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# Disclosure and Security for Costs or How to Address Imbalances Created by Third-Party Funding

Nadia DARWAZEH & Adrien LELEU<sup>\*</sup>

*The growth of third-party funding (TPF) in international arbitrations seems to have intensified recently, as suggested by the rise in the number of publicly-known cases involving funders. TPF is here to stay and it can play an important and commendable role in the arbitral process when it provides an impecunious party with access to justice. However, the flipside is that the addition of funders to the arbitral equation also creates imbalances where there were none before. This article provides an innovative perspective into the issue of TPF, by analysing how funders have impacted the arbitral process. The arbitral community should be aware of these imbalances and seriously consider effective remedies to redress them, thereby safeguarding the integrity and efficiency of the arbitral process. Currently, there is virtually no regulation of TPF conduct in international arbitration, and funders have been left to define their own rules of conduct. In the absence of appropriate and consistent regulation, two remedies can already be implemented to address the imbalances created by TPF. First, a funded party should communicate upfront and transparently about TPF. Second, arbitral tribunals should be more amenable to granting security for costs, especially when an impecunious claimant is being funded and the respondent is faced with a serious risk of a hit-and-run arbitration.*

## 1 INTRODUCTION

At the end of last year, one of the authors was asked to give a talk on third-party funding (TPF) at the *Deutsche Institution für Schiedsgerichtsbarkeit* (DIS) annual autumn conference dealing with power imbalances in international dispute resolution. Specifically, the question posed was whether TPF creates more imbalances than it eliminates.<sup>1</sup>

While there have been an increasing number of conferences and articles in recent years that have addressed various aspects of TPF, this perspective provided an

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<sup>1</sup> This article is loosely based on the presentation given by Nadia Darwazeh at the Conference entitled 'Power Imbalances in International Dispute Resolution' organized by the *Deutsche Institution für Schiedsgerichtsbarkeit* (DIS), Berlin, 23 Sep. 2015.

innovative way of looking at the topic. Indeed, by systematically analysing how TPF impacts the arbitral process, one is able to identify the imbalances that it addresses, but also those that it creates.

Why is it important to identify such imbalances? Because, only if we are aware of the imbalances can the arbitration community consider appropriate remedies to address them, thereby safeguarding the integrity and efficiency of the arbitral process.

When funders were still new to the arbitration game about ten years ago, the key question was whether TPF was in fact legal. Historically, at common law, TPF had been deemed illegal because of principles of champerty and maintenance. Today some jurisdictions such as Ireland,<sup>2</sup> Malaysia,<sup>3</sup> and Singapore,<sup>4</sup> still consider TPF to be outright illegal, whereas in civil law jurisdictions such as France and Belgium TPF falls within a grey area, with the law being generally suspicious of such practice.<sup>5</sup> However, the initial legal roadblocks have been eroded in many jurisdictions including Australia,<sup>6</sup> Germany,<sup>7</sup> the United Kingdom,<sup>8</sup> and the United States,<sup>9</sup> with Hong Kong probably following suit before not too long.<sup>10</sup> Names such as Burford, Calunius, Harbour Litigation, or Vannin Capital, which were unknown or simply non-existent only a few years ago, are now commonly known household names. The growth of TPF in the arbitration space seems to have intensified recently, as suggested by the rise in the number of publicly-known cases involving funders. A recent study in investment arbitration by the ICCA-Queen Mary Task Force found that between 2010 and 2014 (i.e., over a five-year period) there were twelve reported orders, decisions or awards addressing

<sup>2</sup> See, e.g., *Thema Int'l Fund plc v. HSBC Institutional Trust Services Ltd.*, [2011] I.E.H.C. 357.

<sup>3</sup> See, e.g., Christopher Leong, *Dispute Resolution in Malaysia*, Practical L. 2015, at 6.

<sup>4</sup> See, e.g., *Otech Pakistan Pvt. Ltd. v. Clough Engineering Ltd.*, [2006] S.G.C.A. 46 at 36.

<sup>5</sup> For the position under French law see Maximin de Fontmichel, *Les sociétés de financement de procès dans le paysage juridique français*, *Revue des Sociétés* (Dalloz 2012), p. 279. For the position under Belgian law, see Patrick Michielsen, *Third Party Funding for Litigation: Views under Belgian Law*, Lexology (October 2008).

<sup>6</sup> Since the well-known High Court decision in *Campbells Cash & Carry Pty. Ltd. v. Fostif Pty. Ltd.*, [2006] H.C.A. 41 (in which it was held to be permissible for a funder to fund and control a class action in exchange for one-third of any damages). Australia has established itself as a very permissive jurisdiction for TPE.

<sup>7</sup> Gerhard Wagner, *Litigation Costs Recovery- Tariffs and Hourly Fees in Germany*, in *Litigation in England and Germany- Legal Professional Services, Key features and Funding*, Bielefeld: Gieseking Verlag (2010), pp. 149–184.

<sup>8</sup> The champerty principle has been gradually weakened by legislative developments and recent court decisions. See *Arkin v. Borchard Lines Ltd. & ors.*, [2005] EWCA Civ 655.

<sup>9</sup> Anthony Sebok, *Betting on Tort Suits after the Event: from Champerty to Insurance*, 60 DePaul L. Rev., 453 (2011); see also Aren Goldsmith & Lorenzo Melchionda, *Third Party Funding in International Arbitration: Everything You Ever Wanted to Know (But Were Afraid to Ask): Part 2*, 2 Int'l Business L. J., 229–230 (2012).

<sup>10</sup> Tom Jones, *TPF Gets Thumbs up in Hong Kong*, Global Arb. Rev. (October 2015).

questions in connection with TPF.<sup>11</sup> In 2015 alone, the authors are aware of at least seven of such orders, decisions or awards dealing with TPF issues.<sup>12</sup>

TPF is here to stay and it can play an important and commendable role in the arbitral process when it provides an impecunious party with access to justice. However, the flipside is that the addition of funders to the arbitral equation also creates imbalances where there were none before. The arbitral community should be aware of these imbalances and apply effective remedies to redress them. Only by addressing them head on, can TPF be turned into a sustainable mechanism and prevent a further backlash against the use of arbitration in investor-state disputes.<sup>13</sup>

But first things first: what exactly do we mean by TPF? Without discounting the many definitions already suggested in the existing scholarly works,<sup>14</sup> a conceptual point of departure for defining TPF is set out in the new iteration of the IBA Guidelines on Conflicts of Interest, where the practice is referred to as:

Any person or entity that is contributing funds or material support to the prosecution or defense of the case and that has a direct economic interest in the award to be rendered in the arbitration.<sup>15</sup>

This characterization grasps well the essence of what TPF encompasses. Indeed, it excludes other types of financing, such as bank loans, intra-group financing, as well as philanthropic and benevolent financing by non-governmental organizations.

With this definition in mind, this article will first analyse how TPF may create imbalances in the arbitral process. The second part of the article will then explain why transparency and security for costs are the two key remedies to address such imbalances effectively. Also, for ease of reference, attached to this article is an annex

<sup>11</sup> ICCA-Queen Mary Task Force on Third Party Funding Sub Group on Investment Arbitration, Draft Report for discussion summer 2015, p. 15; see also Jean-Christophe Honlet, *Recent Decisions on TPF in Investment Arbitration*, 30 ICSID Rev. 699 (2015).

<sup>12</sup> *RSM v. St Lucia*, ICSID Case No. ARB/12/10, Decision on Saint Lucia's Request for Suspension or Discontinuance of Proceedings, 8 Apr. 2015; *Ambiente v. Argentina*, ICSID Case No. ARB/08/9, Order of Discontinuance of the Proceedings, 28 May 2015; *Eurogas v. Slovakia*, ICSID Case No. ARB/14/14, Order of Disclosure, Hearing on Provisional Measures, 17 Mar. 2015, Transcript, 144–45; *Eurogas v. Slovakia*, ICSID Case No. ARB/14/14, Decision on Provisional Measures, 23 Jun. 2015; *Sehil v. Turkmenistan*, ICSID Case No. ARB/12/6, Procedural Order No. 3, 12 Jun. 2015; *Sehil v. Turkmenistan*, ICSID Case No. ARB/12/6, Decision on Request for Security for Costs (pending according to ICSID website). In addition, the authors are also aware of one unpublished UNCITRAL decision dealing with the issue. Meanwhile the press has reported that Vancouver-based mining company Edgewater Exploration, after securing TPF, intends to launch a BIT arbitration against Spain, See *Canadian Miner Warns Spain of Potential Arbitration over Terminated Gold Mine Project*, IA Rep. (23 Oct. 2015).

