The Economics of Access: Systemic Imbalances in ISDS

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I. INTRODUCTION

Investor-State dispute settlement ("ISDS") in the form of investment arbitration has been subject to significant criticism and increased scrutiny in recent years. Proposals for reform have been widely discussed within the international arbitration community. A number of States have altered their treaty practice in an attempt to give effect to some of these reforms in their future treaties. But there is also now a clear appetite for more sweeping, immediate, multilateral reform. A message is being delivered by States that "we created this system, and since our calls for reform have largely fallen on deaf ears, we will step in and make changes."

This message is manifest in two ongoing multilateral initiatives. The first is the current effort to update the International Centre for Settlement of Investment Disputes ("ICSID") rules and regulations, which began in October 2016 with ICSID inviting member States to suggest topics that merit consideration. The second is the work of the United Nations Commission on International Trade Law ("UNCITRAL") Working Group III on ISDS Reform.

ICSID's consultation process has resulted in a list of 16 topics for potential ICSID rule amendment.[1] Of these, three relate to the economics of access to investment arbitration: (i) an express rule on security for costs, which would govern the process applicable to applications for security for costs, as well as the factors to be taken into consideration when assessing such an application; (ii) a rule clarifying the bases for awards of costs, including possibly adopting a presumption in favor of awarding costs in accordance with the relative success of the parties and their conduct during the proceeding; and (iii) a rule relating to disclosure of third-party funding for the purpose of conflict checking and/or for the purpose of assessing applications for security for costs.

Similar areas of concern were identified at the November 27-December 1, 2017 meeting of UNCITRAL Working Group III on ISDS Reform.[2] Of the procedural issues discussed during

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[1] ICSID, "The ICSID Rules Amendment Process, Potential Areas for Amendment", available at <https://icsid.worldbank.org/en/Documents/about/List%20of%20Topics%20for%20Potential%20ICSID%20Rule%20Amendment-ENG.pdf> (last accessed February 13, 2018). The ICSID Secretariat is currently preparing background papers on each of these 16 topics, which are expected to be available in mid-2018.

[2] The author, Kate Brown de Vejar, attended the session as an observer on behalf of the International Law Institute (see <www.ili.org> (last accessed February 13, 2018)). The official UNCITRAL report of Working Group III's deliberations on ISDS Reform at its 34th Session in Vienna, prepared by the Secretariat, is publicly available. See "Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fourth session" (Vienna, 27 November-1 December 2017), UN Doc. A/CN.9/930, available at http://www.uncitral.org/pdf/english/workinggroups/wg_3/WGIII-34th-session/930_for_the_website.pdf (last accessed February 19, 2018) (henceforth "UNCITRAL WGIII ISDS Reform 34th Session Report").

the meeting, the issue of recovery of costs by States received the most attention. The meeting room was largely united that the practice of allocation of costs in proportion to success of claims, rather than each party bearing its own costs, was to be encouraged. There was a strong feeling that a State which successfully defends a claim should be able to recover the cost of its defense. In a similar vein, the need to review the issue of security for costs, and to ensure that there are assets from which a State would be able to recover its costs, was widely recognized. Third-party funding was another issue of general concern, both in terms of its impact on the number and type of claims brought, and regarding the need for increased transparency in this area.

These concerns, which go to the economics of access to investment arbitration, are the focus of this paper. We first discuss the importance of ensuring that costs orders in investment arbitration are made regularly, and reflect the relative success of the parties' claims (taking into account the quantum claimed) and defenses. We then examine the need to revise the burden of proof and standard applied by investment arbitration tribunals when determining whether to grant an application for security for costs. Next, we look at some of the economic asymmetries and other distortions due to third-party funding of investment arbitrations. We end with a list of initiatives to address these issues.

II. ALLOCATION OF COSTS IN ISDS

At the November 27-December 1, 2017 meeting of UNCITRAL Working Group III on ISDS Reform, the allocation of costs by investment arbitration tribunals was highlighted as an area of real concern.[3] While there is no doubt that investment arbitration tribunals have the power and discretion to shift costs onto the losing party, or to apportion costs between the parties,[4] the concern raised was that this does not happen consistently, often leaving a respondent State to foot the bill of their own successful defense. As the report of the meeting records:

> It was explained that arbitral tribunals in ISDS had historically followed the default rule under public international law and in inter-State cases that each party would bear its own costs. It was pointed out that the respondent State might find itself in the position of not being able to recover a substantial part or any of its costs in defending an unsuccessful, frivolous or bad faith claim by investors. In addition, it was stated that in the absence of allocation of costs, there was no incentive for the parties to limit their arguments and submissions.[5]

These concerns are justified by empirical evidence. Susan Franck's research on costs awards in investment treaty arbitrations, published in 2011 and surveying 102 treaty awards (publicly

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Sound recordings of the session are also publicly available at <http://www.uncitral.org/uncitral/audio/meetings.jsp> (last accessed February 19, 2018).

[3] UNCITRAL WGIII ISDS Reform 34th Session Report, paras. 46-48.

[4] In the context of UNCITRAL Working Group III's discussions, "Article 42 of the UNCITRAL Arbitration Rules (2010, as revised in 2013) was given as an example of a rule providing for allocation of costs among the parties." UNCITRAL WGIII ISDS Reform 34th Session Report, para. 47. See also Art. 61(2) of the ICSID Convention and ICSID Arbitration Rule 47(1)(j) (granting tribunals the power to decide how costs of the arbitration are allocated among the parties).

[5] UNCITRAL WGIII ISDS Reform 34th Session Report, para. 46.

available before June 1, 2006), showed that the majority of investment treaty awards followed the practice of each side being responsible for its own party costs (the fees and expenses of legal counsel and any expert or factual witnesses) and for an equal share in the tribunal costs (the fees and expenses of the tribunal and the administering institution or appointing authority).[6] The study also revealed a concerning lack of consistency in tribunals' approaches to cost allocation, including a lack of any reliable relationship between cost shifting and the ultimate outcome of the case.[7] Awards "typically lacked citation to legal authority and provided minimal rationale, and the justifications for cost decisions exhibited broad variation."[8]

In their December 2016 article discussing the lack of reasoning for the cost award against claimants in the *Philip Morris v. Uruguay* case, Kenneth Reisenfeld and Joshua Robb mused:

> It is possible that there was an unspoken rationale. The case was a controversial one, and some (including Uruguay's counsel) accused Philip Morris of using the arbitration process, and the expense it entailed, as a way to discourage relatively poor countries (not limited to Uruguay) from enacting anti-tobacco measures. The tribunal may have shifted costs to Philip Morris in part to send a message both to companies considering adopting such a strategy and to critics who pointed to the case as an example of the abuses of investor-state dispute settlement. But whether justified or not, if that was the tribunal's justification, it would have been better to say so. Article 48 of the ICSID Convention, after all, requires that an award state the reasons on which it is based, and Article 52(1)(e) permits annulment when a tribunal fails to do so.[9]

The authors agree with these musings. In particular, in cases where costs are shifted because of the tribunal's concerns regarding the abusive behavior of a party, such as an investor's ulterior motive for bringing a claim, these reasons should be articulated so that they may act as an effective deterrent to such tactics going forward.

Since the Franck study was published, the situation has evolved to some extent. In the context of UNCITRAL Working Group III's discussion on costs in November-December 2017, Meg Kinnear, the Secretary General of ICSID, reported that in approximately half of recently issued ICSID awards, arbitral tribunals had ordered that the costs of the arbitration should either be borne by the unsuccessful party or be apportioned between the parties. Therefore, Ms. Kinnear noted, an emerging trend away from each party bearing its own costs could be identified.[10]

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[6] Susan D. FRANCK, "Rationalizing Costs in International Treaty Arbitration", 88(4) Wash. U. L.R. (2011), p. 769 at pp. 777, 809.

[7] *Ibid.* pp. 777-778, 820-821, 826-827, 841.

[8] *Ibid.* p. 769.

[9] See Kenneth REISENFELD and Joshua ROBBINS, "The Achilles' Heel of Investor-State Arbitration Awards", Law360 (December 6, 2016), available at <https://www.bakerlaw.com/webfiles/Litigation/2016/Articles/12-07-2016-Law360-Robbins-Reisenfeld.pdf> (last accessed February 22, 2018).

[10] UNCITRAL WGIII ISDS Reform 34th Session Report, para. 47.

This emerging ICSID trend is in line with the results of a study conducted by Matthew Hodgson in 2013[11] and updated in 2017.[12] The 2013 study revealed that, in cases decided before 2006, investment arbitration tribunals adjusted costs in only 35% of cases, whereas in cases decided between 2006 and 2012, investment arbitration tribunals made some adjustment in the allocation of costs in 49% of cases.[13] The 2017 update to the study showed that, since the end of 2012, there has been a significant increase in the number of tribunals making adjusted costs orders, with 64% adjusting costs in some manner.[14]

The 2013 Hodgson study noted a significant difference between UNCITRAL and ICSID tribunals, with UNCITRAL tribunals making some form of adjustment to costs in 69% of cases, while ICSID tribunals did so in just 36% of cases. This difference was attributed to the importance of the guidance provided in the applicable institutional rules.[15] The UNCITRAL rules state that the "costs of the arbitration shall in principle be borne by the unsuccessful party or parties,"[16] whereas the ICSID Convention and Arbitration Rules provide no such guidance or default rule.[17] The 2017 Hodgson study update reveals, however, that since the beginning of 2013, 61% of ICSID tribunals issued as adjusted costs order, bringing them closer to the rate exhibited by UNCITRAL tribunals, which remained at 69%.[18]

[11] The study involved a review of some 221 cases in which an award or decision was publicly available on December 31, 2012. After making other adjustments (including removing decisions reserving costs to a later stage of proceedings), the final data pool was 176 cases. For the results of the study, see Matthew HODGSON, "Counting the Costs of Investment Treaty Arbitration", Global Arb. Rev. (March 24, 2014) available at <https://globalarbitrationreview.com/article/1033259/counting-the-costs-of-investment-treaty-arbitration> (last accessed February 22, 2018).

[12] Matthew HODGSON, "Damages and Costs in Investment Treaty Arbitration Revisited", Global Arb. Rev. (December 14, 2017) available at <https://globalarbitrationreview.com/article/1151755/damages-and-costs-in-investment-treaty-arbitration-revisited> (last accessed February 23, 2018). This update to the 2013 Hodgson study interpreted data from an additional 140 awards, which were publicly available as of May 31, 2017, including a number of awards that were handed down before the cut-off date of the first survey, December 31, 2012, but which only became public more recently). When combined with 2013 study, the final data pool consisted of 324 awards and 52 decisions on annulment.

[13] M. HODGSON, "Counting the Costs of Investment Treaty Arbitration".

[14] M. HODGSON, "Damages and Costs in Investment Treaty Arbitration Revisited".

[15] M. HODGSON, "Counting the Costs of Investment Treaty Arbitration".

[16] 2010 UNCITRAL Rules, Art. 42(1). The 1976 UNCITRAL Rules contained a similar rule, but its scope is limited to tribunal costs. 1976 UNCITRAL Rules, Art. 40(1).

[17] Article 61(2) of the ICSID Convention leaves broad discretion to the tribunal to "assess the expenses incurred by the parties in connection with the proceedings" and "decide how and by whom those expenses, the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the Centre shall be paid," with no indication of the factors a tribunal may take into account in reaching its decision. Rule 47(1)(j) simply states that the award shall contain "any decision of the Tribunal regarding the cost of the proceeding."

[18] M. HODGSON, "Damages and Costs in Investment Treaty Arbitration Revisited".

The 2013 Hodgson study showed that, of those cases in which investment arbitration tribunals elected to apportion costs, they did so in respect of both tribunal costs and party costs 62% of the time.[19] This trend continued in cases decided after 2012.[20]

Both the 2013 Hodgson study and the 2017 update noted that the increasing trend of allocating both tribunal and party costs in line with the outcome of the case did not extend to annulment proceedings.[21] In both pre-2013 annulment decisions, and in decisions between 2013 and 2017, 85% of *ad hoc* committees ordered parties to bear their own party costs, and just 61% of *ad hoc* committees ordered the losing party to bear all of the committee costs.[22]

A particularly concerning trend noted in the 2013 Hodgson study was the disparity of treatment on costs between investors and States: successful claimants obtained an order for costs in 53% of cases, whereas only 38% of successful respondents also received a favorable costs award.[23] This result in pre-2013 awards certainly lends credibility to the complaints of States that they are, too often, left with a pyrrhic victory: no liability or a very low value payout, but a hefty legal bill. However, this disparity is greatly reduced in more recent awards. In awards from 2013 onwards, successful claimants obtained an adjusted costs award in 65% of cases, and successful respondents obtained an adjusted costs award in 63% of cases.[24]

While the very recent trend is toward greater consistency in cost awards in investment arbitrations, and less disparity of treatment between investors and States, the push by States for multilateral and institutional reform in this regard is understandable. Any disparity in the treatment of investors and States is unacceptable. The allocation of costs in line with the outcome of the case should be the norm. The factors taken into account by investment arbitration tribunals when allocating costs should be discussed in awards, with a view to developing consistent approaches and standards, which can then be used to discourage investors from advancing frivolous claims, adopting a scorched earth approach to their claims, and exaggerating the quantum of their alleged damages. The latter point is important. Data shows that the cost of proceedings increases with the damages claimed by the claimant.[25] Moreover, the tactic of "anchoring" the tribunal's discussion of damages by initially advancing an unrealistically high number, in the hope of achieving a lower but still excessive award of compensation,[26] is misleading, abusive, and can lead to mistakes with disastrous consequences

[19] M. HODGSON, "Counting the Costs of Investment Treaty Arbitration". This is consistent with the Franck study, which also found that where tribunals shifted tribunal costs, they also tended to shift party costs. S. FRANCK, "Rationalizing Costs in Investment Treaty Arbitration", pp. 778, 833.

