REVISTA ROMÂNĂ DE Arbitraj

Anul 15 / Nr. 3 ● iulie-septembrie 2021

REVISTĂ EVALUATĂ, CLASIFICATĂ ȘI AFLATĂ ÎN EVIDENȚA
C.N.C.S.I.S., COD 138, NR. DE ÎNREGISTRARE 9059/5.11.2008

Wolters Kluwer
Romania

ROMÂNIA
Curtea de Arbitraj Comercial Internațional
de pe lângă
CAMERA DE COMERȚ ȘI INDUSTRIE A ROMÂNIEI

THIRD-PARTY FUNDING AND REFORM OF THE ICSID ARBITRATION RULES

FINANȚAREA DE CĂTRE TERȚI ȘI REFORMA REGULILOR ARBITRALE ICSID

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ABSTRACT

This article considers the treatment of third-party funding in the current draft of ICSID's proposed amendments to the ICSID Arbitration Rules. Analysing arbitral tribunal decisions in investment treaty cases that have dealt with third-party funding, the authors conclude that there is little need to revise the ICSID Arbitration Rules to specifically address funding.

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Yet, in light of pressure from some stakeholders to do so, the ICSID Secretariat has proposed to require parties to disclose the name of any funder and to explicitly authorize arbitral tribunals to require disclosure of further information regarding the funding agreement. Requiring disclosure of the identity of funders to identify potential conflicts of interest is not controversial. However, requiring disclosure of the terms of a funding arrangement is unnecessary, unfair, and would implicate serious privilege issues.

The ICSID Secretariat also proposes to add a new rule addressing requests that a party provide security to ensure payment of an eventual adverse cost award. The new rule, appropriately, would prohibit arbitral tribunals from ordering a party to provide security for costs merely because the party is receiving third-party funding. Such funding may be critical to provide access to justice for claimholders who do not have the means to pursue their case without funding, and it is fundamentally unfair to burden them with the additional costs that would be associated with providing security for costs in addition to the other costs of pursuing their claim. In the case of parties that are not impecunious, which for example have sought out third-party funding to manage their balance sheet or risk exposure, the existence of third-party funding has no relevance to the parties' ability or willingness to pay an eventual adverse costs award.

KEYWORDS: *third-party funding; ICSID Rules reform; ISDS; Bilateral investment treaties; BIT; UNCITRAL's Working Group III; EU Parliament's draft report with recommendations to the EU Commission on Responsible Private Funding of Litigation; security for costs; conflicts of interest; extent of disclosure; identity of funder; disclosure of funding agreement; disclosure of third-party funding.*

REZUMAT

Acest articol tratează reglementarea finanțării din partea terților în arbitrajul internațional așa cum este aceasta propusă în actualul proiect de modificare al Regulilor arbitrale ICSID. Prin analizarea hotărârilor tribunalelor arbitrale în cauzele decurgând din arbitrajul de investiții în care s-a discutat finanțarea din partea terților, autorii concluzionează că există o necesitate redusă de a revizui Regulile arbitrale ICSID pentru a adresa în mod specific finanțarea.

Cu toate acestea, sub presiunea din partea unor utilizatori de a proceda astfel, Secretariatul ICSID a propus să se solicite părților să furnizeze numele oricărui finanțator și de a autoriza în mod expres tribunalele arbitrale să solicite furnizarea de informații suplimentare privind acordul de finanțare. Solicitarea informațiilor privind identitatea finanțatorului pentru a identifica potențiale conflicte de interes nu este controversată. Cu toate acestea, solicitarea de informații în legătură cu clauzele unui acord de finanțare nu este necesară, este injustă și ar implica chestiuni serioase ce țin de confidențialitate.

Secretariatul ICSID a propus totodată adăugarea unei noi reguli care să solicite părții să furnizeze o garanție care să asigure plata în eventualitatea unei

hotărâri nefavorabile în ce privește costurile. Noua regulă ar interzice în mod corespunzător, tribunalelor arbitrale să solicite unei părți furnizarea unei garanții pentru costuri pentru simplul fapt că respectiva parte beneficiază de finanțare de la terți. O asemenea finanțare ar putea fi esențială în garantarea accesului la justiție pentru potențialii reclamanți care nu beneficiază de mijloacele necesare inițierii procedurii în lipsa finanțării și ar fi fundamental injust ca aceștia să fie împovărați cu costuri suplimentare asociate obligației de furnizare a garanției pentru costuri, în plus față de costurile necesare acoperirii litigiului. În cazul părților care nu sunt lipsite de mijloace materiale, care, spre exemplu apelează la finanțare de la terți pentru buna administrare a bilanțului sau a expunerii la risc, existența finanțării de la terți nu are nicio relevanță pentru abilitatea sau bunăvoința părții de a achita o eventuală hotărâre nefavorabilă în ce privește costurile.

CUVINTE CHEIE: *finanțarea de către terți; reforma Regulilor arbitrale ICSID; ISDS; tratate bilaterale de investiții; BIT; UNCITRAL Grup Lucru III; Proiectul raportului Parlamentului UE cu recomandări către Comisia UE asupra Finanțării Private Responsabile a Litigiilor; măsuri asiguratorii privind costurile; conflicte de interes; limitele dezvăluirii de informații; identitatea finanțatorului; informații privind acordul de finanțare; informații privind finanțarea de către terți.*

1. Introduction

It is no secret that third-party funding has become a welcomed member of the international litigation and arbitration landscape due in part to the high legal fees and other costs associated with pursuing investor-State dispute settlement mechanisms ("**ISDS"**), including ICSID arbitration.[5]

There are various indicia, however, that the pendulum is swinging the other way,[6] led in part by those whose interests are not served by the increased access to justice that third-party funding provides or who are fundamentally opposed to the availability of ISDS to resolve disputes between investors and States.[7]

[5] See, e.g., Sherina Petit, *Third-party funding in arbitration – the funders' perspective*, published by Norton Rose Fulbright, September 2016, available at https://www.nortonrosefulbright.com/en-no/knowledge/publications/8b8db7d0/third-party-funding-in-arbitration-the-funders-perspective, last accessed on 12 September 2021; Matthew Hodgson, Yarik Kryvoi, Daniel Hrcka, *2021 Empirical Study: Costs, Damages and Duration in Investor-State Arbitration*, published by the British Institute of International and Comparative Study and Allen & Overy, June 2021, available at https://www.allenovery.com/en-gb/global/news-and-insights/publications/costs-damages-and-duration-in-investor-state-arbitration, last accessed on 12 September 2021.

