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Third party funding in international investment arbitration: a dire need of disclosure

1. Introduction

Third Party Funding (hereinafter "TPF") has become one of the most debated aspects of international arbitration, especially in investor-state dispute settlement ("ISDS") context. With the increased shift towards transparency in international investment arbitration,[1] mandatory disclosure of funding agreements has been the most discussed issue among scholars and practitioners.[2] Following the general trend in investment arbitration, it has been argued that TPF should also be subject to greater transparency and scrutiny which can be achieved through its mandatory disclosure. As of today, TPF has remained unregulated in large part, which leaves room for differing approaches of arbitral tribunals. Inconsistency and lack of proper regulation creates a lot of confusion and mistrust, which has a negative impact on the assessment and acceptance of this legal institution in practice.

Irrespective of the controversies surrounding this mechanism, TPF has become a part of the commercial reality and is here to stay. As pointed out in legal writing, despite the lack of precise statistics, "there is evidence that the use of third-party funding in international investment

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1 S.W. Brekoulakis, W. Park & C.A. Rogers, "Report of the ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration" (2018) The ICCA Reports No 4 at 199; E. De Brabandere & J. Lepeltak, "Third-Party Funding in International Investment Arbitration" (2012) 27:2 ICSID Review 379 at 394; W.A. Park & C.A. Rogers, "Third-Party Funding in International Arbitration: The ICCA Queen-Mary Task Force" (2014) 42 Penn State Law Legal Studies Research Paper Series at 13.

2 V. Frignati, "Ethical implications of third-party funding in international arbitration" (2016) 32:3 Arbitration International 505 at 515.

arbitration is increasing rapidly".[3] Therefore, the question that remains is the necessity and the scope of disclosure.

2. Third party funding in investment arbitration: concept and rationale

Costs of arbitration proceedings can be very expensive.[4] Some parties cannot afford to bear such high amounts to pursue their claims, especially in cases concerning expropriation of investor's property. That is due to the fact that throughout the proceedings, claimants may become insolvent and simply be deprived of resources to further contest the actions of the state.[5] TPF has been therefore described as "a specialized form of dispute financing".[6] It consists in providing capital by a third party to one of the parties involved in a dispute for the purpose of covering the costs of arbitral proceedings.[7] A funder does not have a direct interest in the merits of the case. It invests in the proceedings in the hope of obtaining profit.[8] A third-party funder undertakes the risk – in case of a satisfactory award, the financier receives a certain percentage of the compensation. However, if the claim is not successful, the funder not only receives nothing but is oftentimes liable for the legal fees of the party it funds[9]. Nonetheless, the tribunals would most typically lack jurisdiction to award costs against the funder as it is not formally a party to the proceedings.

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[3] De Brabandere/Lepeltak, *supra* note 1, at 380.

[4] J. von Goeler, *Third-party funding in international arbitration and its impact on procedure* (Alphen aan den Rijn, The Netherlands: Kluwer Law International, 2016) at 1.

[5] *E.g.* in *Yukos* shareholders vs. Russia, concerning the largest award in the history of arbitration (amounting to USD 50 bln), the Claimant had to rely on TPF to pursue its claim, see Yukos Universal Limited (Isle of Man) v. The Russian Federation, UNCITRAL, PCA Case No. AA 227.

[6] F.J. Garcia, "Third-Party Funding as Exploitation of the Investment Treaty System" (2018) 59:8 BCLR 2911 at 2914.

[7] De Brabandere/Lepeltak, *supra* note 1, at 381; Garcia, *supra* note 6, at 2914.

[8] *Ibidem* at 379.

[9] S. Khouri, K. Hurford & C. Bowman, "Third-party Funding in International Commercial and Treaty Arbitration a – Panacea or a Plague? A Discussion of the Risks and Benefits of Third-party Funding" (2011) 8 Transnational Dispute Management at 3; G.J. Shaw, "Third-party funding in investment arbitration: how non-disclosure can cause harm for the sake of profit" (2016) 33 Arbitration International 109 at 111.

