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Issues of Third Party Financing in International Commercial Arbitration

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Annotation: This article evaluates and examines the advantages and disadvantages of third-party financing in international commercial arbitration. It also examines different approaches to third-party funding in prestigious jurisdictions.

Keywords: international commercial arbitration, third-party financing, arbitration costs, confidentiality, arbitration court.

Introduction

International commercial arbitration has grown significantly in recent decades, establishing itself as one of the most effective and preferred methods of resolving disputes in international relations. At the same time, as arbitration has grown in popularity, its proceedings have become longer and more expensive. The costs of arbitration proceedings often become a significant obstacle for the parties, necessitating the search for alternative funding mechanisms, such as third-party funding.

Third-party funding in the context of international commercial arbitration is a practice whereby a third party provides financial assistance to one of the parties to a dispute to cover the costs of the arbitration in exchange for a share of the possible reward from a successful outcome of the case. This practice has developed significantly in recent years and has attracted wide interest from both legal practice and academic research. However, despite its positive aspects, third-party funding raises many legal and ethical issues, such as possible conflicts of interest, the threat of loss of confidentiality, and potential risks to the independence of the arbitration proceedings.

In this context, the article analyzes the advantages and disadvantages of third-party funding in international commercial arbitration. Particular attention is paid to the problems associated with its application in different jurisdictions, as well as the possible consequences for the participants in the arbitration process, including the impact on the decision-making process of arbitrators and potential changes in dispute resolution practices.

Methods

In order to conduct a comprehensive analysis of third-party funding in international commercial arbitration, this paper uses various methods of legal research, including comparative, analytical and empirical approaches. This method allows us to study the legal norms governing third-party funding in different jurisdictions. The study examines legislative initiatives and judicial practices of countries such as the UK, the USA and the EU, as well as the specifics of using third-party funding in arbitrations conducted under the rules of leading arbitration institutions (e.g., ICC, LCIA, SIAC). Comparative analysis allows us to identify common trends and differences in the legal regulation of this institution.

This method analyses the theoretical aspects of third-party funding, including its legal basis, potential risks and benefits for the parties to the arbitration process. Particular attention is paid to legal and ethical issues, such as the impact of third-party funding on the independence of arbitrators, potential conflicts of interest and issues with confidentiality of information. To conduct the empirical analysis, specific examples of the use of third-party funding in real arbitrations were examined. This includes an

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examination of arbitration cases in which third-party funding played a key role, as well as an analysis of published reports and statistics on the use of funding in arbitration proceedings.

Results

A study of third-party funding in international commercial arbitration has shown that this institution has a significant impact on the development of arbitration practice and the legal environment. One of the key findings is that third-party funding primarily helps ensure access to justice for the parties, especially in cases where one of the parties does not have sufficient financial resources to conduct arbitration proceedings. This makes it possible to increase the efficiency of arbitration procedures and improve the balance of interests of the parties.

The study also found that third-party funding raises a number of legal and ethical concerns, including potential conflicts of interest and the impact of funding on the independence of arbitrators. While disclosure requirements for third-party funding have been tightened in most jurisdictions, the issue of ensuring transparency and preventing abuse in this area remains relevant.

It was also found that in some cases third-party funding can lead to an increase in the duration of arbitration and its cost. This is due to the need for complex legal development of the terms of funding and financial risk management, which requires additional time and resources.

Overall, the findings support the need for further legal regulation of third-party funding to ensure fairness, transparency and ethics in arbitration proceedings.

Discussion

Over the past twenty years, international commercial arbitration has grown significantly, establishing itself as the preferred method of dispute resolution in international relations. In fact, over time, arbitration proceedings have become lengthy and expensive. The costs of arbitration have matched its widespread appeal and have become prohibitive. As a “low-key method of resolution,” these costs are intended to be entirely hidden by the parties. In this context, third-party funding refers to another method of funding. Broadly speaking, third-party funding means that an outside entity offers monetary assistance to the claimant to cover legal or arbitration costs. Thus, it is not a new phenomenon and has historically emerged in a variety of ways, including insurance contracts, legal financing agreements, or loans from banks and other financial institutions. However, a new funding option has emerged in which a third party covers, either in full or in part, the costs of the arbitration in exchange for a share of the profits. A significant proportion of claimants in international arbitrations either use third-party funding (TPF) or are considering it **[1].** Sponsors usually require a settlement fee as a return on their investment **[2] .** Typically this proportion fluctuates between 15% and 50% of the result.

