International arbitration: Market trends and legal issues in third-party funding

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An event in London organised by Withers addressed third-party funding of international arbitration in the wake of the recommendations in the ICCA-Queen Mary report. Uliana Cooke of Withers in London reports

On 31 May, a group of practitioners gathered in the London office of Withers to hear a panel discussion on market trends, legal issues, international developments and practical tips on third-party funding in international arbitration. The event followed the April publication of the ICCA-Queen Mary Report on Third Party Funding in International Arbitration. As Peter Wood, global CEO of dispute resolution at Withers, noted, third-party funding is an increasingly global means of financing arbitration disputes whether in London, Singapore, Hong Kong or the US.

Stavros Brekoulakis from Queen Mary University of London, who co-chaired the ICCA-Queen Mary task force (with William W Park and Catherine Rogers) chaired the discussion. He pointed out that when the task force started its work back in 2013, the public debate was mainly about whether third-party funding should be permitted in arbitration at all. Since then the debate has moved to what specific issues third-party funding raises in international arbitration and how these should be best addressed. He said the main aim of the report was to educate people about third-party funding, to bring third-party funding closer to arbitration, and to sharpen the debate on legal issues that need to be looked into.

Market trends

Brekoulakis observed that in the past 10 years there has been a significant increase in the number of funders, funded cases and law firms that have worked with funders. In 2017, the aggregate amount of funds available in the UK for funding arbitration and litigation reportedly amounted to over £700 million and globally it was said to be more than £10 billion.

He then invited the other panellists to comment on particularly significant developments in the market of third-party funding in the past 10 years.

Hussein Haeri, co-head of international arbitration at Withers, remarked that more liquidity and funding in the market have had an impact. In his view, there has been a degree of standardisation, for example in the methodology of economic terms that many funders adopt. Equally notable, however, is that there has been some specialisation, with certain funders establishing criteria for the types of cases they are looking to fund, whether in terms of the minimum damages claim, or sector or industry focus.

He noted there are also new products, such as APAD (Arbitration Proceedings Award Default) insurance, and more knowledge in the market than 10 years ago. Also interesting is that claimholders increasingly approach funders and brokers directly.

Susan Dunn, co-founder of Harbour Litigation Funding, said that Harbour receives about 35 applications to fund new cases each month and that Harbour is now funding cases in 14 different jurisdictions. She cautioned that users of funding need to be clear whether they are engaging with a funder or a broker and that one of their first questions should be whether a funder can show it has available funds for the case. Investors' appetite has increased and there is considerable interest from retirement funds and endowments. However, although more money is being invested into third-party funding, sensible investors still expect to see a demonstrable track record and experience in managing money.

Dunn also addressed the term “portfolio funding”. Sometimes the word “portfolio” is used to try to mask the fact that the group of cases is not very

strong, so the same analysis has to be done whether a funder is reviewing a single case or a group of cases. Funders are happy to accept that some cases might be stronger than others, the key being whether the overall risk proposition looks sensible. A portfolio can entail a law firm running a number of cases on risk (ie, covering all the costs of the cases) where they share the costs of doing so with a funder and then share the upside – this is more common in the US than anywhere else, where law firms have been running contingency fees for years. Alternatively, it can mean a client who has a book of similar claims (including where they are respondent) where they want to offload all the costs of the cases and agree that the proceeds of the claims can be used to cross-collateralise losses on other matters in the portfolio. This remains less common than law firm portfolios, but looks likely to increase as corporates recognise it as an option and seek to take the costs risk of these cases off balance sheet.

She commented that there are many good cases that still cannot get funding because the costs of running the claims are too high. If the costs of running disputes could be reduced (not least by dealing with the administrative aspects of cases more cost-effectively) then more cases below £10 million would be funded.

Dunn added that Harbour has seen some law firms lowballing their costs quotes for cases in the hope of attracting funding. Experienced funders will not fund such cases, knowing that the costs will inevitably have to rise while the claim value remains static, making the case economically unviable at the higher cost. Funders have to be very good at analysing budgets so as not to get caught out by apparently low-cost budgets which then double.

Haeri noted that there is an expectation from some clients that law firms will have some skin in the game. Some funders are keen for lawyers to take risks, whereas others are agnostic about it. Haeri observed that having a realistic approach from a law firm perspective is about addressing respective expectations in light of the specifics of the case.

Dan Sarooshi QC of Essex Court Chambers added that in some cases, law firms will pitch at low rates and then they will work with the Bar. In international arbitration, law firms and the Bar are now working much more closely together in providing a winning combination for clients and he considered that as being one of the strengths of the London legal market.

Legal issues

Brekoulakis then turned the discussion to legal issues. He noted that while third-party funding has now been generally accepted as a legitimate commercial practice, it nevertheless gives rise to some legal issues, one of the most widely discussed being disclosure.

Sarooshi explained that the ICAA-Queen Mary Report proposed two alternative approaches to the issue of disclosure. The first, stringent approach states that a party or its representative (that is, its law firm) 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 as soon as practicable after funding is provided or a funding arrangement is entered into. The second approach provides that, during the selection and appointment process of arbitrators, both the arbitrators and arbitral institutions have the authority to request that the parties disclose whether they are receiving support from a third-party funder and, if so, the identity of the funder.

He explained that the first approach placed emphasis on the potential conflict of interest caused by involvement of a third-party funder as a basis for compulsory disclosure: where, for example, an arbitrator or her colleagues or firm have a relationship with a third-party funder involved in the case or where there are repeat appointments for an arbitrator in cases involving the same funder. He quoted from the ICCA-Queen Mary Report that “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”.

