foregone if they choose to finance an ISDS claim, to these participants, third party financing in this context does not seem to be about fundamentally achieving access to justice. Consequently, it was said that it is misplaced to assert that for these kinds of non-impecunious claimants third-party funding is necessary for access to justice.

One participant felt that third-party funding brings other benefits outside of “access to justice.” For example, this participant pointed out that in all legal systems, laws evolve and develop, and so ISDS, which is relatively transparent in comparison to commercial arbitration, exhibits the positive externality of creating public discussion about legal questions. Another participant added that many cases now involve corruption in some respect, and it is a good thing that third-party funding can promote

cases that shed light on these issues and hold governments accountable, both to other countries as well as their own citizens. Other participants, however, disagreed, noting that the arguments rely on the premise that ISDS is transparent, and stating that ISDS is strikingly opaque compared to other forms of public litigation, which thereby limits the magnitude of any positive externalities that could potentially arise from ISDS debates.

The participants then shifted the discussion to whether third-party funders impact the nature of claims actually brought in ISDS. One participant noted that, because the recipients of funding are often well-resourced themselves, and can therefore fund their own cases, particularly if they are confident about the outcome, third-party funding then can actually encourage riskier cases to be brought, because the funders can diversify against risk within a portfolio of cases. This participant likened ISDS to the wild west of arbitration, with unpredictable determinations of liability and damages because of the inherently vague nature of standards in treaties themselves and the inconsistent way in which damages are calculated, and went on to say that third-party funding is like buying a lottery ticket; it has a relatively low entry cost for claimants with an opportunity to win a very large return. Because states cannot initiate claims there is very little downside for claimants, and if third-party funding further eases this cost of entry, there is a large public policy concern about funders' impact on this system. Further, it was said that, because of the inconsistent nature of damages assessments in particular, it appears that funders push claimants to seek damages that exceed restitution for harm done, or that claimants are inflating claims to make them more attractive to funders, so that more speculative claims such as those based on speculative lost profits, are encouraged and ever-larger damage claims may become more of a norm.

To continue this discussion on the nature of claims, another participant noted that "capital seeks returns, not justice". This participant continued, setting forth the position that unlike other business investments outside of the legal field, third-party funding of litigation has profound implications for the development of law and the legal system, rendering the profit-motive of third-party funders particularly problematic when it is injected into a system that is intended to promote justice. Some group members challenged this position, asserting that profit-seeking was not the sole motive for all third-party funders, using the example of NGOs or private investors who can, and have, funded legal efforts for respondents. For NGO funding, the ideological nature does not, for these participants, change the fact that the funder may have a different interest in the outcome than the claimant that could distort how a claim is managed.

Following on this vein of the conversation, another participant raised the possibility of another motive for third-party funding of ISDS – what could happen if states inevitably begin funding investor claims against other states for geopolitical reasons? There was general agreement that these concerns raised the need for some type of disclosure of funding in ISDS claims, but the participants could not agree on whether mandated disclosure would be appropriate. On the one hand, disclosure of the existence of a funding arrangement could bias the legal aspects of the dispute resolution system and distract from the core subject of the case (for example, whether the existence of a third-party funder should be taken into account in damages

calculation, including whether the funder's costs should be included). Furthermore, it was said that financing terms are proprietary corporate information, so disclosure, if made, would have to be made subject to various exceptions. However, on the other hand, participants also noted that ISDS inherently raises public policy concerns given the participation of a respondent state, and tribunals already operate with substantial discretion. Advocating for greater discretion (i.e., something less than some determined level of transparency) therefore exacerbates other problematic aspects of the system that is frequently criticized for its lack of transparency. Furthermore, since claimants are receiving *public* money if they win cases, and in particular cases that are funded by third parties, claimants should be required to disclose their funding sources.

To conclude the first small group discussion, this group was split between whether third-party funding should be evaluated as a phenomenon in and of itself, or whether it is inherently intertwined with, and therefore must be evaluated in light of, the ISDS system as a whole. On the one hand, some participants noted that ISDS is a legal system that currently permits third-party funding, and investors should not be punished for using it. On the other hand, some participants felt that the system has many fundamental problems (noted problems included the asymmetrical nature in the ability to initiate claims, potential negative impacts on third-parties, relatively unregulated arbitrator conflicts of interests, and a lack of transparency), and third-party funding appears to further exacerbate many of these problems.

Small Group II

Small group II first discussed the role in the investor-state dispute settlement system that is played by insurers that provide litigation/arbitration insurance. In this respect, one participant raised the question of whether these kinds of insurers are able to accurately predict the outcome of a case. One participant noted that insurers do in essence possess the capacity to usefully evaluate the merit of claims, but that there was a need to develop it further as they are also not always accurate. It was underlined that there is going to be considerable growth in this area in the future and that there is considerable discussion currently on-going behind the scenes regarding possible new ways of approaching investment insurance, which could be considered an alternative to more traditional forms of third-party funding, or generally as a growth in third-party funding.

The discussion then turned to consider the reasons for which claimants turn to third-party funding. Discussion focused on the two types of claimants that look for funding. The first group consists of investors that lack the resources to finance the claim on their own. Faced with choosing between not being able to bring a claim at all and bringing a claim but giving up a share of the potential recovery, they are unsurprisingly inclined to go with the latter. The second group consists of investors who, while having sufficient funds to finance the claim, prefer not to have the money tied up so that they can streamline funds into their usual business activities. Even though third-party funding may have started as a practice that was primarily oriented towards impecunious claimants, it has over time shifted more towards this second group of non-

impecunious third-party funding beneficiaries. There was disagreement within the group with respect to whether this is problematic from a public policy perspective.

The small group then moved on to discuss whether third-party funders could themselves be considered to be investors and whether they would be able to bring a claim in their own name. There was broad agreement within this group that funders should not have this ability – while, strictly speaking, third-party funders do have a financial investment in the claim, the group was of the opinion that this was not a protected investment within the meaning typically attributed to the term within investment treaties and ISDS, and as a matter of policy should not be considered so. Several participants pointed out that third-party funders themselves do not generally seem to assert that they should be considered protected investors.

