Taming the “Mercantile Adventurers”: Third Party Funding and Investment Arbitration – A Report from the 14th Annual ITA-ASIL Conference

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James Egerton Vernon (Jones Day)

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In his 2014 Assenting Opinion on a security for costs motion in *RSM v. Saint-Lucia*, arbitrator Dr. Gavin Griffith Q.C. described third-party funders as “mercantile adventurers” and associated their activities with “gambling” and the “gambler’s Nirvana: Heads I win and Tails I do not lose.” This was no voice in the wilderness. The increasingly prevalent role of third-party funding (“3PF”) in international arbitration has raised concerns with many stakeholders that it will fuel a rise in frivolous claims. In particular, the role of 3PF in investment arbitration raises unique concerns for policy-makers because, ultimately, a State’s taxpayers will be liable for satisfaction of any award favoring the claimant. For their part, funders, and the claimants and law firms with which they generally collaborate, decry as unfounded the criticism of Dr. Griffith and those of his ilk, and note that their careful screening of claims acts as an effective filter for any unmeritorious action. Funders, after all, have a nakedly capitalist motivation; what do they stand to gain from supporting claims unlikely to turn them a profit?

These starkly divergent views have led to similarly contrasting opinions as to how, if at all, 3PF in international arbitration should be regulated. Calls for regulation have historically embraced two extreme options. At one end of the spectrum a “do not ask, do not tell” approach – *viz*. no regulation at all. At the other “a total ban on 3PF.” How, then, should the arbitral community proceed in the face of such a fractious debate?

The answer came in 2014 when the International Council for Commercial Arbitration and London’s Queen Mary School of Law formed a joint taskforce on “Third-Party Funding in International Arbitration” (the “Task Force”) co-chaired by three leading arbitration academics, Profs. Catherine Rogers, William (Rusty) Park and Stavros Brekoulakis. The Task Force’s aim is to “systematically study and make recommendations regarding the procedures, ethics, and related policy issues relating to third-party funding in international arbitration.” A working draft of the Task Force’s findings was presented, for discussion purposes, at the 14th Annual ITA-ASIL Conference on Third-Party funding, held in Washington, D.C. on 12 April 2017 (the “Draft Report”).

Proceedings commenced with a keynote from Professor Park, in which he highlighted four “musketeers” (*viz*. issues) identified by the Task Force as needing to be addressed:

• *First* **transparency**, without which the very legitimacy of the arbitral process risks being undermined.

• *Second* **privilege**. While in the U.K. and the U.S. common interest privilege would likely cover a claimant and funder working together on a case, this may well not be the case in civil law jurisdictions.

• *Third* the issue of **costs**. To what extent should the existence of 3PF be taken into account in allocating costs in an increasingly "loser pays" legal environment? Should it be a factor when considering whether to grant an order on security for costs?

• *Fourth* and finally (or as Professor Park put it, the "d'Artagnan" issue of the musketeers of 3PF), the question of **definitions**. **Who or what exactly is a third party funder?**

Thereafter two prestigious panels consisting of commercial funders and representatives from the worlds of academia and public policy entered into a lively discussion of the issues raised in the Draft Report. Below, with a focus on the role of 3PF in investment arbitration, I detail five key take-aways.

1. 3PF in Investment Arbitration: 'Relatively Widespread'

While the generally-confidential nature of 3PF and the consequent lack of publicly-available empirical evidence has militated against certainty, it has been the accepted wisdom in recent years that 3PF is becoming increasingly prevalent in investment arbitration. The *Eurogas v. Slovak Republic* tribunal confirmed as much when it described 3PF, in a 2015 Procedural Order, as "a common practice" in investment arbitration. It was thus particularly instructive to be provided, at the conference, with hard data confirming that:

• In the 2015 Queen Mary and White & Case International Arbitration Survey "39% of the respondent group" "[had] encountered [3PF] in practice." This "suggest[ed] that its use is *relatively widespread.*"
• 3PF has been used by claimants in at least *19 investor-state arbitrations*.
• In the 2013 Queen Mary / PwC Arbitration Survey "*49% of respondents reported having used discounted hourly rates* with … a success fee …".
• Contingent or conditional fee agreements have been used by claimants (and at least one respondent) in *at least 10 investor-state arbitrations*.
• Investment tribunals have awarded success fees in both ICSID (*Siag v. Egypt* – ordering payment of \$6.9m in legal fees, of which \$3.2m was a success fee) and UNCITRAL (*Khan Resources v. Mongolia* – awarding claimants \$6m to pay their counsel's contingent legal fees) arbitrations.

2. Issue 1: Uncertainty Remains – What is 3PF in Investment Arbitration?

As Professor Park noted in his opening comments, the definition of 3PF – who or what exactly is a third-party funder? – is key. Ensuring this definition is both accurate and fair is crucial if any proposed regulations are to be effective. As one prominent voice from the funding community recently noted, regulations based on too narrow a definition could result in a situation where "it is proposed that [a funder's] 5% interest in a matter should be disclosed, but a creditor's 10% interest need not be."

