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Issues of Confidentiality and Privilege – Can Third-Party Funding be Regulated?

Abstract

Is the present approach of self-regulation adopted by (certain) Third-Party Funders an acceptable route or should the industry as a whole be regulated? If so, how could this be realized in the borderless world of arbitration? These and other questions will be addressed in connection with practical issues arising in the context of third party funding such as conflicts of interests, disclosures, influence of the funder on conduct of the arbitration and settlements and ethical issues arising for attorneys and their clients, including loss of privilege.

Definition of Third Party Funding

The growing presence of third party funders in international arbitrations has raised a number of new issues for counsel, especially in an international context. The first issue is to clarify what exactly Third Party Funding encompasses. I will apply the following definition:

- Third Party Funding is as a non-recourse investment commitment by a Funder in exchange for a success fee. The success fee can be paid in any form, e.g. a multiple of the funding, a percentage of the proceeds, a fixed amount or a combination of the above.
- The Funder is a party different from the party to the dispute, including an after the event (ATE) insurer and a law firm handling the case under a conditional fee agreement (CFA).

The above definition is the one used by the ABA Section of International Law Working Group on Counsel Guideposts on Third Party Funding in International Arbitration. It is wider in scope than the definition used in the 2014 IBA Guidelines on Conflicts of Interest which covers

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funders and insurers who have a “direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration”.

Third party funding can appear in different shapes. For example as a single incident (“one-off”) funding, as loan to a counsel, as repeat funding by a fund raiser, as funding by private equity or an investment fund, as funding by a publicly listed funder, or as funding by an after-the-event insurer. Funders may act directly or via brokers.

**Existing Regulation?**

Third-party funding raises a number of novel issues. This is owed to the entry of funders in the ordinary relationship between counsel and client. Although rules exist that regulate the relationship between client and counsel, rules on the relationship between funder, client and counsel are in short supply. Certain Funders may be subject to statutory control, others to self-imposed codes of conduct and even others to no external governance at all.

The complexity is increased by the fact that in certain jurisdictions third party funding or specific forms of third party funding are either illegal or prohibited. The common law principles of maintenance (support of a third party’s litigation), champerty (litigation support against a share of the proceeds) and barratry (continuing maintenance or champerty) could provide such confines. Third party financing could also fall under usury (interest rate in excess of legal maximum). Certain civil law jurisdiction consider contingency agreements (pactum de quota litis) as illegal.

The International Arbitration Committee of the ABA Section of International Law has established a Working Group aimed to identify the challenges counsel are confronted with in third party funding and to prepare “guideposts” assisting counsel to deal with these. The Working Group recognizes that counsel has the obligation to assure that the client’s interests are at all times best protected and must comply with ethical and professional rules of conduct. Whereas US counsel generally have to comply with ethical rules of their home jurisdiction, counsel in other countries, such as for example Europe, will have to abide to the rules of the host jurisdiction. The aim of the Guideposts is not to impose any new ethical rules but rather create an awareness of issues that could potentially arise.

With third-party funding becoming more and more prevalent in international arbitration, calls for the regulation of Funders and their relationship with counsel and client, are also becoming more and more frequent. The Queen Mary University/White & Case 2015 survey found that the majority of the international arbitration community is of the view that third-party funding should be regulated in some way, and that disclosure of the identity of the third-party funder is appropriate.²

² QUEEN MARY UNIVERSITY OF LONDON, 2015 INTERNATIONAL ARBITRATION SURVEY: IMPROVEMENTS AND INNOVATION IN INTERNATIONAL ARBITRATION 47—48, http://www.arbitration.qmul.ac.uk/docs/164761.pdf (finding that 71% of survey respondents thought third-party funding should be regulated, and that 63% thought disclosure of the identity of the funder should be mandatory).
This paper will address the need for regulation in connection with several practical problems which typically may arise when a Third Party Funder enters the stage and actively (or passively) participates in the various scenes of an arbitration proceedings.

**Liability and Privilege**

Even though counsel will typically not provide any direct advice to the Funder but rather only to its client, counsel could nevertheless be subject to ethical, contractual and tort liabilities. In US it is for example recognized that there is an ethical obligation of truthfulness\(^3\) (which in some aspects may also reaches out to third parties); furthermore, there are common law duties owed by attorneys to non-client third parties which could impose liability in contract and tort.\(^4\)

A problem can occur when information is exchanged with the Third Party Funder in order to provide to the Third Party Funder adequate substance to make an informed business decision about its “investment” into the dispute. The much debated question arises if case information in the hands of the Funder continues to enjoy privilege.

There are a number of common law doctrines which can be taken into consideration preventing discovery of communications between counsel and the Funder. The work-product doctrine, primarily but also the common interest doctrine need to be mentioned in this respect.

Neither the UNCITRAL Model Law on International Commercial Arbitration nor national laws do explicitly address the issue of document disclosure requests nor do they address the issue of privilege.\(^5\) Also most of institutional arbitration rules refrain from providing details in this respect. Depending on the applicable law, different legal privilege regimes might apply and, following, the scope of document production before an arbitral tribunal might be different. Different practical conduct of arbitral tribunals might eventually trigger different obligations and best practices on the part of counsels.

In any event, counsel should obtain the consent of the client before transmitting any information to a Third Party Funder. In case counsel believes that a Funder may be subject to discovery counsel should take reasonable steps to limit the amount of information provided to the Funder.