According to data released by the International Centre for Settlement of Investment Disputes (ICSID) in connection with a proposal to amend the rules on dispute funding, at least 20% of cases are funded by TPF. According to information provided by one of the market participants, about 60% of claimants allow for the option of third-party dispute funding before filing a claim [**3].**

In this configuration, if the funded organization is successful, the funder receives a share of the award or settlement proceeds. On the other hand, if the outcome is unfavorable, the funder loses its initial capital and cannot recover its funding from the funded party. Third-party funding has acquired a significant role in international arbitration, providing financial support to parties who may otherwise lack the means to pursue or defend a claim [**4]** . By enabling claimants to achieve arbitration, third-party financial support represents a positive advance in access to justice and should therefore be welcomed. However, its vocal critics continually highlight the dangers and disadvantages that the risks entail.

Hong Kong defines third party funding (TPF) as “an offer of funding by a third party included in the terms of the relevant agreement in exchange for financial benefits in the event of a successful resolution of the case” **[5].** In Singapore, the law contains rather strict criteria for classifying an investor as belonging to this category. The legislator understands a third party funder as an

organization whose main activity is the provision of funds for dispute resolution **[6]** . The main place of such activity can be either Singapore or any other country. In addition, the law determines the amount of third party capital **[7].** In Germany, investors are considered part of the legal team and are free to express their ideas regarding the strategy and tactics of the dispute **[8].** By virtue of Art. 38(1) of the Arbitration Rules of the China International Economic and Arbitration Commission, hearings must be held in camera by default, and although the parties may request an open hearing, the final decision rests with the arbitrators **[9].** In Art. 26(3) of the Arbitration Rules of the International Chamber of Commerce, which states that "no person not participating in the proceedings shall be admitted to the hearing without the consent of the arbitral tribunal and the parties" [**10]** . In the United States, the presence of a funder at a hearing is permitted only with the mutual consent of the parties **[11].** Brazilian procedural law does not recognize TPF as an active participant in dispute resolution and prohibits its direct intervention.

In the case of arbitration, even greater investments are expected from the parties involved, as they not only cover the general costs but also the arbitrators' fees and other burdensome expenses. These costs may thus create a financial barrier and act as a catalyst, exacerbating the difficulties of access to arbitration. In this regard, third-party financial support provides a financial opportunity that benefits both categories of potential claimants.

Despite the differences in the approaches indicated, it is possible to identify common key features that are reflected in one way or another in all definitions. These features were identified in a report prepared by a joint working group of the International Council for Commercial Arbitration and Queen Mary University of London [**12]** :

- the funding entity or organization is not a party to the dispute;
- funding or other material support is offered;
- compensation depends on the court's decision .

At one end of the spectrum, third-party financial support can help those who are struggling financially or are marginalized. In effect, when the parties involved in a dispute are on equal footing in terms of their size, the stakes involved, and their access to resources, it creates a level playing field that can occur. Financing options allow smaller firms to compete fairly with their competitors by advocating for affordability. to justice. Sponsors can theoretically influence arbitration proceedings [**13]** .

In general, while some of the potential gains will be disclosed to the sponsor, "it is better for the sponsor to recoup a significant portion of its losses than to recoup absolutely nothing." At the opposite end of the scale, third-party funding can also benefit those with sufficient resources who are looking for another way to fund the arbitration. In fact, those with claims may be reluctant to provide funds to resolve disputes. The outcome of arbitration is completely unpredictable, which makes the parties think twice before starting what could be a protracted battle. The possibility of third-party funding allows outsource the risks and burden to them expenses tied to the claim.

Extended access to justice also has its limitations. In order to fund arbitration, funders must classify it as "suitable". The financiers are not charities and are profit-seeking. Funding will only be provided if the case likely to produce astonishing results. Therefore, the statement must be of a certain caliber and commercial interest, and also be optimistic about the expected results. On the contrary, it is unlikely that the sponsor will invest in this.