<sup>13</sup> See, e.g., recently, Claire Provost & Matt Kennard, *The Obscure Legal System that Lets Corporations Sue Countries*, The Guardian (10 Jun. 2015).

<sup>14</sup> See, e.g., Victoria Shannon, *Judging TPF*, 63 UCLA L. Rev., 5–12 (2016); Maya Steinitz, *Whose Claim Is This Anyway? Third Party Litigation Funding*, 95(4) Minnesota L. Rev., 1275–1278 (2011).

<sup>15</sup> IBA Guidelines on Conflicts of Interest in International Arbitration, adopted 23 Oct. 2014, Explanation General Standard 6(b), 13.

summarizing the various decisions involving TPF in cases addressing questions of transparency and security for costs.

## 2 HOW DOES TPF CREATE IMBALANCES IN THE ARBITRAL PROCESS?

The benefits of TPF have already been discussed *in extenso*,<sup>16</sup> in particular the fact that it can be a tool for an impecunious claimant to finance its arbitration.<sup>17</sup> This article will discuss TPF's other side of the coin, namely, that it creates imbalances in the arbitral process. Specifically and most significantly, TPF creates imbalances between claimants and respondents by potentially exposing respondents to what has been described as a 'hit-and-run arbitration'.<sup>18</sup> The other difficulty is that the tribunal has no de jure control over the funder, which essentially acts as a shadow party in the arbitration.

### 2.1 TPF CREATES IMBALANCES THAT ADVERSELY AFFECT RESPONDENTS

In investor-state arbitrations, where states are mostly unable to assert claims of their own,<sup>19</sup> TPF has exclusively benefitted investors. Indeed, among the publicly-known cases, none concern a case in which the respondent is being funded.<sup>20</sup>

How then does TPF affect respondents? It may affect respondents in several ways. First, TPF may give rise to frivolous and exaggerated claims, which in turn increase respondents' costs of defence. Second, even when respondents are victorious in defeating such claims, because of the involvement of TPF, they are unlikely to be able to recover such costs.

<sup>16</sup> Courtney Barksdale, *All That Glitters Isn't Gold: Analyzing the Costs and Benefits of Litigation Finance*, 26 Rev. of Litig. 707 (2007).

<sup>17</sup> Detlev Kühner, *The Impact of Party Impecuniosity on Arbitration Agreements: The Example of France and Germany*, J. Int'l Arb. 807–818 (2014).

<sup>18</sup> See Jean Kalicki, *Security for Costs in International Arbitration*, 3(5) Transnatl. Dis. Mgt. 1 (December 2006).

<sup>19</sup> See generally, Anne Hoffmann, *Counterclaims in Investment Arbitration*, 28 ICSID Rev. (2013).

<sup>20</sup> There are rare instances in which respondent states in Treaty arbitration have been funded by NGOs. See, e.g., *Phillips Morris v. Uruguay*, ICSID Case No. ARB/10/7, in which Uruguay's defence is being funded by the Anti-Tobacco Trade Litigation Fund, a foundation set up by Michael Bloomberg and Bill Gates to help developing countries ward off legal action from the tobacco industry over anti-smoking measures. However, this type of philanthropic funding falls outside the scope of the definition of TPF we set out in the introduction.

## 2.1[a] *TPF may engender frivolous and inflated claims*

From the perspective of respondents, TPF simply means more claims to defend against. By way of analogy, Australia saw an estimated 16.5% rise in litigation after liberalizing its attitude toward TPF.<sup>21</sup>

While an increase in claims – if they are serious ones – is not condemnable, an increase in frivolous or exaggerated claims is. So, the question arises whether TPF increases the number of frivolous and/or exaggerated claims.

The apostles of TPF argue that TPF in fact acts as a filter of meritless cases. They argue that professional funders apply a rigorous selection process, and will only fund claims that are serious in order to maximize the funders' own chances of success.<sup>22</sup>

While this argument resonates and may be true when it comes to some funders, the reality is different according to a recent UNCTAD Report:

[T]here are serious policy reasons against TPF . . . For example, it may increase the filing of questionable claims. From a respondent State's perspective, such frivolous claims, even if most of them fail, can take significant resources and may cause reputational damage. TPF companies, who build a portfolio of claims, have an economic incentive to put money even into weak cases that have at least some chance of high monetary award.<sup>23</sup>

Indeed, funders appear to mitigate the risk of potential losses by spreading that risk over many cases, with some cases carrying a higher risk-exposure as confirmed by one funder:

If we shy away from risk for fear of loss, as some litigation investors do, we will not maximize the potential performance of this portfolio.<sup>24</sup>

Put slightly differently, and as depicted compellingly by our colleague George Kahale III, TPF is somewhat similar to drilling for oil: 'you know you will be drilling a lot of dry holes, but one discovery can make it all worthwhile'.<sup>25</sup>

As such, funders will also fund claims that are more dubious and that would never have been brought by a claimant save for the availability of TPF. They may take a bet on a case that has a substantial upside, even if the chances of the claim succeeding are low, as confirmed by another funder who stated that 'the perception that you need strong merits is wrong – there is a price for

<sup>21</sup> See U.S. Chamber of Commerce, *Selling Lawsuits, Buying Trouble: The Emerging World of Third-Party Litigation Financing in the United States* (2009), 9.

<sup>22</sup> See Susana Khouri & Kate Hurford, *Third Party Funding in International Commercial and Treaty Arbitration- a Panacea or a Plague?*, Transnatl. Dis. Mgt. 5 (2011); Alain Grec, *Pratique d'une Institution Financière Régulée*, LETTRE DE L'ASSOCIATION FRANÇAISE D'ARBITRAGE, June 2014, No. 12.

<sup>23</sup> See, e.g., UNCTAD, *Recent Developments in Investor-State Dispute Settlement*, (May 2013), p. 25.

<sup>24</sup> Burford, Annual Report 2011, p. 5 (2011).

<sup>25</sup> George Kahale, III, *Is Investor-State Arbitration Broken?*, Transnatl. Dis. Mgt. 33 (2012).



everything'.<sup>26</sup> In this vain, a higher return rate could make it worthwhile for a funder to take the risk of funding a frivolous claim.

One must bear in mind that in order to increase their profitability, funders have a strong incentive to also take bigger risks and thereby maximize the value of their portfolio. A 2009 report for the US Chamber of Commerce supported this point when it concluded that: 'litigation-finance companies have a high appetite for risk and are willing to fund speculative, high-yield cases'.<sup>27</sup> TPF may, therefore, result in a respondent having to defend against more dubious claims.

At the same time, TPF also increases the risk of exaggerated claims. Empirical data shows that claimants already have a tendency to inflate their claims beyond their actual value.<sup>28</sup> It is not far-fetched to consider that this problem of inflated claims may be exacerbated when a funder, whose sole motivation is financial gain, is involved.<sup>29</sup>

2.1[b] *TPF is likely to increase significantly respondents' costs and the risk that it will be unable to recover them*

By definition, a claimant benefiting from TPF will be able to hire counsel and engage in a litigation strategy that it would otherwise not have been able to afford. A respondent will in turn have to step up its defence and incur additional litigation costs that it would not have incurred otherwise.<sup>30</sup> This becomes unacceptable if the respondent incurs increased costs because a funder supports frivolous and exaggerated claims, even more so when the respondent is unable to recover such costs.

For one, such an increase in costs flies in the face of the criticism voiced in recent years that arbitration is too expensive. More worrisome, however, is the problem that a successful respondent is unlikely to be able to recover its costs – costs that it would not have incurred but for the TPF.

Indeed, when a respondent obtains a costs award against an impecunious claimant which has relied on TPF to finance its claims, the respondent is left with no effective means of enforcing that award. The respondent cannot enforce the award against the claimant because it has no assets – which is the very reason why

<sup>26</sup> Quote from Mick Smith co-founder of Calunius, cited in, *Speculating on Injustice*, Published by CORPORATE EUROPE OBSERVATORY and the TRANSNATIONAL INSTITUTE (November, 2012), p. 59.

<sup>27</sup> US Chamber of Commerce, *Selling Lawsuits, Buying Trouble: The Emerging World of Third-Party Litigation Financing in the United States* (2009) p. 6.

<sup>28</sup> Matthew Hodgson, *Counting the Costs of Investment Treaty Arbitration*, Global Arb. Rev. 5 (March 2014).

<sup>29</sup> Lord Daniel Brennan QC, *Third Party Litigation Funding and Claim Transfer – A Perspective from Common Law*, Third-Party Litigation Funding and Claim Transfer 49 (2010).

