The Investment Treaty Arbitration Review

Fifth Edition

Editor
Barton Legum

The Law Reviews

THE INVESTMENT TREATY ARBITRATION REVIEW

FIFTH EDITION

Editor
Barton Legum

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PREFACE

This year's edition of *The Investment Treaty Arbitration Review* goes to press under particular circumstances. Measures to contain the covid-19 pandemic around the world have confined authors to quarters. Despite these constraints, the authors of this volume have delivered their chapters. The result is a new edition providing an up-to-date panorama of the field. This is no small feat given the constant flow of new awards, decisions and other developments over the past year.

Many useful treatises on investment treaty arbitration have been written. The relentless rate of change in the field rapidly leaves them out of date.

In this environment of constant change, *The Investment Treaty Arbitration Review* fulfils an essential function. Updated every year, it provides a current perspective on a quickly evolving topic. Organised by topic rather than by jurisdiction, it allows readers to access rapidly not only the most recent developments on a given subject, but also the debate that led to and the context behind those developments.

This fifth edition adds new topics to the *Review*, increasing its scope and utility to practitioners. It represents an important achievement in the field of investment treaty arbitration. I thank the contributors for their fine work in developing the content for this volume under the difficult conditions prevailing today.

Barton Legum
Dentons
Paris
May 2020

Part II

Admissibility and Procedural Issues

Chapter 11

EVOLUTION OF THE THIRD-PARTY FUNDER

Iain C McKenny[1]

This chapter first appeared in the previous edition of *The Investment Treaty Arbitration Review*. It set out to explore in investor–state dispute settlement (ISDS) the origins of that now ubiquitous feature of investment treaty arbitration – the third-party funder. Questions such as: where does it come from? how did it get here? and how did it spread so quickly? were posed and answers proposed. One year later, it is still a headache to some and a cure for others. This updated chapter seeks to bring new cases to light, address previous predictions and continue to examine the past and present to speculate on the future of third-party funding as it pertains to ISDS.

As with all good investigations that seek to identify what was to explain what has come to be, it is proposed that there are categories with specific characteristics of their age that reveal different stages of development. Each of these categories are designated ages specific to the evolution of the third-party funder, summarised in the following table:

Age	Time	Number of third-party funders	Available investment (US$)	Type	Expansion	Nature	Third-party funding terms*
Pre-industry	Pre-2005	<10**	<30 million†	Opportunity	Litigation	*Ad hoc*	+50%
Industry	2005–2010	<30***	>100 million	Industry	Commercial arbitration	Standardisation	30%
Post-industry	2010–2017	<40‡	>1 billion	Profession	Investment treaty arbitration	Risk pricing	30%–70%
Modern	2017 onwards	>60§	>10 billion¶	Specialist	Sector-specific	Merits-driven	1–2x +%

1 Iain C McKenny is a director at and co-founder of Profile Investment.

*	These are aggregated terms as funders typically use a combination of multiple investments or a percentage of damages return on investment, either in combination or whichever results in a greater return on investment.
**	Hillcrest Litigation Services Limited was established in Australia in 1993; IMF Bentham was publicly listed in the Australian stock exchange in 2001, but was established in 1994; Foris AG was established in Germany in 1996; and Litigation Lending Services was established in Australia in 1999. Harbour Litigation alludes to the origins of its business in 2002. It is estimated that there would have been fewer than 10 known litigation funders prior to 2005 operating globally, most of which would have been in Australia and Germany.
***	Of the 40 listed third-party funders on the Third Party Funding Observatory, around 20 appear to have been established between 2005 and 2010. Most growth coming from the United States and the United Kingdom. The list is likely incomplete and it is estimated that there was a three-fold increase in third-party funders between 2005 and 2010 in line with the increase in reported investment capital.
†	Between 2000 and 2005, IMF's trading volume increased from A$500,000 to nearly A$4 million (https://markets.ft.com/data/equities/tearsheet/summary?s=IMF:ASX). Extrapolating this type of growth to around 10 third-party funders and discounting for variants in performance, it seems likely that the equivalent of less than US$30 million was being invested in third-party funding per annum globally prior to 2005, and likely significantly less.
‡	An additional 20 third-party funders have been identified by the Third Party Funding Observatory after 2010. The list is likely incomplete but provides strong evidence of the continued surge in third-party funding in the United States, the United Kingdom and Germany.
§	With the opening of markets for third-party funding in the United Arab Emirates, Singapore, Hong Kong and mainland China, there is strong evidence from local and international law firms that the number of third-party funders is on the rise. It is likely that as each jurisdiction continues to define its relationship with third-party funding, there will be an increase not only in the number but the types of third-party funders and associated third-party funding services from insurers and brokers.
¶	'Lawsuit funders raise £10bn from yield-hungry investors' *Financial Times*, 13 Jan 2018. www.ft.com/content/926355de-c941-11e7-ab18-7a9fb7d6163e.