Next, this small group focused on aspects of third-party funding that are unique to ISDS because they relate to states, as opposed to private parties, being the respondent. Noting the asymmetrical nature of how ISDS functions, where claimants sue states but states generally do not sue claimants, and claimants are also the parties who can benefit from third-party funding, one participant raised the question of whether it would be possible for a state to get access to third-party funding when it is defending a claim, as well as what the cost of doing so would be. It was noted that apart from cost awards for their legal defence (which are often not awarded at 100 per cent of costs), states do not receive any remuneration in the event that they are successful in defending a claim so there would not be any upside for a third-party funder, and the economics therefore make state funding difficult. One participant responded by explaining that the mechanism through which states can potentially receive funding is known as inverse contingency – the funder provides financing for the state's legal costs during the arbitration and, in return, receives a certain level of compensation in the event that the state is successful in defending against the claim, or is found liable to pay damages that fall below a threshold agreed between the state and the funder. The group briefly considered whether there could be any room for funding states in the case of a counterclaim, but noted that counterclaims are relatively rare. It was then noted that some states have started inserting ICSID clauses in all of the investment contracts that they conclude, so states would have the possibility of initiating contractual claims, and that there is also a possibility of including provisions in future BITs that would allow states to bring claims. One participant questioned, however, whether an increase in state counterclaims is a good thing, and whether it also exacerbates problems with the ISDS system, specifically because counterclaims could have a negative impact on the rights of non-parties to an ISDS dispute but who may also have a claim (in another forum) against the claimant that the counterclaim purports to waive or resolve.

The group moved on to discuss the manner in which a respondent-state might be affected by the existence of a third-party funder supporting a claimant. One participant thought that this might lead to more illegitimate claims simply because it allows more claims to be pursued and there is a built-in incentive for claimants to inflate the value of claims to ensure that they are attractive to funders. Another discussant pointed out that to the contrary, it is difficult to secure third-party funding from the major funders

because they only fund claims that have a strong basis, so it should not result in an increase in illegitimate claims. The first participant pointed out that new entrants or other funders may be less scrupulous.

In a related vein, the group moved on to discuss what may be the biggest concerns by governments regarding third-party funding. In this respect, one participant noted that the primary concern was that the entire nature of ISDS, as envisioned by states as treaty parties, would change if third-party funding becomes prevalent in investment arbitration because of funders' singular focus on profit. This participant pointed out that no state could have anticipated the impacts that third-party funders could have on ISDS at the time when BITs were negotiated. Another participant felt that the biggest concern to states should be the costs of the arbitration, as there is no mechanism in place that prevents claimants from bringing outrageous claims that states are nonetheless forced to defend against, and third-party funders cannot be held liable for the costs of such arbitrations in case the claimant is impecunious. One participant highlighted Panama's recent letter to ICSID in which it raised concern about Panama being unable to collect on several costs awards after prevailing in arbitrations.

Another related issue that was deemed to be of significant importance to this small group was the need for disclosure of third-party funding. One participant noted that there was a need for respondent-states to know when third-party funding was supporting a claim so that it would be easier to discern whether the claimant was impecunious. This fact can have an impact on how the state approaches certain issues in its defence. Some participants pointed out that it was unrealistic to expect claimants to voluntarily disclose information about the presence of third-party funding, but thought that disclosure would be possible if ordered by the tribunal. Participants acknowledged that there are several new international agreements that include provisions that regulate some level of transparency in third-party funding, but that general practice nonetheless remains against disclosure, as in the absence of treaty provisions, tribunals seem not to be inclined to request parties to disclose the presence of third-party funding. The group concluded that there are different degrees of disclosure that can be made regarding third-party funding, spanning from merely revealing the fact that third-party funding is supporting a claim, to disclosing who the funder is (either to the tribunal, to both the tribunal and to the opposing party, or generally as a matter of public transparency), to how and to what extent the claim is being funded and, finally, to revealing the entire funding agreement (again, either to the tribunal, to both the tribunal and to the opposing party, or generally as a matter of public transparency). There were differing opinions within the group as to the precise level of disclosure that would be warranted. One participant noted that one way to avoid many issues would be for claimants to purchase insurance for the costs of the arbitration.

Finally, this group noted that the ongoing debate about the impact of third-party funding in ISDS is largely theoretical, and issues raised during this roundtable discussion difficult to answer, because due to a lack of transparency there remains a lack of reliable data on the percentage of cases that receive third-party funding and on the success rate of those cases. It is therefore difficult to understand the impacts of

third-party funding. One participant stated that with respect to the proportion of cases that receive third-party funding, this percentage was probably less than the ten per cent of cases that are actually brought to third-party funders (the number cited in the Draft Report) and that obtaining third-party funding is extremely difficult. In this context, one participant felt that having a debate in such general terms runs the risk of losing sight of the diversity of individual claims, some of which are legitimate and others that may be inflated claims where the pressure exerted on a state may be exacerbated by a substantial financial commitment of a funder. It was highlighted that the key to a policy solution will be to find an appropriate balance between these two extremes in order to ensure that wronged claimants can access funding, but also to and prevent extortion of states through inflated claims.

Finally, this small group considered how the existence of third-party funding in a claim could impact how the claim is generally perceived by the state, the public, and arbitrators, and how the existence of third-party funding may impact how a respondent-state and arbitrators may approach the claim. The prevailing view within the group was that knowledge that there was funding behind a case would certainly influence how a case is perceived generally speaking, although there was uncertainty whether it would result in the case being viewed more favourably or whether it would be detrimental. As part of this discussion, one participant questioned whether it is possible that obtaining third-party funding would ever be considered to be a de facto prerequisite to bringing a claim, such that if third-party funding ever became the norm in investment arbitration, an unfunded claim may be perceived as less meritorious. Supporting this point, another participant pointed out that a prominent arbitrator had stated that he would look at a case that he knew was being funded as more likely to be meritorious because he knew how demanding the procedure for obtaining funding was. One participant expressed concern that this would compromise the role of arbitrators and distort the nature of the ISDS system by giving outsized power to a largely unregulated funder that is itself not a direct part of the arbitration. The general consensus within the group was that funding should never become or be viewed as a necessary or desirable prerequisite that would taint the merits of a claim.