<sup>30</sup> See, e.g., Aren Goldsmith & Lorenzo Melchionda, *Third Party Funding in International Arbitration: Everything You Ever Wanted to Know (But Were Afraid to Ask): Part 2*, 2 Int'l Bus. L. J., 222–223 (2012).

the claimant resorted to TPF in the first place. At the same time, the respondent cannot enforce the award against the funder because the funder is not a party to the arbitration and it cannot be named in the award, as arbitral tribunals generally lack jurisdiction over third parties.<sup>31</sup>

Such a situation, in which the claimant and the funder both fail to pay a costs award, has been referred to as an ‘arbitral hit-and-run’.<sup>32</sup> It has also been described as an ‘asymmetrical situation’ in which the funders enjoy the ‘best of both worlds’.<sup>33</sup> One arbitrator has referred to this situation as the ‘gambler’s nirvana’: if the claims are successful, the funders win; if a costs award is rendered against a funded party, the funders do not lose because they cannot be ordered to bear such costs.<sup>34</sup>

Unfortunately, with the increase of funded claimants, the number of reported arbitral hit-and-runs is likely to grow.

But one must also not forget that such an arbitral hit-and-run may even occur earlier on in the process, i.e., before an award on costs is even rendered. Indeed, a respondent is faced with a similar issue of being left in the lurch, when a funder withdraws its funding in the course of the arbitration, leaving the claimant with no choice but to abandon the claim. This is what happened, for example, in the case of *S&T Oil Equipment v. Romania*,<sup>35</sup> and more recently in *Ambiente v. Argentina*.<sup>36</sup> In the *S&T Oil* case, the claimant was bankrupt and the dispute was kept alive for two years, only because of cash injections by a funder. When the funder pulled out, S&T Oil discontinued the case and Romania was stuck with millions in legal costs, that it would not have incurred but for the TPF. By the same token, in the recent *Ambiente* case, the funder withdrew from the case after six years of a costly jurisdictional phase dealing notably with questions of mass-claims. In this case, one

<sup>31</sup> Maxi Scherer, *TPF in Arbitration: Out in the Open?*, Com. Dis. Res., 57–58 (May 2012).

<sup>32</sup> Jean Kalicki, *Security for Costs in International Arbitration*, 3(5) Transnatl. Dis. Mgt. 1 (December 2006).

<sup>33</sup> Philippe Pinsolle, *Third Party Funding and Security for Costs*, 2 Paris J. Int’l Arb., 399 (2013).

<sup>34</sup> See *RSM Production Corp. v. Santa Lucia*, ICSID Case No. ARB/12/10, Decision on Saint Lucia’s Request for Security for Costs, 13 Aug. 2014, Assenting Reasons of Gavin Griffith, at 12–13: (‘It is increasingly common for BIT claims to be financed by an identified, or (as here) unidentified third party funder, either related to the nominal claimant or one that engages in the business venture of advancing money to fund the claimant’s claim, essentially as a joint-venture to share the rewards of success but, if security for costs orders are not made, to risk no more than its spent costs in the event of failure. Such a business plan for a related or professional funder is to embrace the gambler’s Nirvana: Heads I win, and Tails I do not lose.’).

<sup>35</sup> *S & T Oil Equipment & Machinery Ltd. v. Romania*, ICSID Case No. ARB/07/13. For a detailed analysis of the case, see, Bernardo Cremades, *Third Party Litigation Funding: Investing in Arbitration*, Transnatl. Dis. Mgt. 25–33 (October 2011).

<sup>36</sup> *Ambiente Ufficio S.p.A. & ors. v. Argentine Republic*, ICSID Case No. ARB/08/9, Order of Discontinuance of the Proceedings, 28 May 2015.

of the co-arbitrators took issue with the majority's decision not to allocate costs when deciding to discontinue the case.<sup>37</sup>

## 2.2 TPF MAY ADVERSELY AFFECT THE FUNCTIONING OF THE TRIBUNAL

TPF also raises problems vis-à-vis the arbitral tribunal. First, the involvement of a funder may give rise to conflicts of interest issues for the arbitrators. Second, it may be problematic that the funder is a shadow party to the arbitral proceedings over which the tribunal has no authority or control.

### 2.2[a] *TPF may give rise to conflicts of interest*

The cornerstone of modern international arbitration is the impartiality and independence of the arbitral tribunal. The introduction of a funder into the arbitral equation may create potential conflicts of interest for the members of tribunals.<sup>38</sup> This is especially the case since the funding industry specializing in international arbitration remains highly concentrated. Below we set out three examples of situations in which the involvement of a funder may create conflicts of interest:

- An arbitrator may serve as an advisor to a funder that is financing the defence of one of the parties in the case. This situation is likely to arise more and more often as an increasing number of well-known arbitrators take on advisory positions with funders.
- An arbitrator's law firm may have a significant relationship with a funder involved in the case. Indeed, the authors are aware of law firms, with arbitrators among their ranks, which have a recurring relationship with funders.
- One of the arbitrators in a case involving a funder may be acting as counsel for a party that is being funded by the same funder in a separate case.

The independence and impartiality of an arbitral tribunal cannot be properly assessed, unless the existence of a funder is disclosed to all the members of an

<sup>37</sup> *Ambiente Ufficio S.p.A. & oths. v. Argentine Republic*, ICSID Case No. ARB/08/9, Individual Statement by arbitrator Santiago Torres Bernárdez, 28 May 2015. ('The Order has also failed to allocate costs as between the Parties because of the opposition of my co-arbitrators, leaving in a limbo pending financial matters.'). It is interesting to note that in those cases where claimants have dropped the case after funders withdrew, tribunals have not issued adverse costs orders. This is in contrast with other cases not involving TPF, where claimants have abandoned the case and tribunals have issued such orders. See, e.g., *East Cement v. Poland*, ICC Case No. 16509/JHN, Partial Award, 26 Aug. 2011; *Quadrant Pacific Growth v. Costa Rica*, ICSID Case No. ARB(AF)/08/1, Order of the Tribunal Taking Note of the Discontinuance of the Proceeding and Allocation of Costs, 27 Oct. 2010.

<sup>38</sup> See generally, Jennifer Trusz, *Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration*, 101 *Georgetown L.J.*, 1649 (2013).

arbitral tribunal, the parties and the arbitral institution. It is insufficient for the funder or claimant to simply assume that there is no conflict of interest. Quite apart from the fact that the funder or claimant may not be aware of all the relevant facts and relationships, it is not for them unilaterally to make such a judgment call. Ultimately, failure to disclose the existence of a funder may also jeopardize the award, which may be prone to set-aside proceedings or be refused enforcement.

This issue of potential conflicts of interest has now been widely acknowledged by the arbitration community and has recently been addressed in the 2014 revisions of the IBA Guidelines on Conflicts of Interest. The Guidelines now specifically provide that a funder shall be considered the ‘equivalent of the party’<sup>39</sup> for conflict check purposes. This addition to the IBA Guidelines has important ramifications. For example, in the first scenario mentioned above, if the arbitrator also serves as an advisor to a funder involved in the case, it would appear to fall under the non-waivable red list of the IBA Guidelines.<sup>40</sup> As to the second scenario described above, where the arbitrator’s law firm has a significant relationship with the funder, it would appear to fall under the waivable red list.<sup>41</sup>

## 2.2[b] *Tribunal lacks control over funders*

The second issue that arises for arbitral tribunals is that they do not have any control over the funder. Since arbitration is based on consent, and funders are generally not a party to the arbitration agreement, arbitrators will have no jurisdiction over such funders.<sup>42</sup> In fact, even under French law, which is one of the most flexible in extending arbitration clauses to third parties, it is highly doubtful that, as of today, the funder’s interest in an arbitration would be sufficient to treat the funder as a party to the arbitration clause.<sup>43</sup>

<sup>39</sup> IBA Guidelines on Conflicts of Interest in International Arbitration, adopted 23 Oct. 2014, General Standard 6(b), 13 (‘If one of the parties is a legal entity, any legal or physical person having a controlling influence on the legal entity, or a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration, may be considered to bear the identity of such party.’); Explanation to General Standard 6(b), 14–15 (‘Third-party funders and insurers in relation to the dispute may have a direct economic interest in the award, and as such may be considered to be the equivalent of the party.’).

<sup>40</sup> See IBA Guidelines on Conflicts of Interest, Non-Waivable Red List, Situation 1.4 (‘The arbitrator or his or her firm regularly advises the party, or an affiliate of the party, and the arbitrator or his or her firm derives significant financial income therefrom.’).