[20] M. HODGSON, "Damages and Costs in Investment Treaty Arbitration Revisited".

[21] M. HODGSON, "Damages and Costs in Investment Treaty Arbitration Revisited".

[22] M. HODGSON, "Counting the Costs of Investment Treaty Arbitration"; M. HODGSON, "Damages and Costs in Investment Treaty Arbitration Revisited".

[23] M. HODGSON, "Counting the Costs of Investment Treaty Arbitration".

[24] M. HODGSON, "Damages and Costs in Investment Treaty Arbitration Revisited".

[25] S. FRANCK, "Rationalizing Costs in Investment Treaty Arbitration", pp. 835-836, Chart 1. See also M. HODGSON, "Damages and Costs in Investment Treaty Arbitration Revisited".

[26] For further discussion of this phenomenon in the context of third-party funding of ISDS case, see Section IV(3) below.

for States.[27] An effective way of discouraging this practice is to include the amount of quantum claimed versus any amount ultimately awarded in the factors to be taken into account by investment arbitration tribunals when allocating costs. *Eastern Sugar v. Czech Republic* provides an example.[28] In that case, the tribunal ordered the investor, which had succeeded in establishing liability, to pay part of the respondent State's share of tribunal costs on the basis that the investor had originally claimed approximately €109 million but was ultimately awarded only €25 million, or roughly 25% of the claimed amount.[29] Another example is *Garanti Koza v. Turkmenistan*, where the claimant was awarded approximately five percent of the compensation it sought, prompting the following remark on costs from the tribunal: "The tribunal considers it appropriate to take the degree to which Garanti Koza prevailed into consideration, along with the fact that it prevailed, in ruling on the Parties' competing applications for costs."[30]

There is a good case for formalizing what appears to be the dominant trend, and making allocation of tribunal and party costs in line with the outcome of the case the default rule in investment arbitration. It is a practice well known in many national jurisdictions,[31] and is now common practice in commercial arbitration cases.[32] And, as highlighted above, it is quickly becoming the dominant accepted approach in both UNCITRAL and ICSID investment arbitrations.[33]

As a matter of policy, a default rule that costs should be allocated in line with the outcome of the case creates incentives for desirable party behavior, such as admissions, settlement opportunities, and efficient management of procedural issues, and it discourages wasteful party behavior, including tactical delays, frivolous claims, and exaggerated damages.[34] The likely costs of a proceeding, and how these costs may be allocated between the parties by a tribunal, "are a part of

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[27] George KAHALE III, "Rethinking ISDS", Transnat'l Disp. Mgmt (forthcoming, February 2018), p. 1 at pp. 18-19.

[28] *Eastern Sugar B.V. v. The Czech Republic* (SCC Case No. 088/2004), Partial Award (March 27, 2007); and *Eastern Sugar B.V. v. The Czech Republic* (SCC Case No. 088/2004), Final Award (April 12, 2007).

[29] *Eastern Sugar B.V. v. The Czech Republic* (SCC Case No. 088/2004), Partial Award (March 27, 2007) paras. 368 and 380; and *Eastern Sugar B.V. v. The Czech Republic* (SCC Case No. 088/2004), Final Award (April 12, 2007) para. 6.

[30] *Garanti Koza LLP v. Turkmenistan* (ICSID Case No. ARB/11/20), Award (December 19, 2016), paras. 450-451.

[31] M. HODGSON, "Counting the Costs of Investment Treaty Arbitration" ("It is usual for a losing party to make at least some contribution to the costs of the winner in the national courts of many jurisdictions, including England & Wales, France, Germany, Hong Kong, Italy, the Netherlands, Poland, Russia, Singapore, Spain and Thailand.").

[32] *Ibid*. ("According to a 2012 study by Queen Mary, University of London, this approach is common in commercial arbitration, being adopted in around one half of cases, with a further 30 per cent of cases seeing some apportionment of costs, leaving just 20 per cent of cases where costs were not adjusted.").

[33] *William Nagel v. The Czech Republic* (SCC Case No. 049/2002), Final Award (September 9, 2003) paras. 337-338; *Kılıç İnşaat İthalat İhracat Sanayi ve Ticaret Anonim Şirketi v. Turkmenistan* (ICSID Case No. ARB/10/1), Award (July 2, 2013) paras. 9.2.5, 9.2.9; *İçkale İnşaat Limited Şirketi v. Turkmenistan* (ICSID Case No. ARB/10/24), Award (March 8, 2016) para. 409; *Transglobal Green Energy, LLC and Transglobal Green Panama, S.A. v. Republic of Panama* (ICSID Case No. ARB/13/28), Award (June 2, 2016), para. 130; *Windstream Energy LLC v. Government of Canada* (PCA Case No. 2013-22), Award (September 27, 2016), para. 514.

[34] S. FRANCK, "Rationalizing Costs in Investment Treaty Arbitration", pp. 795-797.

the risk/reward assessment an investor makes before commencing an investment treaty case."[35] These factors are also relevant for the State as it considers its settlement options.[36] The existence of a default rule on the allocation of costs, and more thorough and detailed reasoning on costs in awards, will makes it easier for a party to an investment arbitration to understand its exposure and act accordingly.

Although, in recent years, both UNCITRAL and ICSID investment arbitrations tribunals have shown a strong trend towards allocating costs in line with the outcome of the case, the current statistics also show there is a way to go before true consistency and predictability in costs awards is achieved. ICSID *ad hoc* committees should also adopt a stricter and more consistent practice of allocating costs to the losing party in annulment proceedings.[37] Three initiatives would help fast track these developments. First, the ICSID Arbitration Rules should be amended to establish a default rule in a manner similar to Article 42(1) of the 2010 UNCITRAL Rules, providing that the costs of the arbitration (or the annulment proceeding) shall in principle be borne by the unsuccessful party, but preserving the tribunal/*ad hoc* committee's discretion to apportion costs where reasonable in the circumstances of a given case.[38] While in practice, ICSID tribunals seem to be adopting this approach more frequently even absent an express provision, such an default rule would "formalise what appears to be current practice", "be more likely to discourage speculative claims and dilatory tactics", and "encourage tribunals to provide more detailed reasoning when exercising their discretion to depart from the default approach."[39] Second, contracting States to a treaty may wish to include similar language in the treaty's ISDS provisions.[40] Third, parties to investment arbitrations and annulment proceedings need to demand that costs be treated in a fully reasoned manner in the award or decision, and investment arbitration tribunals and *ad hoc* committees need to respond to this demand, specifically identifying in the award or decision the party behavior which led to the allocation of costs in a particular manner.[41]

III. SECURITY FOR COSTS IN ISDS

Obtaining an order for the allocation of tribunal and party costs in line with the outcome of the case is only half the battle. Obtaining payment of the costs award is another matter altogether. It is also another area where there is significant imbalance between claimants in investment arbitrations and respondent States.

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[35] M. HODGSON, "Counting the Costs of Investment Treaty Arbitration".

[36] *Ibid*.

[37] M. HODGSON, "Damages and costs in investment treaty arbitration revisited".

[38] M. HODGSON, "Costs in Investment Treaty Arbitration: The Case for Reform", 11(1) Transnat'l Disp. Mgmt. (2014), p. 1 at p. 9.

[39] M. HODGSON, "Damages and costs in investment treaty arbitration revisited".

[40] A number of modern investment agreement have already adopted this approach. See the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union and its Member States, provisionally entered into force September 21, 2017, Art. 8.39(5), and the EU-Singapore Free Trade Agreement, authentic text as of May 2015, Art. 9.26(1).

[41] S. FRANCK, "Rationalizing Costs in Investment Treaty Arbitration", pp. 795-796.

States' concerns in this regard were reflected in the discussions of UNCITRAL Working Group III on ISDS Reform in November-December 2017:

> A further area of concern mentioned related to difficulties faced by successful respondent States in recovering costs from claimant investors. It was said that investors might use shell companies, or might be impecunious, which left States with no possibility of recovery. That was highlighted as another area of imbalance as States had a permanent and financial standing, which investors did not. It was said that that situation was aggravated by the fact that the possibility of obtaining security for costs was not provided for under investment treaties or in certain arbitration rules.[42]

This concern was also reflected in the results of a survey by Judith Gill and Matthew Hodgson published in September 2015.[43] That survey revealed "a common complaint from states that they are not on a level playing field since investors are often 'shell' companies with neither the intention nor the means to make good on an adverse costs decision."[44] This places the parties in an asymmetric position.[45] The following statistics from that survey are revealing:

- "In the investment treaty context at least, the suggestion that most awards are complied with voluntarily is not well founded, at least so far as costs awards are concerned. Only 52 per cent of costs awards in favor of claimants and 49 per cent in favor of respondents were paid in full."[46]
- "37 per cent of successful respondents were paid nothing at all, despite obtaining a costs award in their favour, whereas only 19 per cent of successful claimants suffered the same fate."[47]
- "Even taking account of settlements reached (almost all of which involved only partial payment), only 46 per cent of claimants paid (in full or part) on their own initiative, although 71 per cent of respondents did so."[48]

Anecdotal evidence also confirms the concerns of States that they are too often unable to recover the cost of successfully defending an investment arbitration:

- In *Kılıç v. Turkmenistan*, the tribunal awarded the respondent State over US$1 million in costs upon dismissal of the case for lack of jurisdiction, but the claimant refused to pay.[49]

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[42] UNCITRAL WGIII ISDS Reform 34th Session Report, para. 49.

[43] Judith GILL and Matthew HODGSON, "Costs Awards – Who Pays?", Global Arb. Rev. (September 15, 2015), available at <https://globalarbitrationreview.com/article/1034757/costs-awards-%E2%80%93-who-pays> (last accessed February 22, 2018).

[44] *Ibid.*

[45] *Ibid.*

[46] *Ibid*.

[47] *Ibid.*

[48] *Ibid*.

[49] *Kılıç İnşaat İthalat İhracat Sanayi ve Ticaret Anonim Şirketi v. Turkmenistan* (ICSID Case No. ARB/10/1), Award (July 2, 2013) para. 10.1.1(d).

Despite its failure to pay the costs award, the claimant still managed to find funding for an annulment proceeding, which was also dismissed. The *ad hoc* annulment committee ordered *Kılıç* to post security in the amount of the costs award as a condition for stay of enforcement,[50] but no security was ever posted.

- In *Erhas et al. v. Turkmenistan*, a case discussed in Section IV(1) below in more detail, a group of unrelated claimants all financed by the same third-party funder and represented by its designated counsel attempted to bring a single arbitration proceeding to collectively adjudicate their unrelated claims. The tribunal dismissed the proceeding and issued a costs award, ordering the claimants to pay the respondent State more than US$1 million in legal fees and expenses.[51] However, the claimants and their funders have refused to pay any portion of the costs award.

The Gill and Hodgson survey reported the following incident:

> Counsel to another state complained that a subsidiary of one of the claimant companies was transferred (in potentially fraudulent circumstances) during the course of the proceeding and without disclosure to the tribunal. This ultimately prevented enforcement of the costs award since the claimants were left without substantial assets.[52]

The authors are also aware of an August 2016 UNCITRAL investment arbitration award dismissing all US$573 million in claims against the Islamic Republic of Pakistan, and ordering the claimants to pay to the respondent State £11 million in costs (out of an apparent total of £12 million spent by the state in defending the claims).[53] According to a February 12, 2018 report in connection with set-aside proceedings before the English courts, that costs award remains unpaid to this day.[54]

These outcomes are manifestly unsatisfactory, and calls for reform are well founded. As expressed by one respondent to the Gill and Hodgson survey, "increased availability of security for costs is the 'single change' [I] would propose to the investment arbitration regime

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[50] *Kılıç İnşaat İthalat İhracat Sanayi ve Ticaret Anonim Şirketi v. Turkmenistan* (ICSID Case No. ARB/10/1), Decision on Applicant's Request for Continuation of Stay of Enforcement of the Award (June 5, 2014) paras. 42, 47.

[51] "Turkmenistan Sees Off Group Claim", Global Arbitration Review (June 24, 2015), available at <https://globalarbitrationreview.com/article/1034557/turkmenistan-sees-off-group-claim> (last accessed February 22, 2018).

[52] J. GILL and M. HODGSON, "Costs Awards – Who Pays?".

[53] Jarrod HEPBURN, "Fortier-Chaired UNCITRAL Tribunal Dismisses BIT Claim by Former Iraqi Government Minister Against Pakistan", Investment Arb. Rep. (September 4, 2016), available at <https://www.iareporter.com/articles/fortier-chaired-uncitral-tribunal-dismisses-bit-claim-by-former-iraqi-government-minister-against-pakistan/> (last accessed February 22, 2018).

