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SYMPOSIUM ON GLOBAL LABS OF INTERNATIONAL COMMERCIAL DISPUTE RESOLUTION

GLOBAL LABORATORIES OF THIRD-PARTY FUNDING REGULATION

*Victoria Shannon Sabani**

Third-party funding, also known as “dispute finance,” is a controversial, dynamic, and evolving arrangement whereby an outside entity (“the funder”) finances the legal representation of a party involved in litigation or arbitration, whether domestically or internationally, on a non-recourse basis, meaning that the funder is not entitled to receive any money from the funded party if the case is unsuccessful.¹ It has been documented in more than sixty countries on six continents worldwide—including in many of the jurisdictions highlighted in this symposium that are experimenting with other aspects of international commercial dispute resolution. Indeed, funding greases the wheels of this experimentation. The true prevalence of third-party funding is likely far greater than we know since disclosure is not presently mandated everywhere.² This essay argues that the three biggest global regulatory issues with respect to dispute finance are disclosure, definition, and delegation of oversight and that the global laboratories of dispute finance remain firmly within the control of the private sector with the public regulators continuously struggling to understand and address new developments in the industry. An apt analogy would be that the dispute financiers are driving cars and building spaceships with respect to their innovative financing arrangements, while many of the regulators are aiming their sights at the classic “horse-and-buggy” third-party funding arrangements that are rapidly falling out of use.

Disclosure

The biggest issue with respect to regulating dispute finance that global regulators have begun to address is disclosure.³ Jurisdictions that regulate disclosure of dispute finance often do so through statutes, case law, attorney ethics opinions, ordinary loan regulations, treaties, or other methods.⁴ Moreover, a handful of arbitral institutions and investment treaties have directly addressed or will soon address the disclosure of dispute finance.

The reason for disclosure regulations is that legislatures, arbitral tribunals, and judges need to know about the prevalence of dispute finance to effectively develop comprehensive regulations for the industry. Views range widely regarding whether dispute finance is beneficial or detrimental to the administration of justice, including

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¹ See LISA BENCH NIEUWVELD & VICTORIA SHANNON SAHANI, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION ch. 1 & 2 (2d ed., 2017).

² See generally *id.* (examining the laws on third-party funding in more than sixty countries).

³ See generally The ICCA Reports No. 4: ICCA Queen Mary Task Force Report on Third-Party Funding in International Arbitration ch. 4, ICCA [hereinafter ICCA Report].

⁴ See generally Victoria Sahani, *Harmonizing Third-Party Litigation Funding Regulation*, 36 CARDOZO L. REV. 861 (2015).

concerns about the legitimacy of a process funded through champerty and maintenance (which used to be a crime in many jurisdictions and is still a crime in some),⁵ control over the party's legal counsel,⁶ and conflicts of interest, particularly among arbitrators who also serve as legal counsel, a phenomenon known as "double hatting" in the international arbitration world.⁷

The industry has its hand not only in international commercial arbitration cases, but also investor-state dispute settlement and related litigation.⁸ With respect to arbitration rules, a growing number of institutions have chosen to adopt rules requiring disclosure of third-party funding. For example, Article 27 of the China International Economic and Trade Arbitration Commission (CIETAC) 2017 International Investment Arbitration Rules (For Trial Implementation) (CIETAC Investment Rules) requires the funded party to notify the tribunal and other parties regarding the existence of a funding agreement and to reveal the identity and contact information of the funder.⁹ In addition, Article 44 of the Hong Kong International Arbitration Centre (HKIAC) Administered Arbitration Rules (HKIAC Rules) requires parties to disclose any commencement, change or termination of the involvement of a third-party funder in the case, including disclosing the funding agreement.¹⁰ Moreover, Rules 24, 33 and 35 of the Singapore International Arbitration Centre (SIAC) 2017 Investment Arbitration Rules (SIAC Investment Rules) require the disclosure of the identity of the third-party funder, and where appropriate, its interest in the outcome of the arbitration as well as whether or not it has committed to cover adverse costs.¹¹ Furthermore, the forthcoming 2021 International Chamber of Commerce (ICC) Rules of Arbitration (ICC Rules) will include the new Article 11.7 requiring disclosure "of the existence and identity of any non-party which has entered into an arrangement for the funding of claims or defences and under which it has an economic interest in the outcome of the arbitration."¹² The ICC also publishes and frequently updates its Note to Parties and Arbitral Tribunals on the Conduct of the Arbitration (ICC Practice Note) which requires that arbitrators disclose connections with "any entity having a direct economic interest in the dispute or an obligation to indemnify a party for the award" in Paragraph 28, which would include third-party funders as well as other similarly involved entities.¹³ Finally, the Arbitration and Mediation Center of the Brazil-Canada Chamber of Commerce (CAM-CCBC) Rules do not refer to dispute finance expressly,¹⁴ so in order to clarify its practices, CAM-CCBC promulgated an administrative resolution entitled "AR 18/2016 - Recommendations regarding the existence of third-party funding in arbitrations administered by CAM-CCBC" (Administrative Resolution) on July 20, 2016.¹⁵ The Administrative Resolution defines dispute finance, requires an arbitrator to disclose a potential conflict due to a past or current

