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## **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** **by S. Khouri, K. Hurford and C. Bowman**

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# **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**

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As suggested by the focus of this special issue of TDM, there are a range of funding options available to parties with legal claims and, in particular, those with international commercial arbitration and treaty claims. The development of these funding options has grown, and continues to grow, out of a need by commercial parties for assistance with financing the pursuit of high value commercial and treaty claims, and in managing and sharing the financial risks of pursuing such claims.

This article assesses the risks and benefits of third party funding in international commercial and treaty arbitration. While other funding options available to claimants and their lawyers in different jurisdictions (for example, contingency fees, conditional fee agreements and insurance products) are described and discussed below, the primary focus of this article is on funding provided by for-profit third party funders.

## **Why Third Party Funding?**

In the last year or so, participants in the industry are noticing rising interest in and demand for third party funding for both litigation and arbitration. This rise is driven in large part by the increasing expenses associated with the pursuit of high value claims (particularly lawyer and expert fees) and, in many organisations still feeling the effects of the global financial crisis, the need to carefully manage the financial risks relating to the pursuit of substantial claims. In some jurisdictions, third party funding has been a feature of the legal landscape for a number of years. Litigation funding is an established part of the civil justice system in countries such as Australia (where it has been available for over a decade)<sup>2</sup>, and in other common law countries, such as England, Canada and South Africa. Third party funding is now gaining attention in the United States of America, with companies continuing to enter the US market<sup>3</sup>.

The growth of, and developing jurisprudence in, international commercial and treaty arbitration and the protections arising from the New York Convention for arbitral awards, combined with the desire to use the skills and experience developed in funding litigation, has resulted in specialist commercial third party funders becoming increasingly interested in funding international arbitration and treaty claims. Given the private, and frequently confidential, nature of arbitrations, there is little empirical data to show the exact extent of third party funding of international and treaty arbitrations. However, anecdotal evidence

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<sup>1</sup> IMF (Australia) Ltd ("IMF") is the largest funder of legal claims in Australia. It was listed on the Australian Securities Exchange in 2001 and has been funding legal claims for the past 10 years. The authors thank Wayne Attrill of IMF for his assistance in the preparation of this article. See also W.Attrill, 'Ethical Issues in Litigation Funding' (unpublished paper, February 2009)(<http://www.imf.com.au/pdf/Ethical%20Issues%20Paper%20IMF09%20-%20Globalaw%20Conference.pdf>).

<sup>2</sup> Litigation funding in Australia emanated from funding claims by company liquidators and bankruptcy trustees in the late 1990s under their statutory powers to sell assets (including claims) of the insolvent company or bankrupt concerned. It broadened to include non-insolvency and multi-party commercial claims in the early 2000s.

<sup>3</sup> In June 2011, it was announced in FT.com that Astraea Capital, a specialist financing company, was poised for a GBP100 million flotation on the London Stock Exchange's AIM market. Astraea is expected to compete against other third party funders which have launched on AIM in recent years and which offer funding for legal claims in the US, such as Burford Capital Ltd and Juridica Investments Ltd.

suggests it is clearly on the rise<sup>4</sup>. A recent conference held in New York on 15 June 2011 was billed as a 'Round Table on Third Party Funding of International Arbitration Claims: The Newest "New New Thing"'<sup>5</sup>.

In the litigation context, third party funding is now widely seen as an important means of facilitating access to justice for claimants who have meritorious claims but are unable to finance litigation themselves. However, arbitration practitioners and parties with arbitration claims may know little or nothing about funding and may understandably be wary or suspicious of it. Some of these concerns relate to the historical prohibition against strangers funding litigation under the common law doctrines of maintenance and champerty. Financial support of litigation by a third party was a crime as well as a tort in certain jurisdictions.

Some concerns derive from the perception that third party funding encourages frivolous claims and may tend to corrupt the dispute resolution process by the participation of a party who is unconnected with the merits of the dispute and has a motive for profit<sup>6</sup>. Other concerns relate to a perceived threat to the foundations of the attorney-client relationship and the perception that third party funding may tend to corrupt, or may pose the risk of corrupting, this relationship<sup>7</sup>.

However, these concerns are out-of-date and misplaced. Reflecting a more supportive and flexible approach to the question of third party funding, many jurisdictions have now abolished the criminal and tortious consequences of those ancient doctrines<sup>8</sup> and their relevance in modern day society is waning. Judicial attitudes have relaxed, or are relaxing, in relation to litigation funding in many jurisdictions<sup>9</sup> and policymakers in many countries are also expressing support for its continued development within suitable legal or regulatory frameworks<sup>10</sup>.

What do these developments mean for third party funding in international commercial and treaty arbitration?

This article considers not only the benefits of third party funding for claimants in arbitration but also identifies some of the risks and proposes ways to manage those risks. Third party funding is not a panacea and will not suit all claims and all claimants. However, this article seeks to demonstrate that with a fuller appreciation of the risks and benefits, there is little to fear and much to be gained from the use of third party funding in arbitrations.

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<sup>4</sup> See, for example, D.Samuels, 'Third-party funding: avoiding the pitfalls', *Global Arbitration Review*, 24 June 2011; M.Kantor, 'Costs and third-party funding in international arbitration' *Global Arbitration Review*, April 2010, Volume 5 – Issue 2; and C.Albanese, 'Third-party funding and arbitration' *CDR (Commercial Dispute Resolution)*, 21 July 2010.

<sup>5</sup> The conference was organized by the New York State Bar Association Dispute Resolution Section and Fordham University School of Law.

<sup>6</sup> See NAMIC (National Association of Mutual Insurance Companies) State & Policy Affairs Department, 'Third-Party Litigation Funding: Tipping the Scales of Justice for Profit', May 2011.