**Disclosure**

Conflicts of Interest may occur in several situations. The IBA Guidelines on Conflicts of Interest in International Arbitration (“IBA Guidelines”) define commonly accepted situations. In the list below therefor reference is made to the IBA Guidelines:

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\(^3\) **Model Rules of Professional Conduct, Rule 4.1**

\(^4\) **Restatement (Third) of Law Governing Lawyers §51, cmt e**

An arbitrator is affiliated with a Funder (e.g. as a member of its board of directors or as an advisor to the funder). 6

An arbitrator or the arbitrator’s law firm has a recurring relationship with a Funder. 7

An arbitrator acts as an arbitrator in a case funded by a Funder and as counsel in another case, funded by the same Funder. 8

An arbitrator holds shares in Funder that is funding an arbitration before the arbitrator. 9

An arbitrator is repeatedly appointed in cases involving the same Funder. 10

On the basis of the above the question arises to what extent an arbitrator is under the obligation to address that issue. There appears to be room for regulation. In particular for arbitral institutions to address these issues and to address the arbitrator’s disclosure obligation. The trend has been spotted by some:

The ICC’s guidance note on the ICC Rules of Arbitration 2012 expressly acknowledges that arbitrators should consider, for purposes of disclosure, “relationships with any entity having a direct economic interest in the dispute or an obligation to indemnify a party for the award”. 11

On 20 July 2016 the Brazilian arbitral institution CAM-CCBC, based in São Paulo issued a Resolution regarding the disclosure of third party funding. 12

The CETA (Comprehensive Economic and Trade Agreement between Canada and the EU) and the EU’s draft proposal for the investment chapter of the TTIP (Transatlantic Trade and Investment Partnership) contain an obligation to disclose “the name and address of the third party funder”. 13

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6 IBA GUIDELINES ON CONFLICTS OF INTEREST IN INTERNATIONAL ARBITRATION Part I, General Standard 6(b) and Explanation to General Standard 6, p. 14.

7 IBA GUIDELINES ON CONFLICTS OF INTEREST IN INTERNATIONAL ARBITRATION Part I, General Standard 6(b) and Explanation to General Standard 6, p. 14.

8 See “[t]he arbitrator currently represents or advises one of the parties, or an affiliate of one of the parties”. IBA Guidelines, Part II, Waivable Red List, par. 2.3.1.

9 See “The arbitrator holds shares, either directly or indirectly, in one of the parties, or an affiliate of one of the parties, this party or an affiliate being privately held”. IBA Guidelines, Part II, Waivable Red List, par. 2.2.1.

10 IBA Guidelines, Part II, Practical Application of the General Standards, p. 18 and Orange List, par. 3.1.3 (“The arbitrator has, within the past three years, been appointed as arbitrator on two or more occasions by one of the parties, or an affiliate of one of the parties”).


Investor-State tribunals have also ordered claimants to disclose whether they are being financed by third-party funders and the details of their funder on the basis of concerns regarding potential conflicts of interest. Cases reported are Sehil v. Turkmenistan, South American Silver v. Bolivia, Eurogas v. Slovakia and Corona Materials v. Dominican Republic.

**Conduct of the Arbitration and Settlement**

Much will depend on the Funder itself. If a Funder tends to intervene in the proceedings more issues will arise than with a Funder who opts not to get involved after the strategy and case theory is settled. Typically, a Funder will receive regular reports as to the case progress and in particular, if something unexpected happens or budget adjustments have to be made.

A situation where conflicts are most likely to arise is a (potential) settlement. Here, interest between client and Funder are often diverse. The client’s interest may be drive by pure numbers but often also other (non-monetary) circumstances such as the interest in a continued business relationship with the opponent or on the contrary a desire to fully defeat its opponent. Also, if the costs approved by the Funder pass the agreed limit and the client must self-fund, the client’s interest in the arbitration may change. On the other hand, the Funder will typically look at the return of its investment and may even introduce language in the funding agreement requiring its direct or indirect approval to a settlement. Early in the proceedings, it may be in the Funder’s interests to accept a settlement. At that point in time, the Funder has not spent too much in terms of costs. At a later stage, however, the Funder may not wish to have a settlement. Because at that point in time, the Funder has already paid significant amounts and will try to recover significantly more if it considers its client will ultimately succeed. On the contrary, the client may have a different view, expecting to have its “day in court” on the basis of the funding.

So how to avoid these apparent conflicts? One way is addressing them at the outset and dealing with these in the funding agreement. There, the Funder and its client agree upon to the settlement amount the client will accept at various stages of the proceedings.

Another way is to rely on the self-regulation of certain funders. For example, the Code of Conduct for Litigation Funders who are Members of the Association of Litigation Funders of England & Wales set out that for funding (in within England and Wales) stipulates that if the Funder and the client cannot agree on a settlement a neutral third party should render a binding opinion.

Beyond that, there is only the call for regulation which could arise if the Funders (or black sheep among them) should overstretch their influence on the arbitration. Fortunately, there is no record that such a situation has occurred and it remains to be hoped there never will be. Nevertheless, the door to the debate on national laws (e.g. in Hong Kong and Singapore) and an international code of conduct has already been opened and we will no doubt soon see more rules evolving.