Sarooshi had doubts whether enforceability of arbitral awards is a key consideration here. He was not aware of any case in any domestic court where an award has been set aside by a court or it has refused to enforce an arbitral award because of the lack of disclosure of third-party financing in the underlying arbitration.

He added that another consideration is when law firms effectively act as funders, for example in contingency fee scenarios that have long existed, and he raised a concern whether that would mean that law firms would have to disclose their funding arrangements in accordance with the first recommendation of the ICCA-Queen Mary Report.

In Sarooshi's view, the approach adopted in the International Bar Association’s Guidelines on Conflicts of Interest in International Arbitration, in accordance with which a duty to disclose applies where a third party has a controlling influence on a party or direct economic interest in an award, appears sensible and provides lawyers with a necessary degree of flexibility.

Haeri added that one of the interesting features of the ICAA-Queen Mary Report is that it does not require disclosure of the funding documentation itself. However, in practice the other side often pushes hard for more disclosure once the identity of the funder is released. Haeri said he had come across a number of such instances but that tribunals generally agree that the disclosure of confidential funding documentation is unnecessary.

Brekoulakis raised another pertinent issue of recovery of funding costs in light of the Essar v Norscot case – in which the English Commercial Court ruled that such recovery was allowed – and whether this case has broader implications outside the UK.

Haeri remarked that the *Essar v Norscot* decision highlights a difference between litigation and arbitration as English courts have a more restrictive approach to costs recovery under the CPR Rules. The underlying arbitration in *Essar v Norscot* was governed by the ICC Rules and the English Arbitration Act, which allow for recovery of *“other costs”* and therefore in these circumstances it was possible to recover funding costs. However, he added that not all rules have an equivalent provision and the approach in the jurisdiction of enforcement could be a factor.

Brekoulakis asked whether third-party funding should play a role in decisions on security for costs.

Sarooshi said that essentially the answer is “no”. He pointed out that the ICSID decision in *RSM v Saint Lucia* requiring a funded claimant to pay security is unique and in general, the existence of a funder by itself should not require the grant of security. The majority of the tribunal in *RSM v Saint Lucia* acknowledged that other factors, such as the claimant's track record of failure to make payments in previous ICSID proceedings and

its lack of assets, played a role. Sarooshi added that other investment treaty cases, such as *South American Silver v Bolivia and EuroGas v Slovak Republic*, recognise that the existence of a third-party funder per se does not warrant security for costs, which will be granted only in exceptional circumstances, taking into account all the relevant factors.

Sarooshi added that in investment treaty arbitration the claimant's impecuniosity is often claimed to have been caused by the actions of the respondent state and it would appear unreasonable in such circumstances for the latter to request security if this would effectively frustrate the claim. On the other hand, he acknowledged that this may not frustrate a strong claim, as the funder may be willing to provide security in such a case.

In the domestic courts, Sarooshi cited an example from his recent case *Progas Energy v Pakistan*, where the English Commercial Court, in the context of a challenge to an UNCITRAL award favouring the respondent state, rejected the argument that the existence of a commercial funder should make any difference when deciding whether to require security by payment into court of the award debt.

Haeri addressed whether third-party funders are liable for adverse party costs. He said that since arbitration is a "creature of agreement between the parties", tribunals would not ordinarily have jurisdiction over third-party funders. He observed that there had been a proposal that the SIAC Arbitration Rules 2016 contain a provision that third-party funders could be liable for an adverse costs award but this, sensibly, in his view, did not make it into the final version.

Brekoulakis added that this was a debated point in the task force and a suggested solution if the funders were required to accept potential liability was to ask them to sign a deed agreeing to pay adverse costs at the very early stages of the case.

International developments and practical tips

The panellists turned to the question of international developments in third-party funding and some practical tips.

Brekoulakis wondered whether the rivalry between Singapore and Hong Kong would have an impact and affect the dynamic in other jurisdictions in Asia.

Haeri observed that legal developments in Singapore and Hong Kong can be influential on other jurisdictions in Asia. There is a proposal in Malaysia to amend its arbitration law to address third-party funding. There is also considerable interest in third-party funding in mainland China and South Korea. An interesting question, in Haeri's view, is whether the more prescriptive manner in which Singapore and Hong Kong are dealing with issues in third-party funding (such as disclosure requirements) as opposed to the less regulated approach in the UK, for example, could shape the dialogue and in the end influence practice.

For Dunn, key determining factors for the attractiveness of a market to funders include integrity of the court system, legal consistency and the strength of the enforcement process. She observed that certain changes, such as a change in one judge in smaller jurisdictions dependent on that judge for its jurisprudence creation, may have an impact on whether the funders want to be in that jurisdiction. She mentioned Brazil as a jurisdiction of potential growth, subject to these considerations.

Giving practical tips to claimants, Dunn said she was surprised to see how rarely funders are asked to verify availability of funds and what the funding covers (particularly adverse costs). She cautioned users to be sure of what they are getting upfront, ie, to be sure the funder has the money it says it has and check it is not committing those same funds to multiple cases and thereby risking running out of funds part way through a case – as she has witnessed recently.

Haeri also suggested a claimholder may be more willing to agree to an exclusivity period for funder due diligence if there is some upfront financing attached, for instance, for valuation reports and initial due diligence.

Dunn said that it is vital that the legal team running the case is on top of the budgeting, not just the law, as there is little point in succeeding in a claim only for the budget to have overrun so significantly as to have destroyed the financial viability of the claim for claimant and funder alike. In the past, there were significant issues with cost overruns that reduced the value of claims to funders. Dunn said that this is generally improving but there is still some way to go – the Jackson reforms on budgeting had helped shift the approach to budgeting despite the protests from the profession about it.