I THE PRE-INDUSTRY AGE

Third-party funding as a concept has existed for hundreds of years, and likely more. Despite what critics of third-party funding may say, it has its origins in access to justice. Jeremy Bentham wrote exhaustively on the topic of access to justice in the 1700s in the furtherance of ideas such as utilitarianism and distributive justice, and worked tirelessly for the repeal of champerty and maintenance laws in place since medieval times. The cost of access to justice has long been high in most legal jurisdictions, and without third-party funding good claims were often defeated by deep pockets. The fear that vulnerable people could be used as puppets in staged legal battles between wealthy land owners was not sufficient to deny access to justice for the majority of the population. It was inconsistent with what Bentham defined as the 'fundamental axiom' of his philosophy: the principle that 'it is the greatest happiness of the greatest number that is the measure of right and wrong'.

Since then, very slowly, champerty and maintenance laws or their equivalents in most legal jurisdictions have been diluted or repealed in whole or in part. However, this is, in short, the philosophical origins of access to justice and third-party funding, not third-party funders. Third-party funders with a specific mandate to invest in disputes are a relatively recent phenomenon. Research suggests that prior to 2005, there were few types of third-party funders with the dedicated purpose of investing in claims, let alone a third-party funding industry.[2] Although third-party funding as an investment opportunity existed, it was relatively low-profile and characterised by an infrequent *ad hoc* nature. There is debate as to whether it evolved in Australia (long considered the birth place of third-party funding in the common law world) or Germany as an offshoot from a highly developed form of legal insurance. There is little doubt that, during this pre-industry age, types of third-party funders existed in both these jurisdictions. However, the type of third-party funder unconnected with a claimant prior to the beginning of a dispute (i.e., not premium-based legal cost insurance) with the ability to allow for complete, or near complete, cost-risk transfer in exchange for sharing damages to advance a claim, the essence of the modern day third-party funder is likely to

2 See first table footnote.

have arisen in common law jurisdictions. Why? Cost. The cost of third-party funding in most common law jurisdictions, owing to the nature of their litigation proceedings, is generally higher than civil law jurisdictions. In common law jurisdictions, it was and is for many as the former Irish Judge Sir James Mathew has said, that 'justice is open to all, like the Ritz Hotel.'[3]

A third-party funder during this pre-industry age, from the early 1990s to the early 2000s, was unlikely to have many disputes specialist lawyers working for it let alone ISDS specialists. They would have likely been characterised by insurance and investment experience; it would have undoubtedly required a high appetite for risk. Financial markets at this time were running hot and cold. Surplus funds designated for high-risk investment turned to third-party funding as an uncorrelated asset class.[4] As a consequence, and from mostly anecdotal evidence, commercial terms ran high. Terms as high as 80 per cent of the damages have been seen and were likely common, embedded in questionably enforceable contracts.

In parallel to this development, the notion of beneficial ownership of proceeds and control was being revisited at the ISDS level as exemplified by *CSOB Bank v. Slovak Republic*, where the tribunal found that:

> *Absence of beneficial ownership by a claimant in a claim or the transfer of the economic risk in the outcome of a dispute should not and has not been deemed to affect the standing of a claimant in an ICSID proceeding, regardless whether the beneficial owner is a State Party or a private party.*[5]

The issue at stake in this dispute was nationality and control from financing parties. Such cases involving beneficial ownership of the proceeds of a claim and control set the scene for revisiting this issue with third-party funders at a subsequent stage.

II THE INDUSTRY AGE

In this period, the viability of third-party funding as not just an *ad hoc* investment opportunity but as an industry started to take shape. The evolution was not, of course, uniform; some jurisdictions advanced faster than others. In Europe, the United Kingdom was where many third-party funders began to most resemble modern day third-party funders. Third-party funding contracts were mostly imported and worked on from non-recourse financing practices, and a small body of law began to develop. However, from the decision in *Arkin v. Borchard Lines Ltd* (2005), a shift occurred in the United Kingdom. It is a decision that gave rise to what has since been interpreted as the principle that a funder could be held liable in adverse costs for a failed claim up to the amount that it invested into that claim: the '*Arkin* cap', which has more recently come under review from the 2017 decision in *Bailey v. GlaxoSmithkline UK Ltd*. For some, *Arkin* exposed a potential liability that would deter investors in third-party funding. For others, *Arkin* provided reassuring clarity. A known

3 https://www.jstor.org/stable/25746092?seq=1#page_scan_tab_contents.

4 http://arbitrationblog.kluwerarbitration.com/2017/02/02/third-party-funding-milan-event-offered-view-ahead.

5 *Ceskoslovenska obchodni banka, a.s. (CSOB) v. Slovak Republic*, ICSID Case No. ARB/97/4, Decision of the Tribunal on Objections to Jurisdiction (24 May 1999). More recently, in *David R. Aven and others v. Republic of Costa Rica*, ICSID Case No. UNCT/15/3, Final Award, 18 September 2018: In *CSOB v. Slovakia*, the Claimant assigned its interest in the investment following initiation of arbitral proceedings. The tribunal stated that jurisdiction is determined based on the state of the investment interest upon the date of the arbitration's commencement.

unknown became clearer, and from it contractual risk sharing mechanisms could be forged and business models engineered. *Arkin* provided the bedrock on which a new industry could be founded. It heralded the first paradigm shift of third-party funding from isolated investment opportunity to the creation of third-party funding as a viable business model that would give rise to the burgeoning industry that it is today.