[6] Ian McKenny, *Evolution of the Third-Party Funder*, April 2020, accessible at https://www.lexology.com/library/detail.aspx?g=fcd6f277-5754-4fa0-958f-d1e1701c8730, last accessed on 12 September 2021.

[7] See, e.g., the website maintained by an alliance of over 200 European organizations that are opposed to ISDS, available at https://stopisds.org/, last accessed on 12 September 2021.

The result is a recent trend to consider regulating or prohibiting third-party funding in some jurisdictions, by arbitral institutions, and/or under free trade agreements or bilateral investment treaties ("**BITs"**). These include the initial draft on third-party funding regulation recently published by the UNCITRAL Secretariat for consideration by UNCITRAL's Working Group III[8] and the EU Parliament's draft report with recommendations to the EU Commission on Responsible Private Funding of Litigation.[9]

The Secretariat and member States of ICSID have also taken up the issue of third-party funding in the context of their consideration of amendments to the ICSID Arbitration Rules. In contrast to some of the other institutions considering the matter,[10] ICSID appears to be taking a balanced approach that is informed by its experience with actual ISDS cases as well as with representatives of all of the stakeholders involved in such cases. In doing so, the ICSID Secretariat has actively considered and addressed criticisms and concerns that have been raised regarding ISDS and third-party funding, including the false allegation that third-party funding promotes frivolous claims.[11]

ICSID released the first draft of proposed amendments to the ICSID Arbitration Rules in August 2018,[12] it released its fifth Working Paper with revised proposed amendments in June 2021. The current draft contains two provisions concerning third-party funding:

Proposed new Rule 14 is entitled "Notice of Third-Party Funding". It defines a funder as "*any non-party from which the party, directly or indirectly, has received funds for the pursuit or defense of the proceeding through a donation or grant, or in return for remuneration dependent on the outcome of the proceeding.*" The draft rule requires that where an entity satisfies this definition, the relevant party is

[8] See the *Initial draft on the regulation of third-party funding*, May 2021, and related information on the UNCITRAL Working Group III on Third-Party Funding, available at https://uncitral.un.org/en/thirdpartyfunding, last accessed on 12 September 2021.

[9] EU Parliament, *Draft report with recommendations to the EU Commission on Responsible Private Funding of Litigation* 2020/2130(INL), 17 June 2021, available at https://www.europarl.europa.eu/doceo/document/JURI-PR-680934_EN.pdf, last accessed on 12 September 2021.

[10] See, e.g., International Legal Finance (ILFA), *Comments on the initial draft of UNCITRAL's Working Group III regarding third-party funding*, 30 July 2021, available at https://uploads-ssl.webflow.com/5ef44d9ad0e366e4767c9f0c/61088589e63c5979a9f22599_ILFA%20comments%20UNCITRAL%20WG%20III%20TPF%20Reform%20Proposals%20FINAL.pdf, last accessed on 12 September 2021.

[11] ICSID Secretariat, Working Paper # 1, *Proposal for Amendments of the ICSID Rules,* Vol.3, August 2018, p. 131, par. 242: "*third-party funding does not, in itself, mean a claim is frivolous, and some argue that third-party funding enables the pursuit of meritorious claims or defences, including those that otherwise might not be pursued due to impecuniosity",* available at https://icsid.worldbank.org/sites/default/files/publications/WP1_Amendments_Vol_3_WP-updated-9.17.18.pdf, last accessed on 12 September 2021.

[12] *Idem*.

required to disclose the name and address of the funder "*upon registration of the Request for arbitration, or immediately upon concluding a third-party funding arrangement after registration"*. Moreover, the party shall notify the Secretariat of any changes to the information in such a notice. The draft provision also explicitly empowers the arbitral tribunal to order disclosure of "*further information regarding the funding agreement and the non-party providing funding"*.[13]

A separate new provision, draft Rule 53, addresses Security for Costs. It proposes to explicitly allow arbitral tribunals to consider *"the existence of Third Party funding"* when assessing "*whether to order a party to provide security for costs"*, but specifies that the tribunal "*shall consider all relevant circumstances,"* such as a party's "*ability"* and "*willingness to comply with an adverse decision on costs"* and the "*effect that providing security for costs may have on that party's ability to pursue its claim or counterclaim"*.[14] The Working Paper explaining this

[13] ICSID Secretariat, Working Paper # 5, *Proposal for Amendments of the ICSID Rules,* Vol. 1, June 2021, p. 35 ("*Rule 14 Notice of Third-Party Funding. (1) A party shall file a written notice disclosing the name and address of any non-party from which the party, directly or indirectly, has received funds for the pursuit or defense of the proceeding through a donation or grant, or in return for remuneration dependent on the outcome of the proceeding ("third-party funding"). (2) A party shall file the notice referred to in paragraph (1) with the Secretary-General upon registration of the Request for arbitration, or immediately upon concluding a third-party funding arrangement after registration. The party shall immediately notify the Secretary-General of any changes to the information in the notice. (3) The Secretary-General shall transmit the notice of third-party funding and any notification of changes to the information in such notice to the parties and to any arbitrator proposed for appointment or appointed in a proceeding for purposes of completing the arbitrator declaration required by Rule 19(3)(b). (4) The Tribunal may order disclosure of further information regarding the funding agreement and the non-party providing funding pursuant to Rule 36(3).*") available at https://icsid.worldbank.org/sites/default/files/publications/WP%205-Volume1-ENG-FINAL.pdf, last accessed 12 September 2021.

