

## Third Party Funding (TPF) in litigation – at what cost to the non-funded party?



Gilles Thieffry  
Founding partner at GTLaw

🕒 2 December 2015    💬 [Add comment](#)



Photo: Fotolia

*GTLaw has won a major arbitration victory for an international oil-trading house. The arbitration was brought against the trading house in accordance with UNCITRAL Arbitration Rules before an extremely seasoned and highly-regarded arbitral panel for alleged breach of an oil supply and processing contract. The damages claimed were well in excess of \$100 million. The insolvent Claimant was funded by third-party funders and represented by a major international law firm specialised in litigation. The Respondent trading house, represented by GTLaw, obtained an order for interim relief granting disclosure of the third party funding agreement as well as security for costs. A final order was obtained in April of this year whereby the trading house was successful*

*on all matters and awarded all costs and fees.*

As the debate intensifies over the role of third-party funders (TPFs) in international arbitration, this ad hoc arbitration governed by UNCITRAL Arbitration Rules helps serve to remind us that frivolous ‘hit and run’ arbitrations continue to exist. For better or worse, TPF is an undeniable force that is here to stay. The scope of TPF has expanded and the world’s largest funders use sophisticated marketing strategies to gain market share. These PR campaigns aggressively seek to attract both the legal and financial communities. TPF firms are also recruiting talented lawyers with promises of higher remuneration than the law firms can compete with.

It is without doubt that the TPF industry does serve an important role providing access to justice to those with legitimate claims that would otherwise be unable to fund an action on their own. However, the TPFs do not only fund the unjustly wronged. With an increasing number of TPFs entering the market, there is not only an increasing risk of frivolous claims but the injection of funding undoubtedly drives up the costs of the funded arbitrations (keeping in mind that TPFs are investors seeking high returns).

The need for regulation is a highly debated subject. At present, there are no mandatory regulations governing TPFs involved in international arbitration. The TPFs argue that even without regulation, there is a built in safety mechanism as the funders carry out extensive due diligence and, based on an exacting selection process, only accept a small fraction of the would-be claims requesting funding. However, the TPF industry is not completely risk adverse and experience has shown that TPFs will take on the underdog cases along with the sure winners.

An injection of funds can make the weak case suddenly appear much stronger and the industry has been successful in cleverly convincing the legal community that the only cases chosen for funding are those with merit (whereas one could well imagine balanced risk portfolios where more risky but higher return cases would sit alongside less risky but less profitable cases).

Does the mere presence of a TPF change the perception of a claim? In a recent survey conducted by Burford Capital, a leading TPF with \$500 million of assets under management, Burford states that 79% of clients that used litigation funding made the opposition aware they were using third party litigation funding. The reasons cited included that their clients used it as a sign of strength, they wanted the opposition aware that they were sufficiently well capitalised to fund the case and they wanted the opposition to be aware that the merits of the case had been validated by a TPF.

GTLaw has witnessed first-hand that TPFs sometimes gamble on the wrong player. In the recent arbitration at hand, if a serious due diligence had been conducted by the TPF, it would have uncovered that the Claimant was managed by convicted felons for crimes committed in the same industry. It would also have uncovered that the Claimant had been insolvent at the time of the execution of the contract that gave rise to the dispute (a fact Claimant failed to disclose to Respondent) and was unable to financially carry out the obligations it fraudulently promised to carry out under the agreement between the parties. And yet, one of the TPFs agreed to fund this arbitration; however, not before tagging on a highly-inflated price tag that bore absolutely no reality to any possible merits or claims. Nonetheless, the arbitration went forward and after three years GTLaw's client finally prevailed – but at what cost? Not only was the trading house forced to expend large sums of money, the over-exhaustive document production requests, which can only be described as fishing expeditions, drained the resources of this trading house and at times significantly slowed down actual work to a near standstill.

One can only hope that examples like this are few and far between but what can be done if faced with a speculative arbitration funded by a TPF and, in particular, an insolvent Claimant?

The first step is to conduct your own due diligence. In this example, the use of private investigators was a small investment well spent. The investigators uncovered a story of criminal activity and a web of offshore companies used to hide the identity of the criminals and masterminds behind the speculative arbitration. It was also discovered that the Claimant had a Winding-Up Petition and had fraudulently misrepresented its financial status to the Respondent.

The second step is to immediately seek disclosure of the third-party funding arrangement if TPF is suspected. A party should ideally have the right to know the identity of the real parties behind the arbitration. A recent published award reiterates this tribunal's order for disclosure of the TPF and funding arrangement based on "the importance of ensuring the integrity of the proceedings and to determine whether any of the arbitrators are affected by the existence of the third party funder", and the fact that the Respondent indicated that it would be making an application for security for costs. The Tribunal was "sympathetic to Respondent's concern that if it is successful in this arbitration and a costs order is made in its favour, Claimants will be unable to meet these costs and the third-party funder will have disappeared as it is not a party to this arbitration."