During this time, third-party funding was still mostly concentrated on litigation but, as with all developing industries, satellite opportunities spiralled from it to create third-party funding brokers.[6] A satellite industry was formed by those who had worked on raising financing on an *ad hoc* basis for claims during the pre-industry age – those individuals with ability and foresight but who had neither the means nor arguably the appetite for third-party funding of disputes. Brokers accounted for the majority of third-party funding opportunities for the nascent third-party funder during the industry age. They paved the way through competition and legitimisation for not only a standardisation of terms but the expansion of third-party funding into commercial arbitration. As more funders came on to the market, the need for more investment opportunities expanded. In exchange for a tempering of industry terms to what is still often seen today – the greater of three times the investment or 30 per cent of the damages – brokers sought to increase the number of investment opportunities for these hungry third-party funders. International commercial arbitration was a natural choice. Rooted in practices not too dissimilar to what the third-party funding industry were used to, the leap was not one of faith but of logic.

The nature of international commercial arbitration is more private than either litigation or ISDS. The confidentiality of the proceedings and the privacy of the parties allowed third-party funders to revert to a more creative financial space. How a private party to private proceedings financed its dispute was not the purview of the tribunal in commercial arbitration. This allowed funders to focus more on creative financial solutions than legal issues in respect of access to justice and any form of associated liability for costs. As third-party funders were not considered party to the arbitration agreement, they were not exposed to the same liability as they might be during domestic litigation as with *Arkin* in the United Kingdom. Third-party funders during this time adopted vocabulary from the banking world and started to identify themselves more with providers of non-recourse financing and, accordingly, started adapting third-party funding models on that basis. This allowed them to focus on wealthier claimants rather than access to justice or impecunious claimants. They sought to infiltrate corporate culture by promoting the advantages of financial risk transfer to commercial entities that did not need investment but that may choose it if the advantages in doing so could be justified not in terms of access to justice but in terms of bottom-line profitability. This period gave rise to financing solutions such as portfolio financing: the notion that a financial facility can be put in place across a claimant's portfolio of disputes or indeed a facility for a law firm to be used across multiple disputes. Third-party funders explained the benefits of their financing to corporate clients as one in which a legal department could be converted from a cost centre into a profit centre, and notions of shifting the costs of a dispute off the balance sheet sought to win over chief financial officers. For many, this was a rebalancing of what third-party funders should be – a financial device, not a legal one. Disputes for funders could be seen as purely about compensation of loss without having to concern themselves with issues such

6 This is not to suggest that third-party funding brokers did not exist prior to this time but merely that by this time there were established third-party funders, and therefore brokers who catered for them.

as the dispensation of justice and the role funders play in either supporting, or in some jurisdictions running, claims. It was, like the commercial arbitration agreement, a private matter between commercial entities only.

This view of third-party funding as one chiefly about finance was born in the industry age as it pertains to international commercial arbitration and remains so today. It is perhaps best exemplified in the *Essar Oilfield Services limited v. Norscot Rig Management Pvt Limited* case (*Essar v. Norscot*).[7] This was an International Chamber of Commerce (ICC) arbitration seated in London where Sir Philip Otto, sitting as sole arbitrator, allowed the victorious party to claim its third-party funding costs (including the funders' uplift) from the losing party. The award was challenged on this basis but upheld by the High Court of Justice by J Waksman QC on the basis that recoverable costs were broadly enough defined under the ICC 2012 Rules and the 1996 Arbitration Act that the arbitrator was permitted to do so. There are multiple procedural issues that relate to *Essar v. Norscot*, but from the perspective of third-party funder responsibility, the case is significant for two main reasons: (1) it reinforces the view that third-party funding is purely a financial device and, under the right conditions, recoverable on success; and (2) it raises issues of transparency and the effect of the presence of a third-party funder on all the parties to a dispute. The latter is of particular importance as it pertains to the third-party funder of investment treaty disputes, which dramatically increased in the post-industry age.

III THE POST-INDUSTRY AGE

i Third-party funding and ISDS

The second paradigm shift in third-party funding occurred nearly 10 years after *Arkin* with the now infamous *Excalibur Ventures LLC v. Texas Keystone Inc and Ors*, which was revisited more recently by the court of appeal in 2016. In this seminal case, Lord Justice Clarke drew a clear line between professional and *ad hoc* third-party funders. Weighing the benefits of access to justice against the potential for profiteering, his judgment was reassuring to some and a stern warning to others. In addition to confirming the *Arkin* cap, Clarke LJ inferred that if a third-party funder undertook proper due diligence to meet the claimant and to undertake the requisite assessment of the merits of a claim, it may be treated differently to those third-party funders that had abdicated responsibility and sought to treat a claim purely as an investment opportunity. The latter could be subject to costs orders on an indemnity basis. It imparted a sense of responsibility on third-party funders to be accountable for their investments. For some, *Excalibur* would discourage further investment in third-party funding and for others, as with *Arkin*, it provided additional clarity.