[14] *Ibidem,* pp. 55-56 ("*Rule 53 Security for Costs (1) Upon request of a party, the Tribunal may order any party asserting a claim or counterclaim to provide security for costs. (2) The following procedure shall apply: the request shall specify the circumstances that require security for costs; (b) the Tribunal shall fix time limits for submissions on the request; (c) if a party requests security for costs before the constitution of the Tribunal, the Secretary-General shall fix time limits for written submissions on the request so that the Tribunal may consider the request promptly upon its constitution; and (d) the Tribunal shall issue its decision on the request within 30 days after the later of the constitution of the Tribunal or the last submission on the request. (3) In determining whether to order a party to provide security for costs, the Tribunal shall consider all relevant circumstances, including: (a) that party's ability to comply with an adverse decision on costs; (b) that party's willingness to comply with an adverse decision on costs; (c) the effect that providing security for costs may have on that party's ability to pursue its claim or counterclaim; and (d) the conduct of the parties. (4) The Tribunal shall consider all evidence adduced in relation to the circumstances in paragraph (3), including the existence of third-party funding. (5) The Tribunal shall specify any relevant terms in an order to provide security for costs and shall fix a time limit for compliance with the order. (6) If a party fails to comply with an order to provide security for costs, the Tribunal may suspend the proceeding. If the proceeding is suspended for more than 90 days, the Tribunal may, after consulting with the parties, order the discontinuance of the proceeding. (7) A party shall promptly disclose any material change in the circumstances upon which the Tribunal ordered security for costs. (8) The Tribunal may at any time modify or revoke its order on security for costs, on its own initiative or upon a party's request.*").

provision states that the tribunal would have "*discretion to determine the weight to be given to such evidence pursuant to AR 36(1). However, the existence of third-party funding is not by itself sufficient to justify an order for security for costs.*"[15]

These proposals are addressed in the light of case law and commentaries that have considered the issues, as well as our practical experience in litigation funding. The authors first review, in Section 2 below, how the perceived need to disclose third-party funding arrangements has focused on concerns about avoiding or revealing potential conflicts of interest. In Section 3, the authors then address the issue of security for costs, including whether a funder's involvement in an ICSID arbitration is even relevant to the question of whether a party should be ordered to provide security for costs.

2. Disclosure of Third-Party Funding

Undisclosed direct or indirect relationships between arbitrators and funders may undermine the tribunal's impartiality and independence, leading to potential challenges against arbitrators and/or arbitral awards issued by the same.

Drawing parallels with the IBA Guidelines on Conflicts of Interest in International Arbitration,[16] an immediate concern is the repeated appointment of arbitrators in cases where the same funder is involved.[17] Another potential conflict appears to arise where an arbitrator may have a financial connection with a funder, e.g., an arbitrator may be a shareholder or a director of a funding entity.[18]

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[15] *Ibidem,* p. 307, par. 103.

[16] International Bar Association, *IBA Guidelines on Conflicts of Interest in International Arbitration*, 23 October 2014, accessible at https://www.ibanet.org/MediaHandler?id=e2fe5e72-eb14-4bba-b10d-d33dafee8918, last accessed on 12 September 2021.

[17] Caroline Dos Santos, *Third-party funding in international commercial arbitration: A wolf in sheep's clothing?,* published by ASA Bulletin, Vol. 35, No 4, December 2017, p. 11; See also Burcu Osmanoglu, *Third-Party Funding in International Commercial Arbitration and Arbitrator Conflict of Interest*, Published by Journal of International Arbitration, Vol 32, No 3, 2015, pp. 334-335: "*This scenario is similar to that which is envisaged in situations 3.1.3 and 3.1.4 under the Orange List of the IBA Guidelines on Conflict of Interest where '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' or if the 'the arbitrator's law firm has within the past three years acted for one of the parties or an affiliate of one of the parties in an unrelated matter without the involvement of the arbitrator.'*"

[18] Burcu Osmanoglu, *loc.cit*, p. 335: *"According to the IBA Guidelines on Conflict of Interest, the fact that '[t]he arbitrator holds shares, either directly or indirectly, which by reason of number or denomination constitute a material holding in one of the parties or an affiliate of one of the parties that is publicly listed' is a situation under the Orange List that is likely to give rise to a conflict of interest and therefore needs to be disclosed. 'the arbitrator holds shares, either directly or indirectly, in one of the parties or an affiliate of one of the parties that is privately held,' a situation set out under the waivable Red List of the IBA Guidelines.".*

Arbitrators acting as counsel for clients on different funded matters or in another capacity, such as legal experts instructed to advise a funder for its due diligence on a funding request, may also raise similar concerns. Other indirect relationships, for instance between an arbitrator's law firm and a funder in unrelated proceedings, may be used to impugn an arbitrator's impartiality.[19]

ICSID's proposal to require notice of the existence of a funding agreement would put arbitrators in a position to know of, and disclose, any relationships that might raise concerns about conflicts of interest. The proposed rule is consistent with recent free trade and investment treaties that require the disclosure of the existence of third-party funding to address the potential issue of conflicts of interest.[20] Indeed, the proposal that parties should have a duty to disclose the existence and identity of a third-party funder has widespread support.[21]

However appropriate it may be to require disclosure of the existence of third-party funding and the identity of the funder, it is entirely another question whether a party should be required to disclose further details regarding the funding arrangement.

ICSID and other ISDS tribunals have inconsistently dealt with these issues, but in most cases, have only required disclosure of the identity of the funder. In *Muhammet Çap v. Turkmenistan*,[22] the respondent State asked the tribunal to order claimants to disclose whether they had received third-party funding and, if so, to disclose the terms of the arrangements. Although recognizing its inherent powers to issue orders of such a nature, the tribunal dismissed the request to disclose the funding terms as the respondent had failed to demonstrate how such terms would be relevant for the case. Furthermore, the tribunal understood that there was no "*issue of conflict of interest due to third party funding*".[23]

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[19] Burcu Osmanoglu, *loc.cit.* p. 336.