The third step is a request for interim measures. Interim measures help safeguard the rights of the parties prior to the final outcome of the arbitration. Article 26 Interim Measures of the UNCITRAL Arbitration Rules (as revised in 2010) gives power to the arbitral tribunal to grant interim measures if requested by a party. Article 26(3) provides the conditions or standards the requesting party must establish. When faced with an insolvent Claimant funded by a TPF who is not a party to the arbitration, it is wise to request security for costs.

In general, the granting of security for costs are generally not favoured; however, "one factor that some tribunals have found that justifies ordering security to be posted is insolvency or, as sometimes stated, financial incapability and that "remedies are warranted where there are additional compelling circumstances....where

the claimant's arbitration fees and expenses are being covered by a related entity or individual who stands to gain if the claimant wins, but would not be liable to meet any award of costs that might be made against the claimant if it lost".

In this arbitration, the tribunal did find compelling grounds to grant security for costs. Although the tribunal stated that the granting of security for costs are viewed in general with disfavour, particularly where such an imposition would entail a compression of the right of access to justice because of a claimant party's inability to provide security for an adverse costs award. They cited two exceptions when security for costs may be granted:

1. Where the claims are obviously vexatious or unmeritorious, or
2. The impecuniousness invoked in support of the request for security has been induced fraudulently in order to avoid the consequences of a negative outcome of the proceedings.

The Tribunal further noted that although the Claimant was insolvent and would, by itself, presumably be unable to provide security for costs, the situation as noted by commentators is different in the presence of third party funding.

In this particular example, an award for security of costs was ordered by the Tribunal in favour of the Respondent because there was a possibility that the Respondent would be entitled to recover the costs of the arbitration and there was a risk that the Respondent would be unable to recover such costs, whilst other parties may obtain the full benefit of a favourable award on the merits for the Claimant. The presence of a TPF, with an interest in funding the litigation and presumably in providing security, offsets the potential prejudice to the Claimant's ability to prosecute its claims in arbitration.

However, even with the award granted in favour of the Respondent, the fact remained that the Claimant still had no assets and no ability to obtain security. And further, since the TPF was not a party to the arbitration and therefore the tribunal's award was not binding or enforceable against the TPF, other arrangements had to be worked out between the parties.

On the Claimant's side in a TPF-funded arbitration it is often the case that they have secured adverse cost coverage from an independent insurance provider that would be able to satisfy any reasonable costs in favour of the Respondent. In this arbitration, the tribunal ordered disclosure of such coverage.

The parties agreed to allow for the assignment of an adverse cost-cover portfolio insurance policy, which further granted the Respondent to claim policy proceeds directly from the insurer. This was a workable solution in theory, but the policy was limited to a fraction of the actual costs and expenses awarded at the end of the arbitration in favour of the Respondent. This meant that the Respondent regardless of its efforts lost substantial sums as a result of this frivolous action that would not have been brought forward but for the TPF. To add insult to injury, the TPF who was obligated under the assignment to indemnify Respondent and do all things reasonably required at any time in connection with the Policy stalled the payment procedure and initially failed to respond to any of Respondent's requests for assistance, which required the Respondent to make even further expenditures after the arbitration award in its favour.

The assigned insurance policy contained an express fraud clause, as do most policies. Another potential issue that could have arisen is that the insurance company could have refused to pay out on the grounds of the same fraud that voided the contract between the parties.

In conclusion, speculative arbitration funded by TPFs exists and TPF funding clearly puts the unfunded party at a disadvantage. Unfortunately, there is no concrete way to determine with any accuracy whether this example was one of a few isolated arbitrations or whether the trend is increasing. What is clear is that arbitral tribunals have no power to order the TPF in a funded arbitration to satisfy a cost award, as the TPF is not a party to the arbitration. The TPF stands to gain if the Claimant is victorious and risks nothing if they are not. This has to be

rebalanced.

In any event, readers when faced by a claim they believe is either frivolous or vexatious should follow this basic guidance:

1. Don't be intimidated. Even if TPF funded and the law firm instructed by a Claimant has a high international-litigation profile, it does not necessarily mean that the case is solid. In other words do not give in to what is in essence 'legalised black-mail/intimidation'.
2. Instruct lawyers who know the field and who can think laterally. It may not be necessary or even wise in certain claims to flock to expensive large law firms. In fact, many of the best and brightest arbitration specialists are now in smaller firms to avoid unnecessary conflicts with other departments in the larger firms. A plethoric team is no substitute to solid legal reasoning and strategy. As you may not be able to recover all your costs go for the best cost/return option rather than be blinded by labels.
3. Check as much as possible the background of the party opposite, not merely what you were aware of when entering in a contract.

#### POST A COMMENT

POST COMMENT

[CONTACT US](#)   [ABOUT US](#)   [MEET OUR TEAM](#)   [PRIVACY](#)   [DISCLAIMER](#)  
[COOKIE PRIVACY](#)

Copyright © 2015 TXF Limited.

TXF and the TXF; Trade and Export Finance logo are registered and owned by TXF Limited, a company registered in England and Wales with company number 08421624.