<sup>41</sup> See IBA Guidelines on Conflicts of Interest, Waivable Red List, Situation 2.3.6 (‘The arbitrator’s law firm currently has a significant commercial relationship with one of the parties, or an affiliate of one of the parties.’).

<sup>42</sup> Edouard Bertrand, *The Brave New World of Arbitration: Third-Party Funding*, 29(3) ASA Bull., 613 (2011).

<sup>43</sup> Philippe Pinsolle, *Le Financement de l’Arbitrage par les Tiers*, 2 Revue de l’arbitrage, 385 (2011).

As a result, arbitrators are left with no real means of holding funders accountable for their actions.<sup>44</sup> In this sense, the power of arbitral tribunals differs from that of state courts, which have held funders liable for their actions. Indeed, in the United States, some courts have considered that a certain level of involvement of a funder in a case meant that it was a party to the litigation. Florida's Third District Court of Appeal ruled that litigation funders had 'such control thereof as to be entitled to direct the course of the proceedings' and thus were a 'party' to the litigation.<sup>45</sup> In this case, the funders had a right to approve counsel for the plaintiffs, a veto power over whether the suit was filed and how it would be pursued, and the final say over any settlement agreements; the funders paid the litigation costs, and were entitled to receive a percentage of the amount awarded to the plaintiffs.

While English courts do not consider funders as party to the litigation, they have nonetheless issued an *ex parte* order against funders.<sup>46</sup> In the much-debated *Excalibur* case, the court ordered the nine funders of claimant to bear the costs of the proceedings and apportioned the amount that each funder would have to bear.<sup>47</sup> The decision also illustrates that the courts look at the economic realities in exercising their discretion to order costs.

The difficulty in international arbitration is that arbitral tribunals do not have *imperium*, and will be hard pressed to order that a funder bear the respondent's costs in an award or procedural order. As will be discussed in the proposals section below, a tribunal can, however, address this issue by ordering security for costs in appropriate circumstances. In doing so, the tribunal exercises indirect control over the third-party funder and eliminates the real risk of a hit-and-run arbitration.

### 3 PROPOSALS TO REGULATE TPF IN INTERNATIONAL ARBITRATION

There is virtually no regulation of TPF conduct in international arbitration, and funders have been left to define their own rules of conduct.<sup>48</sup> In the absence of appropriate and consistent regulation, two remedies can already be implemented to address the imbalances created by TPF. First, a funded party should

<sup>44</sup> In some rare instances arbitral tribunals have issued a costs order against TPF when the *lex arbitri* provided for it; Lisa Bench Nieuwveld & Victoria Shannon, *Third-Party Funding in International Arbitration*, (Kluwer International 2012) *passim*.

<sup>45</sup> *Mohammed Abu- Ghazaleh v. Gerardo Martin Demerutis*, District Court of Appeal of Florida, Third District, 36 So. 3d 691 (December, 2009).

<sup>46</sup> See, e.g., *Arkin v. Borchard Lines Ltd. & ors*, [2005] EWCA Civ 655, 41–42 ('A professional funder, who finances part of a claimant's costs of litigation, should be potentially liable for the costs of the opposing party to the extent of the funding provided.').

<sup>47</sup> *Excalibur Ventures L.L.C. v. Texas Keystone Inc. & ors*, [2015] EWHC 566 (Comm).

<sup>48</sup> See, e.g., Code of Conduct for Litigation Funders, adopted January 2014.

communicate transparently and be upfront about TPF. This first step is a *sine qua non* to safeguarding the efficiency and integrity of the arbitral system. The second proposal is for arbitral tribunals to exert indirect control over the funder by granting security for costs applications more willingly. They should be more readily granted in appropriate circumstances, namely, when an impecunious claimant is being funded and the respondent is faced with a serious risk of a hit-and-run arbitration.

### 3.1 UPFRONT DISCLOSURE OF TPF IS A MUST

It is paramount to establish a rule requiring upfront disclosure of a funder if a party is funded in a case. In the past, claimants have not disclosed *sua sponte* the existence of TPF. In fact, it appears that there is only one publicly-known case of upfront disclosure, namely, *Oxus v. Uzbekistan*, where the disclosure was made due to financial disclosure requirements. As it stands, claimants refuse to make such disclosures even when called upon by respondents.<sup>49</sup>

Australia, the historic home of TPF, has enacted such a rule of upfront disclosure,<sup>50</sup> and it stands to reason that international arbitration should follow suit.

Some, especially those who may benefit the most from the growth of TPF, have opposed the establishment of such a rule.<sup>51</sup> They have insisted that once a tribunal becomes aware that a claimant is being funded, it may be inclined to consider a claim as frivolous. Whether this concern is justified or not, it is trumped by the overarching principle of transparency. Indeed, the disclosure of TPF is necessary to assess any potential conflicts of interest between the arbitrators and the funder. Only such upfront disclosure can ensure the efficiency and integrity of the arbitral process. If a funder's involvement is only revealed at a later stage in the proceedings it could have serious if not disastrous consequences, especially at the award enforcement stage.

<sup>49</sup> This was for instance the case in *Sehil v. Turkmenistan*, ICSID Case No. ARB/12/6, and *Eurogas v. Slovakia*, ICSID Case No. ARB/14/14.

<sup>50</sup> See Art. 3.6 of the Federal Court's Practice Note CM 17, last revised on 9 Oct. 2013. See also, Lisa Bench Nieuwveld & Victoria Shannon, *Third-Party Funding in International Arbitration*, 92 (Kluwer International 2012); Jean-Yves Garaud, *Le Tiers Financier: Un Acteur Caché*, Association Française d'Arbitrage (April 2014).

<sup>51</sup> Christopher Bogart, *Public Consultation in Investor-State Dispute Settlement*, OECD 68 (August 2012); Laurent Lévy & Régis Bonnan, *Third-party Funding: Disclosure, Joinder and Impact on Arbitral Proceedings*, in *Third Party Funding in International Arbitration*, (Dossiers ICC Institute of World Business Law 2013), p. 78, Jonas von Goeler, *Third Party funding in International Arbitration and its Impact on Procedure*, 151 (Kluwer International 2016).

Over the past year, the call for such an upfront disclosure obligation has gained ground among commentators.<sup>52</sup> As already mentioned above, the new IBA Guidelines on Conflicts of Interest expressly memorialized the importance of this issue by introducing General Standard 6(b), which now provides that an entity with a direct economic interest in the award shall be considered the ‘equivalent of the party’ for conflict check purposes.<sup>53</sup> General Standard 7(a) then logically goes on to mandate disclosure of the funder’s identity, in order to assess conflicts of interest of arbitrators:

A party shall inform an arbitrator, the Arbitral Tribunal, the other parties and the arbitration institution of any relationship, direct or indirect, between the arbitrator and any person or entity with a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration. The party shall do so on its own initiative at the earliest opportunity.

Thus far, in the absence of a clear obligation to disclose, it is unsurprising that in the vast majority of cases the involvement of funders remained unknown. In fact there are only four publicly-known cases addressing the issue of disclosure.

In *Guaracachi v. Bolivia*,<sup>54</sup> the respondent already knew the name of the funder. It requested disclosure of the funding agreement, which it argued would be relevant to the issues of conflicts of interest and security for costs. The tribunal chaired by José Miguel Júdece declined the request for disclosure of the agreement. However, it confirmed that it was not aware of any conflicts of interest between the arbitrators and the funder. It also noted that the claimants admitted that the funding agreement would not cover payment of a costs award and that the tribunal would ‘draw such inferences’ when called upon to decide on the application for security for costs.<sup>55</sup>

<sup>52</sup> See, e.g., Catherine A. Rogers, *Ethics in International Arbitration*, 201 (Oxford University Press 2014); *Rapport du Club des Juristes – Financement du procès par les tiers*, (June 2014), 59 (‘It is undeniable that the presence of a third party funder in the arbitral proceeding may generate potential conflicts of interest. In this sense, the current situation that does not require anyone to disclose anything cannot persist.’); William Stone, *Third Party Funding in International Arbitration: A case for Mandatory Disclosure*, *Asian Dis. Rev.*, 62 (April 2015); Burcu Osmanogulu, *Third Party Funding in International Commercial Arbitration and Arbitrator Conflict of Interest*, 32 *J. Int’l Arb.* 325 (2015); Anna Joubin-Bret, *Spotlight on TPF in Investor-State Arbitration*, 16 *J. World Inv. & Trade*, 728 (2015).

<sup>53</sup> IBA Guidelines on Conflicts of Interest in International Arbitration, adopted 23 Oct. 2014, General Standard 6(b), 13 (‘If one of the parties is a legal entity, any legal or physical person having a controlling influence on the legal entity, or a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration, may be considered to bear the identity of such party.’); Explanation to General Standard 6(b), 14 (‘Third-party funders and insurers in relation to the dispute may have a direct economic interest in the award, and as such may be considered to be the equivalent of the party.’).