Therefore, despite the funding, the successful party may still have difficulties with recovering the full amount it was awarded.[10]

The most typical categories of third-party funders include banks, hedge funds and insurance companies.[11] TPF can be used to fund both – investors and states.[12] Despite that fact, funding investors has been far more common in practice. It is mostly due to the fact that under the investment treaties (being the source of a binding consent to arbitration), states cannot pursue claims and the possibility of counterclaims in the proceedings initiated by an investor is limited.[13] In the past, TPF was mostly directed at investors who could not have afforded to bring claims against states, *i.e.* it fulfilled the access to justice function.[14] Nowadays, the model has changed. TPF can be divided into three most common categories: (i) claims in which investors have no resources to pursue them; (ii) claims in which investors have sufficient resources and seek funding in order to minimize the risk and cash flow disruptions;[15] (iii) claims involving a not-for-profit TPF.[16] The last category emerged quite recently and arbitral tribunals have not dealt with many cases so far. These proceedings are usually financed by interested foundations which do not seek to obtain any profit.[17] One of the most cited cases involves *Philipp Morris and others v Oriental Republic of Uruguay*.[18] In that case, Philipp Morris

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[10] "International arbitration report" (2016), https://www.nortonrosefulbright.com/-/media/files/nrf/nrfweb/imported/international-arbitration-report---issue-7.pdf?la=en&revision=2b95e882-b426-4aa1-952e-6270bebf896b, 11.05.2020.

[11] Shaw, *supra* note 6, at 110-111.

[12] W. Park & C.A. Rogers, "Third-Party Funding in International Arbitration: The ICCA Queen-Mary Task Force" (2014) 42 PSLLSRPS at 3.

[13] B. Guven & L. Johnson. "The Policy Implications of Third-Party Funding in Investor-State Dispute Settlement" (2019) CCSI Working Paper at 8.

[14] S.E. Moseley, "Disclosing Third-Party Funding in International Investment Arbitration" (2019) 97:6 TLR 1181, at 1186.

[15] Moseley, *supra* note 14, at 1186.

[16] De Brabandere/Lepeltak, *supra* note 1, at 383.

[17] *Ibidem* at 383.

[18] *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7 (formerly FTR Holding SA, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay).

challenged the regulations enacted by Uruguay which increased the surface of health warnings on cigarette packages from fifty to eighty percent. The Bloomberg Foundation and its "Campaign for Tobacco-Free Kids" covered legal costs of Uruguay in part.[19] In a press release, Michael Bloomberg stated that: "No country should ever be intimidated by the threat of a tobacco company lawsuit, and this case will help embolden more nations to take actions that will save lives".[20] It has been argued that investment regime is asymmetric and provides greater benefits to the investor. It certainly makes developing countries vulnerable.[21] Thus, the not-for-profit TPF may become more active role in levelling the field in investor-state disputes in the future.

From the parties' perspective, TPF provides significant benefits. One of the biggest advantages addressed in legal writing is the promotion of access to justice.[22] In theory, TPF's objective was to enable the investors who do not have sufficient means to pursue their claims against the states. Nowadays, the recently emerged type of non-profit TPF also strengthens the position of developing countries in disputes brought by investors coming from highly developed countries. Another benefit of TPF is its "*pre-screening*" function. Before making its choice, a funder will take into consideration several aspects of the dispute, especially chances of obtaining a favorable award. As a result, TPF can significantly reduce the number of frivolous claims.[23]

However, on the other side of the coin, TPF has been regarded as a highly concerning practice in arbitral proceedings. The main concern regarding this mechanism is the funders' impact on arbitral proceedings.

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[19] De Brabandere/Lepeltak, *supra* note 1, at 383.

[20] "Statement by Michael R. Bloomberg on Philip Morris International v. Uruguay Decision" (2016), https://wwwmikebloombergcom/news/statement-by-michael-r-bloomberg-on-philip-morris-international-v-uruguay-decision/, 11.05.2020.

[21] F.J. Garcia, "The Case Against Third-Party Funding in Investment Arbitration" (2018), https://wwwiisdorg/itn/2018/07/30/the-case-against-third-party-funding-in-investment-arbitration-frank-garcia/, 11.05.2020.

[22] As stated by Albert Jan van den Berg: "*arbitration should not be for rich only*"; see Goeler, *supra* note 4, at 82.