[54] Jarrod HEPBURN, "English Court Orders Security for Costs Against Claimants in Set-Aside Proceedings Funded by Burford Capital, But Declines Security Over Still-Unpaid Adverse Costs Order in Underlying Arbitration" Investment Arb. Rep. (February 12, 2018), available at <https://www.iareporter.com/articles/english-court-orders-security-for-costs-against-claimants-in-set-aside-proceedings-funded-by-burford-capital-but-declines-security-over-still-unpaid-adverse-costs-order-in-underlying-arbitration/> (last accessed February 15, 2018).

precisely to discourage frivolous claims."[55] In investment arbitrations, interim orders which allow the respondent State to secure the amount representing its likely arbitration costs are seldom granted.[56] The main argument against making security for the respondent State's costs more frequently available is that it would create additional barriers to the bringing of (meritorious) claims by injured investors. However, in an age where third-party funding is readily available to claimants in investment arbitrations, the weight of this argument is severely diminished. In fact, the prevalence of third-party funding in investment arbitration exacerbates the asymmetry of funding and cost recovery between claimants and States.

Claimants in investment arbitrations frequently turn to third-party funding because they are impecunious and unable to afford the cost of bringing the arbitration themselves. This is not uniformly the case, but it is certainly not unreasonable for a respondent State, faced with a funded claim, to have serious concerns regarding the claimant's ability to pay an adverse costs award. By definition, third-party funders are not parties to the arbitration and are not subject to the tribunal's jurisdiction. Accordingly, unless their funding agreement says otherwise, third-party funders are free to ignore any costs award rendered against the claimant they fund.[57] Hence the asymmetry: the impecunious claimant stands to benefit from a favorable award, but is judgment-proof insofar as an adverse costs award is concerned because it has few or no assets; the third-party funder stands to benefit from a favorable award, but is beyond the tribunal's jurisdiction to order payment of the other side's costs, and may be shielded from an adverse costs award against the claimant by the terms of the financing agreement. For the claimant and its funder, it's all upside, and no downside. By contrast, in this scenario, the respondent State must fund its own defense and has no possibility to recover the cost of its defense in the event of a favorable outcome and award of costs.

This asymmetry can have a direct effect on the manner in which a claimant presents its case, the incentive being to run every conceivable argument irrespective of merit and inflate the quantum

[55] J. GILL and M. HODGSON, "Costs Awards – Who Pays?".

[56] Gary B. BORN, *International Commercial Arbitration*, 2nd edn. (Kluwer Law International 2014) p. 2496. Costs include legal costs, tribunal's fees and other administrative or miscellaneous costs.

[57] Aren GOLDSMITH and Lorenzo MELCHIONDA, "Third Party Funding in International Arbitration: Everything You Ever Wanted to Know (But Were Afraid to Ask) – Part 2", 2012(2) Int'l Bus. L.J. (2012) p. 221 at p. 223 ("In theory, a respondent who is unable to satisfy an award of costs might attempt to act against the funder itself. However, under existing practices, which would generally qualify the funder as a non-party to the proceeding, it would likely be difficult, if not impossible, to obtain an arbitral award for costs against the source of TPF."); Edouard BERTRAND, "The Brave New World of Arbitration: Third-Party Funding", 29(3) ASA Bull. (2011) p. 607 at p. 613 ("[A]n arbitral tribunal could never issue an award binding on the TPF funder in respect of the arbitration costs, because the TPF funder is not a party to the arbitration proceedings, and as such not a party to the arbitral proceedings."). See also *X v. Y and Z* (ICC Case), Procedural Order (August 3, 2012), reproduced in Philippe PINSOLLE, "Third Party Funding and Security for Costs", 2 Cahiers de L'Arbitrage (2013) p. 399 at para. 40 ("The third party funding mechanism at hand makes it possible for the Funder to secure a comfortable share of the proceeds for itself in case the litigation is successful while (i) taking no risk whatsoever with regard to the costs that may have to be paid to the other party as a consequence of an unsuccessful litigation and (ii) retaining the possibility to walk out at any time by simply [']pulling the plug' on [the Claimant] should it appear . . . that the case is going less well for the Claimant than had been anticipated.").

claimed to impossible heights, because there are no cost consequences for such behavior.[58] These behaviors directly increase the cost of the respondent State's defense, exacerbating the problem. [59]

Another problem is that a third-party funder may decide to withdraw its funding at any time, leaving the claimant with no means to continue financing the case and the respondent State with no recourse to recover its costs. Most funding agreements contain provisions regarding discontinuance of the funding.[60] Such provisions "expose the opposing party to costs risks (i.e. the risk of being unable to collect costs from a defaulting entity no longer supported by [third-party funding]) in the event the funder should decide to withdraw funding because the claim appears to have weakened over time."[61] It is also well known that "some [funders] have no intention to finance the proceeding and do not even have money, they just hope to reach a settlement as quickly as possible and, if this does not occur, they abandon the client."[62] The result is that the respondent State is left high and dry.

These are not theoretical problems. The *Bozbey v. Turkmenistan* case is an example. There, the claimant postponed a hearing on jurisdiction and merits at the last minute after being unable to fund the litigation, despite having previously been supported by a third-party funder.[63] The case was suspended for over a year, presumably while the claimant tried to find alternative funding sources, and was eventually terminated by order of the tribunal, nearly three years after it had commenced.[64] The reader can guess whether the respondent State was ever able to recover the cost of its defense.

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[58] A. GOLDSMITH and L. MELCHIONDA, "Third Party Funding in International Arbitration: Everything You Ever Wanted to Know (But Were Afraid to Ask) – Part 2", p. 223 ("[C]laimants will be incentivised to generate and externalise excessive costs.").

[59] See S. FRANCK, "Rationalizing Costs in Investment Treaty Arbitration", pp. 835-836 and Chart 1. See also Maxi SCHERER, Aren GOLDSMITH and Camille FLÉCHET, "Third Party Funding of International Arbitration Proceedings – A View From Europe: Part 2: The Legal Debate", 2012(6) Int'l Bus. L.J. (2012) p. 649 at p. 651 ("[A] claimant with greater financial resources will have access to a larger number of experts and witnesses and their legal fees will be higher than those of a claimant with more limited resources. Accordingly, the costs of the respondent, who as a result will be likely to rely on more experts and witnesses, will also increase.").

[60] The report of a roundtable attended by several third-party funders states that "[a]ll of the funders include clauses relating to the termination of the funding relationship in their contract." One of the funders also indicated that grounds for termination include "material changes in circumstances." Maxi SCHERER, Aren GOLDSMITH and Camille FLÉCHET, "Third Party Funding in International Arbitration in Europe: Part 1: Funders' Perspectives", 2012(2) Int'l Bus. L.J. (2012) p. 207 at p. 218.

[61] Aren GOLDSMITH and Lorenzo MELCHIONDA, "Third Party Funding in International Arbitration: Everything You Ever Wanted To Know (But Were Afraid To Ask)", 2012(1) Int'l Bus. L.J. (2012) p. 53 at p. 59.

[62] Olivia DUFOUR, "Prêts pour le Third Party Funding?" Lettre des Juristes d'Affaires (September-October 2013), p. 8 at p. 9 (quoting H.G. Gharavi; authors' translation).

[63] "Turkmenistan Faces BIT Claim After Human Rights Ruling", Global Arb. Rev. (April 24, 2013), available at <https://globalarbitrationreview.com/article/1032280/turkmenistan-faces-bit-claim-after-human-rights-ruling> (last accessed February 22, 2018).

[64] Luke Eric PETERSON, "Central Asia Round-Up: Updates on Four UNCITRAL Investment Treaty Arbitrations in the 'Stans'", Investment Arb. Rep. (March 11, 2014), available at <https://www.iareporter.com/articles/central-asia-round-up-updates-on-four-uncitral-investment-treaty-arbitrations-in-the-stans/> (last accessed February 22, 2018).

Valle Verde v. Venezuela provides another example.[65] That ICSID case was twice stayed in 2013-2014 for non-payment of the required advances.[66] In May 2015, the Secretary-General of ICSID moved that the tribunal discontinue the proceeding for lack of payment.[67] That prompted the claimant to pay the required advances, but in June 2015, claimant's counsel withdrew.[68] In September 2015, the claimant again resurfaced, represented by new counsel, and filed another application requesting that Venezuela front some of the cost of bringing the case. The tribunal denied that request in January 2016, stating that "Valle Verde always knew about the possibility of having to cover Venezuela's share and therefore cannot claim a breach of its procedural rights once this possibility materialized."[69] In September 2017, the proceedings were again stayed for non-payment of the required advances, and the case remains stayed as of the date of the writing of this article.[70] This kind of stop-start behavior by a claimant is frustrating and costly for the respondent State, which is deprived of any legal certainly regarding the status of the case, and nonetheless has to keep its defense team in place to respond if and when the proceeding restarts, all with zero chance of recovering the cost of its defense if the proceeding is (finally) discontinued, or if the State prevails.

Again, increased availability of security for costs for respondent States is the obvious solution.[71]

It seems ridiculous that there is still any debate as to whether investment arbitration tribunals have the power to order security for costs. Even when there is no express reference to this power in the applicable arbitration rules,[72] the power to order security for costs falls clearly under the

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[65] *Valle Verde Sociedad Financiera S.L. v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB/12/18).

[66] ICSID Case Details, *Valle Verde Sociedad Financiera S.L. v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB/12/18), available at <https://icsid.worldbank.org/en/Pages/cases/casedetail.aspx?CaseNo=ARB/12/18> (last accessed March 12, 2018).

[67] *Ibid*.

[68] Jack Newsham, "ICSID Won't Make Venezuela Put Up Costs in Bank Row" Law360 (February 8, 2016), available at <https://www.law360.com/articles/756357/icsid-won-t-make-venezuela-put-up-costs-in-bank-row> (last accessed March 12, 2018).

[69] *Ibid*.

[70] ICSID Case Details, *Valle Verde Sociedad Financiera S.L. v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB/12/18), available at <https://icsid.worldbank.org/en/Pages/cases/casedetail.aspx?CaseNo=ARB/12/18> (last accessed March 12, 2018).

[71] Jeffrey WAINCYMER, *Procedure and Evidence in International Arbitration* (Kluwer Law International 2012) p. 644 (stating that ordering security for costs is justified "where the claiming party is impecunious and is being funded by a related entity who will benefit if the claims succeed but be beyond exposure if they are lost."); P. PINSOLLE, "Third Party Funding and Security for Costs" ("The fact that this [third-party funding] agreement may exclude 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 precisely because of his insolvency. It seems to us that this asymmetrical situation, when it is clearly established, justifies by itself granting security for costs. Indeed, absent such a guarantee, the claimant will be in a position, in case of failure, to hide behind his impecuniosity to refuse to pay costs, despite the fact that he was able to advance his claim thanks to the funds of the third party. The claimant would thus benefit from the best of both worlds, which does not seem like a desirable situation.").

[72] Compare with London Court of International Arbitration, Arbitration Rules (2014), Art. 25, available at <http://www.lcia.org/dispute_resolution_services/lcia-arbitration-rules-2014.aspx#Article__25> (last accessed

tribunal's general powers to grant interim relief to protect a party's legitimate interest in ensuring that at least part of the cost of its defense will be recoverable.[73]

The ICSID tribunal in *RSM v. Saint Lucia* reasoned:

> [S]ecurity for costs can be ordered based on Article 47 ICSID Convention and ICSID Arbitration Rule 39. The fact that ordering security for costs is not expressly provided for in those provisions does not exclude the Tribunal's jurisdiction to issue such measure.[74]

In the UNCITRAL context, Georgios Petrochilos explains that a tribunal's power to order security for costs is clearly encompassed in Article 26(2)(c) of the 2010 UNCITRAL Rules, which refers to orders requiring a party to "preserv[e] assets out of which a subsequent award may be satisfied."[75] Investment arbitration tribunals constituted under the 1976 UNCITRAL Rules adopted a similar approach, also relying on Article 26.[76]

Nonetheless, and for obvious reasons, claimants in ICSID proceedings continue to argue that the absence of an express provision on security for costs in the ICSID Convention and Arbitration Rules means that no power to make such orders exists. To put this (non)issue to rest, the ICSID Arbitration Rules should be updated to expressly provide that tribunals have the power to issue

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February 15, 2018); Singapore International Arbitration Centre, Arbitration Rules (2016), Rule 27, available at <http://www.siac.org.sg/our-rules/rules/siac-rules-2016#siac_rule27> (last accessed February 15, 2018).

[73] Julian D.M. LEW, Loukas A. MISTELIS, and Stefal Michael KROLL., *Comparative International Commercial Arbitration* (Kluwer Law International 2003) pp. 600-601 ("The respondent against whom the proceedings were brought has an interest in ensuring that at least part of the fees incurred will be recoverable. To this end several arbitration rules contain provisions empowering the tribunal to grant security for costs. . . . However, even where no such express provisions exist, tribunals can grant such orders under their general power to grant interim relief."); Nicolas ULMER, "The Cost Conundrum", 26(2) Arb. Int'l (2010) p. 221 at p. 230 ("[I]t is widely accepted that the ordering of security for costs is within the power of arbitrators to order interim measures"); *RSM Production Corporation et al. v. Government of Grenada* (ICSID Case No. ARB/10/6), Tribunal's Decision on Respondent's Application for Security for Costs (October 14, 2010) para. 5.16; *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 (September 20, 2012) para. 45 (finding that the ad hoc committee's power to safeguard the integrity of the proceeding included the power to order security for costs).