<sup>54</sup> *Guaracachi America, Inc. & Rurelec PLC v. Plurinational State of Bolivia*, UNCITRAL, PCA Case No. 2011-17, Procedural Order No. 13, 21 Feb. 2013.

<sup>55</sup> The tribunal eventually rejected the request for security for costs.

In three very recent cases, the tribunal compelled claimants to disclose the identity of the funders, another sign that we are perhaps on the eve of a general acceptance of this principle in international arbitration. In *Eurogas v. Slovakia*, the tribunal chaired by Pierre Mayer ordered claimant to disclose the identity of their funder. The parties exchanged their views on this issue at a hearing and the tribunal ordered disclosure during that hearing, stating only that: ‘We think that the Claimants should disclose the identity of the third-party funder.’<sup>56</sup> In *South American Silver v. Bolivia*,<sup>57</sup> the respondent requested security for costs and disclosure of the funding agreement. The tribunal chaired by Eduardo Zuleta Jaramillo ordered the claimant in January 2016 to disclose, for ‘purposes of transparency’, the identity of its funder but refused to compel disclosure of the funding agreement, noting that it was irrelevant since the tribunal had already decided to deny Claimants’ request for security for costs.<sup>58</sup> In *Sehil v. Turkmenistan*, the only comprehensively reasoned decision to date on the issue of disclosure, the tribunal chaired by Julien Lew initially denied respondent’s request for disclosure. However, a year later the tribunal granted a renewed request for disclosure that respondent had filed after the IBA Guidelines had been issued and claimant had changed counsel.<sup>59</sup> The tribunal ordered the disclosure of the identity of the funder as well as disclosure of 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’. As a result, claimant had to produce its funding agreement. In the order, the tribunal also noted that it was ‘sympathetic to Respondent’s concern that if it is successful in this arbitration and a costs order is made in its favour, Claimants will be unable to meet these costs and the third-party funder will have disappeared as it is not a party to this arbitration’.

So how can coherent rules on the disclosure of TPF be implemented that apply uniformly to international arbitration?

First, states or parties, as the case may be, could expressly provide for such rules in the Treaty or contract containing the arbitration agreement. In fact, in the recent draft proposal released for the investment chapter of the Transatlantic Trade

<sup>56</sup> *Eurogas v. Slovakia*, ICSID Case No. ARB/14/14, Hearing on Provisional Measures, 17 Mar. 2015, Transcript, 144–45.

<sup>57</sup> *South American Silver Limited v. Bolivia*, PCA Case No. 2013–15, Procedural Order No. 10, 11 Jan. 2016.

<sup>58</sup> The authors note that Bolivia appears to have requested security for costs before requesting disclosure of the funding agreement, which is perhaps why the tribunal ruled on security for costs before deciding the issue of disclosure.

<sup>59</sup> *Sehil v. Turkmenistan*, ICSID Case No. ARB/12/6, Procedural Order No. 3, 12 Jun. 2015.



and Investment Partnership (TTIP), the European Union inserted a provision requiring disclosure of TPF.<sup>60</sup>

Second, arbitral institutions could play a key role in the push for such transparency. While it may be too ambitious to envisage that institutions modify their rules in the short term to require upfront TPF disclosure, they could already make it part of their practice today to ask for this information at the outset. At the time of acknowledging receipt of the notice or request for arbitration, the institution could ask for such information, specifying that such disclosure is required for the purposes of establishing the independence and impartiality of the arbitrators and should occur before the arbitrators accept their appointment. In order to adopt such a practice, a change in the institutional rules would not be necessary. Indeed, in the past, institutions have adopted practices that were not reflected in the rules, and where the rules were subsequently adapted during their revisions.<sup>61</sup>

The obligation of TPF disclosure should not be limited to the identity of the funder. It should also include key terms of the funding service agreement, if not the agreement itself in certain circumstances. For instance, claimants should be required to inform respondents whether the funder has agreed to satisfy an adverse costs order by the tribunal. Similarly, under what terms can a funder withdraw from the funding arrangement? Finally, another key term is the funder's rate of return in case of a successful award, as suggested by the tribunal's decision on disclosure in the *Sehil* case discussed above. Indeed, knowledge of the rate of return may give the tribunal a sense of the funder's involvement in the case. As suggested in the draft report on security for costs by the ICCA – Queen Mary Task Force on TPF, disclosure of those key terms of the funding agreement are essential to assist tribunal in their decision on security for costs.<sup>62</sup>

<sup>60</sup> European Commission, *Draft of Chapter II (Investment) of the Transatlantic Trade and Investment Partnership* (17 Sep. 2015), Art. 8(1), available at [http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc\\_153807.pdf](http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc_153807.pdf) ('Where there is a third party funding, the disputing party benefiting from it shall notify to the other disputing party and to the Tribunal, or where the division of the Tribunal is not established, to the President of the Tribunal, the name and address of the third party funder.').

<sup>61</sup> For example, in 2009, the ICC Secretariat introduced the practice requiring arbitrators to disclose information regarding their availability, when this was not foreseen by the 1998 ICC Rules. This practice was subsequently memorialized in the revised 2012 ICC Rules (Art. 11(2)). By the same token, the ICSID Secretariat requested as a matter of practice that a juridical person filing for arbitration, provide evidence that it had proper authorization to commence arbitration. This practice was then reflected in the 2003 amendments to the ICSID Institution Rules, Rule 2(1)(f).

<sup>62</sup> ICCA–Queen Mary Task Force on TPF in International Arbitration Subcommittee on Security for Costs and Costs, *Draft Report* of 1 Nov. 2015, 18.

### 3.2 TRIBUNALS SHOULD CONSIDER THE TPF FACTOR AND ORDER SECURITY FOR COSTS MORE READILY

The second proposal to address imbalances generated by TPF is that tribunals should be more amenable to granting security for costs. There are a number of reasons militating in favour of a tribunal granting security for costs in cases where the claimant is funded. First and foremost, it prevents hit-and-run arbitrations, as it resolves the problem of a funder walking away without bearing the respondent's costs. It is also a way for a tribunal to discourage frivolous lawsuits. Indeed, a funder is less likely to fund a dubious claim if it is required to post security for costs.<sup>63</sup>

The proposition that a tribunal should account for TPF as a relevant factor in its decision to award security for costs is not new. In the early 1990s, Otto Sandrock already posited:

The following instances are recognized as special circumstances justifying a caution *judicatum solvi*: . . . the claimant is too poor to finance the advance deposit for the fees of the arbitrators out of his own pocket, but must avail himself of the financial aid of a third-person.<sup>64</sup>

Over the years this position has been reaffirmed by other commentators, including Jean Kalicki who observed that:

Security is more likely to be awarded . . . where the claimant's arbitration fees and expenses are being covered by a related entity or individual who stands to gain if the claimant wins, but would not be liable to meet any award of costs that might be made against the claimant if it lost.<sup>65</sup>

Moreover, the ICC Report on Decisions on Costs in International Arbitration recently released and which was issued under the chairmanship of Bernard Hanotiau and Julien Lew, seems to lend additional support to the relevance of TPF when awarding security for costs:

If there is evidence of a funding arrangement that is likely to impact on the non-funded party's ability to recover costs, that non-funded party might decide to pursue [...] security for those costs or some form of guarantee or insurance, at an early stage of the

<sup>63</sup> See, Judith Gill & Matthew Hodgson, *Costs Awards- Who Pays?* 10 Global Arb. Rev.4 (2015), 4 ('The head of treaty claims for one state which currently faces a large number of claims volunteered that increased availability of security for costs is the "single change" they would propose to the investment arbitration regime precisely to discourage frivolous claims.').

<sup>64</sup> Otto Sandrock, *The Cautio Judicatum Solvi in Arbitration Proceedings or The Duty of an Alien Claimant to Provide Security for the Costs of the Defendant*, 14 J. Int'l Arb., 34 (1997).