[23] Moseley, *supra* note 14, at 1191.

A funder is not bound by the arbitration agreement and is not a formal party to the proceedings. At the same time, it has an economic interest in the resolution of the dispute as well as certain degree of control.[24] Naturally, third party funder will seek to minimize costs and obtain an award favorable from the financial angle.[25] There is a risk that if the funder does not approve of the legal strategy, it will stop providing financial assistance. The risk of losing funding to pursue a claim may influence the actions of investors and make them act against their needs in order to maintain the funding.

3. Existing legal framework

The approach to TPF varies in the investment protection regime. The ongoing debates and discussions seem to have sparked some changes in the respective field towards regulating that evolving legal mechanism. It seems that the benefits of TPF as well as its commercial impact work in favour of attempting to introduce regulatory framework rather than absolutely banning its use in arbitral proceedings.

From the regulatory perspective, several recent multilateral and bilateral investment treaties started addressing this issue. During the Transatlantic Trade Investment Partnership (hereinafter "TTIP") negotiations between the EU and the USA, the EU proposed mandatory disclosure of TPF under Art 8. Pursuant to that regulation "the name and address of the third party funder" shall be notified to the other disputing party and the Tribunal.[26] The provision never came into force since the TTIP negotiations were suspended in 2016 after the elections in the United States and the change of administration.[27]

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[24] Goeler, *supra* note 4, at 5.

[25] *Ibidem* at 42.

[26] "Transatlantic Trade and Investment Partnership - Commission draft text", https://trade.ec.europa.eu/doclib/docs/2015/september/tradoc_153807.pdf, 11.05.2020.

[27] J. Zarroli, "German Official Says U.S.-Europe Trade Talks Have Collapsed, Blames Washington", https://www.npr.org/sections/thetwo-way/2016/08/28/491721332/german-official-says-u-s-europe-trade-talks-have-collapsed-blames-washington, 11.05.2020.

With regard to the recently negotiated treaties, also the Canada-EU Trade Agreement (hereinafter "CETA") under Article 8.26 sets forth mandatory disclosure. Similarly, the provision set forth the requirement of the disclosure of a name and address to the tribunal and the opposing party.[28] The same requirement can be found in the EU-Mexico Trade Agreement.[29] However, outside of the currently negotiated treaties with the EU this requirement is not as widespread. The "new generation" of investment treaties such as *e.g.* United States-Mexico-Canada Agreement ("USMCA") or the Comprehensive and Progressive Agreement for Trans-Pacific Partnership ("CPTPP") do not provide for mandatory disclosure. Inclusion of very similar dispute settlement provisions in the treaties negotiated with the EU is not coincidental. Due to the EU's future goal of establishing a permanent standing court (Multilateral Investment Court[30]), similar transitional provisions were introduced to ensure policy coherence at the EU level.[31]

With the increasing demand for further steps, both the United Nations Commission on International Trade Law (hereinafter "UNCITRAL") Working Group III on ISDS reform and the International Centre for Settlement of Investment Disputes (hereinafter the "ICSID") commenced discussions on inclusion of TPF provisions. With regard to the UNCITRAL's Working Group III on the "Possible reform of investor-State dispute settlement",[32] the Secretariat issued a note on the 2nd August 2019. The Working Group III presented several possible solutions as to the ISDS reform – ranging from TPF's prohibition to its regulation. The

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28 Pursuant to Article 8.26 CETA: "*Where there is third party funding, the disputing party benefiting from it shall disclose to the other disputing party and to the Tribunal the name and address of the third party Funder*", Canada–European Union Comprehensive Economic and Trade Agreement Implementation Act (S.C. 2017, c. 6).

29 EU-Mexico Trade Agreement, Art.10.

30 For further reference *see*: M. Bungenberg & A. Reinisch, *From bilateral arbitral tribunals and investment courts to a Multilateral Investment Court: options regarding the institutionalization of investor-state dispute settlement* (Berlin, Germany: Springer Open, 2018).

31 "Impact assessment", https://ec.europa.eu/smart-regulation/roadmaps/docs/2016_trade_024_court_on_investment_en.pdf, 11.05.2020.

