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Title: The Effect of Third Party Funding on Ordering Security for Costs in International Investment Law

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The Effect of Third-Party Funding on Ordering Security for Costs in International Investment Law

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Introduction

International investment law has its own unique and long-standing dispute resolution method: investor-state arbitration. Although investor-state arbitration is the most preferred dispute settlement mechanism in international investment law, it is still a long-lasting and burdensome procedure. Thus, some investors as claimants apply to third-party funding to cover the expenses of the investor-state arbitration. Host states as respondents are not always opposed to meritorious claims but they neither are they wealthy enough to cover all the expenses of the arbitrations. Therefore, the respondent states sometimes request an order of security for costs in case the losing claimant is unable to cover the legal costs of the winning respondent. When the claimant has obtained third-party funding, the requesting respondent may point to this external source of funding to strengthen its security for costs request. That third-party funding may be an indication of the claimant's financial instability causes the presence of third-party funding to be a controversial part of the discussion on security for costs by the investment tribunals. The discussion continues among the parties in international investment law because investor-state arbitration tribunals encounter more third-party funders, and in some cases, deal with requests for security for costs brought forward by the respondents. While the decision of the tribunal will be influenced by the presence of third-party funding, the mere existence of this phenomenon will not be sufficient to order security for costs.

In light of the foregoing, this paper explains the concepts of third-party funding and security for costs by reference to legislation and case law. Furthermore, the interplay between these terms and the influence of third-party funding on the award of security for costs will be analysed comparatively through respective investment tribunals' approaches to the issue. Ultimately, the reality is that third party funding is considered, but is only one factor amongst others considered by the tribunals. The tribunals pursue a restrictive approach towards security for costs and the pure element of third-party funding does not justify a security for costs decision against the claimant.

1. Third-Party Funding in International Investment Law

Third-party funding is usually used by claimant investors as opposed to respondent states. An exception in which the respondent state received third party funding is *Philip Morris v*

Uruguay, where the Bloomberg Foundation funded Uruguay.[1] In other words, third-party funding is primarily invoked by claimants that lack sufficient financial resources to bring their claims.

Third-party funding is also used by the companies 'as a form of corporate finance to raise money for the company, allocate risk, maintain liquidity, or to smooth out the dispute resolution costs line item on the company's balance sheet, if the company finds itself with a steady stream of disputes'.[2] With third-party funding, the financially unstable party can enter arbitration with a highly qualified legal team and enjoy all the procedural rights afforded any other party who can finance the costs of arbitration.[3]

Since the proliferation of third-party funding in investor-state arbitration practice, some states have inserted third-party funding provisions into their bilateral investment and free trade agreements. The first treaty referring to third party funding is the Comprehensive Economic and Trade Agreement (CETA) ratified by Canada and the European Union. The treaty includes provisions regarding the definition of third-party funding and it requires the funded party to disclose to the tribunal and the opposing party the name and address of the third-party funder at the time of the submission of the claim or at the time the funding agreement is concluded, whichever is sooner.[4]

In addition, the EU-Vietnam Investment Protection Agreement, Chapter 3, Article 3.28, contains a similar definition of third-party funding as:

> ...any funding provided by a natural or juridical person who is not a party to the dispute but who enters into an agreement with a disputing party in order to finance part or all of the cost of the proceedings in return for a remuneration dependent on the outcome of the dispute, or any funding provided by a natural or juridical person who is not a party to the dispute in the form of a donation or grant.

The same agreement also mentions the security for costs in relation to third party funding and it demands under Article 3.37 that 'when applying Article 3.48 (Security for Costs), the Tribunal shall take into account whether there is third-party funding'. As seen by these new treaty provisions, third party funding has raised several issues amongst host states, including jurisdiction of the tribunal over the funders, the disclosure of the funding agreement, and its effect on security for costs decisions given by the tribunal.

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1 Victoria Shannon Sahani and Lisa Bench Nieuwveld, *Third-Party Funding in Investor-State Arbitration* (2nd edn, Kluwer 2017) 259.
2 ibid 265.
3 Jonas von Goeler, *Third Party Funding in International Arbitration and its Impact on Procedure* (Kluwer 2016) 334.
4 Comprehensive Economic and Trade Agreement [2016] arts 8.1, 8.26.

2. Security for Costs in International Investment Law

Security for costs is a special type of interim measure requested by the respondent of a claim or counterclaim to address situations in which the claimant may be unable to pay the adverse costs award rendered against it.[5]

'International Arbitration Practice Guideline: Applications for Security for Costs' published in 2016 by The Chartered Institute of Arbitrators has proposed several criteria that tribunals should consider when deciding whether to order security for costs:

When deciding whether to make an order for security for costs, arbitrators should consider the following matters:

> i) the prospects of success of the claim(s) and defence(s) (Article 2);
>
> ii) the claimant's ability to satisfy an adverse costs award and the availability of the claimant's assets for enforcement of an adverse costs award (Article 3); and
>
> iii) whether it is fair in all the circumstances to require one party to provide security for the other party's costs (Article 4).