As a result, third-party funders began to distinguish themselves by those that had invested in the requisite skills and abilities to assess the merits of a claim, and those that were derided as being akin to gamblers, or *ad hocs* in the parlance of the growing third-party funding industry. *Excalibur* was the catalyst for the second paradigm shift that gave rise to the self-proclaimed professional third-party funder. Distinguishing between *ad hoc* and professional third-party funders, however, was unclear. At best, it seemed to be a distinction based on how many lawyers the third-party funder recruited. But, the focus on bringing on

7 http://arbitrationblog.kluwerarbitration.com/2016/10/15/the-essar-v-norscot-case-a-final-argument-for-the-full-disclosure-wingers-of-tpf-in-international-arbitration.

more disputes lawyers and the professionalisation of the industry brought disputes lawyers with ISDS experience – another disputes market for third-party funders to expand into. During this age, third-party funders began more aggressively focusing on ISDS disputes.

Third-party funding of disputes did not start with ISDS but it has become the fastest growing dispute forum for third-party funders. The reasons for this are both qualitative and quantitative: ISDS is expensive (US$6.1 million per side in claimants' costs)[8] and long (an average of 3.86 years to obtain an award, and an additional one to two years for post-award processes and enforcement).[9] The ability to transfer the cost risk to a third party by sharing the upside in a potential award is obviously very attractive, but it was not obvious what the commercial terms of the funding agreement should be. ISDS was relatively untested at early stages of this post-industry age. As a result, what was typically seen in the industry was a reversion to pre-industry pricing revamped and referred to as risk pricing: this was merely a means by which a third-party funder could account for uncertainty by increasing profitability.

But the nature of ISDS disputes are qualitatively different to commercial arbitration. Where investors seek recourse for either the partial or wholesale destruction or expropriation without fair, prompt or adequate compensation of their investment, the loss suffered is often near complete. Third-party funding has its origins in access to justice for the impecunious, as explained above. When the wealthy ruling classes had such disproportionate influence that by their dealings they could destroy not just the transaction but the livelihood, the wealthy were practically above the rule of law, not least of which because of the high cost of access to justice. Investors and states have a similar inequality of arms inherent in the system (notwithstanding certain wealthy multinational companies), and as third-party funding was originally sought to balance the playing field in domestic litigation, it has readily been taken up by investor claimants in ISDS for the same reason.

Suddenly, at the ISDS level during this time, there were a plethora of task forces,[10] white papers,[11] practice directions[12] and salient cases[13] about or concerning third-party

8 In 2012, the OECD concluded that legal and arbitration costs for claimants and respondents in recent ISDS cases averaged in excess of US$8 million, having surveyed 143 ISDS awards (available as of August 2011). In 2013, UNCTAD reported that legal fees and tribunal expenses, on average, 'exceeded $8 million per party per case'. In 2014, an Allen & Overy study concluded that average party costs were US$4,437,000 for claimants and US$4,559,000 for respondents based on a review of 176 ISDS awards (available as of December 2012). In 2015, the European Commission suggested in a paper entitled 'ISDS: some facts and figures' that 'the average legal and arbitration costs for a claimant are around $8 million'.

9 *Procedural Issues in International Investment Arbitration*, J Commission and R Moloo, March 2018, appendix 9.

10 The ICCA-Queen Mary Task Force on Third-Party Funding is a joint task force established by ICCA and Queen Mary, University of London in 2013. https://www.arbitration-icca.org/media/10/40280243154551/icca_reports_4_tpf_final_for_print_5_april.pdf.

11 In Hong Kong, the Commission issued two reports after consultations, in October 2015 and October 2016, which culminated in proposed legislative amendments to Hong Kong's Arbitration Ordinance, as well as proposed amendments to associated regulations. In Singapore, the consultations carried out by the Ministry culminated in two proposed draft instruments: the Civil Law (Amendment) Bill 2016 and the Civil Law (Third Party Funding) Regulations 2016.

12 The author assisted in the drafting of the first practice direction developed by the Dubai International Financial Centre on third-party funding. https://www.difccourts.ae/2017/03/14/practice-direction-no-2-2017-third-party-funding-difc-courts/.

13 There are several examples of investor–state arbitration cases where third-party funders have been involved. Among the more high-profile is the Canadian mining company, Crystallex, which was awarded over

funders. For some, the issues relevant to domestic litigation where the nation state was involved in administering disputes pertaining to transparency and accountability became even more relevant when dealing with the nation state as a party to the dispute. From cases and developments, the dominant issues were those of provisional measures such as security for costs and confidentiality and transparency of the agreement with the third-party funder, as summarised below.

ii Security for costs

The ICSID Convention does not contain an express provision on security for costs and tribunals have tended to be reluctant on granting such orders.[14] This restrictive approach has been maintained in various ICSID proceedings where third-party funders were involved. For instance, the arbitral tribunal in *Commerce Group Corp and San Sebastian Gold Mines, Inc v. El Salvador*[15] maintained a restrictive approach to security for costs even when the proceedings were stayed while the applicants sought third-party funding. In the Order of the Committee Discontinuing the Proceeding and Decision on Costs, dated 28 August 2013, the tribunal ordered the claimants to pay the full administrative costs of the proceedings, but maintained its denial of security for costs.