<sup>7</sup> See B. Cremades, 'Third Party Funding in International Arbitration' at [5] ([http://www.luzmenu.com/cremades/\(S\(we40b5ekrbotha5xuywohcnh\)\)/ing/Publicaciones.aspx](http://www.luzmenu.com/cremades/(S(we40b5ekrbotha5xuywohcnh))/ing/Publicaciones.aspx)). This paper was presented at the Fordham conference held in New York on 15 June 2011 (*supra* note 5).

<sup>8</sup> For example, in England and in some states of Australia and the US. In Australia, the states which have abolished the criminal and tortious consequences of maintenance and champerty include New South Wales and Victoria. In the US, it is understood that 28 states, including New York and Massachusetts, no longer prohibit champerty, or provide extensive exceptions. See also A.Jones, 'The Next National Investment Craze: Lawsuits!', *The Wall Street Journal Blog*, 4 June 2010.

<sup>9</sup> See, for example, in England, the Court of Appeal decision in *Arkin v Borchard Lines Ltd* [2005] EWCA Civ 655, and in Australia, the High Court decision in *Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd* [2006] HCA 41 discussed further in *Access to justice* later in this article.

<sup>10</sup> See examples in *Regulatory developments* later in this article.

## What is third party funding?

Third party funding arrangements for high value claims do not conform to a template. Funding arrangements must be structured to suit the specific needs and interests of the parties, the dispute and the laws governing the dispute and the arbitration. However, 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). Typically, third party funders seek a share of the recovery in the range of 15% to 50% (the median figure is around a third), depending on the costs and risks involved in funding the dispute. In addition, the funder may agree to bear any adverse costs order and provide security for the respondent's costs.

The amounts payable to the funder depend on the successful resolution of the claim. If the claim fails, the funder receives nothing but typically remains liable for any fees due to the claimant's lawyer, together with any adverse costs which it has agreed to pay and have been incurred during the term of the funding agreement.

A funder and a funded claimant can be seen as co-venturers in that both contribute different property to a common endeavour and agree to share the ownership of any successful recovery. As with all commercial ventures, each party to a funding agreement relies on the continuing commitment and full co-operation of the other.

A funder's decision to fund a claim is typically an investment decision. When considering whether to do so, the funder will carefully consider various factors which bear on the financial risks it is being asked to assume. These factors include, not only the prospects of success and quantum of the claim, but also factors relating to the arbitration, including the terms of the arbitration agreement or treaty and the seat of the arbitration<sup>11</sup>.

The process varies from case to case and from funder to funder, but usually a claimant or a claimant's lawyer approaches the funder. If the claim meets the funder's threshold criteria (usually as to claim value and the nature of the claim), the funder will undertake extensive due diligence in relation to all aspects of the claim.

The decision by the funder to fund a claim is often made by a credit or investment committee within the funder. If the funder agrees to fund, then a funding agreement is negotiated and entered into between the funder and the claimant. In some cases, the funder may structure the funding to allocate risk to other parties as well, such as lawyers acting on a contingency or part-contingency basis, other funders or insurers. In those circumstances, there may be additional parties to the funding agreement, or ancillary agreements with other parties linked to a principal funding agreement.

## Benefits of third party funding

Some of the primary benefits which make third party funding an attractive option for claimants are described below:

### Access to justice

The importance of third party funding in facilitating access to justice is widely accepted in many jurisdictions across the world. Parties with meritorious arbitration claims, but with limited financial resources, or a desire to manage scarce resources, can use third party funding to enable those claims to

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<sup>11</sup> Other factors which funders will analyse and assess are set out in *Due diligence* later in this article.

be pursued and resolved. The following examples relate to access to the civil courts, but there is no reason why the same principles should not apply to arbitration.

The rise of third party funding has coincided with the drastic decline in public funding for civil claims in countries such as England and Australia. The English Court of Appeal decision in *Arkin v Borchard Lines Ltd*<sup>12</sup> is considered a turning point in the recognition by the English courts that third party funding could offer access to justice. The court referred to commercial funders “who provide help to those seeking access to justice which they could not otherwise afford”<sup>13</sup>. More recently, in the final report published after his year-long review of the costs of civil litigation in England, Lord Justice Jackson gave significant support to third-party funding of litigation, which he viewed as promoting access to justice<sup>14</sup>.

In Australia, the seminal court decision on third party funding is the High Court of Australia’s decision in *Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd*.<sup>15</sup> In that case, Justice Kirby referred to: “The importance of access to justice, as a fundamental human right which ought to be readily available to all...”<sup>16</sup> Kirby J also rejected the notion that the funder created a controversy where none had previously existed:

*“Controversies pre-existed the proceedings, even if all those involved in them were unaware of, or unwilling earlier to pursue, their rights. A litigation funder...does not invent the rights. It merely organises those asserting such rights so that they can secure access to a court of justice that will rule on their entitlements one way or the other, according to law.”*<sup>17</sup>

## **Risk management and financial support**

Third party funding provides not only the financial resources with which to pursue a claim, but also opportunities to manage financial risks associated with pursuit of a claim through arbitration. A claimant is able to transfer some or all of those risks to the funder. The claimant thereby has the opportunity to achieve a successful recovery, without having to pay legal fees and other costs as the claim progresses, or having to provide or allocate funds to deal with the consequences should the claim fail.

The legal and expert fees and other costs associated with pursuing claims in both international commercial arbitration and treaty arbitration can be substantial, often running into many millions of dollars per dispute. A commensurate amount will also usually have been spent by the respondent. In many arbitrations, there is the risk that, if the claim fails, the claimant will be liable for not only its own legal fees and expenses, but also for the respondent’s costs<sup>18</sup>. Controlling the costs of arbitration is an issue of increasing concern within the arbitration community<sup>19</sup>. The ability to spread and share these risks with a third party may be attractive, even to clients with strong businesses and cash flows.