⁵ See e.g., Jern-Fei Ng, *The Role of the Doctrines of Champerty and Maintenance in Arbitration*, 76 ARB. 208 (2010).

⁶ See e.g., Am. Bar Ass'n Comm'n on Ethics 20/20, *Informational Report to the House of Delegates* (2012).

⁷ See, e.g., Dennis H. Hranitzky & Eduardo Silva Romero, *The 'Double Hat' Debate in International Arbitration: Should Advocates and Arbitrators Be in Separate Bars?*, N.Y. L.J. (June 14, 2010).

⁸ See, e.g., Victoria Sahani et al., *Third-Party Financing in Investment Arbitration*, in CONTEMPORARY AND EMERGING ISSUES ON THE LAW OF DAMAGES AND VALUATION IN INTERNATIONAL INVESTMENT ARBITRATION (Christina Beharry ed., 2018).

⁹ See *China International Economic and Trade Arbitration Commission International Investment Arbitration Rules (For Trial Implementation)* art. 27 (Sept. 12, 2017).

¹⁰ See *Hong Kong International Arbitration Centre Administered Arbitration Rules* art. 44 (2010).

¹¹ See *2017 Singapore International Arbitration Centre Investment Arbitration Rules* (2017).

¹² See *International Chamber of Commerce Rules of Arbitration* (2017).

¹³ See Int'l Chamber of Commerce, *Note to Parties and Arbitral Tribunals on the Conduct of the Arbitration*.

¹⁴ See *The Arbitration and Mediation Center of the Brazil-Canada Chamber of Commerce Rules* (2012).

¹⁵ See Ctr. for Arb. & Med., *AR 18/2016 – Recommendations Regarding the Existence of Third-Party Funding in Arbitrations Administered by CAM-CCBC* (2016).

interaction with a third-party funder as early as possible, and requires funded parties to notify CAM-CCBC of the existence and details of their funding arrangement and the funder's identity at the earliest opportunity.

In investment treaty arbitration, the International Centre for Settlement of Investment Disputes (ICSID) is in the process of revising its 2006 rules.¹⁶ The proposed revisions, if adopted, would require disclosure of dispute finance, and underscore the tribunal's power to order more extensive disclosure regarding the dispute financing arrangement when making costs orders. Relatedly, there are already a few investment treaties that require disclosure of dispute finance and mention the tribunal's power to consider funding when allocating costs, including the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union,¹⁷ the EU-Vietnam Investment Protection Agreement, ratified in summer 2020;¹⁸ and the proposed European Commission Draft of the Transatlantic Trade and Investment Partnership (T-TIP),¹⁹ which remains only a draft.

The United Nations Commission on International Trade Law (UNCITRAL) Working Group III on Investor-State Dispute Settlement (ISDS) Reform is examining various reform options, including regulating third-party funding, and hosted an expert group meeting in fall 2020, in which the Author participated, to assist the UNCITRAL Secretariat with the preparation of draft provisions on third-party funding for consideration by Working Group III.²⁰

All in all, what used to be referred to as a "secret and shadowy" industry is being thrust into the light in a variety of jurisdictions, and the first beam shone upon the industry has been the disclosure mandate.