32 *Possible reform of investor-State dispute settlement (ISDS) Third-party funding – Possible solutions*, Note by Secretariat No A/CN.9/WG.III/WP.172 (Vienna, 2019).

regulation could cover the identity of the funder and failure to disclose it may, in accordance with the raised suggestions lead to imposing sanctions such as *e.g.* cost shifting or suspension of the proceedings. The Working Group III also took a step further and presented a more extreme suggestions. It advocated that a certain transparency standard should be upheld, and thus proposed making the information on TPF available in Transparency Registry under the Rules of Transparency in Treaty based Investor-State Arbitration.

In parallel to reform proposals at UNCITRAL, ICSID has been working on its own solutions. In the third working paper on proposals for rule amendments issued by the ICSID Secretariat on 16th August 2019, Article 14 sets forth the obligation of filing a written notice providing the name of the third party funder.[33]

4. Approach of arbitral tribunals in investor-state disputes

Due to the fact that TPF most typically remains outside of the scope of regulations, the caselaw in this regard demonstrates that arbitral tribunals have not been consistent in deciding on the issue of disclosure without explicit regulations. Since a funder is not a formal party to the proceedings, there is no obligation to voluntarily disclose its involvement in a case.[34] As a consequence, voluntary disclosure does not happen often, there were only few instances, *e.g.* in *Oxus Gold plc v Republic of Uzbekistan, the State Committee of Uzbekistan for Geology & Mineral Resources and Navoi Mining & Metallurgical Kombinat.*[35] The arbitral tribunal recognized in the final award that the claimant was assisted by a third party, however, stated that it had no impact on the proceedings. In *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic* dispute involving disclosure of TPF, the arbitral tribunal took a different approach and ordered the claimant to

[33] *Proposals for Amendment of the ICSID Rules – Working Paper* (International Centre for Settlement of Investment Disputes, 2018).

[34] Shaw, *supra* note 6, at 110.

[35] *Oxus Gold plc v. Republic of Uzbekistan, the State Committee of Uzbekistan for Geology & Mineral Resources, and Navoi Mining & Metallurgical Kombinat* (UNCITRAL) Award, 17 December 2015.

disclose the identity of the third-party funder after the claimant disclosed that it was assisted by a third-party.[36]

Arbitral tribunals ordered the parties to disclose information on TPF despite lack of obligation to do so in several cases. *E.g.* in *Julio Miguel Orlandini-Agreda and Compania Minera Orlandini Ltda v. Bolivia*, the arbitral tribunal ordered the parties to disclose information on whether they were using TPF to cover the costs of the arbitration and the funder's identity.[37] In *Muhammet Çap & Sehil In–aat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan*, the arbitral tribunal took a step further and upon the application of the respondent ordered the claimant to disclose not only whether its claims in the arbitration were funded by a third-party, and if so, the identity of the founder, but also the terms of the funding.[38]

Taking into consideration provided examples, the inconsistency of tribunals' approach can be easily observed. Some tribunals decide not to order disclosure, others go a step further and demand information on not only the identity of a funder but also the terms of the funding agreement. Therefore, there is a need for providing specific regulations in this regard.

5. The benefits of mandatory disclosure

As already mentioned, the arbitral tribunals' decisions concerning TPF are inconsistent. In principle, tribunals do not have the competence to address the issue of external funding as their jurisdiction is limited to the dispute between the investor and the state, and the funding agreement "is alien to the legal relation between the foreign investor and the host State".[39] Without any specific regulations as to the obligation and extent of disclosure, tribunals have been differing in their approaches (see above para. 5). Legal scholars indicate that even without explicit legal grounds

[36] *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic,* ICSID Case No. ARB/14/14, 18.08.2017 (Award), at para. 108.

[37] *Julio Miguel Orlandini-Agreda and Compania Minera Orlandini Ltda v. Bolivia,* Case No. 2018-39, 04.02.2019 (Procedural Order No. 1), at para. 11.