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<sup>12</sup> [2005] EWCA Civ 655.

<sup>13</sup> *Ibid* at [38].

<sup>14</sup> See “Review of Civil Litigation Costs: Final Report”, December 2009.

(<http://www.judiciary.gov.uk/publications-and-reports/reports/civil/review-of-civil-litigation-costs/civil-litigation-costs-review-reports>). Lord Justice Jackson stated “it was better for [a claimant] to recover a substantial part of his damages than nothing at all” at [117].

<sup>15</sup> [2006] HCA 41.

<sup>16</sup> *Ibid* at [145].

<sup>17</sup> *Ibid* at [202].

<sup>18</sup> This will depend on whether the applicable *lex arbitri* of the seat of the arbitration contains provisions under which the winner is usually entitled to recover its costs from the loser, unless the parties have agreed otherwise (for example, where the seat is England or Sweden). Alternatively, where institutional rules apply, generally, the rules leave the arbitral tribunal with a wide discretion on costs. (However, see Article 42 of the UNCITRAL Arbitration Rules 2010 and Article 28(4) of the London Court of International Arbitration Rules.)

<sup>19</sup> See ‘Techniques for Controlling Time and Costs in Arbitration’, International Court of Arbitration Bulletin, a report from the ICC Commission on Arbitration, Volume 18, No. 1, 2007. Note also the recent conference of the Chartered Institute of Arbitrators held in London in September 2011, entitled ‘Costs of

## **Due diligence**

Before agreeing to fund a claim, extensive due diligence work will usually be undertaken by the funder. Some funders will conduct due diligence by retaining external counsel at the client's or the funder's expense. Some funders conduct due diligence predominantly "in-house", relying on the skills and experience of its investment staff.

A funder will carefully and thoroughly analyse and assess all aspects of the claim which bear on the financial risks it is being asked to assume or to share. These factors include: the prospects of success of the claim; possible counterclaims; the terms of the arbitration agreement or treaty; the arbitral institution and composition of the tribunal (if it has been appointed); the seat of the arbitration; the substantive law of the dispute; the quantum of the claim in comparison with the likely costs and risks of pursuing the claim; and the risks associated with enforcing and obtaining payment under an award (including, for international commercial arbitrations, the question of whether the respondent has assets of value in a state which is a signatory to the New York Convention).

A third party funder brings a highly commercial and objective perspective to claim assessment. This can provide real benefits to claimants and can help to shape, in very practical and strategic ways, how a claim is pursued. The funder's role can assist in the efficient management of a claim by ensuring that the focus is kept clearly on the real issues in dispute and by seeking to avoid time and costs being spent on the pursuit of claims which are weak or unnecessary. In some cases, the fact that a funder has agreed to fund a claim may increase the chance of the claim being settled at an early stage by agreement.

## **Experience**

An experienced funder will be able to assist the lawyer and claimant in the due diligence phase and during the course of the arbitration, for example, in the choice of counsel, experts and arbitrators and, in appropriate cases and depending on the jurisdiction, in strategic and tactical decisions during the arbitration. Many firms offering third party funding are run by highly experienced former dispute lawyers who are focused on the successful management and resolution of funded claims. With a broad range of specialist skills and experience, and consistent with its own commercial objectives, a funder can add real value to the management and resolution of arbitration claims.

The nature and scope of the funder's role in a funded claim, including the extent to which the funder can influence how the claim is managed on a day to day basis, depends principally on the contractual arrangements between the funder and claimant and on the application of the rules regarding maintenance and champerty to the particular funding agreement and arbitration. These rules, as they apply to arbitration, are not settled and will likely be clarified piecemeal as disputes arise and come before domestic courts.

In most cases, a claimant will already have engaged a lawyer to assist it with its claim. Usually, the funder will agree to the retainer of the claimant's lawyer. Occasionally, the claimant identifies that its lawyer does not have the skills and experience to conduct the arbitration and seeks assistance from the funder to locate a more suitable lawyer. At all times the lawyer acting for the claimant remains the claimant's lawyer and owes duties and responsibilities solely to the claimant. The claimant's lawyer will likely be asked to provide regular reports to enable the funder to monitor progress of the claim and to ensure compliance with the claimant's obligations under the funding agreement (particularly once there has been a recovery).

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International Arbitration'. The conference focused on the results of a survey on the costs of international arbitration which had been undertaken by CIARB and which aimed to analyse precisely where and how costs are incurred and to explore the ways in which they can be reduced to make international commercial arbitration more cost-effective and efficient (see <http://www.ciarb.org/conferences/costs/>).



## Risks of third party funding

There are inevitably certain risks associated with third party funding in international commercial and treaty arbitrations. Many of these risks stem from the significant amounts of money likely to be spent on the arbitration process and the significant amounts in issue. These risks need to be fully understood by claimants and their lawyers, so that claimants can make properly informed and considered decisions about whether to use third party funding.

The principal risks are described below, together with ways in which many of these risks are often, or can be, addressed.

### Unfair terms

By providing funding, funders may gain a degree of economic power in the relationship with the funded claimant and in relation to the outcome of the dispute. Equally, funders have much at stake and are reliant upon the continuing co-operation and goodwill of the claimant to further the parties' mutual endeavour. In the context of litigation funding and principally in the context of retail or unsophisticated clients, the balance of economic power between the funder and the client has been of concern to regulators.<sup>20</sup> There is a concern that a funder could take advantage of its economic power by insisting on unfair terms in a funding agreement, using its economic position to renegotiate terms to the detriment of the claimant at a mature stage of the litigation process or to achieve a resolution of the claim which may not be consistent with the client's best interests.