<sup>65</sup> Jean Kalicki, *Security for Costs in International Arbitration*, Transnat'l Dis. Mgt. 1 (December 2006); see also, Alastair Henderson, *Security for Costs in Arbitration in Singapore*, 7 Asian Int'l Arb. J. 73-74 (2011); William Kirtley & Koralie Wietrykowski, *Should an Arbitral Tribunal Order Security for Costs When an Impecunious Claimant Is Relying upon Third-Party Funding?*, 30 J. Int'l Arb., 29 (2013).

proceedings. Such measures may be appropriate to protect the non-funded party and put both parties on equal footing in respect of any recovery of costs.<sup>66</sup>

Naturally, funders are not agreeable to providing security since it increases their potential exposure. They prefer to remain immune from adverse costs orders, which is why they have advocated against security for costs.<sup>67</sup>

Most arbitral rules do not expressly refer to security for costs,<sup>68</sup> and neither do treaties – although this may be changing as suggested by the recent draft proposal released by the European Union in the TTIP negotiations, which expressly includes a provision on security for costs.<sup>69</sup> An application for such an order will therefore be dealt with as an interim measure.<sup>70</sup> Indeed, such an application is aimed at preserving the integrity of the proceedings,<sup>71</sup> and ensuring the effectiveness of the final award, which is precisely one of the purposes of interim measures.<sup>72</sup>

It is well established that an arbitral tribunal has the power to order security for costs.<sup>73</sup> To date, tribunals have, however, exercised this power with great reluctance, and only in ‘exceptional circumstances’.<sup>74</sup> It is striking, for instance, that in ICSID arbitrations only one tribunal has so far ordered security for costs.

<sup>66</sup> Commission report: Decision on Costs in International Arbitration, para 90, 2 ICC Dis. Res. Bull. 2015, 13.

<sup>67</sup> Christopher Bogart, *RSM v. St Lucia: Why the Majority got it Wrong on Security for Costs*, Global Arb. Rev. (September 2014); Yasmin Mohammad, *A Partial Commentary of the RSM Production Corporation v. Saint Lucia decision on Security for Costs*, available at <http://emailing.iccwbo.org/events/Yasmin-Mohammad.pdf>.

<sup>68</sup> A notable exception is for instance Art. 25(2) of the LCIA Rules.

<sup>69</sup> European Commission, *Draft of Chapter II (Investment) of the Transatlantic Trade and Investment Partnership* (17 Sep. 2015), available at [http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc\\_153807.pdf](http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc_153807.pdf).

<sup>70</sup> Weixia Gu, *Security for Costs in International Commercial Arbitration*, 22 J. Int'l Arb., 183 (2005); Peter Skoufalos, *Having Arbitrators Order the Posting of Security and Other Interim Measures*, 42 The Arbitrator, 2 (SMA 2011).

<sup>71</sup> Jonas von Goeler, *Third Party funding in International Arbitration and its Impact on Procedure*, 335 (Kluwer International 2016).

<sup>72</sup> Christoph Schreuer, *THE ICSID CONVENTION*, 759 (Cambridge 2009).

<sup>73</sup> See *Libananco Holdings Co. Ltd. v. Republic of Turkey*, ICSID Case No. ARB/06/08, Decision on Preliminary Issue, at 57; *Commerce Group Corp. & San Sebastian Gold Mines Inc. v. Republic of El Salvador*, ICSID Case No. ARB/09/17, Decision on El Salvador's Application for Security for Costs, at 45; *Victor Pey Casado & Foundation Presidente Allende v. Republic of Chile*, ICSID Case No. ARB/98/2, Decision on Provisional Measures, at 88; Rachel S. Grynberg, Stephen M. Grynberg, Miriam Z. Grynberg & *RSM Production Corp. v. Grenada*, ICSID Case No. ARB/10/6, Decision on Respondent's Application for Security for Costs, at 5.16; *Burini S.R.L. & Eagle Games S.H.A. v. Republic of Albania*, ICSID Case No. ARB/11/18, Procedural Order No. 2, at 28; *Guarrachi v. Bolivia*, PCA Case No. 2011-17, Procedural Order No. 13, 11 Mar. 2013, at 5; ICC Award 6632 of 27 Jan. 1993 summarized by FOUCHARD, GAILLARD, *Goldman on International Commercial Arbitration*, 158 (Kluwer International 1999); ICC Award 6697 of 20 Dec. 1990, *REVUE DE L'ARBITRAGE*, 1992, p.135; ICC Award 7489, ICC Bull. Vol. 8 No. 2, p. 68.

<sup>74</sup> See, e.g., ICC Award, *ASA Bull.* Vol. 15 (1997), p. 363; see also Eduardo Zuleta Jaramillo, *Security for Costs: Authority of the Tribunal and Third- Party Funding*, in *Building International Investment Law: The first 50 Years of ICSID* (Kluwer 2015), 567–582.

### 3.2[a] *The TPF factor in investment arbitration decisions to date*

Is TPF therefore a relevant factor in assessing whether a tribunal is faced with exceptional circumstances warranting security for costs? In other words, how much weight should be attributed to the ‘TPF factor?’ At this stage the majority of arbitral tribunals, especially in the treaty arbitration arena, have taken the view that the TPF factor is essentially irrelevant to considering an application for security for costs.<sup>75</sup>

By way of illustration, in the recent *Eurogas v. Slovakia* case, the tribunal denied the respondent’s application for security for costs. Although the tribunal’s reasoning was scarce, it concluded that the involvement of a funder was not a decisive factor.<sup>76</sup>

In the previous case of *Gustav Hamester v. Ghana*,<sup>77</sup> the tribunal chaired by Brigitte Stern took the view that awarding security for costs when a claimant is being funded created a risk that such order would ‘stifle’ the claimant’s claim. This argument is unpersuasive since many funders already anticipate that they may have to post security for costs.<sup>78</sup> In any event, if a funder knows that it may be on the hook for posting security for costs, the claims should not be stifled. The funder can factor this risk into its commercial agreement with the claimant and funding can thereby be ensured.

A tribunal considered the TPF factor for the very first time in an ICSID case in *RSM v. St. Lucia*. In this case, which is famous by now, the tribunal’s *ratio decidendi* for ordering security for costs was the claimant’s track-record of not paying costs – it was a ‘repeat offender’:

Contrary to the situation in previous ICSID cases where tribunals have denied the application for security for costs . . . the circumstances of the present case are different. In

<sup>75</sup> See, e.g., *Libananco Holdings Co. Ltd. v. Republic of Turkey*, ICSID Case No. ARB/06/08, Decision on Preliminary Issue, at 57; *Commerce Group Corp. & San Sebastian Gold Mines Inc. v. Republic of El Salvador*, ICSID Case No. ARB/09/17, Decision on El Salvador’s Application for Security for Costs, at 45.

<sup>76</sup> *Eurogas v. Slovakia*, ICSID Case No. ARB/14/14, Decision on Provisional Measures, 23 Jun. 2015, at 123.

<sup>77</sup> *Gustav F.W. Hamester GmbH & Co. K.G. v. Republic of Ghana*, ICSID Case No. ARB/07/24, Award, 18 Jun. 2010, at 17.

<sup>78</sup> Mick Smith, *Mechanics of TPF Agreements: A Funder’s Perspective*, in Victoria Shannon and Lisa Bench Nieuwveld & Victoria Shannon, *Third-Party Funding in International Arbitration* (Kluwer International 2012) footnote 16 (‘It is also common for a third-party funder to be asked to provide additional capital either by way of provision for a future adverse cost orders, or for security for costs.’); Alison Ross, *The Dynamics of TPF*, *Global Arb. Rev.* (March 2012), 14 (quoting Selwyn Seidel of Fullbrook Management, another third-party funder: ‘Personally I like to assume an obligation to pay adverse costs —because, if I believe in the case, I don’t think there are going to be adverse costs. In any event, he said, his company could have insured against this possibility.’); Jasminka Kalajdzic et al., *Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding*, 93 *The Am. J. Com. L.*, 100 (2013).

particular Claimant's consistent procedural history in other ICSID and non-ICSID proceedings provide compelling grounds for granting Respondent's request.<sup>79</sup>

However, in an often-cited obiter dictum, the tribunal also considered the TPF factor. Specifically, it considered that its decision to award security for costs was supported by the fact that the claimant was being funded:

Moreover, the admitted third party funding further supports the Tribunal's concern that Claimant will not comply with a costs award rendered against it, since, in the absence of security or guarantees being offered, it is doubtful whether the third party will assume responsibility for honoring such an award.<sup>80</sup>

Thus, the TPF factor was expressly recognized as relevant in the decision to award security for costs.<sup>81</sup> However, the tribunal in *RSM* did not expand on the weight that should be attributed to the TPF factor in deciding on security for costs, presumably because it did not need to address this issue. Indeed, since *RSM* was a 'repeat offender', the test of exceptional circumstances was already satisfied based on that fact alone.