This list is not exhaustive; arbitrators should also regard any other additional considerations they may consider relevant to the particular situation of the parties and the circumstances of the arbitration. The criteria in the Guidelines has been summarised elsewhere in six factors as follows:

- whether a claimant has reachable assets in the jurisdiction,
- whether the application is used as a weapon to block a legitimate claim, the extent to which respondent has contributed to claimant's lack of means,
- the timing of the application,
- the appropriateness of a security determination for the specific nature of the arbitration concerned, and
- equitable concerns in light of all circumstances.
  In exceptional situations, other factors may apply, such as: the merits of the claim and chances of success, settlement offers that may have been made, and the likelihood that a claiming party will abscond.[6]

When these criteria are met, the tribunal may assume the power to grant security for costs against the claimant and the claimant must pay the determined amount.[7] The consequence of non-payment is the staying of the proceedings or dismissal of the claim with prejudice.[8]

In international investment arbitration, the International Centre for Settlement of Investment Disputes (ICSID) Convention grants the right to order security for costs under Article 47 only

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5 von Goeler (n 3) 333.
6 Jeffrey Waincymer, *Procedure and Evidence in International Arbitration* (Kluwer 2012) 647–649.
7 For details as to the form, amount, and release of the security payment ibid 652–653.
8 von Goeler (n 3) 333.

in provisional terms. This caveat to awarding security for costs is illustrated when the tribunal in *RSM Production Corporation v Saint Lucia* stated that 'issues such as third-party funding and thus the shifting of the financial risk away from the claiming party were not as frequent, if at all, as they are today.' [9] The tribunal's explanation clearly indicates the reason why ICSID Convention does not contain an express provision on security for costs.

In international investment arbitration, arbitral tribunals can grant security for costs requests, but such requests are interim measures only ordered in extreme circumstances, such as when there is evidence of abuse of process by the claimant. [10] Also, a security payment may prevent access to arbitral justice, which is a sensitive issue in the context of disputes between private investors and states. Against this background, analysing the impact of third-party funding on an arbitral tribunal's decision to order security for costs must be done alongside various relevant criteria in international investment law.

3. Third-Party Funding and its Effect on Security for Costs

The novel funding practice by third-parties does not only affect the playing field in international investment law; it also has an impact on case law regarding security for costs awards by the tribunals. Third-party funding usually implies the impecunity of the claimant and thus could be a reason for awarding security for costs. But the question remains of whether security for costs as an exclusive interim measure should be provided so easily to the respondent as it may cause difficulties in achieving arbitral justice. Additionally, other factors are required for an order of security for costs in accordance with the accepted practice as seen in the following cases. Therefore, the interaction between funding and security for costs is the main question that is posed to tribunals and which will ultimately represent their different approaches to the debate.

First of all, third-party funding promotes access to arbitral justice for the impecunious party who has well-grounded claims but, on the other hand, third-party funding may hinder the respondent in achieving their desired justice because the costs would be paid by the third-party and not by the insolvent claimant. [11] So, while third-party funding does provide access to justice for the claimant, it may prevent the right to compensation of the respondent if security for costs is not ordered. Thus, the claimant's right to arbitral justice clashes with the respondent's concerns about whether they will receive any ordered costs.

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[9] *RSM Production Corporation v Saint Lucia* (Decision on Saint Lucia's Request for Security for Costs 2014) ICSID Case No ARB/12/10 [55].

[10] See also *Libananco Holdings Co Limited v Republic of Turkey* (Decision on Preliminary Issues 2008) ICSID Case No ARB/06/8 [57]; *Commerce Group Corp & San Sebastian Gold Mines, Inc v the Republic of El Salvador* (Decision on El Salvador's Application for Security for Costs 2012) ICSID Case No. ARB/09/17 [45] (*Commerce*); *EuroGas Inc and Belmont Resources Inc v Slovak Republic* (Procedural Order No 3, 2015) ICSID Case No ARB/14/14 [121].

[11] von Goeler (n 3) 334.