International commercial and treaty arbitrations can be anchored to different legal systems (for example, the law of the seat may be different to the law of the hearing location<sup>21</sup> and the law governing the dispute). This means that a claimant and a funder may have a high degree of autonomy in designing the funding agreement and choosing the law which governs the funding agreement, but as funding is not consistently regulated this may also mean that claimants could have few regulatory or other protections<sup>22</sup>.

The claimant's lawyer is a critical element in the funding arrangement. The lawyer is an important check and balance on the funder and is obliged to ensure the proper protection of his or her client's interests. The claimant's lawyer will usually be regulated by reference to their location or the place in which the legal services are provided. The central role of the claimant's lawyer in the funding arrangement is at the centre of a formal opinion recently issued by the New York City Bar Association (NYCBA)<sup>23</sup>. This ruling echoes similar concerns expressed by regulators in England and Australia.

In general, funding a claim in the expectation of earning a return from it is an expensive, risky and protracted undertaking. A claim may take years to resolve. The funder will have outlaid very substantial

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<sup>20</sup> For example, see "Litigation Funding in Australia" Discussion Paper Standing Committee of Attorneys-General, May 2006

([http://www.imf.com.au/pdf/DiscussionPaperStandingCommitteeOfAttorneysGeneral\\_May2006.pdf](http://www.imf.com.au/pdf/DiscussionPaperStandingCommitteeOfAttorneysGeneral_May2006.pdf)).

<sup>21</sup> When, on occasion, the hearing takes place in a country which is not the juridical seat.

<sup>22</sup> See further in *Regulation of funders* later in this article.

<sup>23</sup> See 'Formal Opinion 2011-2: Third Party Litigation Financing' published in June 2011

(<http://www.nycbar.org/index.php/ethics/ethics-opinions-local/2011-opinions/1159-formal-opinion-2011-02>). The Opinion states that if the lawyer reviews or negotiates a non-recourse financing agreement for a client, then under the New York Rules of Professional Conduct he must provide candid advice regarding whether the arrangement is in the client's best interest. The Opinion provides that non-recourse litigation funding is "a valuable means for paying the costs of pursuing a legal claim" for many clients, but points out some ethical risks for lawyers, including "interference in the lawsuit by a third party", which lawyers should be prepared to address "as they arise" at [5].

sums in legal fees and other outlays during that time and may also have incurred a significant exposure to adverse costs. It is imperative, from both the funder's and claimant's points of view, that the funding agreement is clear and well drafted and each party has access to appropriate legal advice.

Given the costs and risks involved, it is in the funder's interest to act with a high level of professionalism towards the claimants that it funds and to enter into funding agreements that are likely to be seen as fair and reasonable, having regard to all the circumstances of the funding and the risks attendant in the arbitration.

In the context of international commercial arbitration and treaty claims, many clients of funders are themselves sophisticated commercial parties who may have decided to obtain funding for their claim in order to appropriately manage the risks of pursuing the claim. Such clients expect and demand professionalism from a funder and usually have access to sophisticated and well-resourced legal advisers. In addition, there is competition amongst third party funders. These factors offer a large measure of protection against any unfair or uncommercial terms which may be proposed by a funder.

### **Funder's financial resources**

The funder's agreement to pay the claimant's legal costs and any adverse costs orders could turn out to be illusory if the funder lacks adequate capital or insurance to meet its obligations.

It is important that the funder's assets and capital structure is properly understood by a claimant and its advisers and the claimant is comfortable with the funder's ability to meet all liabilities which may arise under the funding agreement. Claimants should therefore thoroughly investigate the funder's capital position and the transparency of its business structure prior to entry into a funding agreement.

Due to the costs associated with international arbitration proceedings, third party funding of these claims is extremely capital intensive. Funders provide funding through a range of structures. There are public companies with traded share capital which are required to disclose their financial position publicly. Examples of funders which adopt this structure are IMF (a company listed on the Australian Securities Exchange), and Burford Capital Limited and Juridica Investments Limited (which are both listed on the London Stock Exchange's AIM market). There are private companies such as Harbour Litigation Funding Ltd in England. There are also a number of private funds (including hedge funds) with the expressed intention of investing in high value legal claims.

When seeking funding, claimants and their lawyers should do careful due diligence on the funders who may wish to fund the claim, both in relation to the funder's financial standing and track record and the experience and competence of its staff.

### **Conflicts of interest**

Potential conflicts of interest are another source of concern to critics of third party funding. The issue of particular concern is that the claimant's lawyer may be unduly influenced by the funder (as the funder pays the bills) and favour the funder's interests rather than the interests of the claimant. Lawyers need to carefully assess any relationship they may have with a funder and to ensure that all necessary disclosures are made to a client to enable the client to make an informed decision on the question of funding and its risks and benefits<sup>24</sup>.

This issue can emerge sharply in the context of settlement negotiations, particularly in circumstances where the funder and client may be in disagreement over whether or not to settle a claim. For example, the funder may want an early and cheap settlement in order to improve its cash flow. Where the lawyer has been chosen by the funder, and not the claimant, or where the funder offers the prospect of repeat

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<sup>24</sup> See NYCBA Opinion, *supra* note 23, Section II C at [4].



business for the lawyer, the lawyer may be incentivised to advise the claimant to accept the settlement, even where the settlement may not be in the claimant's best interest.

The identification and management of conflicts of interest should be a subject for discussion between the funder, the claimant and the claimant's lawyer and should be addressed in the funding agreement. The agreement should expressly recognise that the lawyer who has the conduct of the claim owes his or her full professional and fiduciary duties to the claimant and that, in the event of a conflict of interest between the claimant and the funder, the lawyer may continue to act solely for the claimant, even if the funder's interests are adversely affected by him or her doing so. This standard should be observed whether the lawyer is retained by the funder or by the claimant.