Discussants also generally agreed that third-party funding was likely to encourage settlements for two reasons: first, a funded claim is likely to be strong because it will have received careful scrutiny by the third-party funder, so a state is more likely to want to settle than to continue with the time and expense of arbitration, and second, because the respondent-state would be aware that the claim was supported by considerable resources and would therefore have confidence that the claim would continue through arbitration unless settled.

One participant pointed out at the conclusion of the discussion that one possible public interest benefit of third-party funding could be the presence of more awards in the ISDS system, which could result in the law becoming clearer. Another participant noted that the ISDS system is frequently criticized for the lack of consistency in the awards, so more awards would be unlikely to remedy, and could in fact make worse, this underlying problem.

Small Group III

This small group started their discussion by considering the role of third-party funding in promoting access to justice. Members of the group expressed differing opinions as to whether third-party funding should be used to support ISDS claims only for the impecunious, or whether it has a broader role to play for financially sound claimants. Participants considered whether it is possible to determine the solvency of claimants in a practical and cost-efficient way, and whether a claimant's solvency should be the determinant of whether the claimant should be able to access third-party funding. Participants agreed that this issue turned on one's view of ISDS – if one is philosophically opposed to ISDS, any mechanism likely to generate more cases might be undesirable, whereas those who are generally supportive of ISDS are also more likely to support third-party funding, and its broader use, as a general matter.

Some participants expressed concern that an ISDS system featuring claims backed by third-party funders is not what was envisaged or intended by states when concluding investment treaties. These participants felt that it only exacerbates the worst and most controversial aspects of ISDS. Others in this group felt that when monetary obstacles to bringing a claim exist, as they do in ISDS where bringing or defending a claim cost several million dollars, access to this system requires an ability to find funding mechanisms. Whether third-party funding is a cause or a symptom of ISDS was an issue on which participants disagreed.

The group also discussed whether and how third-party funding impacts the asymmetric nature of ISDS – states are always respondents and investors are always claimants. Further, one group member pointed out, investors are also able to access third-party funding or forms of corporate finance whereas the defensive nature of a state's position changes the attractiveness of funding. Therefore, the group questioned whether third-party funding can and should also be used by states, and whether its use by only investors gives them a preliminary advantage in a claim. Most participants felt that if investors access third-party funding there should be some way for states to do so as well. Some participants argued that third-party funding should not be limited to impecunious claimants, but should, as a matter of policy, be available to any claimant that wishes to access it. One participant floated the possibility that the World Bank or another institution could provide additional insurance for states, which would reduce the asymmetry issue.

This small group engaged in an animated debate over whether third-party funders are able to identify meritorious claims. To start, one participant expressed the view that because of the economics of the investment, third-party funders would only invest in claims that were meritorious and highly likely to prevail. Other participants countered this position and pointed out that all ISDS cases are essentially a “shot in the dark” given that no regime of *stare decisis* applies to ISDS and treaty standards are exceptionally vague. ICSID data shows that about one in three cases are dismissed on the basis of jurisdiction and then one half of the remainder win and the other half lose, indicating that claimants are themselves unable to identify when they have a strong

claim. Other participants, however, noted that there are some cases (such as direct expropriation) that are likely to succeed, particularly where the investment and the expropriation was well documented. One participant continued to explain that decisions to fund involve more criteria than just the perceived strength of the legal claim, and that the types of cases that would be unlikely to prevail and thus would be unattractive for funding would also include, for example, the respondent-state itself, such as cases against the United States or Sweden, and further noted that some funders also would not fund claims against deeply impoverished states because of enforcement concerns or otherwise. Relating to impact on outcomes of cases, it was noted that one funder's experience was that none of its funded cases had settled.

The group discussed the economics of third-party funding, noting that it costs about US\$ 5 million to finance an ISDS claim, so damages must be at least US\$ 30-40 million in order to make the claim financially feasible for funders. In this light, some members of the group perceived a risk that claims would be inflated to receiving support from third-party funders. Group members also noted a concern that when a claimant is impecunious but funded, states may not be able to collect costs awards even when a third-party funder is financing the claim, and these members felt that this scenario must be addressed by tribunals or other rules.

This group agreed that there has not been much research on the relationship between third-party funding and access to justice in ISDS. Some participants stated that it is impossible for states, in particular, to get a sense of how prevalent third-party funding is generally, and even in specific cases when acting as a respondent. Some participants expressed the opinion that third-party funding does not have a distortionary impact on the ISDS system as a whole because only a very small percentage of cases are funded. However, it was noted that there is a lack of public data to establish just how prevalent third-party funding is; it was also noted that managing financial risk and third-party funding to achieve this objective is a growing area, so one could expect third-party funding to continue to grow and to back a larger number of cases.

With respect to concluding observations, this small group agreed that transparency steps would be relative easy to take, and could be mandated in the investment agreements. The group did not come to a consensus on whether third-party funding changes access to justice.

Small Group IV

The discussion in this small group began with two questions: (1) Whether third-party funding impacts the volume of cases brought under ISDS? If it does, is there an increase in number of "frivolous" cases financed through third-party funding? (2) Does third-party funding ameliorate or exacerbate systemic power imbalances? If so, how?

On the first issue of whether third-party funding impacts the volume of cases brought under ISDS, some participants noted the lack of empirical evidence to establish a link between the established increase in ISDS cases and third-party funding. Several participants agreed that the increase in the volume of ISDS cases is, in and of

itself, not a worrying trend if the claims brought are not frivolous. Therefore, what is ultimately important is to study whether third-party funding is increasing the number of speculative or frivolous claims, and the focus of this inquiry should be on the quality of claims and not on the quantity.