[38] *Muhammet Çap & Sehil In_aat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan,* ICSID Case No. ARB/12/6, 12.06.2015 (Procedural Order No. 3), at paras 1 et *seq.*

[39] De Brabandere/Lepeltak, *supra* note 1, at 380.

for disclosure obligations, tribunals may request it as a part of its powers to preserve the integrity of the arbitral process and the good faith of the proceedings, although such disclosure would only be possible in case of any doubts as to the impact of TPF on fairness of the proceedings. To this day, such concerns have not arisen in the investment arbitration proceedings so far.[40] The inconsistency in the practice of arbitral tribunals creates confusion and does not allow for proper evaluation of that legal institution. Regulating TPF would provide desired consistency.[41]

Moreover, narrowing the scope of mandatory disclosure to the identity of the funder would balance the need to avoid conflicts of interest in arbitral proceedings and revealing sensitive details of the agreement between the investor and the interested party.[42] In such a highly specialized field, the arbitrators adjudicating cases in some instances may be somehow connected to the third party funders. Independence and impartiality of arbitrators is of crucial importance in the proceedings and constitutes the core value of arbitration. Disclosure of TPF would be a solution to potential conflicts of interest existing between arbitrators and funders.[43] It would be especially desirable in the beginning of the proceedings as at the later stages it could have "costly and public repercussions".[44] Conflicts of interest existing between the arbitrators and the funders are especially dangerous at the enforcement stage of the proceedings as they could render the award non-enforceable or even constitute grounds for setting aside.[45] Risk of non-enforceable awards in cases of non-disclosed TPF should not be overlooked as it is in the party's interest not only to obtain a favourable award but most importantly

[40] *Ibidem* at 397.

[41] Moseley, *supra* note 14, at 1194.

[42] K.H. Shahdadpuri, "Third-party funding in international arbitration: regulating the treacherous trajectory" (2016) 12:2, AIAJ 77 at 103.

[43] D. Yeoh, "Third Party Funding in International Arbitration: A Slippery Slope or Levelling the Playing Field?" (2016) 33:1, JIA 115 at 121.

[44] Shaw, *supra* note 6, at 116.

[45] Guven/Johnson, *supra* note 13, at 43; Frignati, *supra* note 2, at 516.

an enforceable one. Even the most favourable awards are deprived of any meaning if there is no possibility to enforce them.[46]

Without the specific data as to the operation of TPF, all the arguments both in favour of and against TPF in a large part remain in the theoretical field. That is also why mandatory disclosure of TPF is promoted – it is necessary to collect information on operation of TPF in order to identify risks and respectively propose solutions. It has been suggested that in order to collect data not only the existence and identity of third-party funders should be disclosed but also structure of the agreements and other crucial aspects of such an arrangement.[47] Whilst I do agree that study on TPF would greatly benefit from mandatory disclosure, I am of the opinion that mandatory disclosure of solely the identity of a funder would be sufficient as it would constitute a much needed compromise between the proponents and detractors of this mechanism.

6. The risks of mandatory disclosure

The risks of mandatory disclosure mostly concern the procedural aspects. A concern that has been expressed in legal writing relates to the increase of procedural delays.[48] Once a party is aware of the fact that its opponent receives external funding, it may be tempted to undertake actions in order to exhaust it before the dispute gets to the merits phase. As observed, "if a party becomes aware of the other party's litigation budget, an incentive might be created to bring dilatory requests or arguments simply to exhaust that budget before the case is over".[49] Awareness of the funding agreement can also have impact on other financial strategies of the parties. Parties may seek security for costs at the outset of the proceedings being aware of the fact that the potentially losing party will

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[46] Such has been referred to as a "pyrrhic victory" – *see* A. Frischknecht, *Enforcement of Foreign Arbitral Awards and Judgments in New York*, KLI 2018 at 1.1.

[47] A Conference transcript "Reforming International Investment Law: Opportunities, Challenges, Paradigms" (2018) 59:8 BCLR 2899, p. 2946.

[48] Moseley, *supra* note 14, at 1194.

[49] J.C. Honlet, "Recent decisions on third-party funding in investment arbitration" (2015) 31:1 ICSID Review.

not be able to comply with the award.[50] Even though a party is funded by a third person, tribunals would lack jurisdiction to award costs against the funder as it is not formally a party to the proceedings.