A conflict over whether or not to settle can also be dealt with in the funding agreement. It may provide that any irreconcilable difference over settlement must be referred to nominated counsel for a binding expert opinion on whether the settlement is a reasonable one, or the agreement may include some other form of dispute resolution clause to address this situation. A properly drafted funding agreement should recognise and clearly address these issues.

In many jurisdictions, lawyers' professional obligations under their conduct rules also assist by prohibiting a lawyer from acting if there is a conflict of interest<sup>25</sup>. Specific guidance has also been given in the recent NYCBA Opinion. It provides that "absent client consent, a lawyer may not permit the [funder] to influence his or her professional judgment in determining the course or strategy of the litigation, including decisions of whether to settle or the amount to accept in any settlement."<sup>26</sup>

The American Bar Association (ABA), through its Commission on Ethics 20/20, is also in the process of reviewing ethical issues relating to the third party litigation funding industry, including in relation to conflicts of interest<sup>27</sup>.

Another potential conflict of interest, or perceived conflict of interest, could arise between a funder and one of the arbitrators appointed to arbitrate a dispute, for example, where the arbitrator is a partner of a law firm with which the funder has a relationship. Disclosure of such a connection could cause particular difficulties where the funding has been kept confidential until the arbitration process is well under way. However, this conflict can be avoided by the funder undertaking the appropriate conflict checks in relation to all the relevant participants in the arbitration before agreeing to fund and by arbitrators making full disclosure in accordance with the International Bar Association's Guidelines on Conflicts of Interest in International Arbitration<sup>28</sup>.

The types of potential conflicts of interest described above are not new. They may arise in circumstances where a lawyer acts for both an insurer and the insured, or where the lawyer himself or herself is conducting the claim on a contingency basis. To a degree, potential conflicts in a funding situation are often resolved by virtue of the fact that it is in the interests of all parties at risk (the claimant included) to maximize the return from the claim.

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<sup>25</sup> For example, see chapter 3 of the English Solicitors' Code of Conduct 2011.

<sup>26</sup> *Supra* note 23, Section II C at [4]. The Opinion also provides that a lawyer is barred from accepting a referral fee from a litigation financing company if it would impair his exercise of professional judgment in determining whether the financing transaction is in the client's best interest and would compromise his ethical obligation to provide candid advice regarding the financing arrangement.

<sup>27</sup> See *infra* note 39.

<sup>28</sup> Approved 22 May 2004 by the International Bar Association. See, for example, section 2.3.6: "The arbitrator's law firm currently has a significant commercial relationship with one of the parties or an affiliate of one of the parties." This situation is on the "waivable Red List" of the Guidelines and therefore considered "waivable only if and when the parties, being aware of the conflict of interest situation, nevertheless expressly state their willingness to have such a person act as arbitrator" (see Part II.2).

## Confidentiality and privilege issues

To ensure that the funder can perform due diligence, it is important for the funder to have complete access to all information held by the claimant or the claimant's lawyer which might be relevant to the claim and the funder's decision to provide funding. However, the lawyer's duty of confidentiality to the client seeking funding could be compromised by providing information about the claim to the funder. Normally, a confidentiality agreement is entered into between the funder and the claimant at the outset or confidentiality provisions are contained in the funding agreement. However, depending on the jurisdiction concerned, contractual provisions as to confidentiality may not prevent a respondent from seeking to obtain access to documents in the possession of the funder, if they are relevant to the matters in issue<sup>29</sup>.

There is also the risk that legal privilege in documents prepared by the claimant's lawyer or for the purpose of the dispute will be waived when otherwise privileged communications are given to the funder, or that communications between the funder and the funded claimant and/or claimant's lawyer about the claim will not be protected by privilege in jurisdictions which do not recognize a common interest form of privilege<sup>30</sup>. These limitations may stifle third party funding in those jurisdictions and may ultimately require definitive court authority or legislative intervention if the full benefits of third party funding are to be available.

Proper analysis of the arbitration agreement is also required. Some arbitration agreements incorporate, expressly or by reference, particular confidentiality terms (both as to disclosure of information between the parties and the conduct of the arbitration).

Depending upon the amount and type of information which a funder may wish to have disclosed to it during the conduct of a claim, and the applicable law, these issues will likely require ongoing attention and management until such time as the claim is resolved.

## Disclosure of funding and costs

As between a funder and its client, the question of disclosure of the funding agreement to third parties is primarily a matter for agreement between them. However, a broader question arises as to whether a claimant is obliged to notify the participation of a funder to a respondent or an arbitral tribunal.

There appear to be no relevant rules of the leading arbitral institutions requiring a party to disclose if it is being funded<sup>31</sup>. Nevertheless, this information may become known by the respondent during the arbitration. The claimant may voluntarily disclose that it is being funded or the respondent may become aware of the funding, in any event, either during the due diligence phase, during the course of the arbitration or in any settlement negotiations. Does this give rise to any additional costs or other risks for the funded claimant in international arbitration?

In a recent arbitration<sup>32</sup>, an ICSID *ad hoc* committee dismissed an argument that the successful party should not be awarded costs in respect of its legal fees, on the basis that those legal fees had allegedly

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<sup>29</sup> The position in Australia is reflected in *Spatialinfo Pty Ltd v Telstra Corporation Ltd* [2005] FCA 455 where the respondent failed in its attempt to subpoena confidential documents between the funder and the applicant. The Court held that the subpoena directed to the funder was oppressive and should be set aside.