The first known instance where an ISDS tribunal ordered security for costs where third-party funding was involved was the *RSM Production Corporation v. Saint Lucia* case, 13 August 2014,[16] in which the tribunal ordered the claimant to pay security for costs in the amount of US$750,000 in the form of an irrevocable bank guarantee. However, that the claimant had obtained third-party funding was only used as a supportive argument not withstanding the separate 'assent' by Gavin Griffith who saw the ruling as confirmation that there should be automatic or near automatic security for costs where third-party funders are involved in ISDS cases. In contrast, the tribunal's reasoning did not show any such contempt for third-party funders, as the main and decisive reason for ordering security for costs was the claimant's proven history of defaulting on costs orders.

There have been subsequent decisions since *RSM* that have retained the same position in terms of a third-party funder's involvement and an applicant's request for security for costs.[17]

US$1.38 billion in a claim against Venezuela in which Crystallex was supported by third-party funders. More recently, Eco Oro, having filed an ICSID arbitration under the Canada–Colombia Free Trade Agreement relating to the Angosutra gold and silver deposit in the country's Andean region, has the backing of third-party funders.

14 See *Libananco Holdings Co. Limited v. The Republic of Turkey*, Decision on Preliminary Issues, ICSID Case No. ARB-06-08, 23 June 2008.

15 *Commerce Group Corp. and San Sebastian Gold Mines, Inc. v. The Republic of El Salvador*, ICSID Case No. ARB/09/17 (Annulment Proceeding), Decision on El Salvador's Application for Security for Costs of 20 September 2012.

16 *RSM Production Corporation v. Saint Lucia*, ICSID Case No. ARB/12/10, Decision on Saint Lucia's Request for Security for Costs, 13 August 2013.

17 Other cases that have cited *RSM* in matters of security for costs and third-party funding: *Sergei Viktorovich Pugachev v. Russian Federation*, UNCITRAL, Interim Award, 17 July 2017; *Eskosol S.p.A. in liquidazione v. Italian Republic*, ICSID Case No. ARB/15/50, Procedural Order No. 3 (Decision on Respondent Request on Provisional Measures), 12 April 2017; *Interocean Oil Development Company and Interocean Oil Exploration Company v. Federal Republic of Nigeria*, ICSID Case No. ARB/13/20, Procedural Order No. 6 Decision on the Respondent Application for Provisional Measures, 1 February 2017; *Dawood Rawat v. Republic of Mauritius*, PCA Case No. 2016-20, Order Regarding Request for Interim Measures, 11 January 2017; *Lighthouse Corporation Pty Ltd and Lighthouse Corporation Ltd, IBC v.*

These early cases in the post industry age at the ISDS level as they relate to third-party funders suggest that tribunals are thus far inclined to maintain the status quo and to treat the advent of third-party funders in ISDS as nothing that would give rise to deviating from the long held view that security for costs applications should be allowed only in exceptional circumstances.[18] However, there is a growing number of cases that suggest that future tribunals are prepared to investigate third-party funding arrangements more closely.

iii Confidentiality

ICSID tribunals have held that the parties themselves are not under a general duty of confidentiality, absent agreement to the contrary.[19] In contrast, certain tribunals have highlighted the importance of limiting public discussion of the case to not disturb the proceedings.[20] However, as non-parties to the arbitration agreement, third-party funders are not bound by any confidentiality duties flowing from that agreement. This was notably the case during the *EuroGas Inc and Belmont Resources Inc v. The Slovak Republic* case in which the respondent's request for a confidentiality order against the claimants' funder was reportedly rejected by an ICSID tribunal. More recently, in the the *Estate of Julio Miguel Orlandini-Agreda and Compañía Minera Orlandini Ltda. v. Plurinational State of Bolivia*, PCA Case No. 2018-39, Amended Procedural Order No. 1, 27 March 2019:

> *Third Party Funding. The Parties shall submit a written notice disclosing the use of third party funding to cover the costs of this arbitration and the identity of the third party funder. Such notice*

Democratic Republic of Timor-Leste, ICSID Case No. ARB/15/2, Procedural Order No. 2 for Provisional Measures, 13 February 2016; *Lao Holdings N.V. v. Lao People's Democratic Republic II*, ICSID Case No. ARB(AF)/16/2, Procedural Order No. 6, 26 July 2018.

18 There have been two ISDS cases in 2020 that indicate that tribunals are prepared to consider awarding security for costs where there are multiple claimants: *Theodoros Adamakopoulos and others v. Republic of Cyprus*, ICSID Case No. ARB/15/49, Decision on Jurisdiction, 7 February 2020: 'Earlier the Tribunal indicated that if this case were to go forward consideration would have to be given to granting security for costs. The right of tribunals to grant security for costs has been widely recognized, and it has been included specifically in ICSID's proposed amendments to its Arbitration Rules. Its application, however, has been exceedingly limited. Generally, it is considered that security for costs should be awarded only in exceptional cases where a Respondent faces having to defend a claim against a claimant whose past actions or current financial position show that there is a real likelihood that it will not pay costs awarded against it. There is no evidence of this kind in respect of the Claimants. What the Respondent has demonstrated, however, is the difficulty of pursuing claims against claimants to recover costs, when the cost of doing so could well exceed the amount of the costs awarded. The Tribunal recognizes that this is a unique consequence of a mass claim and creates a burden that respondents in cases involving much smaller numbers of claimants do not face. Accordingly, the Tribunal considers that it would be a reasonable protection of the Respondent's interests to make an order for security of costs and condition the continuance of this case on the provision of that security' (paras 264–266).

