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Research on Third-party Funding Agreement in International Investment Arbitration

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Abstract

Third party funding (TPF) is increasingly becoming more and more important in the development of investment arbitration. It had been considered as unjustice for assisting and contracting litigation to the recognition all the time, but now, many international arbitration centers, including the United States, France, Switzerland, Singapore and Hong Kong,have recognized its state in dispute settlement.TPF can provide the economic support for investors and share the risk of losing the lawsuit,while it brings concerns about impartiality, confidentiality and conflict of interest to international arbitration. In order to regulate TPF, there have been some successful international experiences which can be used for reference. Objectively speaking, the link that maintains the legal relationship between the funder and the arbitration cases who finances is the Third-party funding agreement, which is exactly the reason why the funder has "some kind of"legal status in the arbitration they funded. Therefore, in order to solve these problems, the starting point of consideration should logically be the Third-party funding agreement itself, including its validity, nature and content.

Keywords

Third-partiy Funding; Agreement; International Arbitration; Investment.

1. Overview of TPF Agreement

1.1. Concept and Features of TPF Agreement

At the beginning of the discussion, it should be noticed that there doesn't exist any "industry standard" or funding term structure of TPF agreements, And there are many differences in the funding structure depending on the funder, the type of dispute and the terms ultimately agreed upon in the funding agreement. The initial way to provide this institutional funding was for the financier to fund a case in exchange for a portion of the proceeds if the case wins [1]. ICCA-Mary Queen Third-party Funding Task Force defines it as agreement siged by an entity(including its affiliates and representing law firms) who is not the dispute parties and which provides,

(a) Financial or other material support to cover some or all of the costs of litigation, either alone or as part of a particular case, and

(b) such support or financing in exchange for remuneration or reimbursement that depends wholly or in part on the outcome of the dispute, or through grants or in return for premium payments [2].

1.2. Signing of TPF Agreement

When deciding whether to enter into a financing agreement with a claimant, Third Party Funders tend to conduct extensive due diligence and weigh several factors. Of course, an important one is the value of the claim. Investment arbitration offers potential funders a unique advantage as most ISDS arbitration awards have been issued, which reduces uncertainty in

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litigation investments, allowing funders to determine the possibility of winning a case more easily when evaluating in the context of arbitration trends.

The second major factor is the enforceability of the award to the host state. Third-party funders are unlikely to invest in situations if they find it impossible or difficult to enforce against the host country. For example, arbitration under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States is particularly attractive to Third Party Funders,the reason is it is easy to recognize and enforce awards in the host country.

Finally, when deciding whether to fund a claimant, funders also weigh the value of the compensation sought, the scope of the expected legal expenses and the expertise and expenses of the legal team they will hire. In particular, it has been reported on TPF funders that considering development level, expertise and legal capacity of the target country, they will give priority to claims against developing and newly industrialized countries. These countries have the ability to pay compensation and their investment ratings are condidered as respectable while the legal capacity and legal defense budget are limited [3].

2. Effectiveness of TPF Agreement

The emergence and changes of TPF is a perspective of the legal capital market development .It firstly appeared in common law countries where in assisting and contracting litigation happened legally, and it was a tool for Western feudal lords to obtain land ownership. Due to the backward judicial system and the imperfect supervision system at that time, the existence of TPF undermined the judicial fairness and caused the breeding of indiscriminate litigation and defamation.To prevent the expansion of the feudal lords, TPF was prohibited eventually.

The common law system has always opposed any intervention by financiers in the civil justice system--the doctrines of maintenance and champerty. Limiting using outside money to fund litigation as for concern that it would "taint the purity of justice". As the economy has developed, however, underlying public policy considerations have shifted direction. In medieval England, people’s need to be free from the oppression of unscrupulous aristocrats in front of weak courts had turned into a modern consideration, which is the civil justice system had become too expensive for many of them. The advantages of TPF which the civil justice remedies are more accessible are gradually emerging, and the prohibition is out of date for now.

Recent years, countries and regions such as Australia, the United States, the United Kingdom, Hong Kong and Singapore have successively broken the inherent restrictions on TPF. For example, the United Kingdom, the United States, and Australia have recognized the legality of TPF in the field of civil litigation in judicial judgments. The litigation funding "industry" has 20 years history in Australia and about 10 years in England and Wales. These jurisdictions offer significant judicial experience to a well-established industry. Singapore and Hong Kong, drawing on these advanced experiences and resources, amended their laws in 2017 to explicitly recognize the legal status of TPF in arbitration [4].