<sup>30</sup> For example, in the US, it has been argued in relation to funded litigants that communications between the funder and the funded client or client's lawyer are not protected by common interest privilege because the funder's interest in the outcome of the litigation is commercial, rather than legal (see the NYCBA Opinion, *supra* note 23 at [4] and *Leader Techns., Inc. v Facebook, Inc.* 719F. Supp. 2d 373 (D. Del. 2010)). However, these communications may be protected under the work product rule (see *Mondis Technology, Ltd v LG Electronics, Inc.* Nos 2:07-CV-565-TJW-CE, 2:08-CV-478-TJW (E.D. Tex. May 4, 2011)).

<sup>31</sup> However, see the discussion by Cremades, *supra* note 7, at [6-7].

<sup>32</sup> *RSM Production Corporation v Granada* (ICSID Case No ARB/05/14) at [68].

been met by an undisclosed third party. The committee concurred with an earlier ICSID tribunal which stated that it knew “of no principle why any ... third party financing arrangement should be taken into consideration in determining the amount of recovery” of the costs incurred in the arbitration<sup>33</sup>.

A question arises as to whether a failure to disclose the participation of a funder in an arbitration is a breach of the procedural good faith implied as a part of an agreement to arbitrate<sup>34</sup>. There are a range of strategic and tactical considerations which may bear on whether a claimant chooses to disclose the participation of a third-party funder and circumstances may evolve in the course of an arbitration which may merit the disclosure of a funding arrangement. This question is not susceptible to a clear and easy answer. However, it is possible that, at some point, the arbitral institutions or other bodies with influence on how arbitrations are conducted may decide it is necessary to address this issue. Of course, if the involvement of a funder for a claimant in an arbitration is required to be disclosed, there is no reason why potential or actual sources of funding for the respondent should not equally be disclosed.

## Regulation of funders

Unlike lawyers, whose conduct is regulated by their local Bar or law society, there are few external controls on the conduct of a third party funder other than those that might apply by virtue of the place of incorporation of the funder (for example, if the funder is listed on an exchange) and/or the place at which it enters into the funding arrangements (for example, the funding arrangements may be products regulated by legislation). There is no overarching global or other regulatory regime which at present oversees third party funders in international commercial arbitration or treaty claims.

The limited ability to regulate the conduct of funders in an international context may cause practical problems in relation to arbitration, given arbitral tribunals generally do not have the powers to make orders against third parties. There are also no specific rules of the arbitral institutions requiring a party to disclose if it is being funded<sup>35</sup> and so arbitrators may not even be alerted to the participation of a funder. As stated above, a regulatory analysis depends upon an analysis of the rules of any relevant regulatory regime in the location and seat of the arbitration, such as national financial services regulations.

In the litigation context, solutions have been proposed by policymakers in various jurisdictions to enhance the regulation of third party funders, for example, by licensing and voluntary codes of conduct.

In England, Lord Justice Jackson recommended a voluntary scheme for third party funders of litigation<sup>36</sup>. The Civil Justice Council (CJC) has taken this forward by consulting publicly on a self-regulatory code for third party litigation funding.<sup>37</sup> However, the draft code and the work published to date by the CJC do not presently expressly apply to third party funding of arbitration.

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<sup>33</sup> *Ioannis Kardassopoulos and Ron Fuchs v Georgia* (ICSID Case Nos ARB/05/18 and ARB/07/15, Award of 3 March 2010) at [691].

<sup>34</sup> See Cremades, *supra* note 7, at [7].

<sup>35</sup> This is in contrast to court rules in some jurisdictions that require notification of a funding arrangement, for example, in England see Part 44.15 of the Civil Procedure Rules.

<sup>36</sup> See “Review of Civil Litigation Costs: Final Report”, *supra* note 14, chapter 11, at [117–124].

<sup>37</sup> “Code of Conduct for the Funding by Third Parties of Litigation in England and Wales”. In June 2011, the CJC published a summary of the responses it had received to the consultation. Generally, the voluntary code is supported (see <http://www.judiciary.gov.uk/about-the-judiciary/advisory-bodies/cjc/third-party-funding>). This followed on from earlier work undertaken by the CJC in relation to third party funding. In June 2007, it published a report, “Improved Access to Justice, Funding Options and Proportionate Costs – The future Funding of Litigation, Alternative Funding Structures”, which included a recommendation to the UK Government that properly regulated third party funding should be recognised as an acceptable option for mainstream litigation.

In Australia, a litigation funding agreement has been held to be a financial product<sup>38</sup>, requiring the funder to hold an Australian Financial Services Licence issued by the Australian Securities and Investments Commission. The licence and relevant statutory provisions impose capital adequacy, conflicts management, mandatory disclosure and dispute resolution requirements. It is possible that these provisions will apply to agreements to fund arbitrations as the focus of the regulation is on agreements which manage financial risk rather than the nature of the specific risk being managed.

In the United States, a working group of the ABA Commission on Ethics 20/20, which is reviewing the third party litigation funding industry, published an issues paper in November 2010<sup>39</sup> in which it sought comments on possible approaches for dealing with certain ethical issues it had identified, including privilege, confidentiality and conflicts of interest.

The Commission is understood to be considering whether to recommend how those ethical issues should be addressed, whether by draft amendments to the Model Rules of Professional Conduct, court rules or some other method. From the issues identified in the paper, it does not appear that the recommendations will extend to any form of regulation of the funders themselves and it is also not clear the extent to which they will impact on lawyers acting for a funded party in an arbitration<sup>40</sup>.

A clear issue in the context of any regulation is to ensure that the baby is not thrown out with the bath water. In other words, overzealous regulation risks limiting the benefits described earlier in this article.