19 See, for instance, in *Amco Asia Crop. & Others v. Republic of Indonesia*, ICSID Case No. ARB/81/1, Decision on Request for Provisional Measures of 9 December 1983: 'as to the "spirit of confidentiality" of the arbitral procedure, it is right to say that the Convention and the Rules do not prevent the parties from revealing their case'; and *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Procedural Order No. 3 of 29 September 2006 (paras. 114-121).

20 *The Loewen Group Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3, Decision on hearing of Respondent's objection to competence and jurisdiction of 5 January 2001.

shall be sent to the Tribunal once the third party funding agreement has been signed. Each Party bears the ongoing duty to disclose any change in the information . . . including termination or withdrawal of the funding agreement.

iv Conflicts of interest

Arbitral tribunals tend to set aside requests for disclosure of third-party funding agreements raised by respondents at the ISDS level. In *Guaracachi America, Inc and Rurelec PLC v. The Plurinational State of Bolivia* (2013), the tribunal decided not to order the production of the agreement or 'further documentation' because 'the applicable provisions governing conflicts of interest in the present proceedings do not foresee the production of document by the Parties but rather disclosure by the arbitrators upon becoming aware of circumstances that could create a conflict of interest'.[21]

Concerns for conflicts of interest where third-party funding is involved are usually raised by the non-funded party and often relate to potential funder–arbitrator relationships. This issue is closely related to confidentiality, disclosure and transparency. For instance, in *South American Silver Ltd (Bermudas) v. Plurinational State of Bolivia*[22] with respect to Bolivia's request to order South American Silver to disclose the identity of its third-party funder and to disclose the terms of the funding agreement, the claimant readily conceded on the former and the tribunal rejected the latter.[23]

During the *Muhammet Çap and Sehil Inşaat Endustri ve Ticaret Ltd Sti v. Turkmenistan* case,[24] on 23 June 2014, the tribunal issued its Procedural Order No. 2 recording its decision on the respondent's request of 11 April 2014 for disclosure of the third-party funding agreement. The tribunal ruled as follows:

21 *Guaracachi America, Inc. and Rurelec PLC v. The Plurinational State of Bolivia*, PCA Case No. 2011-17, Procedural Order No. 13 (21 February 2013).

22 *South American Silver Ltd (Bermudas) v. Plurinational State of Bolivia*, UNCITRAL, PCA Case No 2013-15, Procedural Order No. 10 (11 January 2016).

23 'The Tribunal considers that while the existence of a third-party funder may be an element to be taken into consideration in deciding on a measure as the one requested by Bolivia, this element alone may not lead to the adoption of the measure . . . the disclosure of the name of the funder, the Tribunal considers that, for purposes of transparency, and given the position of the Parties, it must accept Bolivia's request of disclosure of the name of SAS' funder. Finally, concerning the disclosure of the terms of the financing agreement entered into with the third-party funder, the Tribunal will reject such request. In the Tribunal's opinion, there is basis to order the disclosure of the name of the third-party funder, but not to order the disclosure of the agreement entered into with the third-party funder.' (paras. 75–84). More recently, in *Tennant Energy, LLC v. Government of Canada*, PCA Case No. 2018-54, Procedural Order No. 4, 27 February 2020 it was decided that 'The Tribunal considers that it has the authority to order the disclosure [of third party funding] if doing so would preserve the integrity of the arbitral proces'. Furthermore, the tribunal stipulated that 'Any such disclosures by the Claimant to the Tribunal and the Respondent . . . shall be designated "Confidential Information".' Furthermore, the tribunal stipulated that 'these disclosures need not be made available to the general public [and] the Tribunal's decision is based on the following factors. First, the existence of third-party funding agreements can be relevant to the Tribunal's assessment of applications for security for costs. The Tribunal notes that the Claimant has not denied that there is a third-party funder for its claims in this arbitration. It would have been easy for the Claimant to do so if there was no such funder. Secondly, and in any event, the Tribunal considers that transparency as to the existence of a third-party funder is important to determine whether any conflict of interest exists.'

24 *Muhammet Çap and Sehil Inşaat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan* (Decision on Respondent's Objection to Jurisdiction under Article VII(2) of the Turkey-Turkmenistan BIT).