7. Methods of introducing mandatory disclosure

It seems that despite the differences, both the enthusiast of TPF in investment arbitration and its critics agree that TPF requires a thorough regulation and disclosure requirements.[51] The difference in proposed approaches mostly concerns the scope of mandatory disclosure. There are several ways to tackle the issue of disclosure regulation, however, the changes will require time. The two most effective methods would be either to implement the mandatory disclosure requirement in the treaties or make amendments to the arbitration rules.

It seems that in practice, incorporation of such provisions directly into the trade agreements would be efficient only with regard to the new treaties as amending the existing ones would take a lot of time and effort – investment arbitration treaties are renegotiated or replaced rather on rare occasions.[52] Pursuant to OECD study only 60 out of 2,061 treaties in the sample were amended.[53] Such amendments and modifications of investment treaties are permitted under the law of treaties[54]. In order to provide a more time-efficient proposal which also takes advantage of the existing legal framework, it has been suggested that introducing disclosure obligations in arbitration rules (such *e.g.* ICC, ICSID and UNCITRAL) would be more advisable.[55] The recent attempts to modify arbitration rules such

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[50] Shaw, *supra* note 6, at 115.

[51] In favour of TPF, see *e.g.* Moseley, *supra* note 14; contra *e.g.* Garcia, *supra* note 21. Both of the authors advocate for mandatory disclosure.

[52] "Increasingly mandatory disclosure of third-party funding in arbitration", https://www.financierworldwide.com/increasingly-mandatory-disclosure-of-third-party-funding-in-arbitration#.XcB2m5NKjOR, 11.05.2020.

[53] K. Gordon, J. Pohl, *Investment Treaties over Time – Treaty Practice and Interpretation in a Changing World,* 2 OECD Working Papers on International Investment (2015) at 34.

[54] For further details, *see* the Vienna Convention on the Law of Treaties of 1969, Art. 39 et *seq.*

[55] R.D. Thrasher, "Expansive Disclosure: Regulating Third-Party Funding for Future Analysis and Reform" (2018) 59:8 BCLR 2935 at 2947.

as ICSID or UNCITRAL are heading in this direction. The requirement of mandatory disclosure of identity of the funder seems to be sufficient to eliminate possibility of delays in arbitral proceedings caused by conflicts of interest due to the undisclosed funding agreements. The UNCITRAL Working Group III also attempts to improve the potential procedural delays of undisclosed TPF. It suggests to include repercussions such as cost allocation or stay of the proceedings in case of failure to disclose funding agreements.[56]

Therefore, amendment of the arbitration rules and introduction of disclosure requirement in the new investment treaties appear to be sufficiently practical.

8. Concluding remarks and recommendations

As observed, the efforts to prohibit TPF "will likely face hurdles and resistance". Hence, it would be more effective to provide regulatory framework than to impose a ban.[57] Even TPF's opponents consider disclosure to be a step towards eliminating the risks associated with that mechanism.[58] The mentioned risks may have a negative impact on the proceedings, perception of arbitration and the reputations of arbitrators involved in a case. Unregulated, TPF threatens the integrity of the arbitral proceedings. In general, it may have an impact on the perception of arbitration within the international community. However, it can also have a severe impact on the matters most important to the parties – TPF in some cases may render an arbitral award unenforceable.[59] With prudence as to the scope of mandatory disclosure, there is a chance of balancing two values: on the one hand integrity of the proceedings as well as independence and impartiality of the arbitrators, and on the other the privacy of the relationship between investors and its funders.

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[56] *Possible reform of investor-State dispute settlement (ISDS) Third-party funding*, *supra* note 33.

[57] Guven/Johnson, *supra* note 13, at 43.

[58] Garcia, *supra* note 21.

[59] Moseley, *supra* note 14, at 1189.

Third party funding in international investment arbitration: a dire need of disclosure

S u m m a r y

Third Party Funding attracts a lot of attention, especially in the Investor-State Dispute Settlement context. It has been debated whether it should be allowed. Currently, Third Party Funding has remained unregulated in a large part, which creates inconsistency in case-law, and thus confusion and distrust in the public eye. It has been advocated that introduction of mandatory disclosure requirement could improve the current legal framework.

Key words: Investor-State Dispute Settlement, ISDS, investment arbitration, third party funding, disclosure

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