## Alternative funding products

Third party funding of high value arbitration claims is usually governed by flexible contractual arrangements, structured to suit the particular parties, facts and jurisdictions involved in the dispute. It is the authors' understanding that there are no specifically designed funding products or arrangements for international commercial or treaty arbitrations<sup>41</sup>. In both types of arbitration, the funder will assess the specific requirements of the parties, the underlying merits of the dispute, the prevailing substantive law, as well as the laws governing the arbitration and arbitration procedure. In order to avoid a challenge to any funding arrangement during enforcement of an award, it may also be necessary to consider the law of the place in which an award may be enforced.

Treaty claims have a set of unique procedural features and bring with them additional procedural hurdles (for example, whether the investor is eligible and can enjoy protection under an applicable treaty and other jurisdictional requirements under the Washington Convention). Funders may elect to fund these cases at a later stage, for example, after jurisdiction or other procedural points have been decided in the claimant's favour. However, the structure and terms of funding arrangements for treaty claims will usually mirror those of international commercial arbitration claims.

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<sup>38</sup> See *International Litigation Partners Pte Ltd v Chameleon Mining NL* [2011] NSWCA 50 (a decision of the Court of Appeal, New South Wales, delivered on 15 March 2011).

<sup>39</sup> The paper, 'Issues Paper Concerning Lawyer's Involvement in Alternative Litigation Financing', considers the involvement in "alternative litigation financing" or ALF (as third party funding is referred to in the paper) by individuals and entities other than the parties to the action, their respective lawyers or insurer. The paper is available on the website of the ABA Commission on Ethics 20/20 at [http://www.americanbar.org/content/dam/aba/migrated/2011\\_build/ethics\\_2020/alt\\_lit\\_financing.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/migrated/2011_build/ethics_2020/alt_lit_financing.authcheckdam.pdf). The comments received have now also been published on the Commission's website.

<sup>40</sup> Just prior to publication of this special issue, the Commission published a White Paper on ALF ([http://www.americanbar.org/content/dam/aba/administrative/ethics\\_2020/20111019\\_draft\\_alf\\_white\\_paper\\_posting.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111019_draft_alf_white_paper_posting.authcheckdam.pdf)).

<sup>41</sup> Some funders offer other arrangements such as purchasing arbitration claims or awards (see M.Kantor 'Third-Party Funding in International Arbitration: An essay about New Developments' ICSID Review - Foreign Investment Law Journal, Volume 24, Number 1 (Spring 2009) at [70-71]).

What are some of the alternative funding products available to claimants in international arbitration who require financial assistance to fund their claims?

None of the main institutional rules contain any express rules about funding arrangements. Therefore, the funding options available in international arbitrations may depend on the location of the parties, the law of the seat and other relevant laws, and the creativity of the claimant and its advisers.

### **Contingency fees**

Lawyers in the US often act for claimants on a contingency basis. This is common in litigation but also occurs in various forms in the context of international commercial and treaty arbitration. Under a contingency fee arrangement, the lawyer receives a percentage of any monetary award as payment for part or all of the legal services it provides. If there is no recovery, then the lawyer does not receive any fee. Usually, as the lawyers are often risking significant professional fees, these arrangements are only entered into by lawyers where a claim is considered to be sufficiently strong and a sufficient recovery is contemplated to offset the risk to the lawyer of non-payment. Contingency arrangements between a lawyer and a claimant can allow the claimant to spread risk associated with payment of the lawyer's fees.

Contingency fees (which are based on the amount of a client's recovery) are currently prohibited in England (other than in Employment Tribunal proceedings) but, following a recommendation made in Lord Justice Jackson's review of civil litigation costs, this prohibition is likely to be removed shortly<sup>42</sup>.

Contingency fees are still prohibited in Australia and many other common law jurisdictions.

### **Conditional fee agreements**

Conditional fee agreements ("CFAs") are a form of contingency fee agreement which are allowed in England and have become a common form of funding for claimants in civil litigation in that jurisdiction. Although it does not appear to be widespread, some English solicitors act under conditional fee arrangements in arbitrations<sup>43</sup>. A CFA is an agreement between the law firm and the client which provides that the legal fees and expenses, or any part of them, will be paid only in certain circumstances, usually only if the client is successful in the proceedings<sup>44</sup>. In those circumstances, the lawyer is paid his or her usual charge out rate plus an uplift or "success fee".<sup>45</sup> Currently, the success fee is recoverable from the losing party in proceedings in England<sup>46</sup>.

When the seat of the arbitration is England, the arbitral tribunal has the power to determine the amount of the recoverable costs of the arbitration on such basis as it sees fit<sup>47</sup>, unless the parties have agreed

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<sup>42</sup> In June 2011, a Bill was introduced to the UK Parliament (the Legal Aid, Sentencing and Punishment of Offenders Bill 2010-11) which, if passed, will remove the restrictions on contingency fees or "damages-based agreements" for all civil litigation in England (see section 42 at <http://www.publications.parliament.uk/pa/bills/cbill/2010-2012/0205/12205.i-v.html>).

<sup>43</sup> Under section 58A of the Courts and Legal Services Act 1990, CFAs may be made in relation to proceedings which are defined to include "any sort of proceedings for resolving disputes (and not just proceedings in a court)".

<sup>44</sup> CFAs are often referred to as "no win, no fee agreements".

<sup>45</sup> The maximum uplift must be no more than 100% of the lawyer's normal fees which would be payable if there was no CFA.

<sup>46</sup> However, this is set to change following a recommendation made in Lord Justice Jackson's review of civil litigation costs which has been accepted by the UK government and included in the Legal Aid, Sentencing and Punishment of Offenders Bill (*supra* note 41). The Bill, if passed, will abolish the recoverability of success fees from the losing party in proceedings (see section 41).