> *It seems to the Tribunal that the following factors may be relevant to justify an order for disclosure, and also depending upon the circumstances of the case:*
>
> *a* *To avoid a conflict of interest for the arbitrator as a result of the third-party funder;*
>
> *b* *For transparency and to identify the true party to the case;*
>
> *c* *For the Tribunal to fairly decide how costs should be allocated at the end of any arbitration;*
>
> *d* *If there is an application for security for costs if requested; and*
>
> *e* *To ensure that confidential information which may come out during the arbitral proceedings is not disclosed to parties with ulterior motives.*

Applying these factors, the tribunal was not persuaded that there was any reason to make an order requiring the claimants to disclose how they were funding the arbitration, but the factors listed do open the door to future rulings where such a disclosure can be made, and specifically the tribunal held that 'this decision does not preclude the respondent from making a further request for disclosure at a later stage in this arbitration if it has additional information to justify the application.' Furthermore, at the time of writing, the draft ICSID rules in respect of third-party funding indicate that the fact of third-party funding and the identity of the third-party funder will have to be disclosed to allow arbitrators to clear conflicts.[25]

Taken as a whole, these cases and developments as they pertain to security for costs, confidentiality and conflicts of interest at the ISDS level are strong evidence that the role of third-party funders is unlikely to be relegated to that of mere financial services providers. Questions of transparency and legitimacy will continue to be probed, and, as a consequence, the type of third-party funder, how they conduct themselves, and from where and how they have raised their money are likely to be of greater relevance in the modern age.

IV THE MODERN AGE

When this chapter was first published it was hypothesised that we are currently in what appears to be the third paradigm shift of third-party funding – the modern age. In that chapter, it was postulated that there are two prevailing and competing models of 'professional' third-party funders: risk pricing versus merits-based models. The former dictates that most claims can be funded if the terms are right and adheres to the view that third-party funders are mere providers of bespoke financial products. By this logic, even *Excalibur* could have been funded providing the commercial terms of the investment were sufficiently high to justify the risk. The reason for this is that the risk pricing model considers awards and judgments only in terms of compensation of loss and thus there is nothing wrong in funding an unmeritorious claim if the potential for a windfall is possible. This is the same mentality that characterises many financial markets where higher risks equate to higher rewards.

In contrast, the merits-based model requires the funder to treat a judgment or award as more than just an investment opportunity and a commodity to be invested in. It dictates that an award is first and foremost a judicial instrument for the dispensation of justice. The compensation of loss is as a result of the dispensation of justice, and thus knowingly funding an unmeritorious case or not accepting responsibility to assess the merits can and arguably should expose the funder to a costs liability.

25 ICSID, Proposals for Amendment of the ICSID Rules — Working Paper, Vol. 3, ICSID Secretariat, 2 August 2018, p. 129, https://icsid.worldbank.org/en/Documents/III.Amendments_Vol_3_AR.pdf.

When this chapter was first published, we speculated that if the battle between these two competing models continues unchecked, it is likely that the risk pricing model will prevail. Since then, there have been some interesting developments including the recent Muddy Waters affair[26] that revealed a charge that Burford has made 60 per cent of its reported profits from just four cases[27] – what some might call a classic example of risk pricing. Furthermore, Vannin Capital abandoned its IPO aspirations and was taken over by one of its creditors, Fortress.[28] Both of these events have the potential to harm the attractiveness of third-party funding as an asset class. However, even more recently, covid-19 has become a global pandemic that has had a devastating effect on financial markets and thus correlated asset classes. It is not clear what the impact of these developments have been on the third-party funding market but for many potential investors third-party funding remains an attractive uncorrelated asset class and thereby an attractive investment especially during times of financial market instability. In addition to a new crop of would-be funders that have come to the market recently, there appears to be even greater interest in portfolio financing for third-party funding.[29] This is particularly important as it relates to merits-based models of funding and risk pricing because portfolio financing has the greatest potential to tip the scales in favour of risk pricing models. The reasons for this are clear – portfolio financing does not have to assess the merits of any one case but of a bundle of cases of a likely mixed composition in terms of merits. From a purely compensation of loss perspective, portfolio financing is attractive owing to the inherent risk diversification of investing in multiple cases in a portfolio. However, from a dispensation of justice perspective, the temptation for third-party funders could be to accept funding some cases of questionable merit but high reward because of an artificial financial connection within the same portfolio of cases of stronger merit. The implications for dispute forums that impact on public finances such as national litigation or ISDS is profound because portfolio financing opens the door to speculate more and assess less.

In the previous edition of this chapter it was suggested that this current paradigm shift, characterised by the battle between the risk pricing and merits-based models of third-party funding, is not devoid of indicators as to how it may develop. Consistent with the previous two paradigm shifts, in 2016 the UK Court of Appeal upheld Clarke LJ's judgment on *Excalibur* and, therefore, the merits-based model that encourages thorough due diligence prior to funding a claim, and ongoing and effective monitoring during the life of the dispute. Furthermore, in *Bailey v. GlaxoSmithKline UK Ltd* [2017] Justice Foskett effectively considered the nature of the funder involved and decided that the *Arkin* cap could be lifted if not doing so would lead to an injustice. These advancements in case law at the domestic litigation level in countries such as the United Kingdom are likely to help shape the development of the role of the third-party funder at the ISDS level because of the one common denominator – the nation state. Where public money is involved, whether by administering a dispute or participating in it, questions will be asked about whether third-party funders are adopting a risk pricing model that may well give rise to more and greater disputes of questionable merit

26 *Global Arbitration Review*, 'Burford fights back after hedge fund takes aim', 9 August 2019, https://globalarbitrationreview.com/article/1196194/burford-fights-back-after-hedge-fund-takes-aim.