Definition

The difficulty in defining dispute finance presents one of the biggest hurdles to effective regulation of the industry.²¹ Many definitions of third-party finance promulgated by regulators encompass contingency fee arrangements, insurance, traditionally-structured loans, and parent corporations financing subsidiary legal costs, even though those arrangements are not the main target of this regulation. The alternative is a definition of dispute finance that excludes such arrangements, but would then incentivize funders to create transaction structures that fall within the exclusions to exempt themselves from regulation. As a result, every effort at regulating dispute financing must choose between being overinclusive or underinclusive; there is no ideal definition.

A nascent, but confounding innovation is that a small but growing number of jurisdictions are allowing non-lawyers—including dispute financiers—to invest in and own law firms. For example, England and Wales has a well-developed dispute finance market and has allowed non-lawyer ownership of law firms through Alternative Business Structures since 2013.²² More recently, the Arizona Supreme Court abolished the Rule 5.4 prohibition on non-lawyer ownership of law firms and fee sharing as of January 2021,²³ and California and Utah are entertaining

¹⁶ See Amendments, Int'l Ctr. for Settlement of Invest. Disp.

¹⁷ See Comprehensive Economic and Trade Agreement, chapter 8, arts. 8.1 and 8.26.

¹⁸ See EU-Vietnam Investment Protection Agreement, ch. 3, sec. B, sub-sec. 1, art. 3.28(i); ch. 3, sec. B, sub-sec. 1, art. 3.37; ch. 3, sec. B, sub-sec. 5, art. 3.54(7). See also Vietnam ratifies free trade deal with EU, REUTERS (June 8, 2020).

¹⁹ See European Commission Draft of the Transatlantic Trade and Investment Partnership (draft), ch. II – Investment, sec. 3, sub-sec. 1, art. 1; ch. II – Investment, sec. 3, sub-sec. 3, art. 8.

²⁰ See UN Commission on International Trade Law Working Group III on Investor-State Dispute Settlement Reform.

²¹ See generally, ICCA Report, *supra* note 3, at ch. 3.

²² See Legal Services Act (U.K.).

²³ See e.g., Lyle Morgan, Arizona Approves Nonlawyer Ownership, Nonlawyer Licensees in Access-to-Justice Reforms, ABA J. (Aug. 28, 2020); Anthony Sebok & Bradley Wendel, A Likely Tipping Point For Nonlawyer Ownership Of Law Firms, LAW360 (Sept. 25, 2020).

similar proposals.²⁴ These changes would allow direct, non-lawyer, equity investment in law firms—an opportunity that funders may find attractive. Nevertheless, this development will further complicate the question of whether an entity is a party’s representative or its dispute financier for disclosure purposes under various arbitration rules and national regulations.

Delegation of Oversight

Although there have been some efforts at funder self-regulation,²⁵ there is a growing consensus that the industry is growing too large and too multijurisdictional to be left solely to its own devices.²⁶ But who should regulate dispute financiers? There are wide-ranging options around the world with respect to national oversight, local oversight and self-regulation, as well as combinations of the three. Yet most of these options are indirect and lack clear authority for sanctions or for enforcement.