Participants could not agree on what is meant by a “frivolous case”. Some participants noted that third-party funders carry out an assessment of the merits of a claim before deciding to finance the claim. This rigorous process of assessment, it was said, acts as a buffer against frivolous claims being presented for investment arbitration. One participant also noted the rationalizing influence that an established third-party funder has on buoyant claimants who often show a tendency to inflate the recovery amount sought. It was also noted that third-party funding is sometimes provided to incentivize a settlement of a claim. A few respondents agreed that although third-party funding may increase the number of cases brought under ISDS, if so these are likely to be mostly meritorious cases.

However, it was also noted that “frivolous” cases are hard to identify, and that novel or speculative claims may be used to push the boundaries of the law or for other non-monetary reasons. It was further noted that more novel or speculative claims could be bundled in a portfolio along with other claims that are likely to win and still present a financially viable package for funding. Third-party funders could therefore invest in cases with the strategic interest aimed at their long-term business interests, which is problematic from a “justice” perspective. Other participants, however, felt that there is nothing inherently wrong in stretching the interpretative understanding of substantive law as long as it is within the reasonable permissible margins of the treaty interpretation. Attempts to stretch norms and standards occur in parallel forums such as international human rights courts, civil rights courts, amongst others. The person who originally set forth the concern noted that because states do not initiate claims in ISDS the boundaries of the law are likely to only be pushed in the direction that is favourable to claimants, which is different from other forums. This comment triggered a discussion on the possibility of collusion amongst third-party funders in investment arbitration to challenge a test or standard, which was viewed as problematic and something that should be usefully regulated in a way that would be analogous to antitrust regulations.

Some participants were interested in how a claim that is funded by a third party influences the perception of the claim on the part of arbitrators and respondent states. Specifically, one participant observed that when a reputed third-party funder, after conducting rigorous assessment of a claim, has decided to invest in a claim, the mere presence of the funding could influence an arbitrator’s decision making because they would be biased in favour of the merit of the claim. So, one participant asserted, in a situation in which claims are inflated because of the economics or influence of third-party funding, this combination poses a threat to states in this system.

On the second broad issue tackled by this small group, whether third-party funding ameliorates or exacerbates systemic power imbalances, discussants had divergent views. The discussion started with the question of whether there are actually power

imbalances under the ISDS regime. Some participants felt strongly that there are systemic imbalances in the ISDS regime that are against states, a powerful illustration of the imbalance being that only investors can bring claims under ISDS. These participants felt that this particular issue is exacerbated by third-party funding because it increases the number of claims brought against states. Other participants disagreed, saying that states have extraordinary power over investors, and it is investors who are frequently unable to access the ISDS system to hold states accountable. These participants believed that redressal of investors' claims through ISDS needs to be juxtaposed to domestic redressal mechanisms where investors may not have a reasonable opportunity to challenge the state, or their investments may be expropriated without being given a fair hearing, such as when an investor may be imprisoned and has no ability to challenge an expropriation. Seen, in this light, these participants viewed ISDS as a forum that tries to correct the imbalances in the domestic grievance redressal mechanism in a host state. As such, one participant argued that it is difficult to conclude that there are systemic imbalances in favour of investors in the ISDS mechanism. According to that perspective, third-party funding is only increasing the access to justice for investors who could not have otherwise raised their claims. One participant in this group noted that the examples pointed out are relatively rare, in that most cases do not involve investors who are imprisoned nor direct expropriations, so it is incorrect to use rare examples to make such a broad argument.

Some participants expressed concern that allowing third-party funding at the international investment treaty level would “lock in” the policies permanently and make them difficult to amend if problems with third-party funding were perceived in the future. These participants felt that that it makes better sense to unilaterally liberalize third-party funding at the domestic level than at the bilateral or multilateral level. However, other participants pointed out that there are ways that states can prevent the “locking in” of policies surrounding third-party funding, citing the fact that several countries have withdrawn from their international investment treaties.

Plenary Discussion:

The plenary session commenced with a report by each group on areas of convergence and divergence amongst the groups' discussants. Following this report, the plenary debated various public policy issues related to this session:

Viability of Third-Party Funding of Respondent States; Portfolio Funding

One participant shared knowledge of third-party funding that is being provided to respondent states. This participant noted that funding states in ISDS, from an investment perspective, is a rather complicated process, and that the economics crucially depend on the domestic regulations of states because the financial upside can also depend on claims by states against the investor. However, another participant, observing that funding for respondent states still requires that a state pay some amount

to a funder, felt that this is a lose-lose situation from the state's budget perspective as money is invariably going from the public exchequer to the funder.

Another participant reflected on the absence of commercial upside supporting third-party funding for respondent states. In almost all known cases of state funding, the funding arrangement for the states are either based on ideological agreement and advancing a common cause – such as financial support given to Uruguay by The Anti-Tobacco Trade Litigation Fund in *Philip Morris v. Uruguay* – or, in at least one example, *RSM Production Corporation v. Saint Lucia*, based on a business interest to undercut the claim of a rival firm to a disputed investment. Ideological-focused funding arrangements were also said to be common in WTO cases.

The discussion continued to note the issue that even when an investor is benefitting from third-party funding in bringing a claim, to the extent a state obtains a cost award, the state has no recourse against the funder if it cannot collect from the claimant. One participant said that under a corporate finance approach, recourse could be against the asset under consideration (although this depends on the particular asset and industry).