[74] *RSM Production Corporation v. Saint Lucia* (ICSID Case No. ARB/12/10), Decision on Saint Lucia's Request for Security for Costs (August 13, 2014) para. 54. See also *Lighthouse Corporation Ptd Ltd and Lighthouse Corporation Ltd, IBC v. Democratic Republic of Timor-Leste* (ICSID Case No. ARB/15/2), Procedural Order No. 2 (February 13, 2016), para. 53 ("The Tribunal's power to grant security for costs as a provisional measure is undisputed. This power stems from Article 47 of the ICSID Convention and ICSID Arbitration Rule 39".).

[75] Georgios PETROCHILOS, "Interim Measures under the Revised UNCITRAL Arbitration Rules", 28(4) ASA Bull. (2010) p. 878 at p. 885.

[76] See *Guaracachi America, Inc. and Rurelec Plc v. The Plurinational State of Bolivia* (PCA Case No. 2011-17), Procedural Order No. 14 (March 11, 2013) para. 6 ("[I]nvestment treaty tribunals clearly hold the power to grant provisional measures . . . . Article 26 of the [1976] UNCITRAL Rules expressly envisages this possibility."); *South American Silver Limited (Bermuda) v. The Plurinational State of Bolivia* (PCA Case No. 2013-15), Procedural Order No. 10 (January 11, 2016) paras. 50, 52 ("The Tribunal considers that a request for security for costs should be encompassed in the category of interim or provisional measures, provided for in Art. 26 of the UNCITRAL Rules. . . . [S]everal decisions of arbitral tribunals in investment arbitrations, both under the ICSID Rules as well as the UNCITRAL Rules, confirm that arbitral tribunals are empowered to order security for costs.").

orders for security for costs. As noted above, this is indeed on the list of topics for potential ICSID rule amendment.

Also on ICSID's list of topics for potential rule amendment is a list of factors to be taken into account by the tribunal when assessing an application for security for costs. Closely related to this is the issue of the burden of proof and the standard to be applied by investment tribunals when considering an application for security for costs.

Tribunals in ICSID proceedings have frequently required a State to show exceptional circumstances, such as an element of abuse of process, to justify the making of an order for security for costs.[77] One of the justifications for this high standard is that orders for security for costs create additional barriers to claims, and that it would be unfair for a respondent State to be able to prevent an impecunious claimant from bringing a claim in circumstances where the claimant's impecuniousness was caused by the respondent State in the first place. The purpose of this article is not to engage in a debate on the access-to-justice issue, but rather to point out that this concern falls away when the claim is funded by a third party.

For practical purposes, the funding for the security ordered will presumably be provided by the third-party funder, as a cost of the arbitration. Indeed, there are good reasons why this should be a requirement for international arbitrations funded by third-party funders where the claimant is unlikely to be in a position to satisfy an adverse costs award. As articulated by one ICC tribunal:

> 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.[78]

Other tribunals and commentators share this view.[79] And if the third-party funder has done its homework and believes that the claim has a good chance of success, then there can be no real

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[77] Jean E. KALICKI, "Security for Costs in International Arbitration", 3(5) Transnat'l Disp. Mgmt. (2006) p. 1 at p. 1. See, e.g., *Phoenix Action, Ltd. v. Czech Republic* (ICSID Case No. ARB/06/5), Decision on Provisional Measures (April 6, 2007) para. 32; *Plama Consortium Limited v. Republic of Bulgaria* (ICSID Case No. ARB/03/24), Order (September 6, 2005) para. 38; *Saipem S.p.A v. The People's Republic of Bangladesh* (ICSID Case No. ARB/05/7), Decision on Jurisdiction and Recommendation on Provisional Measures (March 21, 2007) para. 175; *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador* (ICSID Case No. ARB/06/11), Decision on Provisional Measures (August 17, 2007) para. 59; *RSM Production Corporation et al. v. Government of Grenada* (ICSID Case No. ARB/10/6), Tribunal's Decision on Respondent's Application for Security for Costs (October 14, 2010) para. 5.17; *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 (September 20, 2012) para. 44; *RSM Production Corporation v. Saint Lucia* (ICSID Case No. ARB/12/10), Decision on Saint Lucia's Request for Security for Costs (August 13, 2014) para. 75; *Lighthouse Corporation Ptd Ltd and Lighthouse Corporation Ltd, IBC v. Democratic Republic of Timor-Leste* (ICSID Case No. ARB/15/2), Procedural Order No. 2 (February 13, 2016), para. 59.

[78] *X. S.A.R.L., Lebanon v. Y. AG, Germany* (ICC Case), Procedural Order No. 3 (July 4, 2008) para. 21 in 28(1) ASA Bull. (2010) p. 37.

[79] P. PINSOLLE, "Third Party Funding and Security for Costs", 2 Cahiers de L'Arbitrage (2013) p. 399 at paras. 40, 43, reproducing *X. v. Y and Z* (ICC Case), Procedural Order (August 3, 2012) (ordering security for costs after observing that the claimant's third-party funding arrangement "makes it possible for the Funder to secure a comfortable share of the proceeds for itself in case the litigation is successful while (i) taking no risk whatsoever

objection to fronting the security necessary for the claim to proceed. Selvyn Seidel of third-party funder, Fulbrook Management, has been quoted as saying, "[p]ersonally 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."[80]

The Draft Report for Public Discussion of the ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration ("ICCA-QM Draft TPF Report")[81] has recommended certain principles to be applied by arbitral tribunals in awarding security for costs, including that "[a]pplications for security for costs should be determined irrespective of any funding arrangement and on the basis of impecuniousness", and that "the burden is on the moving party; no party should have to defend a motion for security unless and until the moving party makes a *prima facie* showing of impecuniousness".[82] With respect, these recommendations do not respond to the growing asymmetries between investors and States in connection with third-party funded investment arbitrations. They are also unworkable in practice.

As a practical matter, the presence of a third-party funder may be the first, and perhaps the only indication that a claimant may be impecunious. While some claimants may have some publicly available financial information, this is extremely rare. For public companies, some financial information may be available at the group, or holding company level, but obtaining any information as to the assets or financial standing of the precise entity which is bringing the claim

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with regard to the costs that may have to be paid to the other party as a consequence of an unsuccessful litigation and (ii) retaining the possibility to walk out at any time by simply ['pulling the plug' on [the Claimant] should it appear . . . that the case is going less well for the Claimant than had been anticipated."); *Swiss Entity v. Dutch Entity* (HKZ Case No. 415), Award (November 20, 2001) in 20(3) ASA Bull. (2002) pp. 467-468, 471-472 (The respondent had applied for security for costs on the ground that the claimant was "not able to pay the costs of the proceedings and that it is therefore forced to obtain funds from external sources." The tribunal granted the request, stating that "it is most likely that if Respondent were to prevail in this arbitration, a future cost award in its favor could not be satisfied by Claimant."); Jarrod HEPBURN, "ICC Costs Award in Favor of Bulgaria Is Upheld, as Domestic Court Rejects Claimant's Allegation of Tribunal Bias Against Third-Party-Funded Claimant" Investment Arb. Rep. (October 19, 2015), available at <https://www.iareporter.com/articles/icc-costs-award-in-favor-of-bulgaria-is-upheld-as-domestic-court-rejects-claimants-allegation-of-tribunal-bias-against-third-party-funded-claimant/> (last accessed February 15, 2018) ("Noting that [the claimant] Chematur's arbitral claim was funded by a third party, the tribunal had ordered Chematur to post a bank guarantee for $750,000."); M. SCHERER and A. GOLDSMITH and C. FLÉCHET, "Third Party Funding in International Arbitration in Europe: Part 1 – Funders' Perspectives", p. 215; Mick SMITH and Antonio WESOLOWSKI, "Mechanics of Third-Party Funding Agreements: A Funder's Perspective" in Lisa Bench NIEUWVELD and Victoria SHANNON, *Third-Party Funding in International Arbitration*, 2nd edn. (Kluwer Law International 2012) p. 19 at n. 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."); Jasminka KALAJDZIC, Peter CASHMAN, and Alana LONGMOORE, "Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding", 61(1) Am. J. Comp. L. (2013), p. 93 at p. 100 ("The [funding] agreement will often provide that the funder will . . . pay any amount required to be provided by way of security for costs.").

[80] Alison ROSS, "The Dynamics of Third-Party Funding", Global Arb. Rev. (March 7, 2012), available at <https://globalarbitrationreview.com/article/1031171/the-dynamics-of-third-party-funding-in-full> (last accessed February 22, 2018).

[81] ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration, "Draft Report for Public Discussion of the ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration" (September 1, 2017) (henceforth "*ICCA-QM Draft TPF Report*").

[82] *Ibid.* p. 114.

can be virtually impossible. The claimant may well be a special purpose vehicle which was set up for tax purposes, or to try to take advantage of certain treaty protections, but it may have little or no assets itself. For claimants who are private companies or individuals, finding any financial information at all, let alone accurate information, is even more difficult. The most likely scenario is that a respondent State becomes aware of the existence of a third-party funder, but is unable to find any publicly available information regarding the financial standing of the claimant. In these circumstances, putting the burden on the respondent State to make a *prima facie* showing of impecuniousness of the claimant, before the claimant needs to defend the motion, is illogical and unjust. It is the claimant which holds the relevant information.

The tool one would normally use when confronted with this type of information imbalance, in relation to jurisdictional or substantive issues in an investment arbitration, would be to request disclosures or document discovery. There is no good reason why a similar approach could not be used in relation to the issue of impecuniousness of the claimant. Once a respondent State becomes aware of circumstances suggesting that the claimant may be impecunious (including the fact that its claim is being funded by a third party, but also perhaps other circumstances, such as failure to pay an advance on costs, or an SEC disclosure) but not necessarily rising to the level of a *prima facie* showing, the respondent should disclose such circumstances to the tribunal and be permitted to request that the claimant provide information regarding its financial position and, in particular, for the claimant to make a showing that it has the financial wherewithal to cover an adverse costs order. Should the claimant fail to make such a showing, the tribunal must weigh the competing interests of access to justice versus the respondent's right to recover the costs of a successful defense. Where the claim is third-party funded, the scales tip markedly in favor of ordering security for costs.

ICSID Additional Facility case *Luis García Armas v. Venezuela*,[83] and UNCITRAL (PCA) case *Manuel García Armas and others v. Venezuela*,[84] provide an example of how this approach can work in practice. The same tribunal sits in both of these pending cases.[85] Following an application for US$5 million in security for costs by the respondent State based on "strong indications that the family had already or would become insolvent,"[86] the claimants were first required to submit a redacted version of their funding agreement, with the full agreement being submitted in camera to the tribunal to review whether the redactions were appropriate. In the context of that in camera review, the tribunal found that respondent was indeed entitled to see the entirety of the document, as the funding agreement contained (otherwise redacted) language that showed that the funder would not cover any adverse costs order. The tribunal then proceeded, at the respondent's request, to order the claimants to show not only that they had sufficient assets,

[83] *Luis García Armas v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB(AF)/16/1).

[84] *Manuel García Armas, Pedro García Armas, Sebastián García Armas, Domingo García Armas, Manuel García Piñero, Margaret García Piñero, Alicia García González, Domingo García Cámara and Carmen García Cámara v. Bolivarian Republic of Venezuela* (PCA Case No. 2016-08).

[85] Tom Jones, "BIT Panel Orders Funded Claimants to Prove Solvency", Global Arb. Rev. (July 12, 2017) available at <https://globalarbitrationreview.com/print_article/gar/article/1144330/bit-panel-orders-funded-claimants-to-prove-solvency?print=true> (last accessed March 12, 2018).

[86] *Ibid*.

but also that they had sufficient revenue streams, to cover any adverse costs order.[87] The respondent State's application for security for costs is pending, but the tribunal's approach will ensure that it has access to all of the necessary information to determine whether an order for security for costs is appropriate and just in the circumstances of the case.

In this context, it is important to remark that a mere showing by the claimant that its third-party funder has agreed to pay any adverse costs award at the end of the proceeding is not sufficient to protect the respondent State's interests. First, the respondent State is not a party to that agreement and cannot enforce its terms. Second, the third-party funder is not subject to the jurisdiction of the arbitral tribunal which is, in any event, *functus officio* after the issuance of the final award and no longer in a position to coerce compliance through its jurisdiction over the claimant. Third, there is still the risk that the third-party funder will walk away from the funding agreement during the proceeding, rendering its promise to pay any adverse costs order of zero utility. Rather, if a third-party funder has agreed to pay any adverse costs award, then it should have no problem putting up a guarantee at the outset of the proceeding, or at the point when the issue of the claimant's impecuniousness otherwise arises.

A capable tribunal will manage the process of enquiring into the claimant's financial standing as well as its funding arrangements in an efficient manner to minimize delays. Any small delay will in any event be justified given the importance of protecting the interest of a respondent State in being able to enforce a favorable costs award. Moreover, what is at stake is much more than an unpaid costs award. Concrete measures must be taken to address the asymmetries in funding and cost recovery as between investors and States in investment arbitration, which have been a key contributing factor to the diminished confidence of States in ISDS as a system.