Investors typically include experienced litigators and lawyers with substantial case management knowledge and experience on their team. As a result, funders are well equipped not only to offer outside legal counsel, specialists or arbitrators, but also to offer strategic guidance and a second opinion on a specific case. This can benefit the party receiving the funding and its team.

Confidentiality is a fundamental element of international commercial arbitration. With few exceptions, materials and information obtained during the arbitration proceedings are private and therefore must not be disclosed. The claimant, when presenting his/her the case to the potential sponsor, puts

confidentiality is at risk, potentially leading to a breach. In fact, before funding is provided, an experienced third-party funder team regularly conducts a comprehensive assessment of the case to determine whether it should be funded or not. This the team doesn't just look at the elements related to a statement (e.g. chance of success; amount) but further explores the elements regarding the arbitration itself (e.g. the arbitration agreement; the venue; the structure of the arbitration panel; the relevant laws; the jurisdiction in which the award is made) be implemented; probable terms of arbitration). If the financing agreement achieved, the next phase begins - the case supervision phase - during which the sponsor is kept informed of the progress of the case. Funding body is considered a non-signatory to the arbitration agreement. As a result, it is not subject to confidentiality, even if it is relevant, since such. When presenting the situation to a financial sponsor - before or after arbitration initiated - the plaintiff faces the risk of breach of his duties. This can lead to catastrophic consequences for an unfunded party as the sponsor may obtain information concerning them and use it against them in a separate case involving them. On the other hand, disclosure of information about the existence and details of funding arrangements may also result in strategic disadvantages for the funded party **[14].**

The need for independence and impartiality of arbitrators is recognized worldwide and is included in all institutional rules. These rules require arbitrators to disclose “all information which could reasonably be considered grounds for “disqualification”.

In the current state of affairs, the funded party is not required to disclose the fact of funding, as no rule expressly requires it. However, the presence of a sponsor may expose the arbitrator to a conflict of interest, which may jeopardize the effectiveness of the arbitration. Various situations may arise, such as, but not limited to, the following cases:

1. An arbitrator selected multiple times by the same financial sponsor may have a conflict of interest. This echoes the orange list in the IBA Conflict of Interest Guidelines, which refers to “previous service of arbitrators to a party or other involvement in the case.” Arbitrators may potentially have some connection to the sponsor’s finances. An arbitrator who is a shareholder in a publicly traded external funding company may have a conflict of interest. Similarly, an arbitrator who is a significant shareholder or director of a funding company is also likely to have a conflict of interest.

2. Third party funding carries significant risks to the effectiveness of arbitration. A conflict of interest poses a risk to the proper composition of the arbitration panel, as it may lead to a challenge to the arbitrator due to a perceived lack of independence or neutrality. Such a situation will complicate the arbitration process, resulting in unnecessary delays and increased costs. Furthermore, if a conflict of interest is only identified after the final award has been made, it may be potentially unenforceable or unrecognized under Article V (2) of the New York Convention. Before entering into a funding agreement, there will be discussions between the funder and the claimant regarding the terms. Due to its monetary benefits, the funder has significant leverage. Thus, a financial funder can use its authority to impose unfair terms on its contractual partner (e.g. imposing a disproportionate share). Funders’ remuneration is contingent on the success of the claim, which may lead to the temptation to defend their views throughout the process. There may be significant conflicts regarding the strategic methods used or, as specified below, regarding the settlement. Another risk faced by parties benefiting from third party funding is the provision of cost coverage, which, even if unsuccessful, may increase the costs of litigation [**15].**

Unlike state courts, arbitration courts do not have discretionary power to hold third parties liable for costs. However, the case reinforces the prevailing view among funders about oversight and the ongoing debate about regulation of the topic, as well as the importance of strong automatic regulation.

By facilitating access to justice, third-party funding can lead to an influx of minor claims. Funding can motivate parties to bring lawsuits—even meritless ones—in situations that would otherwise remain unresolved. Funders are more likely to act as gatekeepers, sifting through minor claims rather than advancing them.

