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The Impact of Third Party Funding on Allocation for Costs and Security for Costs Applications: The ICCA-Queen Mary Task Force Report

Stavros Brekoulakis (General Editor International Journal of Arbitration, Mediation and Dispute Management; Queen Mary University of London) · Thursday, February 18th, 2016

The last several years have witnessed a tremendous increase in the participation of third-party funders in international arbitration. A growing number of claimants are seeking external funding, either because they lack the necessary funds to commence arbitration proceedings (which are becoming increasingly more expensive) or because they want to maintain cash-flow and offset the risk of an uncertain arbitration outcome. Anecdotal evidence suggests that at least 40% of the current investment arbitration claims have either secured or explored funding from third-party funders.

Partly because third-party funding (TPF) became very popular within a relatively short period of time, the international arbitration community is not yet sure about the nature of its impact and regulation has not yet caught up with it. The only existing efforts to address issues relating to TPF include the 2014 IBA Guidelines on Conflicts of Interest and very few recent examples of International Investment Agreements, such as the TTIP and a few Model BITs, such as the French BIT Model, which purport to deal with TPF in investment arbitration. There is currently no provision in any national arbitration law or any set of arbitration rules dealing with TPF in international arbitration, though both Hong Kong and Singapore are currently contemplating applicable reforms.

Despite the lack of concrete guidance, arbitrators, parties, and counsel are experiencing with increasing frequency that TPF can give rise to a host of important and complex ethical and procedural issues in international arbitration. These issues include the nature and degree of influence of funders in the management of the dispute, issues of jurisdiction and admissibility (i.e. who owns the claim?), issues of transparency and disclosure of the funding arrangements, issues of attorney-client privilege, issues of conflicts of interest for tribunals, and issues of allocations of costs and security for costs.

The need to examine and investigate the impact of TPF on the process of international arbitration prompted creation of the joint ICCA-Queen Mary Task Force on TPF in 2014 (co-Chaired by Professors William Park, Catherine Rogers and Stavros Brekoulakis), with the aim of creating a forum of discussion and debate on these important issues. To that end, the Task Force includes a wide range of stakeholders—third-party funders, arbitrators, practicing arbitration lawyers and barristers, representatives from arbitration institutions, governmental representatives, and

academics—from a range of jurisdictions.

The Task Force has been operating through several sub-committees, each of which has been commissioned to investigate and produce a report on a specific topic.

- Subcommittee on Definitions
- Subcommittee on Conflicts of Interests
- Subcommittee on Costs
- Subcommittee on Attorney-Client Privilege,
- Subcommittee on Investment Arbitration Subcommittee on TPF Best Practices

The final work of the Task Force will be published in the form of a Report *on Third-Party Funding in International Arbitration* as a volume in the ICCA series by September 2016. In the meantime, a draft report on Costs has already been completed and has become available for public consultation at both QMUL website and at the ICCA website.

While a detailed presentation of the Costs Report[1] would exceed the scope and purpose of this post, it is worth drawing attention to some of its main findings.

First, *third-party funding arrangements in and of itself is not sufficient indication that a claimant is impecunious and therefore the mere existence of a third-party agreement is not sufficient reason for a tribunal to order security for costs*. Relatedly and for the same reasons, the presence of a funder should not shift the burden of proof as to whether the requirements for security for costs are fulfilled.

While Gavan Griffith in his well-known assenting opinion in *RSM Production Corporation v. Saint Lucia* (2014) stated that the existence of TPF should create a presumption in favour of security for costs, his views have not been adopted by either the reasoning of the *RSM* decision itself or subsequent decisions on the same matter.

For example, the Tribunal in *EuroGas Inc. and Belmont Resources Inc. v. Slovak Republic* (ICSID Case No ARB/14/14) denied the request for security for costs, distinguishing the facts of the case from the "exceptional circumstances" in *RSM*. Similarly, the Tribunal in *South American Silver Ltd v Bolivia* (PCA No.2013-15) very recently (11 January 2016) rejected the request for security for costs which Bolivia has requested, *inter alia*, on grounds of TPF, noting that

If the existence of [TPF] alone, without considering other factors, becomes determinative on granting or rejecting a request for security for costs, respondents could request and obtain the security on a systematic basis, increasing the risk of blocking potentially legitimate claims

Second, *if there are evidence suggesting that the Claimant is impecunious or is likely to become impecunious by the end of the arbitration, the existence of TPF may come into play in the decision of a tribunal to order security for costs and this may require disclosure of the TPF arrangements.* In such a case, tribunals may need to carefully review the terms of the funding agreement and in particular, the terms that provide whether and under which circumstances a funder may terminate the funding, and whether the funder is liable for adverse costs.

For example, an ICC tribunal (*X v. Y and Z*, ICC Case, Procedural Order of 3 August 2012) granted a security for costs request against a claimant that had entered into a funding agreement, on the basis that, *inter alia*, the funding agreement did not cover adverse costs and allowed the funder to

"terminate the Agreement at any time, entirely at its discretion".

Third, *the fact that a party's costs have been paid by a third-party funder should not generally be regarded as a relevant factor in determining whether or not costs are to be allocated based on the outcome of the case*. These costs are incurred by the funded party who is typically obliged, under the funding agreement, to pay back to the funder if the claim is successful. The usual practice, where TPF are in place, is that invoices by lawyers are issued in the funded party's name and become payable by the funder as a result of the funding agreement. The funded party's lawyers would usually send the invoice to the funder (along with a monthly report).

Fourth, it *should not be appropriate for tribunals to award funding costs (such as a conditional fee, ATE-premium, or litigation funder's return), as they are normally not legal costs incurred for the purpose of an arbitration.* The success portion payable to a third-party funder results from a trade-off between the funded party and the funder, where the funder assumes the cost and risk of financing the proceedings and receives a reward if the case is won. This agreement is not linked to the arbitration proceedings as such, although an argument may be made to the Tribunal that such costs are recoverable if they are "reasonable".

Fifth, in principle, a tribunal will lack jurisdiction to issue a costs order against a third-party funder. The TPF is not typically a party to the arbitration agreement, and has no involvement in the underlying dispute between the two parties in an arbitration. While funders may be involved in the proceedings, this cannot readily be interpreted as consent to arbitrate. While in national court litigation there have been cases in which funders (who are not a party to the litigation) have been directly ordered to pay adverse costs, there has been no arbitral award ordering a third-party funder to pay adverse costs in international arbitration.

The public consultation for the ICCA-Queen Mary Costs Report ends by 15 March, and all comments are welcome (please, sent to s.brekoulakis@qmul.ac.uk)

[1] The Subcommittee for the Costs Report included, Stavros Brekoulakis (Chair), Audley Sheppard, Susan Dunn, Mick Smith and Jonas von Göler.

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