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New ICSID Arbitration Rules: A Further Step in The Regulation of Third-Party Funding

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On March 21, 2022, the Member States of the International Centre for Settlement of Investment Disputes ("ICSID") approved a comprehensive reform of its rules and regulations, including the rules of procedure for ICSID arbitration proceedings ("New ICSID Rules"). Drafted over a five-year consultation process and six working papers, this profound amendment aims to "modernize, simplify, and streamline the rules" and will enter into force on July 1, 2022. The highlights of the recently approved amendments have recently been covered on the Blog (here).

One of the overarching aims of the New ICSID Rules is to increase transparency in various aspects of ICSID proceedings, thereby aligning the ICSID Rules with a recognizable trend among arbitration rules worldwide. This post focusses on the approach taken under the New ICSID Rules to third-party funding ("TPF") disclosures, analyzing the scope of the duty to disclose in comparison with other institutional rules, and the underlying policy concerns.

TPF and the Duty to Disclose

The TPF phenomenon has been at the center of extensive debates recently. It suffices to note that TPF is a form of non-recourse financing, in which a funder – typically a specialized company with no direct involvement in a dispute – undertakes to bear the costs of a party to an arbitration. In the event that the funded party prevails, the third-party funder receives a profit, typically consisting of a percentage of the award or a multiple of the funds provided, whichever is higher. However, TPF agreements can materialize in different forms, including contingency fee agreements with a party's legal counsel.

At a first glance, one might think that TPF is a tool primarily directed towards impecunious parties that would otherwise not be able to afford arbitration. However, TPF has also become a viable instrument for financially stable entities that seek funding to facilitate smoother cash-flow management.

The rise of these new actors in arbitration proceedings has provoked various concerns, mainly related to possible conflicts of interests that may arise out of relationships between funders and arbitrators, counsels or parties.

This has spurred some arbitral institutions to develop ways to shed light on the existence of funding agreements, including by granting tribunals the power to order disclosure of TPF arrangements, or by imposing a generalized duty on parties to disclose details as to the existence and nature of their funding agreements. The very first institutional rules addressing TPF were the SIAC and CIETAC investment arbitration rules in 2017 (Articles 24(l) and 27, respectively), followed by the HKIAC arbitration rules in 2018 (Article 44), the BAC investment arbitration rules in 2019 (Article 39), the CAM arbitration rules in 2020 (Article 43), the ICC arbitration rules and the VIAC investment arbitration rules in 2021 (Article 11(7) and Article 13a, respectively). The amendments in the New ICSID Rules build, at least in part, on these precedents.

What to Disclose?

The principal divergence that arises from the above institutional rules is the extent to which such disclosure is required; that is, what kind of agreements should be disclosed; and to what extent should those agreements be disclosed?

The new Rule 14(1) of the amended ICSID Arbitration Rules provides:

A party shall file a written notice disclosing the name and address of any non-party from which the party, directly or indirectly, has received funds for the pursuit or defense of the proceeding through a donation or grant, or in return for remuneration dependent on the outcome of the proceeding ("third-party funding"). If the non-party providing funding is a juridical person, the notice shall include the names of the persons and entities that own and control that juridical person.

At the beginning of the arbitration or "immediately" after concluding the funding arrangement, the party is to file such notice (and any updates) with the Secretary-General, who in turn is to transmit it to the parties and any arbitrator proposed for appointment or appointed in the proceeding (Rules 14(2)–(3)).

Rule 14(1) presents a number of noteworthy features not seen elsewhere.

First, while certain rules do not define TPF (e.g., the HKIAC and CAM rules), Rule 14 sets forth a broad definition of TPF, reflecting the wide variety of TPF agreements employed in practice. By doing so, it aims at preventing possible issues of interpretation on what qualifies as TPF and what does not.

Second, Rule 14(1) includes in the TPF definition arrangements with party representatives, such as contingency fee agreements with legal counsel, thereby further extending the scope of the duty to disclose. This is in contrast with, for instance, the VIAC investment arbitration rules (Article 6), in which the definition encompasses only agreements with persons who are not a party nor "party representatives".