3. Main Contents of TPF Agreement

TPF agreements set out the terms on which the funder will provide resources to the disputing party, and what the disputing party will pay in return. They are also confidential in nature and unique to each situation and funder. There is no set of "industry standard" terms or forms of agreement. Rather, institutional investors will each have a specific type of case, some of which they will fund, for example, for a portfolio or other type of model, and their own concept of assessment, risk tolerance and terms. Although each agreement has different attributes, there are some certain types of clauses generally [5].

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3.1. Payback

The benefit or return structure of TPF agreements is a key provision, as it outlines the payments that should be made to the funder if the funded party wins the case. Typically, Third-party funders seek a share of the final amount between 15% and 50% (with a median value of about one-third), depending on the costs and risks involved in funding the dispute. Payment to the funders may also increase over time to reflect additional costs and risks incurred.

3.2. Revenue Priority

TPF agreements generally contain provisions relatesd to priority of payment after indemnity,and he claimant would be the beneficiary. The payment of proceeds takes the following orders: (1) the funder's investment or fees to date are repaid; (2) the funder receives a return; (3) the attorney (if applicable to a risk-sharing model receives the remaining fees; (4) the attorney (if risk sharing model is applied) is paid back, and (5) the balance belongs to the claimant. TPF agreements also include a clause that any recovery will be paid into a trust account held by the claimant's attorney, with the funder's portion in escrow for the funder and the remainder for the claimant. In some Third-party funding agreements, an attorney is a party to the agreement and agrees to distribute the proceeds according to the priorities set out in the agreement. In other agreements, the attorney is not a party, but the claimant irrevocably instructs the attorney to pay under the agreement at the request of the funder.

3.3. Conflict of Interest

As the funder will benefit from the dispute outcome, and the lawyer will work with the funder (and may also have interests in the process, depending on the risk sharing arrangement), it is possible for lawyers to distribute their benefits to the client and the funder or themselves . At all times, the duty of the attorney working with the funder is to act in the best interests of the client, to comply with the duty of loyalty to the client, and to act in accordance with the client's instructions (to the extent of the ethical obligations). A properly drafted TPF agreement will clearly state that control over litigation decision-making and strategy rests solely with the principal. However, conflicts may arise between a party to the dispute and the funder. One can imagine a scenario where a critical decision, such as whether to accept settlement and eliminate divergence. With such circumstance, the TPF Agreement should contain procedures on how to resolve the dispute and clarify the obligations of outside counsel to remain consistent with the client. Outside legal counsel should also get their clients prepared for this possibility and, where appropriate, advise their clients to obtain independent legal advice before entering into any TPF agreement [6].

3.4. Control, Termination and Settlement

To comply with the remaining rules on maintenance and champerty in jurisdictions where these theories still apply, Third Party Funders should not exercise control over strategic and day-to-day litigation decisions. Regardless of who pays the attorney's fees, the attorney is obligated to take instructions from the client and must always make independent advice that is in the client's best interests. Under these restrictions, in some cases, courts may review TPF agreements and related evidence to assess whether the funding arrangements impair the plaintiff's right to direct and control the litigation, or in any way impair the attorney's duties.

Reasonable termination rights do not diminish plaintiffs' control over arbitration. To control the risk, TPF agreements often include provisions that allow the funder to terminate on notice. Sometimes the right of termination is unrestricted, and other times it exists as precondition,which means the emergence of new information such that the funder is no longer satisfied with the value or commercial viability of the arbitration. As a balancing factor, termination right may also mean that the funder will no longer be entitled to all or part of its contractual return. In practice, the right is rarely exercised as once a funder spends a significant

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amount of money to fund a case, the incentives between the agreement parties are usually aligned to ensure a certain return.