Furthermore, while the right to arbitral justice is achieved by third-party funding for the claimant, the right to legal compensation for the respondent may be endangered due to the financial conditions of the claimant. Therefore, the financial circumstances of the claimant are an important factor for tribunals in assessing the risk of the claimant not being able to satisfy an adverse costs award. Before a tribunal grants an application for security of costs, it must determine whether there is enough proof that the current financial situation of the funded party will result in the non-payment of the requesting party's costs at the end of the proceedings.[12]

The existence of third-party funding and the agreement with the funder can provide evidence of the financial situation of the claimant, which is why it is one of the factors considered when deciding whether to grant an application for the security for costs.[13] But third-party funding is not the only factor to be regarded by the tribunal; rather, the financial situation of the funded party should be evaluated as a whole. Therefore, the tribunal should base its decision not only on the existence of the funding agreement, but also on further financial records of the funded party.[14] As such, if the funded party can provide evidence that the funder will cover the adverse costs or that it has adequate financial means, an order granting security for costs is not necessary.[15]

With regard to the multiple factors involved, an application by the opposing party for security for costs simply because the opposing side has a third-party funder would not be appropriate - unless there is additional evidence indicating that the funded party is also impecunious. This principle was articulated by the tribunals in *RSM v Saint Lucia*, *EuroGas v Slovak Republic*, and *South American Silver v Bolivia*.[16]

In *Guaracachi and Rurelec v Bolivia*, the respondent state requested an order for security for costs to the amount of USD 1,500,000.[17] The respondent state contended that Rurelec, the second claimant, was unable to pay any potential adverse costs due to its precarious financial condition. Additionally, Rurelec had appealed to a 'third-party funder' in order to continue with the proceedings.[18] Furthermore, the first claimant, Guaracachi, was a shell company, which could harm the proceedings in terms of 'arbitral hit and run'.[19] Opposing the security for costs request, the claimants emphasized that awarding security for costs based on the involvement of a third-party funder would be unprecedented in investment arbitration and

12 Waincymer (n 6) 650.
13 William Kirtley and Koralie Wietrzykowski, 'Should an Arbitral Tribunal Order Security for Costs When an Impecunious Claimant Is Relying upon Third-Party Funding?' (2013) 30 Journal of International Arbitration 17.
14 von Goeler (n 3) 342.
15 *Guaracachi America, Inc (U.S.A.) and Rurelec plc (United Kingdom) v Plurinational State of Bolivia*, (Procedural Order No 13, 2013) PCA Case No 2011-17 [6].
16 Sahani and Nieuwveld (n 1) 266.
17 *Rurelec* (n 15) [10].
18 ibid [3].
19 ibid [3].

that the respondent had not demonstrated a reasonable possibility of succeeding on the merits. [20]

The arbitral tribunal referred to Article 26 of the UNCITRAL Rules and held that, even though it had the power to order security for costs, such orders remain 'very rare and exceptional' in investment arbitration. [21] It also held that:

> the Respondent has not shown a sufficient causal link such that the Tribunal can infer from the mere existence of third-party funding that the Claimants will not be able to pay an eventual award of costs rendered against them, regardless of whether the funder is liable for costs or not. The Respondent's analysis of Rurelec's balance sheet and other related financial documents also does not sufficiently demonstrate that Rurelec will lack the means to pay a costs award or to obtain (additional) funding for that purpose. [22]

In summary, the tribunal was not convinced that Rurelec could not pay the adverse costs because of its financial situation. Moreover, the tribunal highlighted that third-party funding obtained by the claimant cannot be the only reason for ordering security for costs against the claimant.

The approach of the tribunal aligns with the 'exceptional' nature of security for costs and tribunals' reluctance to order it. Security for costs is rendered based on restrictive criteria and in rare circumstances, such as bad faith on the side of the funded party.[23] Thus, the funding is not a strong argument backing the security for costs decision, but it fuels the debate on the interaction between these terms. To that point, the tribunal added that 'the appropriate balance between the right of access to arbitral justice of entities that have allegedly been expropriated and the protection of States against frivolous claims by parties who may not have sufficient assets to guarantee the payment of an adverse costs award is a serious issue'.[24]

The ICSID annulment committee in *Commerce Group Corp and San Sebastian Gold Mines, Inc v El Salvador* adopted a similarly restrictive approach to security for costs.[25] The claimants had obtained third-party funding to pursue annulment proceedings against El Salvador due to their financial difficulty. Then, the annulment proceedings were stayed in December 2011 after the applicants failed to pay the advance on costs ordered under ICSID rules. Subsequently, El Salvador requested the annulment committee order the applicants to pay USD 2 million as security. In case of non-payment, El Salvador asked for discontinuation of the proceedings.[26] Furthermore, the respondent state argued that 'there is a risk that the Applicants will abandon the proceedings for lack of funding'.[27]

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[20] ibid [4].
[21] ibid [6].
[22] ibid [7].
[23] von Goeler (n 3) 350.
[24] *Rurelec* (Procedural Order No 14, 2013) [9].
[25] *Commerce* (n 10).
[26] ibid [29].
[27] ibid [27].