In connection with this proposed procedure, the rules on security for costs in jurisdictions with significant experience with third-party funding in domestic litigation are instructive. In the United Kingdom, for example, the Civil Procedure Rules allow courts to order security for costs to be provided by third parties who fund litigation on a commercial basis.[88] Addressing the issue of security for costs, the High Court has stated that the test was not whether the circumstances were "exceptional", but whether they were "just".[89] Traditionally, the English courts have limited the amount of a security for costs order against a third-party funder to the upper limit of the fund's contribution to funding the litigation.[90] However, a more recent decision makes it

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[87] *Ibid*. See also ICSID Case Details, *Luis García Armas v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB(AF)/16/1), available at https://icsid.worldbank.org/en/Pages/cases/casedetail.aspx?CaseNo=ARB(AF)/16/1 (last accessed March 12, 2018); PCA Case View, *Manuel García Armas, Pedro García Armas, Sebastián García Armas, Domingo García Armas, Manuel García Piñero, Margaret García Piñero, Alicia García González, Domingo García Cámara and Carmen García Cámara v. Bolivarian Republic of Venezuela* (PCA Case No. 2016-08), available at <https://www.pcacases.com/web/view/135>(last accessed March 12, 2018).

[88] United Kingdom, Civil Procedure Rules 1998 (No. 3132 (L. 17) (as amended as of October 1, 2017)), Rule 25.14.

[89] *The RBS Rights Issue Litigation* [2017] EWHC 1217 (Ch).

[90] In *Arkin v. Borchard Lines, Ltd. No. 2*, the English Court of Appeal found the third-party funder liable for all costs up to the amount of its contribution to the litigation. *Arkin v. Borchard Lines, Ltd. No. 2* [2005] EWCA Civ. 655, paras. 37-45. See also Carolyn B. LAMM and Eckhard R. HELLBECK, "Third-Party Funding in Investor-State Arbitration: Introduction and Overview" in Bernardo .M. CREMADES and Antonio DIMOLITSA, eds., *Dossier X: Third-Party Funding in International Arbitration* (ICC Institute of World Business Law 2013), p. 101 at pp. 111-112 (describing *Arkin v. Borchard Lines, Ltd. No. 2*, stating that "[t]he underlying rationale was that justice

clear that the English courts have started taking a broader approach in exercising their discretion in relation to security for costs, scrutinizing the financial standing and resources of both claimants and their third-party funders, and awarding security for costs in excess of the funder's contribution where the interests of justice so require.[91] Likewise, in Australia, if the litigation is funded by a third-party funder, the court will generally order security for costs, considering that the third-party funder intends to benefit from any recovery.[92] Australian courts have general powers to make costs orders against parties and non-parties alike,[93] and courts can order costs against a third-party funder in circumstances where they have an interest in the subject of the litigation.[94] In 2016, for example, the Court of Appeal of the Supreme Court of Victoria went beyond the terms of the order for security for costs and upheld a non-party costs order against a third-party funder, where the amount ordered by way of security for costs was insufficient to cover the defendant's actual costs.[95] Like their English equivalents, the Australian courts scrutinize the funding agreement, and the capacity of both claimants and third-party funders to meet the costs,[96] and have focused on whether the "interests of justice" require orders for security of costs, and costs orders, rather than on whether or not "exceptional circumstances" exist.

The experience of these national jurisdictions with a history of dealing with funded litigation provides meaningful guidance as to the right balance to be struck when assessing security for costs applications in funded arbitrations. Requiring a respondent State to make a showing of "exceptional circumstances", such as abuse of process, is unreasonable and means that orders of security for costs have become the unicorns of investment arbitration. Everyone has heard of them, and apparently they are beautiful creatures, but no one has actually seen one. Investment arbitration tribunals should instead be striving to achieve just outcomes, having scrutinized the

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would be better served by allowing a right to recover from the professional funder whose intervention had permitted the continuation of a claim that had ultimately been found to lack merit.").

[91] *Sandra Bailey & Others v. GlaxoSmithKline UK Limited* [2017] EWHC 3195 (QB). In this case, the High Court ordered security for costs against the third-party funder in the amount of £1.75 million, when the third-party funder had provided only £1.2 million of funding toward the litigation in return for a share in the proceeds of any recovery. The case is notable in that it went beyond the cap established *Arkin v. Borchard Lines, Ltd. No. 2*, and opened the door to increased orders for security for costs and, consequently, increased liability for third-party funders.

[92] *Idoport Pty Ltd v National Australia Bank Ltd* [2001] NSWSC 744.

[93] See, e.g., Uniform Civil Procedure Rules 2005 (NSW), Rule 42.21(1A); Uniform Civil Procedure Rules 1999 (Qld), Rule 672. These statutes provide non-exhaustive lists of matters to which the Court may have regard in exercising its discretion whether to order security for costs.

[94] *Knight v. FP Special Assets Ltd* [1992] HCA 28.

[95] *Ryan Carter and Esplanade Holdings Pty Ltd v. Caason Investments Pty Ltd & Ors* [2016] VSCA 236.

[96] For example, in *Domino's Pizza Enterprises Limited v. Precision Tracking Pty Ltd (No. 2)* [2017] FCA 211, the funded party opposed a security for costs order being made on the grounds that there was no risk that any costs order would not be satisfied owing to the combined effect of the litigation funding indemnity, an adverse costs insurance policy and proposed undertakings by Precision Tracking Pty Ltd to notify the parties of any relevant change of funding circumstances. However, the court upheld the application for security for costs, concluding that (1) Precision Tracking Pty Ltd did not itself have the capacity to meet an adverse costs order, (2) the funding agreement limited the indemnity to a counterclaim in the proceeding, and (3) the adverse costs insurance was taken out for the primary claim. Additionally, the funder had an absolute discretion to terminate its funding arrangements with Precision Tracking Pty Ltd at any time, including the adverse costs indemnity and the adverse costs insurance.

funding agreement, and the capacity of both claimants and their funders to meet any adverse costs order. Since they do not have jurisdiction to make adverse costs orders directly against third-party funders at the end of a case in the event that the claimant cannot pay, investment tribunals must make more frequent use of early orders for security for costs, which can then be advanced by the funder at a point in the proceeding when it is incentivized to do so. In short, third-party funders who stand to benefit from the outcome of a case by funding an impecunious claimant should also assume the risk of an adverse costs award.

IV. THIRD-PARTY FUNDING IN INVESTMENT ARBITRATION

The ICCA-QM Draft TPF Report observes that "[t]hird-party funding in investment arbitration is a particularly divisive issue in a larger debate over the legitimacy of the investment arbitration regime."[97] The same draft report notes that "key elements of these debates are often premised on factual assumptions, for which empirical information regarding third-party funding specifically is not generally available,"[98] and draws significantly on anecdotal evidence. Steinitz and Field observe that, despite the importance of the litigation funding industry and the robust academic debate surrounding the benefits and risks associated with it, there is a "complete absence of information about or discussion of litigation finance contracting."[99] That is, there is very little publicly known about the actual terms of litigation financing, despite the fact that it is precisely these terms which give rise to the benefits and risks that we all sit around discussing. In short, "[l]itigation finance is an opaque industry."[100]

This article likewise relies on anecdotal evidence, drawing on real experiences which serve to highlight the distortive effects of third-party funding in investment arbitration, including its tendency to: (1) lead to speculative funding of cases lacking in merit; (2) incentivize the accumulation and coordination of claims by funders in the manner of a plaintiffs' attorney; (3) amplify the quantum claimed by investors; (4) alter the parties' normal settlement incentives; and (5) accord third-party funders disconcerting influence in the appointment of arbitrators, to the detriment of arbitrators' independent exercise of judgment.

1. Speculative Funding of Cases Lacking in Merit

The U.S. Chamber of Commerce has characterized third-party litigation funding as a "clear and present danger to the impartial and efficient administration of civil justice in the United States."[101] In 2012, the Chamber made a proposal to regulate third-party litigation funding, in

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[97] *ICCA-QM Draft TPF Report*, p. 157.

[98] *Ibid*.

[99] Maya STEINITZ and Abigail C. FIELD, "A Model Litigation Funding Contract", 99(2) Iowa L. Rev. (2014) p. 711 at p. 718.

[100] *Ibid*. p. 719.

[101] John H. BEISNER and Gary A. RUBIN, U.S. Chamber Institute for Legal Reform, "Stopping the Sale on Lawsuits: A Proposal to Regulate Third-Party Investments in Litigation" (2012), available at <http://www.instituteforlegalreform.com/uploads/sites/1/TPLF_Solutions.pdf> (last accessed February 15, 2018), p. 1.

which it stated that litigation funding could be expected to increase the volume of abusive litigation, undermine the control of plaintiffs and lawyers over litigation, deter plaintiffs from settling and thus prolonging litigation, compromise the professional independence of attorneys, and more generally corrupt the attorney-client relationship.[102]

In response to the concern that third-party funding in ISDS will result in an increase in non-meritorious claims, the third-party funding industry has provided a number of responses and statistics, many of which were picked up in the ICCA-QM Draft TPF Report. First, there is the claim that third-party funders are sufficiently detached, and skilled, to make an independent, realistic assessment of the merits and value of a case. In the abstract, this argument is not unreasonable. Certainly, third-party funders have no incentive to back a losing claim, and they generally have skilled teams of lawyers who assess the claim before determining whether to invest. But studying the form guide doesn't mean that the punter will pick the winning horse. The fact that the third-party funder has studied what is known about the case at a certain point (usually before anything is known of the respondent State's position) and is financially incentivized to bet on a winner does not mean that because the funder decides to invest, the case is bulletproof, or even that it is likely to end in a result favorable to the investor. It also does not mean that a fundamentally unmeritorious claim, which should never have been brought, will not receive third-party funding.

In this context, the authors of the ICCA-QM Draft TPF Report apparently draw comfort from the following:

> Leading funders report an average review-acceptance rate of 10-1, meaning that for every 10 cases they reviewed, they only agreed to fund one case.[103]

With respect, even if true, such a statistic is meaningless in qualitative terms. It tells us precisely nothing about the quality of that one-in-ten claim which receives funding; only that, for any number of reasons, the third-party funder determined that it was better than nine other options.

The fact is that investing in a claim at the outset of a case, when so little is known about the asset, is highly speculative. Steinitz and Field draw a parallel between venture capital and litigation finance. They note that the two endeavors "have a similar risk profile: they invest in high-risk assets with the hope that, even if many of their investments fail, a handful will be wildly successful."[104] The same commentators observe that "[v]enture capitalists and litigation funders have similar (mid-length) investment timelines; they represent pools of investors' capital; and their profitability is measured across a portfolio of investments, not a single investment."[105] The comparison is apt, and the argument that there is no basis for any concern that third-party funders will ever back unmeritorious claims is terribly flawed. A funder may well back a claim which has a lower percentage chance of success (based on a very early

[102] *Ibid*., pp. 1-2.

[103] *ICCA-QM Draft TPF Report*, p. 56.

[104] M. STEINITZ and A.C. FIELD, "A Model Litigation Funding Contract", p. 723.

[105] *Ibid*.

assessment of the case), or which relies on a novel legal argument, or which has a high chance of failing on jurisdiction but good chances on the merits, provided the potential upside is sufficient, and provided the gamble fits into the risk profile of the funder's claim portfolio.[106]

The authors' and their firm's own experience of third-party funding in investment arbitration underscores the point: third-party funders are willing to fund investment arbitrations which, from the outset, range from significantly to highly speculative when the potential upside is sufficient. This experience stems *inter alia* from a series of claims brought by Turkish investors against Turkmenistan under the Turkey-Turkmenistan bilateral investment treaty ("BIT"), all of which arose out of the construction industry.

The first of these cases was *Kılıç v. Turkmenistan*, which was registered before ICSID on January 19, 2010.[107] In its Decision on Article VII.2 of the Turkey-Turkmenistan BIT dated May 7, 2012, the tribunal unanimously found that that provision requires an investor:

> to submit its dispute to the courts of the Contracting Party with which a dispute has arisen, and must not have received a final award within one year from the date of submission of its case to the local courts, before it can institute arbitration proceedings in one of the fora in the manner permitted by Article VII.2.[108]

Then, in its July 2, 2013 award, the *Kılıç* tribunal ruled: (i) that the requirement to comply with Article VII.2 of the BIT, and to have prior recourse to the Turkmen courts, constitutes a precondition to the existence of the Tribunal's jurisdiction, and (ii) that the claimant's failure to give effect to that requirement meant that the Tribunal did not have jurisdiction over the dispute. The claimant's claims were dismissed in their entirety for lack of jurisdiction, and the claimant was ordered to pay to the respondent State 50% of its reasonable legal costs and disbursements plus 75% of the costs incurred by the tribunal and ICSID following the Decision of May 7, 2012.[109] Arbitrator William W. Park issued a separate opinion in which he found that the claimant's failure to fulfill the requirement to submit the dispute to the local courts was a procedural flaw that went to the ripeness, or admissibility, of the claimant's claims, not to jurisdiction.[110] Under both approaches, the result was that, unless a Turkish claimant's claims

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[106] The "portfolio" point is key. Even the ICCA-QM Draft TPF Report acknowledges that "[i]t is uncertain the extent to which these case assessment procedures are as rigorous when cases are financed as a part of a portfolio." *ICCA-QM Draft TPF Report*, p. 58.