It can be argued that third-party funding discourages settlements because the funded party does not bear the financial risk of an unsuccessful outcome and thus suffers a loss, removing its incentive to

settle. However, experience tends to show that the opposite is probably true. Funders may therefore prefer a quicker – and more certain – resolution to a lengthy and uncertain outcome. This is reinforced by the reality that financiers also bear the risk of non-implementation of the award. Consequently, settlements are more likely to be encouraged rather than discouraged when funding is provided. Importantly, a "quick resolution" may be in stark contrast to the claimant's idea of a "good resolution." Funding agreements therefore sometimes specify who has the ultimate authority over the agreements.

The arbitral tribunal must exercise its discretion in determining whether to grant security for costs. To date, there is no standardized criterion. Tribunals tend to use their discretion with caution and deliberation, to consider the financial position of the party opposing the measure sought. If the party is expected to face financial difficulties and is unlikely to meet the potential costs award, the request for an order should be approved. In these situations, the onus should be on the party seeking the measure to provide evidence.

The availability of external funding in these cases has generated interest, particularly as to whether the tribunal should 'routinely' grant security for costs when the claimant receives funding. The traditional situation supporting this assertion is that the financially constrained party enters into a funding agreement which stipulates that the funder will not be liable for negative costs. In this scenario, it seems highly unlikely that this organization would be able to settle the costs awarded by guaranteeing the costs to be ordered. It has therefore been argued that in order to preserve the defendant's rights, the very existence of the sponsor must justify the request for security for costs. This view has led to a wave of criticism. There is no doubt that third-party financial support is not the exclusive goal of individuals in financial difficulties, but is also often requested by financially stable entities seeking a financing option.

Once the arbitral tribunal has considered the substantive issues, it must consider the issue of costs. First, it must decide whether or not to award costs. It must then determine how to allocate them. Various institutional rules state that "costs should follow the event" unless the circumstances suggest that this is inappropriate. In this context, there has been considerable debate as to whether the mere availability of external funding should be taken into account in determining costs. However, even if the case under consideration has a high probability of success, sponsors may refrain from making a proposal [**14].**

Driven by profit maximization, the industry has evolved over time, moving to "financing" in less than a decade. This evolution has been accompanied by the diversity and complexity of the products provided by sponsors. As the market has grown, sponsors have become less enthusiastic about individual investments and more willing to "bundle claims." In this way, the sponsor spreads funds across multiple claims belonging to the same entity, combining them into a single "portfolio" or "basket." Independent claims with significant risks may be considered too risky and unpredictable for investors. Portfolios allow them to balance high-risk claims with low-risk claims where liability is clear. To spread the risks, each portfolio will consist of different claims with varying degrees of risk. This allows the financier to more easily absorb losses. However, it also leads to more complex instruments. In fact, hidden products may emerge, leading to the development of products close to credit default swaps, which led to the collapse of Lehman in the not-so-distant past. Brothers and the Collapse of the Global Economy.

Although third party financing opens the door for parties to resort to arbitration in cases where when they would otherwise have no legal recourse, and may be really useful for some applicants, it is important to know potential disadvantages of financing by third parties. Before approaching a third party for financing, parties should consider the following: factors such as ethical issues, conflicts of interest, disclosure issues, difficulties in obtaining funding, consequences, costs, implications for dispute resolution and regulatory uncertainty. However, in the case of third-party financing of investor-state dispute resolution, excessive TPF involvement may create additional barriers **[16].**

Conclusion

The study found that effective dispute resolution in international trade is an important element for ensuring stability and predictability in the global marketplace. Legal mechanisms such as arbitration and mediation play a key role in resolving conflicts between parties, providing a more flexible and faster dispute resolution process than traditional court procedures.

The analysis found that arbitration and mediation procedures offer a number of advantages, including confidentiality, the ability to choose arbitrators, and compliance with specific conditions that may be more suitable for parties involved in international trade. However, there are a number of challenges, such as differences in national legal systems, which may create obstacles to the uniform application of decisions.

Based on the analysis conducted, it can be concluded that there is a need to further improve international legal mechanisms for dispute resolution, taking into account the globalization of trade and the growth of transnational commercial relations. Strengthening cooperation between states and international organizations in the field of legal regulation of disputes contributes to the creation of a more stable and fair legal environment for participants in international trade.

Thus, for the effective functioning of international trade, it is important not only to develop harmonized legal norms, but also to ensure the availability of dispute resolution mechanisms that will help protect the rights and interests of all participants in trade transactions.

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