Considering the arguments of the respondent, the committee stated that its inherent powers to preserve the proceedings could be used to order security for costs, but that this power should be 'only exercised in extreme circumstances, for example, where abuse or serious misconduct has been evidenced'.[28] In so saying, the committee rejected the security for costs request because evidence of such misconduct was not provided by the respondent and third-party funding was not itself such evidence.

The ICSID tribunal in *RSM Production Corporation v Saint Lucia*,[29] ordered the claimant to pay security for costs in the amount of USD 750,000 in the form of an irrevocable bank guarantee.[30] This order of the tribunal is the first time of ordering security for costs against the claimant to date.

The respondent argued that, while no ICSID tribunal had until then ordered security, such measure would be justified in the present case for two reasons. First, it pointed the tribunal to a number of ICSID arbitrations in which the claimant had failed to pay ICSID's advance on costs and had not honoured costs awards rendered against it, indicating the claimant in this case was likely to do the same.[31] Second, the respondent noted that 'the proceedings initiated by Claimant are funded by third parties',[32] alleging these third parties would not be liable for adverse costs, thus enabling the claimant to engage in 'arbitral hit and run'.[33] The claimant contested the tribunal's jurisdiction to order security, and additionally argued that a difficult financial situation would not be sufficient to grant security payment against claimants in ICSID proceedings.[34] The claimant also stated that its current conduct would not give reason to doubt its willingness to pay adverse costs.[35] The majority of the tribunal held that, in accordance with ICSID case law, it had the power to order security for costs under Article 47 of ICSID Convention and Article 39 of ICSID Rules.[36]

The tribunal then clarified that security for costs can be granted only in exceptional circumstances in ICSID arbitrations.[37] Turning to the facts, the tribunal was satisfied that the claimant might not have the financial means to satisfy a costs award in favour of the respondent because the claimant had admitted this in its submissions on ICSID's advance payment.[38] While the tribunal acknowledged that while this was not enough to order security, other facts demonstrated the existence of exceptional circumstances:

> Those circumstances are, in summary, the proven history where Claimant did not comply with cost orders and awards due to its inability or unwillingness, the fact that

[28] ibid [45].
[29] *RSM (*n 9*)*.
[30] ibid [90].
[31] ibid [30]-[32].
[32] ibid [33].
[33] ibid.
[34] ibid [38]-[40].
[35] ibid [42].
[36] ibid [54]-[57].
[37] *RSM (*n 9) [75].
[38] ibid [76], [81] - 82].

> it admittedly does not have sufficient financial resources itself and the (also admitted) fact that it is funded by an unknown third party which, as the Tribunal sees reasons to believe, might not warrant compliance with a possible costs award rendered in favour of Respondent.[39]

In consequence, the tribunal ordered the claimant to post security for costs in the amount of USD 750,000 in the form of an irrevocable bank guarantee.[40] This decision highlights the multiple reasons tribunals base their decision on when awarding security for costs and one of these grounds is third-party funding. However, the performance of funding is regarded as supportive argument and the mere fact of funding would not lead to the security payment of the claimant.

In sum, the existence of third-party funding agreement is not sufficient to evidence the financial instability of the claimant. Thus, such an agreement is not able to justify an order for security for costs against the funded party. More facts are required to order security for costs against the funded party.[41]

Conclusion

In investment arbitration, tribunals require the party seeking security to provide evidence of extreme circumstances, such as serious misconduct or a similar element of bad faith on the claimant side, before security for costs can be granted. Notably, the recent decision of an ICSID tribunal in *RSM Production Corporation v Saint Lucia* to grant a security for costs request against a funded party is in line with the international investment case law. The decisive factor in this case was the claimant's history in failing to honour costs awards rendered against it, rather than the fact that it had obtained funding. This view has recently been confirmed by the ICSID tribunal in *EuroGas Inc and Belmont Resources Inc v Slovak Republic*, where the arbitrators denied the respondent's security request, holding that:

> financial difficulties and third party-funding – which has become a common practice – do not necessarily constitute per se exceptional circumstances justifying that the Respondent be granted an order of security for costs.[42]

There is no reason to deviate from the predominantly restrictive approach in investment arbitration to awarding security for costs on the basis of a third-party funder. As such, it is vital to examine other criteria of security payment and must be accepted that third-party funding is only an ancillary consideration for tribunals when awarding security for costs.

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39 ibid [86].
40 ibid [90].
41 ibid.
42 *EuroGas* (n 10) [123].