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Towards an Exceptio Fundati? Assessing a (Potentially) Emerging Exception for Third Party Funding in Investment Treaty Decisions on Security for Costs in the Wake of Armas v. Venezuela

Alexander G. Leventhal (Quinn Emanuel Urquhart & Sullivan, LLP) · Tuesday, September 18th, 2018

"The problem with money," wrote the American poet and philosopher Ralph Waldo Emerson, "is that it costs too much." This may soon ring all too true for some investment treaty arbitration claimants and the third parties that seek to fund their claims.

Recent developments suggest that there may be support – albeit embryonic – for an exception to traditional standards for ordering security for costs where a claimant-investor in an investment treaty arbitration receives third party funding. This touches upon an issue for which investment treaty arbitration has struggled to find a condign response. A respondent-State may face a claim from an impecunious, yet well-funded, claimant against whom it will be unable to enforce an award on costs. Although that claimant will have ample funds for the arbitration, the source of those funds, the third party funder, lies beyond the jurisdiction of the arbitral tribunal. Existing standards for provisional measures or security for costs may not address the unique nature of third party funding in investment treaty arbitration. At the same time, however, care must be taken not to stifle potentially meritorious claims for which no alternative forum exists.

In a recent decision in the case of *Manuel García Armas and others v. Venezuela* (PCA Case No. 2016-08, Procedural Order No. 9, 20 June 2018 (the "Decision")), a tribunal ordered claimants to provide security for costs in an investment treaty arbitration for only the second known time. While this alone would merit some interest, two aspects of this decision are worthy of particular reflection.

First, after the claimants disclosed the existence of a third party agreement, the tribunal ordered the claimants to produce that agreement, invoking a duty to protect the integrity of the proceedings (see Decision, ¶2).

Second, having established that the agreement did not provide that the funder would cover an award for costs, the tribunal ordered the *claimants* to prove that they could cover such an award (Decision, ¶242). In so doing, it effectively reversed the burden of proof, which would usually lie with the moving party, and placed the onus on the non-moving parties to demonstrate their solvency. While the tribunal shied from declaring that the existence of third party funding automatically reversed the burden of proof, it found – quite creatively – on the basis of the *"procedural principal that obliges the parties to cooperate in good faith with the Tribunal"* and the shifting of the burden of proof, that *"the burden should lie on the party that is in the best conditions to produce the evidence"* (Decision, ¶246).[1)] Be that as it may, the decision suggests no basis for the shifting of the burden of proof *other* than the third party funding agreement and, in particular, the fact that the agreement did not cover a costs award.

The *Armas* tribunal ultimately concluded that the claimants had not met the burden, brushing aside a number of concerns raised by the claimants, including:

- the State's role in contributing to the claimants' insolvency, an argument whose assessment, according to the tribunal, would prejudge the merits, (Decision, ¶214);
- the concern that providing information on the claimants' assets could lead to reprisals from the respondent-State (Decision, ¶219); and
- the concern that the decision would stifle an otherwise meritorious claim, a worry that, the tribunal found, lacked merit because the claimants themselves had alleged that they were solvent and thus could meet an award on costs (although the tribunal itself found such solvency had not been demonstrated) (Decision, ¶232) and because, the tribunal concluded, the "denial of justice" would in fact be greater for the respondent-State if it could not collect an award for costs (Decision, ¶235).

The grounds for this decision are unique, but its result is not entirely so. In *RSM Prod. Corp. v. Santa Lucia* (ICSID Case No. ARB/12/10, Decision on Saint Lucia's Request for Security for Costs, 13 August 2014 ("RSM Decision")), an investment treaty tribunal ordered security for costs – and even later discontinued proceedings when the claimant failed to comply with that order. The tribunal, however, did not base its decision solely on the fact that the claimant was funded by a third party. Instead, it found that the claimant's conduct in those and other proceedings – its refusal to pay its share of the provision on costs and its failure to satisfy a prior award on costs – created a *"material risk"* that an award on costs would not be met (Id., ¶81), a risk that was "supported" by the fact that the claimant was funded by a third party (RSM Decision, ¶83).

A dissenting opinion by one arbitrator, Gavin Griffith QC, went even further. Alluding to the fact that a respondent-State may face an impecunious, yet well-funded, claimant, Mr Griffith suggested that the existence of a funding agreement alone should constitute exceptional circumstances justifying an order for security for costs (RSM Decision., Dissenting Opinion, ¶11).

Mr Griffith puts his finger on a delicate issue. In commercial arbitration, a moving party has the ability to know the financial state of its counterparty when entering into the arbitration agreement. A party, therefore, should not be able to stifle a meritorious claim if it cannot prove some change in the counterparty's circumstances. Some commercial tribunals have found that the third party agreement itself constitutes a change in circumstances that merits a security for costs order (Procedural Order – Security for Costs August 3, 2012, 2 *Cahiers de l'arbitrage* 399 (2013)) This inquiry, however, is more challenging in investment treaty arbitration where the respondent-State does not choose its arbitral counterparty in the same way. The respondent-State's offer to arbitrate is an open one and the State is forced to take its claimant as it lies, usually without the ability to bring a counterclaim. When the arbitration agreement is concluded, the funding agreement will generally already exist .