Third, the last sentence of Rule 14(1) requires a party to reveal the names of the entity or individuals ultimately controlling the funder (if the funder is a juridical person). This was introduced in the sixth working paper in order to ensure additional "transparency regarding the identity of the funder" and to "allow the arbitrators to accurately identify any conflict of interest" involving the "ultimate beneficial owner" of the funding entity. This provision, invoked by a number of States and by the European Union, had been initially rejected by the Secretariat (in the fifth working paper) because, among other things, this language risked creating confusion among the interpreters and, in any event, did not respond to concerns actually encountered in practice (accordingly, no other sets of rules feature similar provisions). Criticisms have been risen also by commentators, including because Rule 14(1) oddly requires disclosure of more information from the funder than from the funded party itself, which is not required to reveal its shareholders. On the other hand, one can see that, in circumstances where the funder is a shell company, limiting the duty to disclose details only to the funder might defeat the purpose of disclosure.

Lastly, while many sets of rules (e.g., the HKIAC, ICC and VIAC rules) generically refer to the disclosure of the "identity" of the funder, new Rule 14 specifies that the written notice shall include its "name and address" to avoid any confusions.

The Funding Agreement Dilemma

Under the new Rule 14(4): "The Tribunal may order disclosure of further information regarding the funding agreement and the non-party providing funding …". This open wording appears to be a halfway solution to the heated discussion surrounding the duty to disclose the details of any TPF agreement.

The policy considerations upon which the duty to disclose is premised include the assumption that a funded party is likely to be financially distressed and might thus be unable to comply with an adverse costs award in the event of an unfavourable outcome in the arbitration. All the more so provided that the funder might not have any contractual obligation to cover adverse costs and, in any event, might benefit from termination clauses or other contractual tools to escape responsibility deriving from such an award (the so-called "arbitral hit and run").

Therefore, disclosure of the funding agreement to allow the assessment of the extent of the funder's rights and obligations might be sensible to protect the non-funded party, especially when it comes to deciding on an application for security for costs[1)].

This appears to be the reason why, for instance, the 2021 UNCITRAL proposals for provisions on TPF in ISDS suggest the systematic disclosure, among other things, of "the funding agreement and the terms thereof". Arbitral institutions have so far adopted less-onerous approaches to TPF than those advanced by the UNCITRAL[2)]. For instance, Article 39(2)(d) of the 2019 BAC investment arbitration rules requires parties only to reveal "whether or not the third-party funder has committed to cover adverse costs liability", as opposed to the entire agreement. Other institutions, such as the ICC and the HKIAC, do not grant tribunals any powers concerning any funding agreement.

Avoiding a general obligation to disclose the funding agreement seems entirely reasonable, primarily because nowadays it is far from certain that a funded party is impecunious since, as mentioned above, TPF is increasingly becoming a cash-flow management tool used also by stable entities. Consequently, always requiring the parties to reveal the confidential and commercially sensible information contained in funding agreements does not appear justified.

In light of the above, the ICSID's decision to give tribunals a discretional power to require additional information about the funding agreement only when and to the extent necessary (e.g., in circumstances in which the funded party strongly appears to be financially distressed and an application for security for costs is brought) appears appropriate. Nonetheless, how these issues will be addressed will only be revealed through their use in practice and it is easy to foresee the opening of a new battleground around whether, and to what extent, such power ought to be exercized.

Conclusion

The new provisions of the ICSID Rules dedicated to TPF can be favorably welcomed, as they address the critical point of conflict of interests with more precision than other sets of rules, while maintaining a balanced and modern approach to the delicate issue of disclosure of the funding agreement.

References

?1 Coherently, the new Rule 53 requires tribunals to consider the involvement of a funder when deciding an application for security for costs

?2 The UNCITRAL proposals seem overall overly sceptical towards TPF. For instance, among the proposed approaches, there is the generalized prohibition of TPF aimed *inter alia* at eliminating the risk of an increased number of frivolous claims. However, this issue is at least overstated for the obvious reason that funders have zero interest in funding baseless claims

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