[20] United Nations Commission on International Trade Law, Working Group III (Investor-State Dispute Settlement Reform), *Third-party funding – Possible solutions*, Ed. 38, 14-18 October 2019, Vienna, p. 8, footnote 21 (these include the Canada-European Union Comprehensive Economic and Trade Agreement (CETA), European Union-Viet Nam Investment Protection Agreement, European Union-Singapore Investment Protection Agreement, Canada-Chile Free Trade Agreement (CCFTA) and the Slovak Model BIT), available at http://undocs.org/en/A/CN.9/WG.III/WP.172, last accessed on 12 September 2021.

[21] White & Case and Queen Mary University of London*, 2015 International Arbitration Survey: Improvements and Innovations in International Arbitration*, 2015, p. 48: "*Respondents showed widespread support for disclosure of the use of third party funding (76%) and the identity of the funder (63%)"* available at http://www.arbitration.qmul.ac.uk/media/arbitration/docs/2015_International_Arbitration_Survey.pdf, last accessed on 12 September 2021.

[22] *Muhammet Çap & Sehil Inşaat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan*. ICSID Case No. ARB/12/6.

[23] *Muhammet Çap & Sehil Inşaat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan.* ICSID Case No. ARB/12/6. Decision on Respondent's Objection to Jurisdiction under Article VII (2), 13 February 2015, p. 13, par. 50.

The respondent subsequently submitted a second request and added that it intended to apply for security for costs due to the alleged threat that the funder would "*evade a costs award in the event of an adverse decision*",[24] as had apparently happened in a previous case.[25]

The arbitral tribunal granted the respondent's second request in this case. In addition to the identity of the funder, claimants were ordered to disclose the *"nature of the arrangements concluded with the third-party funder(s), including whether and to what extent it/they will share in any successes that Claimants may achieve in this arbitration"*.[26] After the claimants declined to produce the funding agreement, Turkmenistan (the respondent) sought, without success, to compel the funder to do so before the French courts.[27]

In *Oxus Gold plc v. Republic of Uzbekistan,* an UNCITRAL case, the arbitral tribunal took a different view, deciding that the funding had no impact on the proceedings and that the terms of the funding agreement were irrelevant.[28]

In *Eurogas v. Slovak Republic,* the respondent State requested that the arbitral tribunal order the claimants to "*specify the identity of their third party funder for the purposes of determining whether there is any conflict of interest*".[29] The State also asked for an order that the funder not be granted access to any confidential information. Only the first request was granted (the funder's identity), as the tribunal decided that the funder would be subject to the "*normal obligations of confidentiality".*[30]

Finally, in *South America Silver v. Bolivia,* a PCA arbitration, the tribunal ordered the claimant to disclose the identity of the third-party funder due to the potential

[24] *Muhammet Çap & Sehil Inşaat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan.* ICSID Case No. ARB/12/6. Procedural Order no 3, p. 1, par. 2.

[25] *Kiliç Înşaat Ithalat Ihracat Sanayi Ve Ticaret Anonim Şirketi v. Turkmenistan*. ICSID Case No. ARB/10/1.

[26] *Muhammet Çap & Sehil Inşaat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan*. ICSID Case No. ARB/12/6. Procedural Order No. 3, 12 June 2015, par. 13.

[27] Lisa Bohmer, *Analysis: Arbitrators Hearing Large-Scale Construction Dispute Decline To Broaden Their Jurisdiction Beyond Expropriation Claim, And Dismiss The Case On The Merits,* 12 May 2021, available at https://www.iareporter.com/articles/analysis-arbitrators-hearing-large-scale-construction-dispute-see-no-evidence-that-claims-were-assigned-to-third-party-funder-decline-to-broaden-their-jurisdiction-beyond-expropriation-claim-and-di/, last accessed on 12 September 2021. Later in the proceedings, the arbitral tribunal declined Turkmenistan's security for costs application.

[28] *Oxus Gold v. Republic of Uzbekistan*, Final Award, 17 December 2015, p. 63, par. 127.

[29] *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic*, ICSID Case No. ARB/14/14. Award, 18 August 2017, paras. 105, 108 and 110.

[30] As discussed in chapter 4 below on Security for Costs.

existence of conflicts of interest between the funder and arbitrators. However, it denied the disclosure of the funding agreement.[31]

ICSID's proposal to include a provision explicitly allowing tribunals to "*order disclosure of further information regarding the funding agreement*"[32] seems to unnecessarily restate an arbitrator's inherent discretionary power to order the production of evidence. Tribunals already regularly proceed on the understanding that they have such powers even when no express provision is provided in the applicable rules, as demonstrated by the cases mentioned above.

ICSID's discussion of the text of draft Rule 14 reveals, however, the intent that this authority be exercised cautiously. ICSID did not accept the proposal of some States that disclosure of further information about the funder or funding agreement be mandatory upon request of the opposing party.[33] ICSID also rejected the suggestion that a party should not be entitled to invoke the confidential business information privilege ("**CBI"**) as a ground for not providing such information. As stated by the ICSID Secretariat: "*Arguably, if further information is ordered disclosed under [the new rule], it potentially could be CBI, attorney-client privileged, or otherwise confidential and protected. It would be inappropriate to bar parties from invoking relevant and applicable privileges*."[34]

The ICSID Secretariat correctly recognized that the terms of a funding agreement typically include privileged information. The commercial terms agreed with a claimant are competitively sensitive for the funder. In addition, the funder's compensation structure in a specific case is the result of its due diligence and assessment of the case, including review of attorney work product, potential review of attorney-client privileged information, and legal opinions that may have been provided to the funder by independent counsel retained by the funder.

Details such as a cap on the amount of funding or time-based success fee structures could also be used strategically by the opposing party, e.g., to push for or against an early settlement or particular settlement amount, or to engage in tactics that delay and/or increase the costs of the proceeding to the detriment of the funded party. This would give the party that is not required to disclose information about its financial resources or the manner in which it is funding the case an unfair advantage over the funded party.