[107] *Kılıç İnşaat İthalat İhracat Sanayi ve Ticaret Anonim Şirketi v. Turkmenistan* (ICSID Case No. ARB/10/1) Decision on Article VII.2 of the Turkey-Turkmenistan Bilateral Investment Treaty (May 7, 2012) para. 1.2.

[108] *Ibid*., para. 11.1(c).

[109] *Kılıç İnşaat İthalat İhracat Sanayi ve Ticaret Anonim Şirketi v. Turkmenistan* (ICSID Case No. ARB/10/1), Award (July 2, 2013) para. 10.1.1. See Luke Eric PETERSON, "Claimant's Failure to Pursue Local Remedies for 12 Months Derails $300 Million Claim Against Turkmenistan; Use of Local Courts Not Proven to Be Futile" Investment Arb. Rep. (July 5, 2013), available at <https://www.iareporter.com/articles/claimants-failure-to-pursue-local-remedies-for-12-months-derails-300-million-claim-against-turkmenistan-use-of-local-courts-not-proven-to-be-futile/> (last accessed February 15, 2018).

[110] *Kılıç İnşaat İthalat İhracat Sanayi ve Ticaret Anonim Şirketi v. Turkmenistan* (ICSID Case No. ARB/10/1), Separate Opinion of Professor William W. Park (May 20, 2013).

against Turkmenistan had first been submitted to Turkmen courts and no final award had been received within one year from the date of submission, then the ICSID tribunal could not hear those claims under Article VII.2 of the Turkey-Turkmenistan BIT.

On December 20, 2010, another case brought by a Turkish claimant against Turkmenistan under the Turkey-Turkmenistan BIT was registered before ICSID, *İçkale v. Turkmenistan*.[111] There, the respondent State's objections to jurisdiction on the basis of Article VII.2 of the Turkey-Turkmenistan BIT were not bifurcated. In its award dated March 8, 2016, the *İçkale* tribunal decided by majority that the requirement to have prior recourse to the Turkmen courts in Article VII.2 of the BIT was a procedural requirement that related to the admissibility of the claim rather than the Tribunal's jurisdiction.[112] The majority also ruled that since a number of aspects of the dispute had been the subject of litigation before the Turkmen courts (*e.g.*, for the application of delay penalties and termination of abandoned contracts), "it would be inappropriate . . . to require that the Claimant subsequently commence further court proceedings under the relevant Contracts seeking relief thereunder and/or under the Treaty, given that the Contracts at issue had already been terminated by Turkmen courts."[113] Arbitrator Philippe Sands issued a Partially Dissenting Opinion on both points, finding (i) that the requirement for prior recourse to national courts went to the tribunal's jurisdiction, not merely to admissibility of the claims, and (ii) that in any event, the Turkmen court proceedings which had been brought did not fulfill the requirement for prior recourse to national courts: those proceedings had not been brought by the claimant, they involved certain breach of contract claims but did not concern any allegation of a violation of the BIT, and importantly, "six of the thirteen contracts appear never to have been raised before any national court in Turkmenistan, not for breach of contract or any other cause of action."[114]

Despite their divergent views on Article VII.2 of the Turkey-Turkmenistan BIT, all three members of the *İçkale* tribunal found that the claimant was not entitled to import the fair and equitable treatment, full protection and security, non-discrimination, and umbrella clause protections from other investment treaties concluded by Turkmenistan with third States on the basis of the most-favored-nation ("MFN") clause in Article II.2 of the BIT.[115] That meant that all of the claimant's claims, except for expropriation, were dismissed. The *İçkale* tribunal went on to find by majority that there had been no expropriation.[116] Thus, all of the claimant's claims were dismissed in their entirety for lack of merit, and the claimant was ordered to pay the respondent State more than US$1.7 million in costs.[117]

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[111] *İçkale İnşaat Limited Şirketi v. Turkmenistan* (ICSID Case No. ARB/10/24).

[112] *İçkale İnşaat Limited Şirketi v. Turkmenistan* (ICSID Case No. ARB/10/24), Award (March 8, 2016) para. 247.

[113] *Ibid.,* paras. 262-263.

[114] *Ibid.,* Partially Dissenting Opinion of Professor Philippe Sands QC (February 10, 2016), paras. 14-15.

[115] *İçkale İnşaat Limited Şirketi v. Turkmenistan* (ICSID Case No. ARB/10/24), Award (March 8, 2016) para. 332.

[116] *Ibid*., paras. 350-355.

[117] *Ibid.* para. 411(d)(e).

In parallel with the *İçkale* case, a third case was brought by a Turkish claimant and its main shareholder against Turkmenistan under the Turkey-Turkmenistan BIT. This case, *Muhammet Çap & Sehil v. Turkmenistan*, was registered at ICSID on March 26, 2012.[118] It emerged that a third-party funder was funding the claim. At the time funding was obtained for the *Sehil* claim:

- the *Kılıç* tribunal had not yet rendered its Decision on Article VII.2 of the Turkey-Turkmenistan BIT which found that the local court requirement was a mandatory provision and ordered the claimant to pay costs;
- the *Kılıç* tribunal had not yet issued its Award dismissing the claimant's claims in their entirety for lack of jurisdiction and ordering the claimant to pay costs; and
- the *İçkale* tribunal had not yet issued its unanimous award finding that no substantive provisions could be imported into the Turkey-Turkmenistan BIT via the MFN clause, with the majority dismissing all of the claimant's claims and awarding costs to the respondent.

Nonetheless, these must have been issues which were examined by the funder's legal team prior to agreeing to fund the *Sehil* claim. The existence of the dissenting opinions of Professor Park in *Kılıç* and Professor Sands in *İçkale* of course show that different arbitrators were capable of having different views on, for example, the jurisdiction/admissibility issue. But that does not change the fact that, from its inception, the *Sehil* claim faced very significant legal hurdles, which were obvious from the plain language of the BIT in question, before anything was known about the respondent State's defenses on the merits or any proper exploration of the facts had been undertaken. And yet, the *Sehil* claim was apparently that one-in-ten case which received funding.

Erhas & others v. Turkmenistan, also brought under the Turkey-Turkmenistan BIT,[119] is another example. In this UNCITRAL case, 22 separate Turkish claimants sought to bring – in a single class action-type proceeding – 11 distinct claims against Turkmenistan, involving at least 31 different projects spanning a period of approximately 20 years and ranging across numerous industries, including a water bottling business, various factories, and a multitude of different construction projects. Indeed, the only common link between the claims was that a single third-party funder was funding them. As one commentator described it, FTI Consulting and Global Arbitration and Litigation Services essentially "convinced half a dozen Turkish companies . . . to rely on its alleged financing to initiate arbitration against Turkmenistan."[120] Turkmenistan objected that it did not consent to such a joint arbitration claim, but ultimately agreed to appoint an arbitrator following agreement with the claimants that the tribunal would address

[118] *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) of the Turkey-Turkmenistan Bilateral Investment Treaty (February 13, 2015) para. 11.

[119] See generally Luke Eric PETERSON, "An UNCITRAL Tribunal Declines Jurisdiction Over a Joint Treaty Claim Brought Against Turkmenistan by a Series of Unrelated Claimants" Investment Arb. Rep. (June 23, 2015), available at <https://www.iareporter.com/articles/an-uncitral-tribunal-declines-jurisdiction-over-a-joint-treaty-claim-brought-against-turkmenistan-by-a-series-of-unrelated-claimants/> (last accessed February 15, 2018).

[120] Hamid G. GHARAVI, "Le Financement par un Tiers dans l'Arbitrage d'Investissement" 2017(1) Belgian Rev. Arb. (2017), p. 67 at para. 18 (authors' translation).

Turkmenistan's preliminary objection at the outset of the case. In its June 8, 2015 award, the *Erhas* tribunal declined jurisdiction over the jointly submitted case, finding "'that consent to arbitration in a treaty based context does not imply the acceptance to the joint adjudication of entirely unrelated claims made by unrelated claimants in the context of different and unrelated investments.'"[121] The claims in this case were, in the tribunal's words, "'entirely unrelated.'"[122] The majority ordered the claimants to pay the costs of the proceedings and a reasonable portion of the respondent's legal fees and expenses.[123] Viewed under any lens, the *Erhas & others* claim was a highly speculative one. And yet, it received third-party funding.

The notion that third-party funders finance only meritorious claims, which too many in the international arbitration community seem to have swallowed, is patently naïve.[124] The ICCA-QM Draft TPF Report comments on the existence, and rising prominence, of portfolio investment strategies by third-party funders, noting that a funder "may well provide funds for twenty or more cases at a time, each of them with different chances of success and different amounts at stake."[125] The Report goes on to note that a funder's assessment of these cases may in practice be less rigorous than in individually selected cases, and speculates that the issue of portfolio funding "may require reconsideration of issues relating to how cases are assessed for funding."[126] It would seem, however, that the actual practices of funders are far more advanced along those lines than the ICCA-QM Draft TPF Report contemplates. The following statement from Burford Capital's Annual Report from 2010 (eight years ago in a fast-moving industry) speaks for itself:

> Not every investment will meet or exceed expectations. The model we use is very similar to that employed in venture capital, where poor results are expected from some investments and are balanced against high returns from other investments, in an effort to achieve desirable portfolio-wide returns. . . . [W]e regularly expect to have investments that disappoint, just as we regularly expect surprises to the upside as well . . . . If we shy away from risk for fear of loss, as some litigation investors do, we will not maximise the potential performance of this portfolio.[127]

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[121] L.E. PETERSON, "An UNCITRAL Tribunal Declines Jurisdiction Over a Joint Treaty Claim Brought Against Turkmenistan by a Series of Unrelated Claimants".

[122] *Ibid*.

[123] *Ibid*.

[124] See Miriam K. HARWOOD, Simon N. BATIFORT and Christina TRAHANAS, "Third-Party Funding: Security for Costs and Other Key Issues" in Barton LEGUM, ed., *The Investment Treaty Arbitration Review*, 2nd edn. (Law Business Research 2017) p. 103 at pp. 108-109.

[125] *ICCA-QM Draft TPF Report*, p. 58.

[126] *Ibid*.

[127] Burford Capital 2010 Annual Report, available at <http://www.burfordcapital.com/investors/financial-reports-and-presentations/> (last accessed February 17, 2018) p. 5.

As the co-founder of third-party funder Calunius Capital puts it, "[t]he perception that you need strong merits is wrong – there's a price for everything."[128]

During the preparation of this article and in the context of the authors' consultation with other law firms with significant experience representing States in investment arbitration, one lawyer commented:

> Often, the funder is taking a flyer on a case that may have only a 40% chance of success, or worse. If you talk to funders (which I have), they will confide that they'll take a case on a coin flip chance (or worse). So the funding is not an access to justice issue, it's more like a patent troll issue. The funder is taking fairly worthless claims and then pumping them up into economic blackmail.

The fact is that the right price and terms of the funding agreement can make a weak case worth funding.[129] In addition, there are new products being developed by funders to further diversify their risk. Selvyn Seidel of Fulbrook Management explains:

> There are other products we're considering . . . . Anything from derivatives, where we fund a single motion rather than the entire case, to a basket of five or six cases put together as a mini-portfolio to give some security through diversification. There is even the possibility – heaven forbid – that we could fund a case and then resell it to third parties, a bit like credit default swaps.[130]

This is no longer just a possibility. An arbitration practitioner with experience advising both established funds, and some investment banks which are now moving into the funding space, confirmed to the authors:

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[128] Pia EBERHARDT *et al.*, Corporate Europe Observatory and the Transnational Institute, "Profiting From Injustice: How Law Firms, Arbitrators and Financiers Are Fuelling on Investment Arbitration Boom" (November 2012), available at <https://corporateeurope.org/sites/default/files/publications/profiting-from-injustice.pdf> (last accessed February 22, 2018) p. 59 (quoting Mick Smith, Co-Founder of Calunius Capital).

[129] *Ibid*. See also "Recent Developments in Investor–State Dispute Settlement (ISDS)", UNCTAD, IIA Issues Note No. 1, 2013, UN Doc. UNCTAD/WEB/DIAE/PCB/2013/3 (May 2013) n. 172 ("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 a high monetary award."), p. 25 ("[T]here are serious policy reasons against TPF of IIA claims – 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."); John BEISNER, Jessica MILLER, and Gary RUBIN, U.S. Chamber Institute for Legal Reform, "Selling Lawsuits, Buying Trouble: Third-Party Litigation Funding in the United States" (October 2009), available at <http://www.instituteforlegalreform.com/uploads/sites/1/thirdpartylitigationfinancing.pdf> (last accessed February 22, 2018) pp. 5-6 ("[A]lthough providing non-recourse loans to fund litigation is inherently risky, it does not follow that litigation-finance companies will only finance claims that are likely to succeed. These companies – like all sophisticated investors – will base their funding decisions on the present value of their expected return, of which the likelihood of a lawsuit's success is only one component. The other component is the potential amount of recovery. . . . Moreover, third-party funding companies are able to mitigate their downside risk in two ways: they can spread the risk of any particular case over their entire portfolio of cases, and they can spread the risk among their investors.").