27 ibid.

28 *Financial Times*, 'Vannin Capital sold to Fortress a year after abandoning IPO aspirations', 6 September 2019, www.ft.com/content/1288d980-d0ae-11e9-b018-ca4456540ea6.

29 Portfolio financing as it applies to third-party funding can be defined in many ways. For these purposes, portfolio financing is meant to describe a funding facility that provides financing for multiple disputes for a single claimant or for a law firm to run multiple disputes from a single facility.

in search of windfall returns regardless of the cost to the public, or whether funders will be compelled to adopt a merits-based model where funders scrutinise more and temper returns on investment. At the time of writing, the author is unaware of any significant developments in this respect but it may suffice to say that it may have significant implications for those third-party funders currently and strongly advocating for the benefits of portfolio funding.

In the first edition of this chapter, it was said that the differences between funders is greater today than their similarities. Third-party funders, irrespective of their origins, continue to evolve as their environment changes. There are now more funders that have opted to be publicly listed,[30] or have front offices regulated by financial authorities[31] and there appears to still be only one that has set up regulated asset management funding vehicles for the specific purpose of funding disputes.[32] However, as of writing, the vast majority of third-party funders appear to opt for a form of self-regulation with no oversight or transparency on conduct, how money is raised or from where.[33] Tribunals in ISDS and courts in national litigation cases are likely to be put under more pressure to probe further not only into who the third-party funder to a dispute is, but also how much control it is exerting over the dispute. So far, tribunals have mostly been reluctant to inspect the workings of the funding agreement. Instead, they tend to prefer to focus on who the funder is for the purpose of conflicts of interests with the tribunal. However, it is not inconceivable that at some point during the modern age, if third-party funding remains an unregulated activity, tribunals will more frequently seek to inspect funding agreements to determine whether the funder has subrogated any of the rights typically reserved for the claimant. In the absence of an ability to develop an equivalent to the *Arkin* cap principle, ISDS tribunals may more frequently render orders for provisional measures such as security for costs.[34] In the previous edition of this chapter it was speculated that as a counterbalance, such a development may lend greater weight to arguments that the costs of such security should be recoverable from the respondent if the claim ultimately prevails. In January 2020 of this year such an order was issued.[35]

The evolution of the third-party funder from litigation through commercial arbitration to ISDS has brought with it a desire for greater oversight and control of third-party funding. The question is what type of regulation – negative (responding to a problem) or positive (ensuring access to third-party funding) – will prevail? In the previous edition of this chapter

30 e.g., IMF Bentham, Burford Capital, Foris, LCM.

31 e.g., Augusta Ventures, Harbour Litigation Funding and, until the recent decision to cease trading, Calunius.

32 Profile Investment, https://globalarbitrationreview.com/article/1176253/a-new-fully-regulated-third-party-funder-opens-in-paris.

33 The Association of Litigaiton Funders is the most well-known example of a self-regulating body owned and controlled by the members it regulates.

34 In 2017, Burford Capital's role as funder of a pair of treaty claims against Pakistan worth US$640 million ended with the claimants being ordered to pay around £11 million in costs; Vannin Capital's role in financing a US$100 million DR-CAFTA claim against Costa Rica ended in a victory for the state and a US$1 million costs award against the claimant. At the time of writing, in *Italba Corporation v Oriental Republic of Uruguay* (ICSID Case No. ARB/16/9), the state prevailed leaving a cost awards against the claimant who was funded by IMF Bentham for US$5.9 million.

35 Dirk Herzig as Insolvency Administrator over the *Assets of Unionmatex Industrieanlagen GmbH v. Turkmenistan*, ICSID Case No. ARB/18/35, Decision on the Respondent Request for Security for Costs and the Claimant Request for Security for Claim, 27 January 2020. In this matter, the tribunal ordered that the claimant provide security for costs but also ordered that the costs associated with the security for costs are recoverable from the respondent if the claimant prevails.

it was submitted that the answer lies in the type of third-party funder and the third-party funding model that prevails between risk pricing or merits-driven models as it pertains to ISDS. We speculated earlier in this updated chapter that portfolio funding may be to the advantage of risk pricing models in this contest. However, there are early signs that an alternative merits driven model may yet prove to be a significant counterweight to portfolio financing and that is the rise of the law firm/funder hybrid. A law firm with a dedicated fund. A single new legal life form that can combine the cross disciplinary expertise of legal assessment with investor acumen around an asset class understood by both disciplines. For some jurisdictions, such an entity would not be allowed to exist owing to restrictions on a lawyers ability to have a vested interest in any one case. However, for jurisdictions where such restrictions are more relaxed, the law firm/funder hybrid could be an evolution of the merits-driven model.

Appendix 1

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Iain C McKenny is a director and co-founder of Profile Investment (PI), and heads its legal analysis division. Iain spent his formative years as a disputes lawyer with Freshfields Bruckhaus Deringer and subsequently Latham & Watkins in London and Paris. Prior to founding PI in 2018 with Alain Grec, he was general counsel of disputes and managing director at Vannin Capital. Iain specialises in international commercial and investment treaty arbitration across various sectors, including construction, technology, finance and general commercial.

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