Further, a funder's risk analysis encompasses much more than merely the merits of a claim. It extends to issues including the expected length of a case, a

[31] *South American Silver Limited v. Bolivia*, PCA Case No. 2013-15. Procedural Order No. 10, 11 January 2016, pp. 13-14, paras. 84 and 85.

[32] ICSID Secretariat, Working Paper # 5, *loc. cit*, p. 35 (Rule 14). Said Rule 36 (3) deals with general principles on evidence production, establishing the possibility of Tribunals to order parties to produce documents or other evidence in any stage of the proceeding.

[33] *Ibidem,* p. 279, par. 42.

[34] *Ibidem,* p. 279, par. 43.

funder's own costs (e.g., expert/legal opinions obtained during its due diligence and beyond), and the enforcement landscape, all of which are taken into account when a funder prices its risk. The funder analyses the legal, economic and financial aspects of a case, including the cost of capital over time, undertaking complex assessments of probabilities, and using proprietary pricing and valuation models.

All of that is considered against the background and benchmark of other financial markets (such as venture capital), both with respect to the investors' risk appetite and expected internal rate of return (IRR) as well as the alternative funding (if any) that may be available to the party seeking funding.[35] Moreover, funders will typically consider the size of the exposure and the concentration risk a specific case may present, e.g., whether the funder has already invested in the same or similar claims and/or against the same party.

In that vein, the disclosure of the terms of the funding arrangement could trigger speculation about the merits of the case, when in fact those terms are driven by factors not relevant to the merits.

Taken all together, disclosure of the terms of a funding agreement should be reserved for exceptional circumstances, for example where the funding relationship is itself the core subject of the legal proceedings.[36]

3. Security for Costs

a) What is Security for Costs?

Security for costs is an interim measure that requires a party to provide a financial guarantee sufficient to satisfy an adverse costs order if the claim or defence is not successful. Such security can be provided in the form of a bank guarantee, a letter of credit or other forms of surety. The funds thereby secured are to be used to pay an eventual award on costs in favour of the opposing party, i.e., the attorneys' fees and other costs incurred in pursuing or defending the claim that are awarded by a tribunal.

In that regard, security for costs "*should be distinguished from security ordered to guarantee the substantive claims in the proceedings, such as posting a bond for*

[35] See Tets Ishikawa, *Funders' pricing and the real value of litigation risks,* 25 June 2021, accessible at http://disputeresolutionblog.practicallaw.com/funders-pricing-and-the-real-value-of-litigation-risks/, last accessed on 12 September 2021.

[36] This was the case in *S&T Oil Equipment & Machinery Ltd v. Romania* – ICSID Case No. ARB/07/13. The ICSID arbitration was discontinued due to lack of payments by the funder, which alleged that the Claimant concealed significant evidence from the funder. The Claimant then sued Juridica Investments (the funder), alleging a breach of the funding agreement, which led to the discovery of the funding agreement. *Juridica Invs. Ltd. v. S&T Oil Equip. & Mach. Ltd*. No. 14 C 9135. United States District Court for the Northern District Of Illinois, Eastern Division, 30 December 2014, available at https://casetext.com/case/juridica-invs-ltd-v-st-oil-equip-mach-ltd, last accessed on 12 September 2021.

the stay of enforcement in the context of annulment proceedings. Further, security for costs relates only to the legal fees and expenses arising from the defence [or pursuit] of claims in the proceedings".[37]

Security for costs is regarded as a provisional measure, incidental to the main proceedings, which facilitates the conduct of the main proceedings, the enforcement of the award, and/or preservation of the status quo.[38]

It is worth noting that, while discussions about security for costs typically centre around whether claimants should be required to provide security for costs to protect defendants, it may also be appropriate in certain circumstances to require a defendant to provide security for costs. One example would be where a defendant raises a counterclaim and other circumstances that favour a security for costs order are present.

b) Security for Costs in ISDS Proceedings

Between 1984 and 2015, parties filed only 30 security for costs applications in both ICSID and UNCITRAL arbitrations combined, an average of less than one application per year. Since 2015, security for costs applications have increased, with parties filing an average of six applications per year.[39] However, the increase in security for costs applications has not resulted in an increase in tribunals granting such requests. Only 4% of security for costs applications in ICSID and UNCITRAL arbitration proceedings have been successful.[40] In ruling on these applications, arbitral tribunals have had little difficulty determining that they have jurisdiction and authority to do so within the scope of the existing rules. Against this background, it is reasonable to question why ICSID is proposing to amend the ICSID Arbitration Rules to address security for costs.

Some controversial decisions concerning security for costs have given rise to public debate on the relevance and use of security for costs in ISDS, most notably

[37] Christine Sim, *Security for Costs in Investor–State Arbitration*, Arbitration International, Oxford University Press, September 2017, Vol. 33, Issue 3, pp. 427-495.

[38] Yves Fortier, *Interim measures: An arbitrator's provisional views',* in Contemporary Issues in International Arbitration and Mediation, published by The Fordham Papers, Vol. 2, 2008, pp. 47-57, available at https://doi.org/10.1163/ej.9789004175556.i-382.21, last accessed on 12 September 2021.

[39] In ICSID and UNCITRAL arbitrations respondents filled 88% of all applications. Out of 66 security for costs applications, 46 have been filed in ICSID proceedings; see more in Jeffrey Commission, Craig Arnott, *Reexamining the role of security for costs*, 4 August 2020, available at https://www.burfordcapital.com/insights/insights-container/reexamining-the-role-of-security-for-costs/, last accessed on 12 September 2021.

[40] *Idem*. 77% of applications were rejected and the remaining percentage is pending or the data is not available.