[130] A. ROSS, "The Dynamics of Third-Party Funding", p. 15.

> In the process of syndicating the debts attributable to funding, the level of scrutiny and due diligence by the hedge funds to which the funding is being syndicated is almost non-existent. They are acquiring such debt on trust, based on a combination of who the first reviewing law firm was for the funder and a ravenous desire to acquire risk.

The same lawyer compared this practice to the sub prime market "where debt was wrapped and rated with little awareness of the underlying asset." His concern is the scenario where this debt becomes "a significant 'prop' for the arbitration market which might ultimately undermine its integrity."

In short, the fear that third-party funding will lead to more, and more speculative, claims is founded. The U.S. Chamber Institute for Legal Reform has recognized that third-party litigation funding can be "expected to increase the volume of abusive litigation" as funders "hedge any 'investment' against their entire portfolio of cases."[131] The risk which is supposed to moderate the bringing of frivolous claims is being diversified away to the point where there is no longer any sense of responsibility for the cost of bringing the claim, or the manner in which the case is run, or the costs incurred by the other party. The claimant, having started the claim, passes the risk to a funder, and "[i]f the money doesn't come, the claimant has nothing to lose, but the defendant (a government) has still been forced to pay top-tier firms for their services."[132]

2. Accumulation of Claims in the Manner of a Plaintiffs' Attorney

Even given all of the arguments above, one could still ask, what would make a third-party funder fund a case such as *Erhas & others v. Turkmenistan*?

The authors can imagine two possible answers. The first is relatively simple. In the tradition of plaintiffs' attorneys in the United States, collecting numerous claims means bargaining power and cost savings. A respondent State faced with the possible cost of defending 11 separate investor-State arbitrations brought by 22 different claimants relating to at least 31 different projects may indeed be inclined to settle. The effect of third-party funding on settlement incentives is discussed in more detail below. But there is no doubt that the more claims a single funder can collect against one respondent State, the more pressure it can bring to bear on that State, and the higher the likelihood of negotiating a quick settlement and a financially favorable outcome for the fund. This is yet another reason why the notion that third-party funders are financially incentivized to fund only meritorious claims rings hollow. Third-party funders are financially incentivized to reach early settlements where possible.[133] And what better way to

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[131] John H. BEISNER and Gary A. RUBIN, U.S. Chamber Institute for Legal Reform, "Stopping the Sale on Lawsuits: a Proposal to Regulate Third Party Investments in Litigation" (October 2012), available at <http://www.instituteforlegalreform.com/uploads/sites/1/TPLF_Solutions.pdf> (last accessed February 15, 2018), p. 1.

[132] P. EBERHARDT *et al*., Corporate Europe Observatory and the Transnational Institute, "Profiting From Injustice", p. 58 (quoting John Jones of risk insuring company Aon).

[133] Maya STEINITZ, "Whose Claim Is This Anyway? Third-Party Litigation Funding", 8(4) Transnat'l Disp. Mgmt. (2011) p. 1268 at p. 1313 (Noting that funders "have an incentive to settle early for a relatively low, but certain,

increase the odds of early settlement than to accumulate as many claims as possible against the same respondent State?[134] The individual merits of each case are immediately of less importance: quantity, not quality.

The second reason is more complex, and even more concerning. Corporate Europe Observatory reports that "[i]n their quest for selling more services, some litigation funders are also exploring 'less passive business-models', providing for more influence on the management and strategies of arbitrations."[135] This includes managing and strategizing across multiple cases against the same respondent State. The authors have seen entire paragraphs from a claimant's memorial in one confidential investor-State proceeding appear word-for-word in a second investor-State case, brought by a different claimant, represented by a different law firm. This occurrence raised a few eyebrows, and inspired the questions: could the same third-party funder be behind both claims? Is that how the information was shared? Some letter-writing and an application for security for costs later and, indeed, the existence of a third-party funder was revealed. Putting aside any breach of confidentiality concerns, States need to understand that funders also coordinate multiple claims against a single respondent State to maximize the possibility of favorable outcomes across the claims, seeking out potential claimants with similar grievances (perhaps affected by the same State measure), and then deciding which claim in the series should proceed first as the most likely to generate a favorable "precedent" on which the other claimants, with perhaps lower initial probabilities of success, can then rely.

This cross-case coordination is unlikely to stop at cases against a single respondent State. If it is not already happening, Maya Steinitz predicts that financiers will likely "invest in rule change," selecting a claim to fund not because of its individual risk profile, but because it provides an opportunity to advance certain arguments or procedural changes which, if successful, will set a favorable precedent, leaving a lasting mark on the whole investment arbitration system and

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recovery rather than incur the costs of going to trial and risking no or lesser recovery" and that this incentive is only exacerbated by the portfolio approach to investing.).

[134] A number of States have already had, and continue to have, to weather this type of pressure. Luke Eric PETERSON, "Solar Investors File Arbitration Against Czech Republic; Intra-EU BITs and Energy Charter Treaty at Center of Dispute" Investment Arb. Rep. (May 15, 2013), available at <https://www.iareporter.com/articles/solar-investors-file-arbitration-against-czech-republic-intra-eu-bits-and-energy-charter-treaty-at-center-of-dispute/> (last accessed February 15, 2018) (indicating that a bloc of at least 10 investors brought claims against the Czech Republic under a number of treaties, including the Energy Charter Treaty and Czech bilateral investment treaties with the Netherlands, Germany, Cyprus, Luxembourg, and the United Kingdom); *Abaclat and Others v. The Argentine Republic* (ICSID Case No. ARB/07/5), Decision on Jurisdiction and Admissibility (August 4, 2011) paras. 1 (noting that, at the time of the initiation of the arbitration, the total number of claimants exceeded 180,000), 696 (finding that the consent of Argentina to jurisdiction "includes claims presented by multiple Claimants in a single proceeding"); "Spanish Arbitrator to Hear Abaclat Mass Claim" Global Arb. Rev. (January 23, 2012), available at <https://globalarbitrationreview.com/article/1030917/spanish-arbitrator-to-hear-abaclat-mass-claim> (last accessed February 21, 2018) (reporting on *Abaclat v. Argentina*, noting that it was "the first mass claim in ICSID's history"); and *Bernardus Henricus Funnekotter and Others v. Republic of Zimbabwe* (ICSID Case No. ARB/05/6), Award (April 22, 2009) para. 3 (indicating the claimants as being 13 Dutch farmers bringing a consolidated claim).

[135] P. EBERHARDT *et al*., Corporate Europe Observatory and the Transnational Institute, "Profiting From Injustice", p. 59 (citing Luke Eric PETERSON, "Republic of Georgia Agrees to Pay 1/3rd of ICSID Award; Litigation Funders Eyes Recovery After Bumpy Ride", Investment Arb. Rep. (December 31, 2011), available at <http://www.iareporter.com/articles/20111231_6> (last accessed February 22, 2018)).

maximizing the future value of funders' portfolios.[136] One can indeed imagine this having been a consideration in the decision to fund the *Erhas* case. Imagine if the claimants had been successful in their petition to bring multiple, unrelated claims against a single respondent State in a single proceeding. For the fund, imagine the value of the accumulated claims (increased potential upside) and the cost savings (decreased investment) associated with bringing them all in one proceeding. In an *ad hoc* system with no precedent and no appeal structure, where arbitrators are free to render decisions on points of law in accordance with their own views,[137] and so, therefore, the choice of arbitrator can dictate the outcome of the case, no one can say that a finding on jurisdiction favorable to the *Erhas* claimants was an impossibility. For the fund, such a gamble on a very slim chance of success may indeed have been worthwhile.

A question in the minds of the authors is whether any of this can have been within the contemplation of the contracting States when they included ISDS provisions in their BITs. Could they have imagined that a very large portion of the benefit of the rights being accorded to the other State's investors would ultimately inure to a category of venture capitalists of undisclosed nationality? Did the contracting States contemplate and consent to a system of ISDS where highly speculative claims would be brought against them, funded by third-party funders trying either to pressure a settlement or even to engineer legal outcomes which will favor their investment portfolios going forward?[138] It is not the purpose of this paper to discuss the jurisdictional implications for an investor's claim against a State when that claim is sold, or control over that claim is sold.[139] The broader issue is whether this phenomenon is changing the economics of access to investment arbitration in a way which is beyond what was originally contemplated by the States that designed it in the first place, and what can be done to manage these changes.

3. Amplified Quantum Claimed by Investors

The distortive effect of "anchoring" by claimants is not a new complaint.

> It should come as no surprise that claimants in any legal system tend to begin their cases with exaggerated claims of compensation, whether it be a personal injury claim of millions of dollars for a coffee spill or a multibillion-dollar expropriation claim. The technique is known as "anchoring." The exaggerated claim is made in the hope that a less exaggerated but still indefensible amount will seem reasonable by comparison. In a mature legal system with professional

[136] M. STEINITZ, "Whose Claim Is This Anyway? Third-Party Litigation Funding", p.1312.

[137] See generally G. KAHALE, "Rethinking ISDS", pp. 12-13.

[138] The *ICCA-QM Draft TPF Report* does refer to concerns by critics that speculative portfolio claims may "expand the bases for liability for States beyond the originally intended meanings in investment and trade agreements," but these concerns are somewhat glossed over. *ICCA-QM Draft TPF Report*, pp. 159-161. Rather, the Report notes that most recent investment and trade agreements do not preclude or limit the use of third-party funding, but instead focus on transparency and disclosure. *Ibid*., p. 162.

[139] For further discussion on this point, see M.K. HARWOOD, S.N. BATIFORT and C. TRAHANAS, "Third-Party Funding: Security for Costs and Other Key Issues", fn. 113 above, pp. 114-116.

> judges, there are checks and balances to curb abuse, but in the world of ISDS, the risk of abuse is much higher. That is especially true in cases requiring complex valuations of businesses, often involving natural resources, which are typically at issue in investor-state arbitration.[140]

The practice of claiming a phenomenally high and unsupported quantum of damages in the hope of achieving an award of a lower, but still unsupported, amount is as old as dispute resolution itself, although certainly it has taken on a new significance in this age of mega-claims.[141] Anchoring is another area where the participation of third-party funders generates a perceptible negative impact.

Whatever a third-party funder's own internal estimates of reasonable recovery in a given investment arbitration might be, in the proceeding itself, a funder's only incentive is to inflate the damages claimed to the highest amount possible for the purpose of anchoring the damages discussion in the arbitration and achieving the best possible, if still unreasonably high, economic result. This is not a theoretical risk – it occurs. Moreover, there are currently no checks on, or consequences for, funders and claimants which engage in this practice. As discussed above, security for costs orders are rare, and if it turns out that the claim was exaggerated and the claimant is awarded significantly less, no one bats an eye.

In one recent investor-State case, evidence on the record revealed that, prior to the involvement of a third-party funder, the investor had valued its own losses as a result of the State's actions at approximately US$155 million. This amount was stated in the context of negotiations when legal action was already contemplated (suggesting that the investor had already received legal advice), and can reasonably be understood as representing the upper end of the investor's expected recovery. Moreover, there were no circumstances that would suggest that the investor was not sophisticated, or had not done sufficient work at that stage to come to a realistic estimation of its own losses.

Less than a year later, the investor entered into a third-party funding agreement and, in the months that followed, commenced an ICSID arbitration. In its request for arbitration, the investor claimed US$300 million, double the upper end of the investor's own expected recovery just 18 months before. Nothing else had happened in the interim to increase the investor's damage, just the signing of the third-party funding agreement. Now, if the terms of that funding agreement provided that the funder would receive 50% of any damages ultimately awarded, it makes perfect sense to try to increase the quantum claimed, by any means possible, so that 50% of the award will in fact fully compensate the investor for its real damage. After all, there is currently absolutely no reason not to do so. As discussed above, that needs to change.

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[140] G. KAHALE, "Rethinking ISDS", p. 18 (internal citations omitted). See also Lucy REED, "The 2013 Hong Kong International Arbitration Centre Kaplan Lecture – Arbitral Decision-Making: Art, Science or Sport?", 30(2) J. Int'l Arb. (2013) p. 85 at pp. 89-90.

[141] G. KAHALE, "Rethinking ISDS", pp. 18-20.

4. Alteration of the Parties' Normal Settlement Incentives

The ICCA-QM Draft TPF Report highlights a concern regarding the "extent to which the funder will take over control of the arbitration and the claimant's decision-making process (*e.g.*, whether, when and at what level to settle the claim)."[142] Many funding agreements require the approval of the funder before the funded claimant can settle the dispute. Some funding agreements permit a claimant to settle without the funder's agreement, but only if the settlement offer is above a certain amount. The terms of a funding agreement may also reduce the claimant's percentage share of any recovery in the event of a settlement below a certain amount. These types of terms in a funding agreement can have a significant impact on the possibility for a State to settle a funded claim.

For example, even if it appeared reasonable to prevent or discourage settlement below a certain sum (or floor) when the third-party funder first evaluated a dispute, no matter how sophisticated the funder's review was, it occurred before anything was known of the respondent State's position, before significant development of the facts of the case, before document production, and before the hearing. As a case progresses and more is known, the prospects of a financial outcome above that floor can diminish. Imagine a respondent State's frustration upon learning from a claimant that, given how the case has proceeded, it would be happy to accept an offer of US$x, but it cannot because of the terms of its third-party funding agreement.