3.5. Privilege and Confidentiality

Privilege and confidentiality matters in three ways: (1) a party must disclose information when seeking funding; (2) if the party receives funding, continue to disclose the information during the dispute, and (3) the terms of the funding arrangement and Third-party funding Statement of Privilege or Confidentiality in the Agreement itself. In order to obtain funding, a party will need to disclose substantial information about the dispute, and once funds are obtained, such disclosures will continue during the dispute. This requires disclosure of litigation privilege material and attorney-client privilege material. To date, few courts have specified the extent to which these communications are privileged; however, it is likely that litigation privilege, attorney-client privilege, and common interest privilege may, individually or collectively, apply in these situations.

3.6. Disclosure

In international arbitration, it is customary to promptly disclose the existence of a financing arrangement and the identity of the funders so that arbitrators can identify any potential conflicts and, increasingly, enable the parties to explore any potential issues surrounding who pays adverse costs.

3.7. Adverse Costs and Guarantees

Most jurisdictions adopt "loser pays" civil litigation system, meaning that the winning party is presumed to be entitled to a portion of the legal fees and expenses incurred during the process. Adverse cost consequences are a key consideration in whether and how to file a civil claim and can also affect the dynamics among litigants. As such, they also tend to be eccential motivator for parties seeking TPF. In many cases, the location and nature of the case will determine the nature of the funding sought and what provisions can be made for adverse costs in the TPF agreement. Third-party funders may also agree to guarantee cost orders in the agreement. While parties in a TPF agreement may agree that the funder will pay the court in cash any sums as security for costs, the funder may also agree to meet the costs of any court order through a promise to the defendant or a similar non-cash mechanism guarantee.

3.8. Recovery

Assessing whether funding costs are recoverable will involve a specific review of funding recovery claims. In international arbitration, when TPF is involved, a new practice is developing whereby asserted claims may include Third-party recovery of funds (such as litigation loans).

4. Nature of the TPF Agreements

There are three important roles in TPF: the funded party, the funder, and the law firm that provides professional legal services to the funded party. Under the traditional triangle model, the funder, the client and the attorney representing the client maintain the status of an independent legal person or natural person throughout the transaction process. The core of which is that the Third-party funder is always an entity independent of the client and the law firm.

4.1. Agreement between Funder and Dispute Party

The first is the relationship formed when a Third-party funder provides direct financial support to the parties in an arbitration case (not a package case). A funding agreement is signed between the Third-party funder and the parties. At this time, the Third-party funder is generally a bank, a hedge fund, an insurance company, or other companies and individuals. This most

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classic TPF agreement has the following three characteristics: First, a typical TPF arrangement usually has the following three characteristics: (1) The funder directly enters into a contract with the original party to the case (that is, not with the principal's (2) the original party is still a party to the case; (3) the funder does not become a party to the case (that is, not as an assignment contract) [7]. If the funded party is the applicant in the arbitration, the funder will generally agree with the funded party to take a certain percentage of the case income when the case wins. If the funded party is the respondent in the arbitration, the funder and the parties agree on a fixed amount of compensation in the funding agreement, and if the respondent wins the case, the funder can also receive additional remuneration [8].

4.2. Agreement between Funder and Law firms

In another case, not only will there be no legal agreement between the funder and the client, but the name of the client will not be mentioned in the funding agreement signed by the funder and the law firm, but in the first model, the funder and the The agreement between the parties usually identifies the attorney and the firm for which they are represented, as this type of funding agreement details how attorneys' fees will be paid. Funders can fund law firms rather than individual clients. Funders can fund individual cases or all or part of a law firm's cases. A funded law firm is structured like a loan secured by a law firm's receivables or anticipated contingent expenses [9].

Therefore, in practice, Third-party funders will prepare different model or format contracts in advance according to the two different situations of funding parties and funding law firms, but in a specific case, these two contracts will not exist at the same time.

5. Conclusion

With its unique institutional advantages, TPF agreements have gradually expanded from litigation to international arbitration. Although TPF has its own limitations, it has become a force to be reckoned with in the corporate reality and dispute resolution process. Judging from the current trend, there is still huge room for TPF to develop. Although there are still many controversies about many specific issues concerning TPF in theory, such as the content and degree of disclosure, the degree of control of the Third-party over the procedure, the legal status of the Third-party, the cost of funding, etc., it is important to clarify and deal with the TPF agreements are the first step towards addressing these issues. Therefore, formulating rules for Third-party autonomous agreements, rather than allowing them to develop independently, is the key for TPF to play an active role in international arbitration.

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