Kluwer Arbitration Blog

Third Party Funding Again Under the Spotlight

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It is known that third party funding has become one of the hot topics in the international arbitration arena. Indeed, it is not the first time this blog deals with the matter. Amongst others, Munir Maniruzzaman and Lisa Bench Nieuwveld have already explored this tool that provides the necessary capital to either distressed parties or parties willing to manage their cash flow.

1. Hitches surrounding TPF

The presence of a third party funder in arbitration has raised concerns around its disclosure and the necessity of *cautio judicatum solvi* (security for costs).

Indeed, the initial dilemma versed on whether, or to what extent, third party funding agreements should be disclosed in international arbitration proceedings. Practitioners were especially concerned about ensuring the arbitrators' impartiality and independence. A risk could exist if an arbitrator sitting in a proceeding in which one of the parties was funded by a third party could also be serving as a counsel in another proceeding in which the claim was funded by the same funder. The fact that the funder could eventually pay her fees in the second proceeding could make her inappropriate to sit as an arbitrator in the first proceeding. Despite no soft law has been issued on this regard[1)], it seems that the potential obligation to disclose funding agreements has already been accepted by the arbitral community.

The second controversial issue was the costs of the arbitration. It was unlikely that the prevailing party could turn to the third party funder to recover its legal costs. Besides, the arbitral tribunal very likely lacked jurisdiction to order the third party funder to pay advances on costs. It was unquestionable until today that the funder was neither a signatory to the arbitration agreement nor a party to the proceeding and, therefore, had no duty to reimburse the prevailing party's legal costs.

2. Recent ICSID decision

The topic has gained renewed attention after an ICSID tribunal[2)] recently issued a decision on the respondent's request for security for costs[3)] in a pending oil arbitration proceeding. The ICSID tribunal's decision issuing security for costs was based on three cumulative elements: the claimant's non-payment proven history, its admitted lack of financial resources and the presence of a third-party funder.

Indeed, it has been the first time security for costs has been enjoined in an investor-State dispute. Such decision has opened the debate of whether states should be able to obtain security for costs in cases where claimants are assisted by third party funding, unless the claimant has sufficient financial resources.

Taking into account the *Commerce Group Corp. & San Sebastian Gold Mines, Rachel S. Grynberg and others v. Government of Grenada, Libananco H, Gustav FW Hamester GmbH & CO KG v. Republic of Ghana*, and *Guaracachi America, Inc. and Rurelec* precedents; in which the tribunals did not grant security for costs, the controversy is already served.

3. The *cautio judicatum solvi* debate

The discussion is attention-grabbing as security for costs is still unknown and not universally accepted in many civil jurisdictions, although it has become increasingly common in international arbitration proceedings.

Tribunals have typically ordered security for costs when the requesting party had a *prima facie* case of succeeding on the merits and the opposing party lacked financial means and was not in a position to satisfy a future adverse award on costs.

Turning to the case under review, it is worth noting how the majority tribunal found power to order security for costs based on the respondent's request[4)]. Its decision was based on the power to order provisional measures for the preservation of rights set in Article 47 of ICSID Convention and ICSID Arbitration Rule 39 (1). According to the majority, the fact that the security for costs was not expressly provided for in the ICSID rules did not exclude the panel's jurisdiction as there were "exceptional circumstances".

The majority held that a right in need of protection existed under those exceptional circumstances as the claimant had demonstrated a serious risk of non-compliance of prior ICSID cost orders awards or request for payment of advances. Interestingly, it was considered that the State's right requested was both a procedural and contingent one, depending respectively on the cost and success on the merits. The reasoning also underlined that the hypothetical element of the right at issue was one of the inherit characteristics of the regime of provisional measures.

Furthermore, the majority held that it was doubtful that the unidentified third party would assume the responsibility of honoring costs unless ordered to do so. Therefore, as it considered inappropriate to wait for the arbitral award, the procedural right as part of the respondent's defense was granted.

Noteworthy, one of the arbitrators, Mr. Griffith, issued an assenting reason in which he openly manifested that in cases where third party funding exists states should be granted security for costs unless claimants prove otherwise.

By contrast, the dissenting opinion of the third arbitrator, Mr. Nottingham, stated that the scope and language of ICSID Arbitration Rule 39 was recommending provisional measures, not ordering them as the majority had issued in the order. Furthermore, the dissenter considered that the right under scope related to security for costs had not yet arose and, therefore, no preservation of rights could be admitted. Additionally, he underlined that the majority's reasoning was creating a burden of financial proof on every claimant with third party funding.

4. Consequences

Apparently the objective supporting the decision under discussion is that funders should also bear the risks of adverse decisions on costs. Hence, the funding community has not remained silent. The first reaction has been questioning whether tribunals will impose security orders whenever a third party funder is present. Indeed, they point out that depriving a claimant of the ability to pursue its claim does not compensate the risk of a governing state not collecting its costs. It has been underlined that provisional measures with views to preserve rights should only be held once the right exists.

However, it should not be forgotten the fact that respondents may use *cautio judicatum solvi* requests to expand the proceeding both in time and costs. Furthermore, as underlined by the arbitral tribunal in *Guaracachi America, Inc. and Rurelec PLC v. The Plurinational State of Bolivia,*

> "the appropriate balance between the right of access to justice of entities that have been allegedly expropriated and the protection of States against alleged frivolous claims by parties who may not have sufficient assets to guarantee the payment of an adverse costs award is a serious issue".

There is a substantial risk that the previous analyzed security for costs decision builds a precedent and whenever third party funding is present reimbursement of legal cost is granted without any further considerations. We may even end up taking a step back if parties are no longer willing to disclose the existence of a third party funder. Consequently, the substantial risks in the arbitrators' impartiality and independence that seemed to be over may turn back.

Thus, a uniform test setting the conditions for granting requests for security for costs is highly demanded and desirable. In the meantime, ICSID interest in the topic as well as agreed standards remains to be seen.

References

?1 It would be unfair not to mention that the English Association of Litigation Funders' Code of Conduct addresses this current issue since 2011.

?2 RSM Production Corporation v. Saint Lucia (ICSID Case No. ARB/12/10), Decision on St. Lucia's request for security for costs, August 13, 2014.

?3 The investor has been requested to post US$750,000 within 30 days as a security for the state's costs in the case.

?4 Interestingly, one of the party appointed members of the tribunal issued a dissenting opinion (Sir Edward Nottingham) and the other a brief separate assenting reasons (Sir Gravan Griffith QC).

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