While the Task Force members acknowledged that the definition of 3PF is contentious, and that there remained much debate on this even within Task Force's subcommittee on definitions, the Draft Report adopted the following Working Definition:

> 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 disputing party, an affiliate of

> that party, or a law firm representing that party: a) in order to provide material support or to finance part or all of the cost of the proceedings, either individually or as part of a selected range of cases, and b) such support or financing is provided either through a donation or grant or in return for remuneration dependent on the outcome of the dispute.

While scholars and funders have provided their own varying suggestions as to what the definition of 3PF should encompass (and the issue of how after-the-event insurance should be categorized remains especially contentious), states have also been responsive to this issue. The Draft Report notes, for example, that the revised Comprehensive Economic and Trade Agreement, ratified by Canada and the E.U. in October 2017, includes the following definition of 3PF:

> 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.

The treaty further provides for disclosure of "the name and address of the third party funder." Similar provisions are contained in the (as yet unratified) E.U.-Vietnam Free Trade Agreement, as well as the French and Slovak Model Bilateral Investment Treaties. The E.U. has, further, put forward specific language defining and addressing 3PF to be included in its Transatlantic Trade and Investment Partnership with the U.S.

This, however, remains the extent of state involvement to date. While it is thus possible to discern a relatively uniform E.U. approach to the definition of 3PF in investment arbitration, we remain none-the-wiser as regards the views of other major investor-state stakeholders such as the U.S., China, Africa and Latin America. This is thus an area where the conclusions of the Draft Report will be especially helpful.

3. Issue 2 – Conflicts of Interest

The issue of 3PF and potential conflicts of interest was a key theme throughout the conference, with potential conflicts identified as being those:

• *Between the arbitrator and the funder*, including: where the arbitrator is a member of the investment advisory panel of a funder; where he or she serves as a consultant to the funder; where the same arbitrator is regularly appointed in cases financed by a particular funder; or where the arbitrator has acted as counsel or an expert in other proceedings financed by the same funder.

• *Between the attorney and the funder*, including: the risk of a waiver of privileges (such as the attorney-client privilege) through disclosure to the funder during the due diligence process; "intermeddling" by the funder in the attorney-client relationship (e.g. through the funder attempting to influence the attorney in key strategic decisions); and the funder appointing one or more nominees to the board of the funded company.

• *Between the claimant and the funder*, including: the funder "intermeddling" in the attorney-client relationship (e.g. by influencing the attorney in key strategic decisions); and through appointing directors to the board of the funded company.

• *Between the claimant and the contingent fee attorney*, including: the possibility of discord when it comes to settlement; issues as to what is covered and not covered in the contingency arrangement (e.g. funding may be required for more than just legal fees); and the potential need to revise a contingent fee arrangement should the budget be exceeded and the claimant require additional funding from a funder.

4. Issue 3 – 3PF Can Adversely Affect the Conduct of Investors

A number of pertinent observations were also made regarding the influence the availability of 3PF may have on investors *vis-á-vis* host states, as follows:

• The object and purpose of a number of bilateral investment treaties is to advance sustainable development, a goal potentially at odds with the involvement of profit-driven funders.
• The availability of 3PF to fund an investment claim could adversely incentivize investors, in particular at a time when relations with the host state are beginning to deteriorate. Will the availability of funding weaken an investor's resolve and render it more likely to abandon attempts to settle in favor of leaving and claiming damages? Does the availability of lost profits in investment claims perversely incentivize such behavior?
• While the counter-argument to the "adverse incentive" point is that it makes no sense for funders to fund frivolous cases, perhaps we should instead be considering whether the presence of 3PF enables more *marginal*, as opposed to *frivolous*, investment claims to be brought, and whether that, in turn, is a good thing.
• Finally, the research of two scholars (Chen & Abrams) into the effects of 3PF on Australian litigation was highlighted. This study confirmed not only that 3PF leads to more claims, but also that funders have tended to support cases raising novel issues. Funders can thereby enjoy an outsized influence over the development of the law in influential areas, which in turn warrants particular caution as concerns 3PF in investment arbitration.

5. Possible Solutions & Conclusion

While the aim of the Draft Report was limited to stimulating a preliminary debate (a goal which was certainly achieved at the conference), some potential solutions to the issues identified above were nevertheless discussed, all of which, interestingly, utilize *existing arbitral tools*:

• Conflicts of interest involving funders could be resolved through the careful application of the *IBA Guidelines on Conflicts of Interest in International Arbitration*;
• *Tribunals can order disclosure* of the existence of a third-party funder (as they did in both *Muhammet Çap v. Turkmenistan* and *South American Silver v. Bolivia*); and
• As noted above, states can and some have included specific provisions pertaining to 3PF in their investment treaties.

In sum, the Draft Report marks but an initial step in a lengthy process, particularly as regards the role of 3PF in investment arbitration. As Prof. Franck noted in her closing remarks, there remains a great deal of work to be done. The Task Force will be revising the Draft Report and posting a version for formal public comment in July 2017, as well as organizing further public events.

The arbitration community will be monitoring these developments with a keen interest.