Definitional Issues

Participants agreed that difficulties in defining third-party funding continue to persist because of the presence of a large variety of models that continue to evolve. Participants disagreed over classifications of various modes of funding. Several discussants took the position that the definition of “third-party funding” should not include traditional financial instruments (such as bank loans) because in these latter forms of financing the third-party funder does not exhibit a certain level of control over the dispute that is seen in other kinds of financing. However, one participant felt that there was no perceptible distinction between the level of control that funders in either of these structures would have over the final outcome and approach to a dispute. Another participant questioned whether pro bono legal services, or contracts that give firms contingency fees in exchange for cheaper up-front rates, could be considered third-party funding, but this position was countered by at least one participant who said that pro bono legal services are, in fact, third-party funding because of the in-kind nature of the service even though no payment is received.

Security for Costs

It was noted by one participant that in a number of cases in which tribunals have ordered claimants to cover states' legal costs, particularly when a claimant does not have the assets to cover this award or otherwise does not pay, tribunals are unable to hold third-party funders accountable even though the funder played a central role in the ability of the claimant to bring the case, thereby leaving states to foot the bill. This scenario is of particular concern in the event of cases that have little to no legal merit. One participant noted that seeing as how funders and others take the position that third-party funding does not increase the number of marginal claims brought by investors,

funders should have to “put their money with their mouths are” by providing security for costs up front to protect against non-payment of cost awards. Other possible alternatives suggested to address this situation included obtaining insurance for security for costs, and the ability to pierce the corporate veil to collect from higher up the corporate chain of the claimant. One participant raised concern as to whether the respondent would be liable to pay the third-party funder’s success fee.

Assumption of Permanence of Third-Party Funding in Investment Arbitration

Participants disagreed about whether it is possible to highly regulate or even prevent in many cases third-party funding international investment arbitration. Some participants challenged the assumption that is made in the Draft Report that third-party funding is here to stay. One participant noted that the assumption in the Draft Report, that third-party funding is here to stay, was based on trends visible in Bilateral Investment Treaties (BITs) and Free Trade Agreements (FTAs) which are trying to regulate third-party funding rather than prohibit it (when it is mentioned at all). For example, the French BIT model and the EU-Canada Comprehensive Economic Trade Agreement both allow third-party funding but regulate its operation. There was general agreement among participants that in order to better evaluate the policy need for third-party funding there is a need for empirical information that will permit an understanding on how third-party funding is increasing access to justice for investors who would not have otherwise been able to initiate a claim. Participants expressed agreement that there may be situations in which third-party funding is valuable from a public policy perspective, but its overall value would depend on the manner in which it is being used in the ISDS system. Some participants felt that in considering its value, information about funding of meritorious claims must be distinguished from frivolous claims, and there was a need for information describing how third-party funding may be contributing to or even participating in increasing non-meritorious claims. Participants generally agreed that greater transparency would aid in actually understand the role of third-party funding.

To conclude this portion of the discussion, the conversation returned to focus on the interlinkages between third-party funding and the ISDS system as a whole, and whether it is possible to reform only third-party funding provisions to address public policy concerns, or whether the only way to address concerns about third-party funding is through reform of the broader ISDS system. Some participants argued that the challenges arising from third-party funding could be addressed through greater transparency, security for costs, or potentially even prohibitions on third-party funding, thereby addressing public policy concerns without having to address concerns with the ISDS system. Another participant took issue with this approach, comparing these types of provisional fixes to “only third-party funding” as more ways to “patch a leaking bucket” (with the bucket representing ISDS) without asking more fundamentally why the bucket keeps sprouting holes and questioning whether it is time to throw out the

bucket. In other words, for this participant, third-party funding is a symptom of a larger problem and the symptom cannot be addressed without broader ISDS reform.

Settlement

One participant raised the issue of whether the presence of a third-party funder in a case would impact settlements, either to increase or decrease their likelihood, or to prevent non-monetary settlements. The speaker noted that from a public policy perspective, settlements can be useful to the parties, but can also be problematic to the extent that they impact rights of non-parties. One participant said that based on this participant's experience, third-party funding does not increase the likelihood of settlement, but another participant disagreed, also based on that participant's experience. The participant who initially raised the topic noted that there is a lack of data in this area and in order to draw policy conclusions it is necessary to have more information about what the impacts are.

Access to Justice

The plenary turned to the question of whether third-party funding promotes access to justice. One participant said that yes, third-party funding does promote access to justice, and mentioned a case in which an investor was imprisoned and required funding to pursue a claim. Other participants, however, expressed the opposing view, noting that this example is an exception not the rule, and that it would be helpful to know more about these kinds of situations to empirically assess whether third-party funding is indeed necessary for access to justice in some situations. The participant further stated that in other cases, that there are alternative forums for claimants to pursue justice, such as domestic courts for a start. It was also said that the term "access to justice" is used in different contexts to describe attempts to secure relief, after exhaustion of remedies, for harms to lives, livelihoods, and freedom, and that the claim that third-party funding ensures "access to justice" for investors should not be used lightly. Another participant noted that third-party funding fundamentally changes ISDS as a system of justice, because "capital looks for return, not for justice".

Session 2: Third-Party Funders in a Dispute, Including as "Parties" or "Investors"?

The second session considered the role of third-party funders in ISDS proceedings themselves, including arguments that funding is a form of investment. This session also considered issues surrounding transparency.

Specific questions that roundtable participants were asked to address included:

- What kind of claimants are using third-party funding? What kinds of cases are third-party funders funding? What kinds of cases are not being funded?

- Does the presence of a third-party funder impact the outcome of a dispute? Does a funder impact case strategy or case management (i.e., selection of arbitrators, arbitral institutions)? Does it impact the substantive development of the law? If so, or if potentially so, what are the policy implications of this?
- Does having a third-party funder impact the likelihood of settlement? In either case, is this a good thing?
- What kinds of conflicts of interest arise with respect to funders and arbitrators, or funders and counsel/parties?
- Who benefits and who is harmed by transparency in third-party funding? How much transparency is desirable? What are the implications of mandating disclosure of the funder? Of the funding agreement? When transparency is mandated with no tribunal discretion? With tribunal discretion?
- If challenges stemming from transparency/disclosure impact a proceeding, are there options to mitigate this cost?
- Are governments capable of being funded? In which ways? Are they interested in funding?