For example, Singapore’s law embodies the classic view of regulating dispute financiers: regulate lawyers who will then indirectly regulate the dispute financiers. Singapore amended its Civil Law Act in 2017 to permit dispute finance in international arbitration proceedings and related court and mediation proceedings,²⁷ including proceedings in connection with the enforcement of arbitral awards, and in late 2019, the Singapore Ministry of Law announced that it will likely soon permit dispute finance in domestic arbitrations.²⁸ The law includes the classic provision that lawyers must disclose their clients’ dispute finance arrangements and may not accept any referral fees or commissions from third-party funders. The Law Society of Singapore has also issued Guidance Note 10.1.1 on Third-Party Funding for lawyers practicing in Singapore.²⁹ Similarly, the Dubai International Financial Centre (DIFC) represents another example of lawyer-based regulation of dispute finance through its Practice Direction No. 2 of 2017 on Third Party Funding (Practice Direction), which requires disclosure and transparency with respect to the identity of the funder but does not compel disclosure of the funding agreement.³⁰ In 2019, DIFC also issued Order No. 4 of 2019 entitled “Mandatory Code of Conduct for Legal Practitioners in the DIFC Court,” which prohibits attorneys practicing before DIFC from creating conflicts of interest involving funders, taking instructions from the funder without client consent, and accepting referral fees or other referral benefits from the funder.³¹

Other jurisdictions have engaged in regulating dispute financiers directly at the state or territory level, rather than the national level. For example, Australia currently has no federal agency charged with regulating third-party funders, but some Australian states have issued statutes or enacted court rules to address dispute financiers, and other forms of guidance have been issued, such as Regulatory Guide 248³² addressing conflicts of interest and

²⁴ See Sam Skolnik, *D.C. Nonlawyer Partner Rule Spurs Interest as States Mull Change*, BLOOMBERG L. (Oct. 30, 2019).

²⁵ See, e.g., Association of Litigation Funders of England & Wales (ALF) (“plays an important role in regulating the litigation funding industry in England and Wales”); Kevin Penton, *Major Litigation Finance Firms Create New Trade Group*, LAW360 (Sep. 8, 2020) (announcing the creation of “the International Legal Finance Association”).

²⁶ See, e.g., *After Merger, IMF Bentham Rebrands as Omni Bridgeway*, LAW.COM (Feb. 14, 2020); Alison Frankel, *Burford, Gerchen Keller to Merge: Turning Point for Litigation Funding?*, REUTERS (Dec. 14, 2016).

²⁷ See *Civil Law (Amendment) Act* (2017) (Singapore).

²⁸ Felicia Choo, *Third-Party Funding in Legal Cases to be Extended*, STRAIT TIMES (Oct. 11, 2019).

²⁹ See Law Soc’y of Singapore, *Guidance Note 10.1.1 on Third-Party Funding* (2017).

³⁰ See Dubai Int’l Fin. Ctr., *Practice Direction No. 2 of 2017 on Third Party Funding* (2017).

³¹ See Dubai Int’l Fin. Ctr., *Order No. 4 of 2019* (2019).

³² See Australian Sec. & Invest. Comm’n, *Regulatory Guide 248* (2013).

the Federal Court Practice Note Class Actions (GPN-CA).³³ The Australian government announced in May 2020 that it will soon require litigation funders to hold an Australian Financial Services License and comply with existing investment fund regulations.³⁴ Australia will be the first country in the world to impose a national licensure requirement on its dispute finance industry. Similarly, the United States federal government has neither taken any policy positions nor passed any legislation regarding dispute finance. Funding is regulated on a state-by-state basis, and the regulation varies dramatically between states. In November 2018, the Federal Civil Rules Advisory Committee held a conference to gather information regarding whether to revise the Federal Rules of Civil Procedure to directly address dispute finance, but no rule revisions have been proposed yet. A few U.S. states require licenses for consumer litigation financiers, but the licensure requirements end up not affecting global commercial dispute financiers—which neither operate in those states nor engage in consumer-focused dispute finance.³⁵