RSM v. Saint Lucia,[41] the first case in which an ICSID tribunal ordered a party to provide security for costs.[42]

In *RSM v. Saint Lucia*, the tribunal found that exceptional circumstances existed warranting the imposition of security for costs. The claimant RSM had commenced two other ICSID arbitrations against Grenada (*RSM Production Corporation v. Grenada*, ICSID Case No. ARB/05/14; *Rachel S. Grynberg and Others v. Grenada*, ICSID Case No. ARB/10/6) before commencing the third case against Saint Lucia. In one of the previous cases, RSM did not honour the costs award against it. The other case was discontinued after RSM failed to pay the advance on costs required for its annulment application to proceed.[43] The respondent also pointed to other cases brought by RSM in which it had failed to honour adverse costs awards, and argued that RSM was engaging in "*arbitral hit-and-run*" tactics.[44]

RSM contested the tribunal's jurisdiction or authority to order security for costs. The tribunal disagreed, pointing to its authority to order provisional measures under Article 47 of the ICSID Convention and ICSID Arbitration Rule 39,[45] but noted that "*provisional measures should only be granted in exceptional circumstances*".[46] In light of RSM's prior conduct, the *RSM v. Saint Lucia* tribunal concluded that "*there is a material risk that Claimant would not reimburse Respondent for its incurred costs*".[47] The tribunal further noted that RSM was being supported by third-party funding, and stated that "*in the absence of security or guarantees being offered, it is doubtful whether the third party will assume responsibility for honoring an adverse costs award*".[48] Finding that these circumstances, together, constituted exceptional circumstances, the tribunal ordered RSM to provide security for costs in the form of an irrevocable bank guarantee.[49]

While arbitral tribunals may have authority to order security for costs, critics caution that it is difficult for tribunals to avoid prejudging the merits of a case

[41] *RSM Production Corporation v. Saint Lucia*, ICSID Case No. ARB/12/10.

[42] *RSM Production Corporation v. Saint Lucia*, ICSID Case No. ARB/12/10, Decision on Saint Lucia's Request for Security for Costs, 13 August 2014, par. 27; Chiara Cilento, Benjamin Guthrie, *Is Investor-State Arbitration Warming up to Security for Costs*?, Kluwer Arbitration Blog, 18 June 2019, available at http://arbitrationblog.kluwerarbitration.com/2019/06/18/is-investor-state-arbitration-warming-up-to-security-for-costs/, last accessed on 12 September 2021.

[43] *RSM Production Corporation v. Saint Lucia*, ICSID Case No. ARB/12/10, Decision on Saint Lucia's Request for Security for Costs, 13 August 2014, paras. 30, 76-80.

[44] *Ibidem*, par. 32.

[45] *Ibidem*, paras. 38, 46-48, 54-57.

[46] *Ibidem*, par. 48. Also par. 75.

[47] *Ibidem*, par. 81.

[48] *Ibidem*, par. 87.

[49] *Ibidem*, paras. 83, 90.

when assessing such requests. For example, in *Maffezini v. Spain*,[50] the tribunal recognized that when deciding upon the demand for security for costs, one should consider the likelihood of the following two conditions being met: first, whether the respondent will eventually prevail, and second, whether the claimant will ultimately be ordered to pay the respondent's costs.

It is worth emphasizing that the latter – whether the claimant will be required to pay any of the respondent's costs and, if so, to what extent – lies in the tribunal's discretion and results not only from the outcome of the case but also from other factors including the parties' conduct during the proceedings.[51] Thus, assessing whether the conditions for ordering security for costs are met inherently involves close *prima facie* consideration of the merits of the case before they are fully briefed as well as facts that are not known – and are unknowable – at the time the decision on security for costs is made.

Given the need to find the existence of exceptional circumstances and the desire to avoid prejudging the case, it is not surprising that ISDS tribunals have been reluctant to order parties to provide security for costs.

c) Security for Costs and Third-Party Funding

Many arbitral tribunals have rejected security for costs applications that were merely based on the fact that the claimant was supported by third-party funding.[52]

[50] *Emilio Agustin Maffezini v. Kingdom of Spain* (ICSID Case No. ARB/97/7), Procedural Order No. 2, 28 October 1999, par. 16 et seqq.

[51] Giulia Previti, *Recently published decision confirms exceptional nature of security for costs*, 7 December 2020, available at https://www.burfordcapital.com/insights/insights-container/security-for-costs-ruling/, last accessed on 12 September 2021.

[52] For example, the Tribunal in *Tennant Energy v. Canada*, which rejected a security for costs application drawing from *EuroGas v. Slovak Republic* that stated that "*financial difficulties and third-party funding – which has become a common practice – do not necessarily constitute per se exceptional circumstances justifying that the Respondent be granted an order of security for costs*". The same *Tennant Energy* tribunal also quotes *South American Silver v. Bolivia* which established that if "*the existence of these third-parties alone, without considering other factors, becomes determinative on granting or rejecting a request for security for costs, respondents could request and obtain the security on a systematic basis, increasing the risk of blocking potentially legitimate claims*". *Tennant Energy, LLC v. Government of Canada*, PCA Case No. 2018-54, Procedural Order No. 4 (Interim Measures), 27 February 2020, paras 176 and 179. Also, in B*ay View v. Rwanda*, the tribunal frequently quoted the decision in *Herzig v. Turkmenistan* determining that the existence of third-party funding was not sufficient to grant security for costs, finding that "(...) *that fact does not, of itself, amount to exceptional circumstances justifying the making of an order for security for costs" Bay View v. Rwanda,* Procedural Order No. 6 on the Respondent's Request for Security for Costs, 28 September 2020, para 62*.* Finally, the tribunal in *Orlandini v. Bolivia* observing that although third-party funding and the claimants' serious and proven financial difficulties may play a role in assessing whether to order security for costs, it decided that "*those factors should be assessed in the context of all other relevant circumstances and would typically not, in and of themselves, constitute a sufficient basis for such an order*." *The Estate of Julio Miguel Orlandini-Agreda and Compañía Minera Orlandini Ltda. v. The Plurinational State of Bolivia, PCA Case No. 2018-39*, Decision on the Respondent's Application for Termination, Trifurcation and Security for Costs, 9 July 2019, para 144.