As with the first session, to facilitate comprehensive deliberation the discussants split into four sub-groups and then reconvened into a plenary group. Rapporteurs were only present in two of the four small groups for this session.

Small Group Discussions:

Small Group II

This small group started off this session by considering potential conflicts of interest that might arise due to third-party funding. The group tried to flesh out the different types of conflicts that could come up and considered what might be an appropriate test for assessing whether a conflict of interest existed. It was noted by one participant that an increasing number of arbitrators were being asked to sit on the advisory boards for third-party funders, which fact, if true, was deemed to be highly problematic by the group as a whole. There was agreement that this scenario would be likely to further perpetuate the impression that based on this kind of conflict of interest, the cases that were being funded were more likely to be successful. To continue this conversation, one participant highlighted that the potential conflicts that might arise with respect to arbitrators could concern both issue-based conflicts and firm-type conflicts. Examples that were deemed to be particularly problematic included instances where an arbitrator could have previously participated in evaluating the case for the third-party funder, but also deemed problematic would be a situation in which a funder with whom the arbitrator had an institutional connection was funding a case before that arbitrator, even when the arbitrator did not participate personally in the evaluation of the specific case. Some participants believed that there would certainly be a conflict of interest on behalf of the arbitrator whenever there was an institutional connection between a funder and an arbitrator with respect to

any given case. Some discussants did note that regulation may not be easy, because with the introduction of portfolio funding the entire nature of funding is more decentralized and the conflicts more attenuated thereby making it both more difficult to identify potential conflicts as well as to have clear rules as to what a relevant conflict of interest would be. Some participants felt that even though there may be complications in implementation, conflicts rules remain necessary to protect against abuses.

Remaining with the conflict of interest discussion, this small group considered on whom the duty to look into possible conflicts would fall – whether this would be a responsibility of the parties themselves or whether the arbitrators should also be expected to investigate their own conflicts. The group noted that when the existence of a third-party funder being involved in a case is disclosed, there are a lot of additional questions that arise with respect to conflicts of interest and some of these questions could give rise to time-consuming challenges. Because of this, it was noted by one participant, some parties are hesitant to disclose the existence of a third-party funder. Another participant raised the opinion that every instance of third-party funding needed to be disclosed, but that the existence of a third-party funder should not necessarily affect whether an order for the security of costs would be issued – that other factors should also determine security for costs. This group also discussed whether the existence of funding should be disclosed to both the opposing party and the tribunal, or whether it was sufficient to simply inform the tribunal. While some participants were of the opinion that disclosure to the tribunal would be a sufficient safeguard, others were concerned that failing to inform the other party might give rise to a problem with respect to procedural propriety and potentially endanger the eventual award. One participant also pointed out that, in any event, there was no need for the tribunal to know what the specific conditions of the funding agreement were as the conflicts questions and security for costs concerns could be addressed without the entire agreement being disclosed.

The group then moved on to discuss the role that third-party funders should have in the arbitral proceeding itself. One participant discussed experiences in which third-party funders were present at oral proceedings and also experiences in which a funder exerted influence with respect to the way in which the case was being presented. There was agreement within the group that it was not desirable for a third-party funder to take active participation in the proceedings or even to be present during the oral phase. One participant felt that the presence of the third-party funder was likely to negatively affect the conduct of the arbitration because of the funder's focus on profit, and could also impact the perception that the tribunal may have of the funded party and the claim, depending on the arbitrators' view of third-party funding generally.

Finally, this small group briefly addressed whether third-party funders could have an impact on the development of the substantive law. One participant noted that funders choose certain kinds of cases and these cases may therefore be brought more frequently than other kinds of cases, and furthermore funders may have the financial ability, particularly through portfolios of claims, to fund some claims with marginal legal merit but that are intended to push the boundaries of the law and are in the long-

term economic interest of the funder. This participant felt that in this way, the introduction of third-party funders further distorts a system in which only claimants can initiate cases and are already incentivized to stretch the intent of the state parties to the treaty. Other participants disagreed, feeling that it would be unlikely that funders would fund these kinds of cases noting that funding is an investment business and the economics must make sense.

Small Group IV

This small group began their second discussion by considering the process by which third parties decide to fund particular cases. The participants agreed that funders, of economic necessity and as a general matter, seek meritorious cases with claims large enough to merit the initial investment and ensure a reasonable return, which amount would generally translate to claims of at least US\$ 50 million. Such claims can provide for a 10:1 return on capital investment for the funder. One participant said that in order to determine which potential cases make for good investments, many funders pay outside law firms around US\$ 40,000 to assess the merits of the case, based on due diligence of a week of research. One participant noted that anecdotally, funders may only achieve a return on investment of closer to 5:1, half of their intended return, which therefore raises questions about the quality of the legal advice that the funders are receiving as well as funders' claim that they only fund meritorious cases.

It was also noted that the need for a relatively high return on investment inevitably leaves a number of potentially meritorious cases that do not get funded, simply because the claims are not sufficiently large. For these smaller investors/claims, third-party funding does not improve the ability for investors to bring even meritorious claims. One participant considered that perhaps a way to provide small investors access to the ISDS system would be to create a "fast track" tribunal process for small claims. One participant expressed concern that this would lead to a massive proliferation of cases and would create an entirely new industry model, leading many new boutique law firms to enter the market. Another participant wondered why claimants don't hire cheaper law firms, particularly for less complicated cases, thus lowering litigation costs. Several participants felt that all cases are complicated, and that damage awards are highly correlated with the quality of representation, so it pays off to hire expensive lawyers who are more likely to help the claimant prevail.