Likewise, where a tribunal applies a standard for provisional measures, rather than one specific to security for costs, a State's request may not always meet the requirements of such test. Where the award is years in the future, the potential for irreparable harm may not satisfy the condition of urgency necessary for a provisional measures order (see e.g. *Burimi S.r.l. and Eagle Games Sh.a. v. Albania*, ICSID Case No. ARB/11/18, Procedural Order No. 2, 3 May 2012, ¶40).

But does this justify a shift in the *onus probandi* that could stifle a potentially meritorious claims? As the tribunal in the *Pey Casado v. Chile* case noted, the respondent-State could easily have included in its offer to arbitrate – i.e. in the relevant provisions of the applicable treaty – an appropriate way to deal with the issue (ICSID Case No. ARB/98/2, Décision sur les Mesures Conservatoires sollicitées par les Parties, 25 September 2001, ¶85). The same can be said of the rules governing procedure. In another dissenting opinion in the *RSM* case, Judge Edward Nottingham warned of the *"mischief which can follow if individual tribunals adjudicating particular cases latch on to broad language in the governing documents as a warrant to address matters which, if they were matters of general concern, could and should be addressed by the ICSID Administrative Council after input and consultation with all interested parties"* (RSM Decision, Dissenting Opinion, ¶17).

In this sense, the *Armas* Decision is timely because it was rendered only months before the Proposals for Amendment of the ICSID Rules.

These Proposals would expressly grant ICSID tribunals the power to order security for costs – separately from provisional measures. That an ICSID tribunal already has the power to do so is not in dispute. However, an independent provision could ultimately result in an autonomous standard that would allow tribunals to take into account a party's ability to comply with an adverse decision on costs – potentially, in the same way that the *Armas* tribunal did.

In addition, the Proposals require parties to disclose the source of any third party funding, which could invite the tribunal to order production of the underlying agreement itself – as in the *Armas* case.

These Proposals, if adopted, could lead to special treatment for funded claimant-investors in security for costs decisions. Some tribunals may even be tempted to follow the lead of the *Armas* tribunal and shift the burden of proof onto the funded party, requiring it to demonstrate its solvency where a third party funding agreement exists and/or does not cover an award on costs.

The *Armas* Decision – along with the ICSID Proposals – invites us to ponder whether the future holds an emerging *exceptio fundati* – an exception to the traditional security for costs standard. One that would even shift the burden of proof in the presence of a third party funding agreement onto the funded party and require it to show that it can meet an award for costs. Such an exception is no trifle. It could effectively allow an investment treaty tribunal to put a halt to a claim where neither the party to the dispute nor the funder are prepared to satisfy an order for security for costs. This would be revolutionary. It would require funders to rethink their cost assumptions in investment treaty cases and could make it harder for some claimants to obtain funding.

While we may not yet be there, the *Armas* Decision brings us closer to Emerson's reality.

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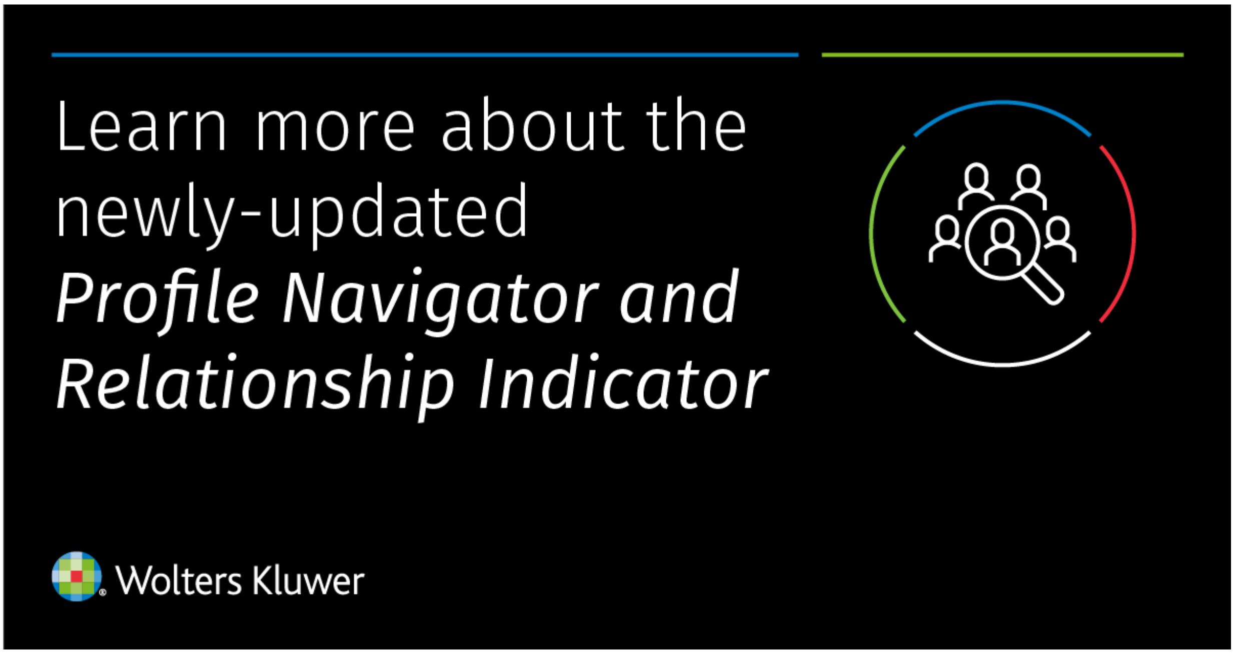

References

?1 Translation from the original Spanish is the author's.

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