In *South American Silver v. Bolivia*,<sup>82</sup> the tribunal echoed the *RSM* decision when it stated in its security for costs decision that 'the existence of a third-party funder may be an element to be taken into consideration in deciding on a measure [security for costs]'.<sup>83</sup> However, despite the fact that claimant was funded and appeared to lack financial assets of its own, the Tribunal refused to order security for costs:

Even admitting Bolivia's interpretation of the Claimant's financial statements and conclude [*sic*] that SAS/SASC would end up with a financial problem by the end of 2015, that would imply, in the worst case, a cash flow difficulty but would not prove a total lack of funds or assets to pay, and even less of a situation of impossibility to pay.[...] [Security for costs] shall be granted only in case of extreme and exceptional circumstances, for example, when there is evidence of constant abuse or breach that may cause an irreparable harm if the measure is not granted. This element is not proven in this case by Bolivia.<sup>84</sup>

The standard laid down by the tribunal in its decision should be assessed critically since it is so high that it would be virtually impossible to meet.

As there is an increasing resort to TPF and respondents are more likely to be exposed to hit-and-run arbitrations, it is essential that tribunals take account of this change in paradigm and do not shy away from addressing it. In order to properly

<sup>79</sup> *RSM Production Corp. v. St Lucia*, ICSID Case No. ARB/12/10, Decision on Saint Lucia's Request for Security for Costs, 13 Aug. 2014, at 82.

<sup>80</sup> *Ibid.*, at 83.

<sup>81</sup> Commercial tribunals have awarded security for costs, see below.

<sup>82</sup> *South American Silver Limited v. Bolivia*, PCA Case No. 2013-15, Procedural Order No. 10, 11 Jan. 2016.

<sup>83</sup> *Ibid.*, at 75, 78.

<sup>84</sup> *Ibid.*, at 66, 68.

address the imbalances created by the involvement of TPF, security for costs should not be limited to cases such as *RSM*, in which a claimant has already demonstrated its unwillingness to make payments. Tribunals need to strike an appropriate balance between claimants' and respondents' interests. If the arbitral community continues to ignore the TPF factor, and victorious respondents are left to bear their own costs because a funder is simply able to walk away, it may result in a further backlash against arbitration.<sup>85</sup> The authors suggest the following two-prong test for establishing a case for security for costs.

### 3.2[b] *Two-prong test for security for costs*

The respondent would have to show that: (i) the claimant appears unable or unwilling to satisfy any adverse costs award; *and* (ii) the claimant is relying on TPF to finance its claims. If this cumulative two-prong test is satisfied, then there would be 'exceptional circumstances' warranting security for costs and the burden of proof would then shift onto the claimant to show that security for costs is not warranted in the specific case.

#### 3.2[b][i] The Claimant Appears Unable Or Unwilling to Satisfy Any Adverse Costs Award

The first prong of this test would require the respondent to show that the claimant is apparently unable or unwilling to satisfy an adverse costs award. There are several indicators to consider for the purposes of this prong of the test. First and foremost, a party in financial difficulties would certainly appear impaired in its ability to satisfy an adverse costs order.

In a 2008 case, an ICC tribunal decided to grant security for costs on the basis that the funded party was 'manifestly insolvent'.<sup>86</sup> Indeed, the tribunal in this case had evidence to show that the party was manifestly insolvent. However, it is important to bear in mind that the first prong of the test would be satisfied by the mere appearance of insolvency. A tribunal seated in Switzerland ruled in this sense when it granted respondent's request for security for costs. The respondent had applied for security for costs on the grounds that the claimant was 'not able to pay

<sup>85</sup> See recently, Claire Provost, Matt Kennard, *The Obscure Legal System that Lets Corporations sue Countries*, *The Guardian* (10 Jun. 2015).

<sup>86</sup> See *X S.A.R.L., Lebanon v. Y A.G., Germany*, International Court of Arbitration of the International Chamber of Commerce, Procedural Order No. 3 dated 4 Jul. 2008, 28 ASA Bull. 21 (2010) ('If a party has become manifestly insolvent and therefore is likely relying on funds from third parties in order to finance its own costs of the arbitration, the right to have access to arbitral justice can only be granted under the condition that those third parties are also ready and willing to secure the other party's reasonable costs to be incurred.').

the costs of the proceedings and that it is therefore forced to obtain funds from external sources'. The tribunal noted that the claimant was undergoing bankruptcy proceedings and concluded that: 'it is most likely that if respondent were to prevail in this arbitration, a future cost award in its favour could not be satisfied by Claimant'.<sup>87</sup>

A second indicator of a claimant's inability to satisfy an adverse costs award is that it lacks assets of its own, which does not necessarily mean that the claimant is in financial distress. The claimant, i.e. funded party may, for example, be a holding company with no or very limited assets of its own. Accordingly a holding, shell or mailbox company would also satisfy the first prong of the test, since there would undoubtedly be an appearance that such a company would be unable to meet an adverse costs award.

Another indicator could be that the party had great difficulties satisfying the institution's advance on costs before it secured funding. If the party was unable to post such funds and requested extensions to secure outside funding, then the party may indeed be unable to satisfy any adverse cost award. More broadly if claimant could not have participated in the arbitration but for the involvement of a funder then it is a strong indication as to the inability of claimant to satisfy an adverse cost order. This appears to be the view adopted by Maxi Scherer:

The tribunal might order security for cost if the funded party lacks financial means to participate in the arbitration but for the existence of the funding agreement, and thus is likely not to be in a position to satisfy a future adverse costs award.<sup>88</sup>

A final point that the tribunal may take into account with regard to the first prong of the test is the apparent unwillingness – as opposed to inability – of a claimant or its funder to satisfy an adverse cost award. For example, a party's previous behaviour in other arbitral or court proceedings may be relevant, as well as declarations on point made during the course of the proceedings. Such apparent unwillingness to satisfy an adverse cost award would also be established in the absence of a funder's binding obligation in the funding agreement to cover an adverse cost order. An ICC tribunal chaired by Charles Poncet considered this point when it ruled:

The Arbitral Tribunal takes into consideration the fact that the [Funding] Agreement rules out any payment of costs awarded to the respondents, [and]

<sup>87</sup> *Swiss Entity v. Dutch Entity*, HKZ Case No. 415, Award, 20 Nov. 2001, 20(3) ASA Bull., 467–471 (2002).

<sup>88</sup> Maxi Scherer, *TPF in Arbitration: Out in the Open?*, Comm. Dis. Res., May 2012, available at [www.cdr-news.com](http://www.cdr-news.com), 57.

concludes that in this case the [Funding] Agreement changed the circumstances in such a fundamental manner that security for costs is justified.<sup>89</sup>

Philippe Pinsolle, who commended this decision, went on to observe that:

The fact that the funding agreement excludes the payment of arbitration costs in case of failure, as it appears to be most often the case, places the respondent against a claimant who, by definition, now has the means to move forward with his arbitration without really taking any risk regarding its outcome.<sup>90</sup>

While the above list of indicators is certainly not exhaustive, it contains some of the most common ones that a tribunal may wish to take into consideration.

### 3.2[b][ii] The Claimant Is Relying on TPF to Finance Its Claims

If a claimant is being funded and it discloses such funding upfront (as the authors are advocating) determining whether this part of the test is met should be straightforward. It is interesting to note that in his assenting opinion in the *RSM v. St Lucia* case, Gavan Griffith took the view that the mere involvement of a funder cast the burden of proof onto the claimant to show why security for costs should not be ordered.<sup>91</sup>

### 3.2[c] *If the two-prong test is satisfied, the burden of proof shifts onto the claimant*

Pursuant to the proposed two-prong test, the burden of proof only shifts onto the claimant if the respondent has shown that the funded party appears unable or unwilling to satisfy a costs award. In his treatise on international commercial arbitration, Gary Born laid down a similar test:

Where a party appears to lack assets to satisfy a final cost award, but is pursuing claims in an arbitration with the funding of a third party, then a strong prima facie case for security for costs exists.<sup>92</sup>

Once the burden of proof shifts, the onus is on the funded party to explain why an order for security for costs is unwarranted.

<sup>89</sup> Philippe Pinsolle, *Third Party Funding and Security for Costs*, 2 Paris J. Int'l Arb., 399 (2013).

<sup>90</sup> *Ibid.*

<sup>91</sup> *RSM Production Corp. v. Santa Lucia*, ICSID Case No. ARB/12/10, Decision on Saint Lucia's Request for Security for Costs, 13 Aug. 2014, Assenting Reasons of Gavin Griffith, at 18 ('Once it appears that there is third party funding of an investor's claims, the onus is cast on the claimant to disclose all relevant factors and to make a case why security for costs orders should not be made.').