The discussants then moved to discuss the way in which the presence of a third-party funder in a case can impact the case overall. While no participant questioned the presumption that third-party funding impacts case outcomes, the group split about whether that impact would be positive or negative. Some argued that the normative impact is difficult to measure, but analysts should nevertheless be wary that often, normative assumptions are embedded within other arguments. For example, when investors bring self-funded claims, they often agree to contingency fees, aligning their law firm's interest in providing solid legal advice with its financial interest in a way that can also produce perverse incentives. It was said that third-party funding removes

complications surrounding contingency fees, thereby allowing the claimant's lawyers to consider only how to best represent their client and not about their financial upside. It was also put forward that third-party funders can be valuable, neutral evaluators of a case's merits, thereby increasing the quality of cases that get brought, and that they can act as a neutral manager of litigation costs by cutting off hours sunk into the case.

Another participant pointed out, however, that these counter arguments also rely on a number of normative and factual assumptions. Notably, it was said that one could wonder whether the constraint on cases being brought is access to capital or conservatism in the face of risk. This participant continued, if third-party funders only fund large claims in the first place, one might assume that risk, and not raw capital, is the limiting factor that third-party funding overcomes to allow for a proliferation of cases. If this is true, then it is unlikely that a week of legal research actually leads to more meritorious cases being brought, particularly because of the vague nature of treaty standards in the first place that makes cases difficult to assess with certainty so early on, but rather cases that have a higher ratio of potential damages magnitude to risk that the claimant will lose the case. In addition, another participant noted, it is incorrect to say that third-party funders are neutral in these cases because funders also have ongoing business relationships and firms have vested interests in their relationships with funders. So, in reality, third-party funding causes as many potential conflicts of interests as it solves. For example, whether a lawyer is in practice fully accountable to its client or whether there is some space where this duty would be limited because of an interest in an ongoing relationship with the funder, and the potential for intertwined relationships between funders, firms, and arbitrators. The participant also noted that even when lawyers take cases on a non-contingency basis the lawyer can still have a personal interest in how the case progresses and its outcome, but noted that fiduciary duties attempt to regulate this scenario.

Session III: Third-Party Funding: Looking Ahead

The third and final session considered future trajectories of third-party funders and funding.

Specific questions that roundtable participants were asked to address included:

- Are funders proliferating?
- What will be the impact of any increase in funded cases or changes in funding models (e.g., portfolio funding)? Are criteria for funded portfolio cases the same as for funded individual cases?
- Can funding contribute to effective case management or contribute to early case evaluation?
- What empirical data is needed to assess and monitor the effects of funding in ISDS?
- What can we learn from experiences in domestic courts?
- Can the existence of a third-party funder reduce the overall cost of ISDS? For whom?

Plenary Discussion: Session II and Session III:

Following the presentation to the plenary of small group reports on the topics from Session II, the participants continued their discussion in the plenary session.

Because the agenda was running behind schedule, in addition to discussing the points in Session II, this plenary also considered Session III.

The Funding of Unmeritorious Cases by New-Comers to Third-Party Funding

The discussion was initiated by a participant who brought up a potentially problematic scenario in which a case, after being rejected by reputable funders because of a lack of legal merit, would then be picked up by less reputable funders who may be more inclined to take on unfounded, high-risk cases. Anecdotal examples were presented in which some participants discussed situations in which this has happened. One participant noted that in a conversation with a well-established funder, the funder said that the funder had been approached by claimants with respect to two thirds of the cases that were registered at ICSID in one particular year. This funder had rejected all but one of these cases, but the rest nonetheless ended up on the case registry, which means that someone funded them, or the claimants found alternative means of financing. This participant noted that this anecdote demonstrated that less reputable funders are out there. While participants agreed for the sake of argument that the well-established funders may have well developed internal rules and codes of conduct and may not fund claims with questionable legal merit, less reputable funders might be a cause for concern, and that regulation may be necessary to prevent these kinds of abuses of the ISDS system.

One participant noted that there were indeed new entrants into the system, but that it was questionable how long they would last. And in response to the point made about one funder rejecting so many cases that were nonetheless brought, this participant noted that the value of the claim also needed to be taken into account and that one could not assume that the cases were rejected because they lacked legal merit, as some meritorious cases may have been rejected just because they are not sufficiently large. These types of cases are not inherently problematic if taken on by less established funders after they are rejected by the well-established ones. The problem would only arise to the extent that some funders fund less meritorious cases, which is a cause for concern, but this participant felt that funders that would invest in such cases would be unlikely to last for a long time. Another participant rebutted that even if these “fringe” funders are likely to go out of business, a lot of damage can be done to a respondent state even if only one unmeritorious case is brought.

Another participant said that based on the nature of financial investors generally, one could expect to see entrance in this kind of market where there is an opportunity for high return on the basis of high risk. The participant argued that it was not inconceivable that someone could develop an algorithm that could successfully predict the outcome, or the probability of a given outcome, in certain cases or types of cases,

which would then turn this high-risk option into a more attractive alternative. This kind of scenario would be problematic because particularly if portfolio funding were used, these high-risk cases present a systemic danger to respondent states.

Third-party Funding and Underlying Concerns with ISDS

One participant noted that more information is needed on what kinds of cases are being funded. From a public policy perspective, certain kinds of cases are inherently problematic because of the issues that are raised and argued, and the implications of those disputes and arguments on governments' willingness and ability to regulate, as well as the rights or interests of non-parties. In these kinds of inherently problematic situations, if third-party funding were making these kinds of cases more likely to be brought, third-party funding would be exacerbating the pre-existing and underlying problems with ISDS. For example, this participant continued, in mining investments, the cases often arise when there is a conflict between, on the one hand, an economically, socially, or politically marginalized local community, and a relatively powerful foreign investor, and the government ultimately sides with the local community against the investor. When ISDS cases challenge government support of those domestic constituents (or when the ISDS cases challenge inadequate government support for the investor), those ISDS can exacerbate existing power imbalances between local communities and foreign investors, causing the government to favour the latter over the former. This participant felt that it would be easy to see how mining cases, as one example, would be attractive to funders given their generally higher claim amounts, and if funders were permitting more cases with underlying public policy concerns to be brought, funders would be exacerbating the pre-existing public policy problems with ISDS.