<sup>47</sup> Under section 63 of the Arbitration Act 1996 if there is no agreement between the parties as to what costs are recoverable then the tribunal "may determine by award the recoverable costs of the arbitration on such basis as it thinks fit". (Under section 61, the tribunal has the power to allocate the costs of the

otherwise. The tribunal may determine the recoverable costs on the basis that there “shall be allowed a reasonable amount in respect of all costs reasonably incurred”<sup>48</sup>. If the claimant has entered into a valid CFA under English law, it is possible that the costs awarded could include recovery of the success fee which the successful claimant will owe its lawyer<sup>49</sup>.

In a recent case before the English Commercial Court<sup>50</sup>, the judge refused to grant an extension of time for applications to challenge an arbitral award<sup>51</sup>. In assessing whether an extension would cause any prejudice, he took into account the fact that the claimants’ participation in further proceedings depended on the existence of a CFA with their solicitors (who had done the work in relation to the hearing before the arbitrator under a CFA). The judge concluded that the grant of an extension of time would inevitably result in the protraction of proceedings, and the need to conclude further CFAs. This amounted to relevant prejudice to the claimants for these purposes. The court took no issue with the fact that the arbitration had been funded by a CFA.

### **After The Event insurance**

After The Event (“ATE”) insurance is a type of legal expenses insurance taken out after a dispute has arisen to protect the insured claimant<sup>52</sup> against the risk of having to pay the respondent’s costs (which includes legal fees and expenses) if the claimant loses. ATE insurance can be obtained in relation to international arbitration proceedings<sup>53</sup>. ATE policies vary but will often include cover for some or all of the claimant’s disbursements, such as expert’s fees and may also include the arbitrator’s fees. On occasion, ATE policies extend to include cover for the claimant’s own legal fees, but this is not common. Usually, the ATE insurance is taken out in conjunction with a CFA (which protects the claimant’s liability for its own legal fees). ATE is distinct from Before The Event (“BTE”) insurance which is available before a dispute has arisen and is commonly provided in combination with other forms of insurance.

In England, the ATE premium is currently recoverable from the losing party in litigation as part of the costs awarded<sup>54</sup>. The ATE premium can be “self-funded” under the policy and so if the claim is lost, the claimant is not liable to pay any premium to the ATE insurer. These features have made ATE insurance attractive to claimants. However, it is unclear the extent to which an international arbitral tribunal would

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arbitration as between the parties, subject to any agreement of the parties themselves. The general rule is that costs will “follow the event”, namely the loser pays the winner’s costs, as well as its own costs. It is common for the tribunal to make an award on the allocation of costs between the parties and provide for such costs to be assessed, if not agreed, and to reserve to itself the jurisdiction to assess those costs if necessary.)

<sup>48</sup> Ibid, section 63(5).

<sup>49</sup> Unless it can be shown by the losing party that it was unreasonable. Under section 63(5) of the Arbitration Act 1996, any doubt as to whether costs were reasonably incurred or were reasonable in amount shall be resolved in favour of the paying party. See Ian Meredith and Sarah Aspinall, ‘Do Alternative Fee Arrangements Have a Place in International Arbitration?’ (2006) 72 Arbitration 22–26 at [23-24].

<sup>50</sup> *DDT Trucks of North America Ltd and others v DDT Holdings Ltd* [2007] EWHC 1542 (Comm).

<sup>51</sup> The arbitration had been held in London under the auspices of the International Centre for Dispute Resolution (an organ of the American Arbitration Association).

<sup>52</sup> ATE insurance is also available to defendants, although some insurers only offer insurance to claimants (see <http://www.fundingcontrol.co.uk/faq.htm#q12>, a website owned by English law firm, Addleshaw Goddard, which offers different funding options to clients).

<sup>53</sup> For example, see the website of TheJudge, an independent UK broker of litigation insurance and/or third party funding (<http://www.thejudge.co.uk/index.php/after-the-event-insurance/international-arbitration-funding>).

<sup>54</sup> Under section 29 of the Access to Justice Act 1999 (AJA). However, this is set to change. The Legal Aid, Sentencing and Punishment of Offenders Bill (*supra* note 41) also provides that most after the event insurance premiums will no longer be recoverable (see section 43).

allow recovery of such a premium, particularly given they are often very high (typically 50% or more of the amount of cover being provided)<sup>55</sup>.

### **Other products**

In addition to the products described above, which involve lawyers and insurers, credit default swaps from financial institutions may enable a claimant to hedge the risks inherent in arbitration proceedings<sup>56</sup>.

### **Conclusion**

While there are a range of funding options for international commercial and treaty arbitration claims, the financial benefits and risks associated with these claims mean that they are likely to provide attractive opportunities for third party funders into the future and accordingly be a valuable resource for claimants. The challenge will be to ensure that the interests of claimants and funders are kept in appropriate balance and reflect the mutuality of risks and benefits. Third party funding is neither a panacea nor a plague but for suitable claims it can offer tangible commercial benefits to claimants and its evolution in the sphere of international commercial and treaty arbitration should be positively nurtured, not constrained.

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<sup>55</sup> Section 29 of the AJA provides that "Where 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 phrase "any proceedings" is not defined in the context of ATE insurance but it is likely that it extends to tribunal proceedings and at least domestic arbitrations in England, except where the parties to the arbitration have agreed otherwise after the dispute has arisen. ATE insurance cannot usually cover matters in other jurisdictions because of recoverability and regulatory requirements. However, bespoke insurance policies can be designed for international arbitrations, whether they are commercial or treaty arbitrations, *supra* note 52.

<sup>56</sup> Credit default swaps are a type of derivative instrument used to hedge credit risk, for example, they are used by creditors to purchase financial assurance against the default or bankruptcy of a debtor. See M.Kantor 'Third-Party Funding in International Arbitration: An essay about New Developments' *supra* note 40 at [72].