Third-party funding in arbitration: a costs insurance broker’s view

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Arbitration analysis: Steve Jones, a director in the dispute resolution practice in the London office of Arthur J. Gallagher Insurance Brokers Ltd (Gallagher), considers the International Council for Commercial Arbitration (ICCA)–Queen Mary Task Force ‘Draft Report on Third-Party Funding in International Arbitration’ from a costs insurance broker’s view, and takes issue with the task force’s broad definition of third-party funding.

Original news

Third-Party Funding draft report now available online for public comment, LNB News 04/09/2017 27

Third party funding remains in the spotlight in international arbitration and has come under renewed scrutiny following publication of the draft report of the Task Force established in 2013 jointly by ICCA and Queen Mary University of London.

What types of insurance does Gallagher offer to parties involved in international arbitration?

Gallagher offers a range of insurance solutions designed to hedge many of the contingent liabilities that associate themselves with high-stakes disputes. In addition to after-the-event (ATE) legal expenses insurance, which is predominantly used to cover costs risks for the losing party, there are a number of novel solutions we have developed in recent years. The most notable of these is arbitration proceedings award default insurance which can be available to insure the arbitration award if a sovereign respondent fails to honour an award made in the plaintiff’s favour. In addition, we have placed damages-based agreement (DBA) insurance for law firms, security-for-costs policies, cross-undertakings as to damages policies, judgment enforcement insurance and many forms of key personal cover. We like to believe that our range of solutions is market-leading.
Do you perceive there to be an increased number of ethical tensions as the funding and costs insurance market evolves?

Before we put the various forms of third-party funding under the ethical microscope, I think it’s important to understand that ethical tensions inevitably exist and always have existed in disputes, in what we would regard as ‘normal’ circumstances.

For example, it could be argued that a law firm billing on an hourly rate has an inherent incentive to prolong a dispute, while its client has the opposite incentive. Likewise, a law firm on a fixed fee, or perhaps a precarious contingency arrangement, is incentivised to resolve a dispute as quickly as possible, while its client may feel he can prolong the dispute with impunity.

Of course, the existence of ethical tension is not the same as being influenced by it. We rely on regulation, reputation and integrity to overcome these things. It is important therefore that we understand that, whatever view we take on third-party funding, ethical tensions have always existed in disputes. The question, therefore, is not how third-party funding introduces ethical conflicts, but more about if or how it affects existing ones.

What comments do you have on the way the task force’s draft report deals with ‘before-the-event’ (BTE) and ATE insurance?

As the report identifies, BTE insurance is purchased mainly by future defendants and claimants without prior knowledge or assessment of the claim and indemnifies the insured from the point at which the dispute arises, not only in terms of costs but potentially damages also.

ATE insurance is generally only available for plaintiffs with strong cases and is offered after extensive underwriting and, on larger cases typically will cover only adverse costs and at the point at which the case concludes. The premiums for ATE are much larger and in many cases linked intrinsically to the outcome of the dispute with part of the premium payable contingent on a successful outcome.

It is not difficult to see, therefore, that a BTE insurer might wish to have a very high degree of control and see the case run as cheaply as possible, whereas an ATE insurer will predicate part of their underwriting on the quality and cost of the law firm acting and will get a warm feeling when the claimant has instructed reassuringly expensive counsel.
Is it correct that BTE insurance provides funding in return for reimbursement?

It is correct that BTE insurance will provide day-to-day funding for a case, and remuneration for the same is by way of a premium which is paid before any potential case is initiated. BTE insurance is also mainly a defendant product whereby the ‘funding’ is to try and defeat a claim and avoid an order for damages. To this extent the motivations are clearly very different from those of a traditional funder who is looking to identify meritorious plaintiff cases and profit from the successful outcome via a share of the proceeds. A BTE insurer has no ability to predict if a claim will come and what the outcome may be. Their premium will be a small fraction of the sum of their liability and while they may eventually recover some or all of their expenditure if the case is successful, they certainly do not make profit via this means as they do not receive any share of the proceeds of the dispute.

Do you agree with the task force’s broad definition of third-party funding?

The ‘broad v narrow’ debate is at the very heart of the report, and contrary to the task force’s findings, we make the argument for narrow. To reach this conclusion, Gallagher conducted some informal market research and asked leading arbitration professionals which of six definitions they felt accurately described third-party funding in international arbitration. Interestingly, while the research returned a very clear picture of what individuals thought definitely did constitute third-party funding, it is equally clear that there is a high degree of ambiguity attached to many of the definitions.

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<th>Traditional Funders</th>
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<th>Investors</th>
<th>ATE Insurers</th>
<th>Law Firms</th>
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If one applies the ‘duck test’ to the definition provided in the report then the above results may seem strange as they should all be coming out at 100%. By ‘duck test’, we essentially mean inductive reasoning—if it looks like funding, acts like funding, operates like funding, then it must be funding.
ATE insurance would most certainly qualify on this criteria as there will always be an agreement in place, being the insurance policy—the insurance company will not be a direct party to the dispute. They will provide material support and will be remunerated for the same—often with part of their remuneration linked to outcome.

However, 66% of our respondents (including the author of this piece) disagree. To understand why these differences of opinion arise, we need to consider ATE insurance in a little more detail. As previously explained, ATE insurance certainly matches the broad characteristics of third-party funding outlined in the ICCA report and may be considered to have functional similarities. Both products recognise high-quality cases as a commercial asset and in many instances facilitate access to justice. Third-party funding and ATE insurance are both ways to transfer financial risk and allow more cases to proceed on a fully-resourced basis.

However, perhaps the most significant issue here is the motivation of the plaintiff. Put simply, funding may well be something they need while insurance is something they hope they never will. The ATE insurer does not provide day-to-day financing, but instead will pay out on an indemnity basis if the insured event occurs at the conclusion of the proceedings. Furthermore, the insurance premium is typically much lower than the return sought by a third-party funder.

Insurance is also already heavily regulated with clear best practice guidelines and a raft of procedures in place to mitigate issues such as a conflict of interest which, rightly so, is a hot topic in the report. Indeed, insurance companies have always been parties to legal disputes—they have their own regulations as well as legal precedents to comply with, the boundaries of involvement are clearly drawn, and debates on ethical tensions are well rehearsed as insurance has played its part in disputes for centuries. Insurance, one might say, is an established way of life—why would a plaintiff not protect their litigation asset in the same way they protect their tangible assets such as factories and ships?

Insurance is also far broader in scope—numerous risks can be insured beyond the actual cost of a dispute, which remains the sole focus of funding. For example, the risk of sovereign non-payment is an insurable event where arguably a positive outcome for the plaintiff could be viewed as a negative outcome for the insurer as it brings the risk of a claim into view.

So, in conclusion, there is no doubt insurance shares many of the characteristics of other forms of third-party funding. However, the more we look at this, the more we wonder if there really are too many unique factors to all forms of funding to group them all as one, and if we achieve anything in trying to do so.

*Steve is a director in the dispute resolution practice whose primary role involves working with law firms and litigation funders to achieve insurance solutions for their clients’ varied requirements in complex litigation and international arbitration.*
Gallagher’s major risks division incorporates a specialist client-focused food and drink practice with a dedicated team working in areas such as food product recall and food contamination. Other areas of expertise include contractual agreements, single site exposures, capital expenditure, fire protection, complex claims and human risk. Its parent company, Arthur J Gallagher & Co, is an international insurance brokerage and risk management services firm headquartered in Itasca, Illinois. It has operations in 33 countries and offers client service capabilities in more than 150 countries around the world through a network of correspondent brokers and consultants.

Interviewed by Jenny Rayner.

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