Other participants agreed that indeed, there are a lot of cases of the type described that are being funded by third parties, but pointed out that whether or not such cases received funding depended primarily on the stage of the investment and the certainty of damages. One participant felt that the problem was actually with the investors who had invested, for example, US\$ 3 million of sunk costs, but were not able to get their cases funded due the unlikelihood of a high return. Another participant asked whether these kinds of cases could not have used the domestic court system of the host state to address the investor's grievance, and questioned why ISDS, let alone being funded by a third-party, was considered necessary for these claimants to seek a remedy.

Another participant, addressing the original question about mining claims, stated that, while such cases were indeed being funded, this participant did not agree with the depiction of such a practice as a negative thing. The participant noted that the situation needed to also be looked at from the perspective of the investor (in this particular case, mining companies) who had invested considerable resources and might, under the circumstances, deserve compensation. In response, the speaker who had posed the original question rebutted to note that mining exploration was an inherently risky business from a commercial perspective and that it was therefore problematic that an

investor might be in a position to force a state into settlement or secure damages simply because, for example, a license to exploit – which had never been guaranteed under domestic law – had ultimately been refused. It was further said that ISDS sees many cases in which investors seek to transfer commercial risk onto a host state through an ISDS claim and if third-party funders are exacerbating these kinds of claims and risk transfers it is problematic. The previous discussant responded that, even in such a situation, compensation might be justified if there was a legitimate expectation that the license would be granted, noting that this would be a very factual matter that depended on a cluster of circumstances and disagreed with the idea that, as a matter of general approach, mining companies should not have a right to be granted a license.

A separate participant interjected into this discussion to note that contracts are frequently used in extractive industries there should be no sympathy for a company that was sinking significant costs into an investment based on promises or insinuations that were not written into a contract.

At this point a participant tried to steer the discussion back to the public policy issues surrounding third-party funding and not ISDS generally, while other participants noted that this discussion was an example of how intertwined the public policy aspects of ISDS per se, and third-party funding are, and that there remained important questions about whether and how third-party funding exacerbates these public policy issues. One participant noted the earlier analogy to a leaky bucket saying that we are indeed only patching holes and need to deal with the bucket. However, another participant took issue with these positions noting that to the extent investors are given rights under international investment agreements, then they should be able to pursue those rights, regardless of whether one thinks that they should have such rights in the first place. The discussant further noted that a very problematic issue was the small investors who cannot bring claims due to a lack of funding and end up not pursuing them.

On a related note, another speaker commented that it was indeed peculiar that that some participants believed that issues that were generally problematic within ISDS could be resolved through third-party funding. For example, the fact that somehow investors require third parties to facilitate “access to justice”, indicate that the system itself cannot provide justice. It was submitted that, if the real issue pertained to whether the ISDS system was problematic as such, then it seemed that a discussion that skirted around the edges and only touched on third-party funding was misplaced, and the debate should be aimed at whether the ISDS system should be shut down or completely reformed in its entirety. The problem seemed to be that there was a stalemate on the other issues in ISDS that needed reform and that, therefore, the momentum that existed with respect to third-party funding was being channelled to address these issues. But it would be misplaced to expect that addressing issues with third-party funding could in any meaningful way help to address the underlying problems with ISDS.

Do Funders Have “Skin in the Game”?

One speaker noted that lawyers, and contingency fees, are generally not perceived as problematic to the same level as other kinds of third-party funding because it is perceived that lawyers have “skin in the game” and are interested in integrity of the legal system and not just in making a profit. This participant raised the issue of whether third-party funders could contribute to the system in ways that did not include the direct funding of claims. It was noted that funders do not take part in initiatives that, for example, facilitate education about the system, that they do not support report or research into how the system can be improved, nor do they contribute to, for example, providing third parties who may be impacted by an investment dispute with access to the system. The discussant asked whether investing in initiatives that have a positive public relations impact might, in the long run, end up being beneficial by increasing the good will surrounding third-party funding and ISDS more generally. It was underlined that this could potentially change the perception of third-party funding in the future, so that it is not only seen in a negative light, but also as a mechanism that makes a positive contribution.

One answer that was put forward emphasized that the ISDS system and the role of third-party funders in it was inherently problematic from the perspective of states because it was not balanced – states need to be able to bring claims and there needs to be more equality between the parties.

Another speaker, referring to the initial comment about funders engaging in activities that would generate more goodwill, stated that from a human rights perspective, doing a positive thing in one respect does not necessarily justify and negate the negative impact in other areas. Human rights obligations, including of funders, are independent of whether they try to offset them with positive actions elsewhere. In this sense, the speaker continued, underlying aspects of ISDS that are inherently problematic from a human rights perspective remain problematic and funders still have obligations to not exacerbate these problems even if they engage in good will gestures on the side. As an example of an underlying human rights problem with ISDS, the speaker noted that third parties whose rights are often impacted by an ISDS dispute have no ability to join a dispute to defend those rights. The participant who had posed the original question responded to note that positive engagement by funders may nonetheless help to impact how the ISDS system is perceived.

Another participant noted the issue of small claims and the generally accepted US\$ 5 million ticket price to ISDS entry. If these types of investors with small claims are to have access, the ISDS system has to be changed and third-party funding will not address this problem.

Another participant also pointed to the fact that the discussion had principally been aimed at the primary market for third-party funding, but that the proper functioning of a financial market also requires the presence of a secondary market. The introduction of a secondary market could bring about an increased possibility for funding small cases, which could be a positive development as it would provide access to ISDS for a

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section of the investment community that otherwise would not have such access, such as the US\$ 3 million claims. Another positive consequence of the development of a secondary market for third-party funding would be that investors would be in a position to diversify and therefore get access to better funding. The discussant noted that it was expected that the secondary market will develop in the next five year or so, which will be a game changer and have an impact on how the system is regulated.

At this point, the discussion concluded and the organizers thanked all in attendance for their fruitful debate.

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