Some countries have implemented a Code of Conduct or Code of Practice, with various methods of enforcement, none of which are robust or neutral. As an example of private regulation, the Singapore Institute of Arbitrators has issued non-binding guidelines for third-party funders to promote best practices among funders in Singapore-seated international arbitrations and encourage funders to behave with high ethical standards towards funded parties to uphold the integrity of the international arbitration practice in Singapore. Still, those guidelines are not mandatory, so they do not achieve a robust regulatory function. As an example of public regulation, Hong Kong legalized dispute finance in international arbitration, but not domestic litigation, by enacting the Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Ordinance 2017 (Arbitration Ordinance),³⁶ and has promulgated a binding Code of Practice for Third Party Funding of Arbitration (Code of Practice).³⁷ The Code of Practice does not impose direct legal liability as a penalty for noncompliance, however, but is admissible as evidence in court or arbitral proceedings when the issue of compliance or failure to comply is relevant and material to the case. In essence, Hong Kong's Code of Practice relies on enforcement indirectly by parties who decide that it is strategically beneficial to raise a violation of the Code of Practice in court, which is an unpredictable, case-specific method of regulation at best. As an example of a public-private partnership, England and Wales has a voluntary funder self-regulatory organization called the Association of Litigation Funders (ALF).³⁸ ALF is the first funder self-regulation effort in the world that has been directly endorsed by a government.³⁹ ALF has promulgated a Code of Conduct⁴⁰ for funders and created a complaints procedure for funded parties to lodge complaints against funders who are members of ALF.⁴¹

Finally, the majority of jurisdictions around the world are still taking an exploratory, light-touch approach to regulating dispute finance. For example, in China, the Legal Capital Research Institute (Shenzhen) was created in 2017 “to explore the intrinsic logic between law and capital, to prompt the development of legal service market,

³³ See J.L.B. Allsop, *Federal Court Practice Note Class Actions* (2019).

³⁴ See Christopher Niesche, *Australia to Regulate Litigation Funders to Reduce Shareholder Class Actions*, LAW.COM.

³⁵ See NIEUWVELD & SAHANI, *supra* note 1 at ch. 6 (addressing laws in the United States).

³⁶ See *Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Ordinance 2017*.

³⁷ See *Code of Practice for Third Party Funding of Arbitration*, Arbitration Ordinance (Chapter 609).

³⁸ See ASS'N OF LIT. FUNDERS.

³⁹ See *About Us*, ASS'N OF LIT. FUNDERS.

⁴⁰ See *Code of Conduct*.

⁴¹ See *complaints procedure*.

to promote China's progress in economy and the rule of law, as well as to safeguard the social justice."⁴² This body is engaged in research but does not appear to have direct regulatory authority over the industry.

This lack of consensus regarding which actors should regulate the dispute finance industry is creating global loopholes in the oversight umbrella that enable dispute financiers that operate in multiple countries to exempt their innovative new financial products and thereby escape some of the regulations aimed at them. If one jurisdiction regulates in a way that makes dispute finance less profitable, then the financier can instead switch to investing in jurisdictions that are more funding-friendly.

Conclusion

The innovations described in this brief essay further normalize and legitimize dispute finance in jurisdictions around the world, even though the mechanisms and levels of regulation range widely from jurisdiction to jurisdiction. The patchwork of worldwide regulation allows for proverbial "laboratories" to try out various methods of regulation so that other jurisdictions can learn from, emulate, ignore, or criticize those experimental regulations without fear of reprimand based on some converging global regulatory norm.⁴³ Nevertheless, the lack of coordination and consensus makes it easy for global dispute financiers to forum shop thereby avoiding jurisdictions with heavy-handed regulations and opting into jurisdictions with a more favorable regulatory approach. Arbitration rules provide a more unified and uniform approach to defining and regulating dispute financiers given their transnational reach, but this feature also makes arbitral institutions hesitant to do more than require disclosure or allow for cost orders for fear of conflicting with national laws or losing market share. Nevertheless, while there is currently a "free market" for wide-ranging dispute finance regulation, eventually the gravitational pull of convergence will likely begin to exert its force driven by consensus among arbitration rules and investment treaties, just as those forces have contributed to harmonizing other international arbitration norms and practices worldwide.⁴⁴

⁴² *Legal Capital Research Institute (Shenzhen) to Speak at the 5th Litigation Funding Conference in Sydney on May 31, 2019*, LITIGATION FINANCE JOURNAL (May 21, 2019), <https://litigationfinancejournal.com/legal-capital-research-institute-shenzhen-speak-5th-litigation-funding-conference-sydney-may-31-2019/>.

⁴³ *Cf.* *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J. dissenting opinion) ("It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.").

⁴⁴ See consensus among arbitration rules and investment treaties.