Nevertheless, there are two scenarios alleged to justify security for costs orders, both of which are based on misconceptions about third-party funding: (i) that funders promote frivolous claims; and (ii) that respondent States would not receive payments ordered in a final adverse costs award from a claimant that is supported by a funder.

The first argument (promotion of frivolous claims) is wholly unsupported by any evidence. The non-recourse nature of third-party funding (in comparison to "traditional" loans or secured credit) plays a significant role in an investor's risk appetite.[53] Because of the non-recourse nature of third-party funding, funders are careful to select only cases with strong merits, where the probability of success is high. Third-party funding providers who want to stay in business will only invest their capital after thorough scrutiny of a funding application, including internal and external due diligence. It is therefore highly unlikely from the outset that a third-party funder would commit to support frivolous claims. Indeed, the available data shows that only around 10% of the cases in which funding is sought are able to find a funder willing to invest in the claim.[54]

In addition, it should go without saying that the fact that a claim does not ultimately succeed does not mean that the claim was frivolous or should never have been brought. As any litigator will confirm, even the strongest cases sometimes lose. Moreover, it is notoriously difficult to predict how an arbitral tribunal will ultimately rule in a specific ISDS case.

Nor does the second argument (that a funded claimant will evade paying adverse costs orders) withstand scrutiny. The fact that a claim is supported by third-party funding does not mean that the claimant is impecunious. Claimants seek funding for a variety of reasons, including because they wish to manage risks associated with litigation or use available capital to invest in their business rather than litigation. Such claimants should be treated no differently than a claimant that is funding litigation itself. Indeed, a party that obtains third-party funding may be in a better position to pay an eventual adverse costs award than a party that has expended its own assets pursuing the claim.

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[53] For more reading see Stavros Brekoulakis, Catherine Rogers, *Third-Party Financing in ISDS: A Framework for Understanding Practice and Policy*, Academic Forum on ISDS Concept Paper 2019/11, 31 July 2019, p. 14, available at https://www.jus.uio.no/pluricourts/english/projects/leginvest/academic-forum/papers/papers/13-rogers-brekoulakis-tpf-isds-af-13-2019-version-2.pdf, last accessed on 12 September 2021.

[54] See, e.g., *Report of the ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration,* Published by the International Council for Commercial Arbitration, ICCA Reports No. 4, April 2018, accessible at https://cdn.arbitration-icca.org/s3fs-public/document/media_document/Third-Party-Funding-Report%20.pdf, last accessed on 12 September 2021; International Legal Finance Association (ILFA), *Comments on the initial draft of UNCITRAL's Working Group III regarding third-party funding*, 30 July 2021, available at https://uploads-ssl.webflow.com/5ef44d9ad0e366e4767c9f0c/61088589e63c5979a9f22599_ILFA%20comments%20UNCITRAL%20WG%20III%20TPF%20Reform%20Proposals%20FINAL.pdf, last accessed on 12 September 2021.

With respect to the case of impecunious claimants that seek funding, there is no evidence that funders are engaging in so-called "*hit-and-run*" ISDS arbitration other than a few isolated cases such as *RSM v. Saint Lucia*. Responsible funders are well aware of the reputational risks as well as the risks to the funding industry as a whole associated with engaging in such behaviour. In addition, the budget and investment for funded cases is negotiated and agreed between the funded party (advised by its counsel) and funder, and may include an allowance to cover the risk of an adverse costs award. Options are also available to hedge such risk, e.g., supplemental insurance coverage.[55]

It is important to note, however, that (i) any increase in the amount of funding required for a case increases the cost of the funding; and (ii) providing financial guarantees as required in security for costs orders is very expensive. It is inappropriate and unjust to burden a claimant with the additional costs of providing security for costs simply because the claim is being pursued with third-party funding. This is particularly inappropriate in cases where the funded party's inability to self-fund was a product of a respondent State's actions – which is quite common in ISDS cases – whether or not the State's actions are ultimately found to be internationally unlawful.

Such considerations led the arbitral tribunal in *Dirk Herzig as Insolvency Administrator over the Assets of Unionmatex Industrieanlagen GmbH v. Turkmenistan* to rescind an earlier order that the claimant provides security for costs.[56] In that case, the administrator of an insolvent German construction company was pursuing a third-party funded claim against Turkmenistan. The majority of the tribunal initially ordered the claimant to post USD 3 million security, either deposited in an escrow account or in the form of an unconditional and irrevocable bank guarantee. Two months later, after the claimant demonstrated that it was not able to obtain the funds to deposit or a bank

[55] In that sense, the ICCA-Queen Mary Task Force notes that "*The funding agreement should normally clearly set out whether the funder will pay a defined sum to the claimant in the event of an adverse award of costs, whether that promise endures if the funding agreement has been breached or otherwise terminated, and whether the funder will pay any order of security for costs." Report of the ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration,* published by the International Council for Commercial Arbitration, ICCA Reports No. 4, April 2018, p. 181, available at https://cdn.arbitration-icca.org/s3fs-public/document/media_document/Third-Party-Funding-Report%20.pdf last accessed on 12 September 2021.

[56] *Dirk Herzig as Insolvency Administrator over the Assets of Unionmatex Industrieanlagen GmbH v. Turkmenistan*, ICSID Case No. ARB/18/35, Decision on Security for Cost, 27 January 2020, and Procedural Order No. 5 on Claimant's Request for Reconsideration and Respondent's Request for Termination of the Proceedings, 9 June 2020. The latter decision, rescinding the security for costs order, is not public and the information referred to here is quoted from the following article: Lisa Bohmer, *Majority in Unionmatex v. Turkmenistan agrees to rescind security for costs order,* IA Reporter, 26 June 2020, available at https://www.iareporter.com/articles/majority-in-unionmatex-v-turkmenistan-agrees-to-rescind-security-for-costs-order/, last accessed on 12 September 2021.

guarantee on commercially viable terms, the tribunal allowed the claimant to explore the possibility of concluding an after-the-event ("**ATE"**) insurance policy for USD 1.5 million.