<sup>92</sup> Gary Born, *International Commercial Arbitration*, 2496 (Kluwer International 2014), see also Jeffrey Waincymer, *Procedure and Evidence in International Arbitration*, 644 (Kluwer International 2012).



### 3.2[d] *Potential defences by the funded party*

What are some of the possible defences that a funded party may raise to defeat an application for security for costs? There are the same classic defences available, as in interim measures cases that do not involve the TPF factor. A funded party may, of course, argue that one of the two prongs of the test is not satisfied. For example, it may disclose financial information to show that it could satisfy an adverse costs order and that it is resorting to TPF as a means of managing its financial risk, or by way of off-balance-sheet financing. The funded party could also rely on the fact that it has subscribed to an ‘after the event’ insurance to cover any adverse costs award,<sup>93</sup> or that the funder has undertaken to pay an adverse costs award in the funding agreement.<sup>94</sup>

Overall, the test laid out above strikes the right balance in that it protects both parties’ interests: it addresses important concerns of respondents while not imposing a disproportionate burden on funded claimants.

## 4 CONCLUSION

In the wake of the growth and diversification of TPF products as well as the increased scrutiny of the use of public funds in international arbitration, it is paramount that the various arbitration players offer remedies to rebalance the arbitral process and maintain its integrity. Such rebalancing is important for all the players at the arbitration table – including funders, who have become and legitimately want to remain an integral part of the process.

The authors have suggested two solutions that could redress significantly the status quo. The IBA has taken the first step last year by essentially requiring upfront disclosure of TPF, and a few tribunals have started following suit. However, the disclosure of the identity of a funder is only the first stepping stone to tackle imbalances created by TPF. Funded parties should also be required to disclose the key terms of the funding agreement, as recently ordered by the tribunal in the *Sehil* case. For cases in which a respondent is faced with the real threat of a hit-and-run arbitration, tribunals should also be more disposed to award security for costs so as to protect the respondent’s interests and, ultimately in the case of investor-state arbitration, protect taxpayers’ money.

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<sup>93</sup> See, e.g., Alison Ross, *Buford offers indemnity coverage for adverse costs award*, Global Arb. Rev. (October 2015).

<sup>94</sup> If the funding agreement provides that the funder will bear any adverse cost order, it still raises the question as to whether a respondent can enforce that right since it is not a party to the agreement. Thus, the enforceability of the covenant and the reputation of the funder should be taken into consideration when assessing the meaningfulness of this defence.

Needless to say, the two solutions put forward by the authors, namely, disclosure and security for costs, are not the alpha and omega of what constitutes proper regulation of TPF. It will therefore be particularly interesting to see what recommendations come out of the ICCA-Queen Mary task force on TPF and how these may set the tone for future regulation.

### Annex: TPF Cases on Issues of Disclosure and Security for Costs

<i>Disclosure of Third-Party Funding</i>		
1.	<i>Oxus Gold v. Uzbekistan</i> , UNCITRAL Case, Press Release, 1 March 2012	Oxus issued a press release disclosing recourse to TPF and revealing details of the funding agreement.
2.	<i>Guaracachi v. Bolivia</i> , PCA Case No. 2011-17, Procedural Order No. 13, 21 February 2013	The tribunal refused to order the production of the funding agreement requested by respondent. However, the tribunal confirmed that it had no conflicts of interest with the claimant's funder.
3.	<i>Eurogas v. Slovakia</i> , ICSID Case No. ARB/14/14, Decision of the tribunal, 17 March 2015	The tribunal ordered the claimant to disclose the identity of the funder.
4.	<i>Sehil v. Turkmenistan</i> , ICSID Case No. ARB/12/6, Procedural Order No. 2, 23 June 2014	In this initial order, the tribunal refused to order that the claimant disclose the identity of the funder.
5.	<i>Sehil v. Turkmenistan</i> , ICSID Case No. ARB/12/6, Procedural Order No. 3, 12 June 2015	The tribunal ordered the claimant to disclose the identity of the funder. It also ordered disclosure of the 'nature' of the funding arrangement, including the funder's rate of return if the claimant is successful in its claims.
6.	<i>South American Silver Limited v. Bolivia</i> , PCA Case No. 2013-15, Procedural Order No. 10, 11 January 2016	The tribunal ordered the disclosure of the identity of the funder. However, the tribunal refused to order disclosure of the terms of the funding agreement.

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| 7.  | <i>Swiss Entity v. Dutch Entity</i> ,<br>HKZ Case No. 415, Award, 20 November 2001,<br>20 ASA BULLETIN 467–71 (2002)                        | The tribunal awarded security for costs after noting that the claimant could not afford the costs of the proceedings but for TPF.  |
| 8.  | <i>Libananco Holding v. Turkey</i> ,<br>ICSID Case No. ARB/06/8, Decision on Preliminary Issues, 23 June 2008                               | The tribunal dismissed the request for security for costs.   |
| 9.  | <i>X S.A.R.L., Lebanon v. Y A.G., Germany</i> ,<br>ICC Arbitration, Procedural Order No. 3, 4 July 2008<br>28 ASA BULLETIN 37–49 (2010)     | The tribunal ordered security for costs. It ruled that if a party has become manifestly insolvent and is likely to rely on TPF in order to finance its own costs of the arbitration, the right to have access to arbitral justice can only be granted under the condition that those third parties are also ready and willing to secure the other party's reasonable costs to be incurred. |
| 10. | <i>Gustav Hamester v. Republic of Ghana</i> ,<br>ICSID Case No. ARB/07/24, Procedural Order No. 3, 24 June 2009                             | The tribunal dismissed the request for security for costs. It found that there was a serious risk that an order for security for costs would 'stifle' the claimant's claims.   |
| 11. | <i>X v. Y and Z</i> ,<br>ICC Arbitration, Procedural Order, 3 August 2012<br>2 PARIS JOURNAL OF INTERNATIONAL ARBITRATION 399 (2013)        | The tribunal ordered security for costs after observing that the claimant's TPF arrangement did not provide for the funder to pay an eventual adverse costs award.   |
| 12. | <i>Commerce Group v. El Salvador</i> ,<br>ICSID Case No. ARB/09/17, Annulment Proceeding, Decision on Security for Costs, 20 September 2012 | The tribunal dismissed the request for security for costs.   |
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*Security for Costs in Cases Involving Third-Party Funding*


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| 13. | <i>Guaracachi v. Bolivia</i> ,<br>PCA Case No. 2011-17, Procedural<br>Order No. 13, 11 March 2013  | The tribunal dismissed the<br>request for security for costs.  |
| 14. | <i>RSM Production Corp. v. Santa Lucia</i> ,<br>ICSID Case No. ARB/12/10, Decision<br>on Saint Lucia's Request for Security for<br>Costs, 13 August 2014 | The tribunal awarded security<br>for costs on the grounds that<br>the claimant was a 'repeat<br>offender' who had failed to<br>pay arbitration costs in the<br>past. The tribunal also referred<br>to the fact that claimant was<br>relying on TPF to finance its<br>case. |
| 15. | <i>Eurogas v. Slovakia</i> ,<br>ICSID Case No. ARB/14/14, Decision<br>on Provisional Measures, 23 June 2015  | The tribunal dismissed the<br>request for security for costs.  |
| 16. | <i>South American Silver Limited v. Bolivia</i> ,<br>PCA Case No. 2013-15, Procedural<br>Order No. 10, 11 January 2016                                   | The tribunal dismissed the<br>request for security for costs.  |
| 17. | <i>Sehil v. Turkmenistan</i> ,<br>ICSID Case No. ARB/12/6  | Decision on security for costs<br>pending.   |
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Since its 1984 launch, the Journal of International Arbitration has established itself as a thought-provoking, ground-breaking journal aimed at the specific requirements of those involved in international arbitration. Each issue contains in-depth investigations of the most important current issues in international arbitration, focusing on business, investment, and economic disputes between private corporations, State controlled entities, and States. The new Notes and Current Developments sections contain concise and critical commentary on new developments. The journal's worldwide coverage and bimonthly circulation give it even more immediacy as a forum for original thinking, penetrating analysis and lively discussion of international arbitration issues from around the globe.

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- [3] The article should contain an abstract of about 200 words.
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- [5] The first footnote should include a brief biographical note with the author's current affiliation.
- [6] Special attention should be paid to quotations, footnotes, and references. All citations and quotations must be verified before submission of the manuscript. The accuracy of the contribution is the responsibility of the author. The journal has adopted the Association of Legal Writing Directors (ALWD) legal citation style to ensure uniformity. Citations should not appear in the text but in the footnotes. Footnotes should be numbered consecutively, using the footnote function in Word so that if any footnotes are added or deleted the others are automatically renumbered.
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