The terms of a third-party funding agreement also often fail to take into account other incentives to settle. Where a claimant might otherwise settle a case, for example for non-economic reasons such as resuming business in the host country or obtaining injunctive relief, a third-party funder may be solely focused on financial gain.

As Steinitz and Field observe:

> A funder's objective is to maximize profits for the benefit of its investors. The funder also has a relationship with the plaintiff. These competing loyalties have a concrete consequence: in some scenarios, a funder may have objectives extrinsic to the claim, leading it to push for outcomes for its own benefit that disadvantage the plaintiff.[143]

Indeed, some have argued that third-party funding results in a "Bermuda Triangle" of divergent interests, often between the claimant, the counsel representing the claimant, and the third-party funders.[144]

Third-party funding not only affects a claimant's settlement incentives. Respondent States are less inclined even to enter into settlement negotiations when they know that a claim is funded by

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[142] *ICCA-QM Draft TPF Report*, p. 19.

[143] M. STEINITZ and A.C. FIELD, "A Model Litigation Funding Contract", p. 722.

[144] C.B. LAMM and E.R. HELLBECK, "Third-Party Funding in Investor-State Arbitration Introduction and Overview", fn. 79 above, p. 107.

a third-party funder. No respondent State wants to get a reputation as a "settler." That will only incentivize more claims funded by funders against that State in the hope of a quick and painless settlement (a fast and lucrative return on the funder's investment). Rather, in this age of third-party funded investment arbitrations, a State has a strong incentive to generate a reputation as a "fighter," ensuring that obtaining any money from the State will be expensive, time-consuming, and difficult.

Respondent States also have a legitimate concern that the fruits of any settlement of what may be a meritorious claim should not go into the pocket of a fund which may then turn around and use that money to fund another suit against the same State (since the State is now known as a "settler"). Thus, settling even meritorious claims becomes more complicated when a third-party funder is involved.

Systematic disclosure of the existence and identity of a third-party funder in an investment arbitration is essential so that a respondent State can know who the real parties in interest are, with whom it is really negotiating, whether the funder is funding other claims against it, and whether it can impose conditions on any settlement of a claim which protect it from the ignominy of having its own money used to fund future claims against it.

5. Funders' Influence in Arbitrators' Decision-Making

The risk of potential conflicts of interest between a particular third-party funder and a given arbitrator is discussed at length elsewhere,[145] and there is an emerging consensus in favor of mandatory, systematic disclosure of the existence and identity of a third-party funder in any international arbitration claim as a potential solution.[146] This consensus is also reflected in the

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[145] *ICCA-QM Draft TPF Report*, pp. 67-92; M.K. HARWOOD, S.N. BATIFORT and C. TRAHANAS, "Third-Party Funding: Security for Costs and Other Key Issues", fn. 113 above, pp. 98-99.

[146] See IBA Guidelines on Conflicts of Interest in International Arbitration, adopted on October 23, 2014, Guidelines 6(b) and 7(a) and Explanations to General Standards 6(b) and 7(a) (providing that a party shall disclose, "on its own initiative at the earliest opportunity", "any relationship, direct or indirect, . . . between the arbitrator and any person or entity with a direct economic interest in . . . the award," and recognizing that a third-party funder has a "direct economic interest" in the award); Catherine A. ROGERS, *Ethics in International Arbitration* (Oxford University Press 2014) para. 5.79("[F]or arbitrators to assess the potential for conflicts and make necessary disclosures, third-party funders' participation in particular international arbitration cases will necessarily have to be disclosed"); Burcu OSMANOGLU, "Third-Party Funding in International Commercial Arbitration and Arbitrator Conflict of Interest", 32(3) J. Int'l Arb. (2015) p. 325 at pp. 339-340 ("[A]n obligation on the parties to disclose the presence of third-party funders in the arbitration proceedings is vital and would closely relate to the obligation of the arbitrators to disclose any relationship that they have with third-party funders that may imperil the arbitral tribunal's independence and impartiality."); Catherine KESSEDJIAN, "Good Governance of Third Party Funding", Columbia FDI Perspectives No. 130 (September 15, 2014), pp. 1-2 ("Some of the best practices for arbitral tribunals confronted with third party financing could include the following: Financing by third parties must be disclosed for arbitration proceedings to be conducted appropriately."); Commision Financement de Procés par les Tiers, Club des Juristes, "Financement du Procès par les Tiers" (June 2014), p. 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.") (authors' translation); William STONE, "Third Party Funding in International Arbitration: A Case for Mandatory Disclosure?", 2015(2) Asian Disp. Rev. (2015) p. 62 at p. 68 ("Absent disclosure of a funding relationship within the arbitration, the independence of an arbitrator cannot be assured.").

text of a number of recent treaties.[147] However, this solution does not address the risk of more general, systemic influence of third-party funders in arbitrators' decision-making.

One aspect of the third-party funders/arbitrators conflict discussion which has received less attention is the risk that, because arbitrators are aware of the role that third-party funders play in their appointment, or because they also have practices as counsel and have economic relationships with the funders that fund their clients' claims, they will be influenced to issue decisions favorable to the third-party funding industry, or influenced to not issue decisions viewed as unfavorable to the industry.

We discussed above the incentive for third-party funders to fund claims, not (or not solely) on the basis of the potential for economic return, but also in the hope of establishing procedural or substantive precedents tending to maximize the potential for future economic gain from the fund's investment portfolio. Is there a danger that arbitrators, conscious of the influence of third-party funders in the business of international arbitration, will be inclined to favor the interests of the third-party funding industry in their decisions?

In *Sehil v. Turkmenistan*, the tribunal ordered the claimants to disclose "whether their claims in this arbitration are being funded by a third-party/parties, and, if so, the names and details of the third-party funder(s) and the terms of that funding."[148] The tribunal stated 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."[149] When the claimants refused to disclose the funding agreement, the *Sehil* tribunal warned that it may draw adverse inferences.[150] In short, the *Sehil* tribunal determined that the terms of the funding agreement were relevant to the issue of security for costs and therefore ordered their disclosure. The terms of a funding agreement may also be of fundamental relevance to the issue of true ownership of a claim and jurisdiction.[151] Given that third-party funders have worked hard to maintain the confidentiality of the terms of their funding arrangements, one wonders how many arbitrators will be willing to order the disclosure of such agreements when necessary to properly consider a security for costs application or to ascertain whether a claimant remains the actual owner of the claim in dispute, and how many may, with one eye on their future income stream, decline to do so.

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[147] EU-Vietnam Free Trade Agreement, agreed text as of January 2016, Chapter 8: Trade in Services, Investment and E-Commerce, Chapter 2, Section 3, Article 11.1; CETA, Article 8.26; European Commission, Draft of Chapter II (Investment) of the Transatlantic Trade and Investment Partnership, released on November 12, 2015, Section 3, Article 8.

[148] *Muhammet Çap & Sehil Inşaat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan* (ICSID Case No. ARB/12/6), Procedural Order No. 3 (June 12, 2015) para. 8 (emphasis added).

[149] *Ibid.* para. 12.

[150] See Hamid G. GHARAVI, "Le financement par un tiers dans l'arbitrage d'investissement" (2017) 1 Belgian Review of Arbitration, p. 67 at para. 36.

[151] M.K. HARWOOD, S.N. BATIFORT and C. TRAHANAS, "Third-Party Funding: Security for Costs and Other Key Issues", fn. 113 above, pp. 108-113.

Arbitrator Gavan Griffith's opinion in *RSM v. Saint Lucia* was critical of the activities of third-party funders in investment arbitration, whom he characterized as "a new industry of mercantile adventurers."[152] He considered that third-party funding would normally provide the "exceptional circumstances" required to grant security for costs since otherwise the funder would enjoy the upside of the case but not assume the corresponding risk (a "gambler's Nirvana").[153] This led the claimant in that case to propose his disqualification,[154] and "drew a sharp response, especially from litigation financiers."[155]

The institution of safeguards to insulate arbitrators in investment arbitrations from the influence of individual third-party funders, and from the third-party funding industry in general, is long overdue. The only real solution to this, and indeed other conflicts of interest which are the direct and natural result of arbitrators also acting as counsel, is simply to ban the practice of "double hatting." Lawyers who act as counsel should be prohibited from being appointed as arbitrators in investment arbitrations, or as *ad-hoc* committee members. Arbitrators and *ad hoc* committee members must also disclose as a matter of course any other relationship they may have with third-party funders, whether as a board member or an advisor, or in any other capacity. A starting point would be for both of these safeguards to form part of the topics for potential ICSID rule amendment, and to form part of the UNCITRAL WGIII discussions on ISDS Reform.

V. SUGGESTED WAYS FORWARD

The above discussion highlights a number of areas where reform, regulation, and changes in States' treaty practice are required to correct systemic imbalances in investment arbitration. These imbalances include States bearing the economic burden of defending unmeritorious claims with little or no possibility of costs recovery, the funding of claims based on factors distinct from the underlying merits of the claim, the exponential inflation of the quantum claimed, the alteration of incentives to settle, and a concern that arbitrators may be influenced by economic incentives generated by the participation of third-party funders in the investment arbitration industry.

The following is a list of initiatives aimed at addressing these imbalances for further consideration and debate:

- Amend the ICSID Arbitration Rules to provide that the costs of the arbitration (both tribunal costs and party costs), or the annulment proceeding, shall in principle be borne by the unsuccessful party, but preserving the tribunal/*ad hoc* committee's discretion to apportion costs where reasonable in the circumstances of a given case.

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[152] *RSM Production Corporation v. Saint Lucia* (ICSID Case No. ARB/12/10), Decision on Saint Lucia's Request for Security for Costs, Assenting Opinion of Mr. Gavan Griffith QC (August 13, 2014) para. 14.

[153] *Ibid*., paras. 13, 16.

[154] *RSM Production Corporation v. Saint Lucia* (ICSID Case No. ARB/12/10), Decision on Claimant's Proposal for Disqualification of Dr. Gavan Griffith QC (October 23, 2014) paras. 39-42.

[155] J. GILL and M. HODGSON, "Costs Awards – Who Pays?".

- States should include similar language in a treaty's ISDS provisions.
- Parties to investment arbitrations and annulment proceedings should demand that costs be treated in a fully reasoned manner in the award or decision; investment arbitration tribunals and *ad hoc* committees need to meet this demand, specifically identifying in the award or decision the party behavior which led to the allocation of costs in a certain manner.
- Include the amount of quantum claimed by an investor versus any amount ultimately awarded to it as a factor to be taken into account by investment tribunals when allocating costs, to discourage inflated damages claims.
- Amend the ICSID Arbitration Rules to confirm the power of tribunals to issue orders for security for costs.
- Claimants in investment arbitrations should be required to disclose the existence of any third-party funding, and the identify of the funder, as a matter of course, at the earliest possible moment (including at the time of the notice of dispute or the request for arbitration, or as soon as a third-party funder becomes involved). This requirement should be incorporated into the ICSID Rules amendment procedure and the discussions of UNCITRAL Working Group III on ISDS Reform. States should include a similar requirement in a treaty's ISDS provisions.
- The burden of proof applicable to, and standard for issuing, orders for security for costs in investment arbitrations need to change to reflect the reality of the availability of third-party funding in the market, the unavailability of accurate information regarding claimants' financial standing, and the asymmetries this creates.
    - Burden of proof: Once a respondent State becomes aware of circumstances suggesting that the claimant may be impecunious (including the fact that its claim is being funded by a third party, but also perhaps other circumstances, such as failure to pay an advance on costs, or an SEC disclosure) but not necessarily rising to the level of a *prima facie* showing, the respondent should disclose such circumstance to the tribunal and be permitted to request that the claimant provide information regarding its financial position, and in particular make a showing that it has the financial wherewithal to cover an adverse costs order. Should the claimant fail to make such a showing, the tribunal must weigh the competing interests of access to justice versus the respondent's right to recover the costs of a successful defense. Where the claim is third-party funded, the scales tip markedly in favor of ordering security for costs.
    - Standard: Investment tribunals should ensure that they have sufficient information regarding the relevant terms of a funding agreement, and the financial capacity of both the claimant and its funder, to be able to judge when the "interests of justice" (not "exceptional circumstances") require an order for security for costs to protect the respondent State from the risk of an unpaid cost award. Funders will factor such security into the cost of funding the dispute, removing the access-to-justice concern from funded cases.
- Systematic, early disclosure of the existence and identity of third-party funders in all investment arbitrations to ensure that:

  - the respondent State in a given case knows who the real parties in interest are in the dispute, with whom it is really negotiating, whether the funder is funding other claims against it, and whether it can impose conditions on any settlement of a claim which protect it from the ignominy of having its own money used to fund future claims against it; and
  - tactical behavior and coordination of multiple cases by third-party funders against different respondent States can be detected and monitored.
- A prohibition on lawyers who act as counsel being appointed as arbitrators in investment arbitrations, or as *ad-hoc* committee members.
- Compulsory disclosure by arbitrators and *ad hoc* committee members of any relationship they may have with third-party funders (board member, advisor, or in any other capacity).

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