The tribunal revisited its security for costs order three months later in light of the proposed ATE insurance policy that the claimant had been able to obtain. Payment of the premium for the insurance would have had to come from the claimant's funder, with the result that if the claims were ultimately successful the eventual cost of this security would have amounted to USD 4.4 million. Finding that it was impossible or financially unreasonable for the claimant to provide the security the tribunal had ordered, the majority of the tribunal decided to rescind its order. The majority considered that denying the claimant the opportunity to substantiate its claims, including that its insolvency had been caused by Turkmenistan's actions, would amount to a denial of access to justice.[57]

Issues related to disclosure of third-party funding arrangements and security for costs were considered together in the PCA Case *Bacilio Amorrortu v. Republic of Peru*.[58] There, the tribunal was faced with a broad request by the State to order the claimant: (i) to disclose the name of any funder with which the claimant had entered or planned to enter into an agreement; (ii) to confirm that the funder was obligated to pay any adverse costs award; and (iii) to disclose copies of the provisions of the funding agreement(s) related to cost awards and the conduct, termination or settlement of the arbitration.[59]

As an initial matter, the claimant agreed to disclose the identity of the third-party funder so that any conflicts could be identified.[60]

With respect to its other requests, the State argued that an undertaking (or its absence) by the funder to pay an adverse costs award would be relevant to a potential application for security for costs, and pointed out that the claimant was acting in his personal capacity "*unlike a company which may have access to ongoing corporate revenue or to shareholder funds*".[61] The tribunal, however, noted that the existence of a third-party funding agreement does not imply that a claimant is impecunious. As stated by the tribunal: "*There are numerous other reasons why a claimant may seek third party funding, including risk management and validation by a more objective third party of the merits of the claim."*[62]

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[57] *Idem.*

[58] *Bacilio Amorrortu v. Republic of Peru*, PCA Case No. 2020-11, Procedural Order No. 2 on Request for Disclosure of Funding Agreement, 19 October 2020, available at https://www.italaw.com/sites/default/files/case-documents/italaw11965.pdf, last accessed on 12 September 2021.

[59] *Ibidem,* par. 1.

[60] *Ibidem,* par. 6.

[61] *Ibidem,* par. 9.

[62] *Idem.*

Concerning whether the claimant would be able to settle or terminate the proceeding without the funder's permission, the tribunal noted that third-party funding arrangements vary, and "*[t]here is no onus on the Claimant to demonstrate that in this case he is free to negotiate and terminate the arbitration as he sees fit.*"[63] The tribunal explained that in its view, the State's requests raised an access to justice issue: "*If the claimant can meet the jurisdictional requirements to have his claim arbitrated [...] then there is no additional requirement that he prove financial capacity to meet any potential adverse costs award or that he is the master of his own litigation*".[64]

To the contrary, the tribunal insisted that it "*is for the Respondent to establish the need for special protective measures*".[65] As the State had not even alleged any bad faith by the claimant or any other circumstances "*except for the simple fact that the Claimant has entered into a third party funding agreement*", the tribunal denied the State's request to order disclosure of the terms of the funding agreement.[66]

4. Conclusion

In light of ISDS arbitral tribunals' treatment of third-party funding to date, there seems little need to revise the ICSID Arbitration Rules to specifically address funding. Calls to do so and the positions expressed by some stakeholders regarding third-party funding appear to be based on fundamental opposition to ISDS, scepticism regarding the investment and finance industries, and/or a lack of familiarity with third-party funding rather than the realities associated with use of third-party funding in ISDS cases. Proposals regarding how the rules should be changed to address third-party funding therefore need to be viewed in their proper context and with caution.

It appears that the ICSID Secretariat is indeed proceeding with caution, giving thoughtful consideration to the views of member States as well as representatives of investor claimants that are the users of the ICSID Arbitration Rules.

The available evidence shows that there is no need to regulate third-party funding beyond requiring the disclosure of the existence of a funding arrangement and the identity of the funder in order to avoid or address potential conflicts of interest with respect to the arbitral tribunal. Requiring disclosure of the terms of a funding arrangement is unnecessary, unfair, and would implicate serious privilege issues.

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[63] *Ibidem*, par. 10.

[64] *Ibidem,* par. 11.

[65] *Idem*.

[66] *Idem.*

Against that background, the part of the proposed new Rule 14 of the ICSID Arbitration Rules that would require parties using third-party funding to disclose the name and address of the funder is understandable. However, its statement that the arbitral tribunal may order disclosure of "*further information regarding the funding agreement and the non-party providing funding"*[67] is an unnecessary addition to tribunals' existing authority to order the production of evidence and to make provisional orders. In most cases, additional information about the funding agreement is likely to be irrelevant to the matters to be decided in the arbitration. And as the ICSID Secretariat has recognized,[68] further information regarding the funding agreement is likely to be commercially sensitive and privileged. Hence, tribunals should continue to tread carefully when considering to order any disclosure of the terms of the funding.

Nor should the existence of third-party funding be considered a factor sufficient to justify an order requiring a party to provide security for costs. Third-party funding may be critical to provide access to justice for claimholders who do not have the means to pursue their case without funding. It is also fundamentally unfair to burden them with the additional costs that would be associated with providing security for costs in addition to the other costs of pursuing their claim. In the case of claimants that are not impecunious, which for example have sought third-party funding in order to manage their balance sheet or exposure to risk, the existence of third-party funding has no relevance to the claimants' ability or willingness to pay an eventual adverse costs award.

In that regard, the current draft of Rule 53 of the ICSID Arbitration Rules appropriately would prohibit tribunals from ordering security for costs based solely on the existence of third-party funding, and it would require tribunals to consider the *"effect that providing security for costs may have on that party's ability to pursue its claim or counterclaim"*.[69]

[67] ICSID Secretariat, Working Paper # 5, *loc. cit.*, p. 35.

[68] *Ibidem*, p. 279, par. 42.

[69] *Ibidem,* pp. 55-56.