Third-Party Financing in Investor-State Dispute Settlement: For Better or for Worse?

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ABSTRACT

The proliferation of international investments during the past few decades has contributed to the rise in the number of disputes that are submitted to Investor-State Dispute Settlement forums. Concomitantly, the criticisms of the conventional ISDS have also increased. Critics often refer to certain inherent flaws in the system *inter alia* the involvement of third-party financing for ISDS cases. With the growing costs and the significant interests involved in investment disputes, 'investment claims' themselves have emerged as a new class of assets that international actors pursue. In such circumstances, this study attempts to evaluate the existence of TPF for ISDS claims, and how that could contribute to or undermine the essence of ISDS, as an impartial dispute settlement mechanism which balances and accommodates diverse interests of the parties involved, namely, the largely commercial interests of the investors and the macro-economic, public and social interests of the host states. This study was conducted as a library-based study with relevant case law being analysed to comprehend the trend of TPF in ISDS cases. Evidently, TPF is not unwelcoming in its entirety. While it could *inter alia* provide financial support for meritorious claims which are otherwise unable to withstand the rising costs of ISDS which is positive, it could

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also have the negative effect of *inter alia* untenably increasing the number of ISDS cases by minimising the risk factor and possibly encouraging marginal claims. The paper concludes by recommending both the bilateral treaties and the international arbitration institutions should strive to achieve transparency in the matter of ISDS where TPF is involved.

1. INTRODUCTION AND BACKGROUND FOR THIRD-PARTY FUNDING IN ISDS

In the backdrop of proliferated numbers of International Investment Agreements (IIAs) concluded between the states and the private investors, the number of disputes submitted to Investor-State Dispute Settlement (ISDS) is also on the rise. With such extensive use of ISDS, its flaws are bound to come to light and attract rigorous scrutiny. For instance, ISDS in its current form is challenged based on a lack of regard for non-economic issues such as environmental and social impacts, public policy etc, lack of review of the decisions, lack of third-party intervention in the proceedings, inconsistent awards, rising costs, lack of transparency, issues pertaining to arbitrators and etc. *Inter alia,* third-party financing (TPF) is also one such criticism levelled at ISDS, which demands regulation. Scholars identify third-party financing to be a recently emerged phenomenon, where institutional investors offer financial support for legal claims in exchange for a share in the claim and a contingency in the potential recovery.[1]

It could be well argued that TPF may have been greatly influenced by the rising costs in investment disputes and the significant stakes inherent in international investments. As for the rising costs, the recent statistics on ISDS reveal that the average cost incurred by each party per case exceeds USD 8 Mn. These costs comprise a range of expenses, including legal fees, which generally account for around 82% of the total expenditure, along with tribunal expenses.[2] In the well-known *Abaclat*[3] case, the tribunal recognised that the claimants have invested around USD 27 Mn while Respondent state, Argentina has incurred an expenditure of around USD 12 Mn just as far as reaching the stage of an order on the jurisdictional issue. Therefore, the situation is self-explanatory as to why investment litigation would require third-party financial backing even if the third parties demand a contingency fee for the damage claimed. On the other hand, investments made internationally are substantial in nature and are expected to run longer despite the complexities involved due to their cross-border nature. Thus, the interests involved in international investment are such that investors operating on foreign soil would rather submit it to an impartial tribunal (although expensive) that could efficiently inquire into the matter and dispose of the rights of the parties.

Despite the compelling reasons to have TPF in the ISDS setting, its consequences are not always desired. For instance, it appears that TPF facilitates a third party to benefit from someone else's dispute. This becomes even more of a legitimacy issue since this third party is not contributing to the economic development which is a fundamental objective of international investment law. Moreover, TFP is also argued to have the effect of increasing the number of ISDS cases and questionably encouraging frivolous and spurious claims. These are a few of the many that will be later discussed in this paper.

In that background, this research aims to investigate the implications of TPF in ISDS and evaluate its benefits and shortcomings to determine the appropriate level of regulation for TPF in ISDS. The paper also seeks to assess the existing regulation

1 Steinitz, M., Whose claim is this anyway? Third party litigation funding, 95 Minn. L. Rev. 1268 (2011).

2 The OECD Secretariat survey of 143 available ISDS arbitration awards listed on the www.italaw.com, See also UNCTAD, Investor-State Disputes: Prevention and Alternatives to Arbitration (2010) at pp. 16-18

3 *Abaclat v. Republic of Argentina*, Decision on Jurisdiction and Admissibility, ICSID (4 August 2011)

on TPF within the ISDS framework, with the objective of suggesting potential improvements for its regulation.

2. DEFINITION AND SCOPE OF THIRD-PARTY FINANCING

Third-party financing, sometimes known as 'litigation finance' or 'litigation funding', involves a non-party sponsoring a disputant party in litigation.[4] The unanimity on this broad definition appears to be rather limited beyond this point. The diversity of lawsuit funding systems and the overlap of litigation finance with other practices contribute to this lack of consensus. There is disagreement over whether pro bono legal services and insurance, which also cover the cost of litigation, are third-party funding. Furthermore, there is no agreement on the ramifications of contingent or conditional fees, where lawyers act as both advocates and financiers. These three situations can be considered maintenance or champerty (as under the common law), legislatures, regulators, courts, and arbitral tribunals are unlikely to identify them as third-party funders.[5] Arguably, pro bono legal services and insurance are increasingly considered distinct entities with separate legislative and regulatory frameworks, although not expressly acknowledged. This lack of consensus can also be seen in connection with the approach taken by different institutions dealing with investment disputes (as discussed further below).

However much, third-party funding in ISDS has garnered attention recently, data and statistics directly related to the sector are limited because only a few investment treaties or arbitration procedures compel the disclosure of such, until very recently. Due to this lack of empirical data, TPF's role in ISDS's rising number of cases and higher damages claimed is still in the shadows.[6] Nevertheless, the experts argue that the rise in the claims inter alia is fuelled by in fact TPF. According to a prominent funding entity, it has been observed through interactions with claimants, practitioners, and other individuals frequently engaged in international arbitration that a majority of claimants participating in significant international arbitration cases either receive financial backing or have contemplated utilising funding at some point during the proceedings.[7] A study conducted by Globalex points out that a majority of cases where funding has been obtained involve developing countries that have vulnerable economies, or are newcomers to international investment regimes.[8] For instance, the list comprises mostly of cases initiated against Venezuela, Bolivia, Georgia, Turkmenistan, Turkey and Colombia. This demonstrates why TPF requires scrutiny and thereby necessary regulation in order to protect the vulnerable stakeholders within the international investment regime.

3. THE DESIRABILITY OF THIRD-PARTY FUNDING FOR INVESTOR-STATE DISPUTE SETTLEMENT

Since the use of TPF is on the rise, so have the debates and apprehensions surrounding the same. Thus, it becomes pertinent to adequately discuss such concerns with respect to both the legal and ethical aspects of such funding.

To begin with, critics contend that the use of TPF has the potential to increase the number of ISDS cases, as TPF reduces the perceived risk and financial burden involved with commencing a legal claim. The TPF mechanism offers claimants the chance to transform their unliquidated interests in claims into monetary worth, while simultaneously allowing them to transfer a portion or the entirety

4 Black's Law Dictionary, 2019, 262

5 Steinitz, M., n(1) 4

6 Xin Chen, S., Hough, K., Researching Third-Party Funding in Investor-State Dispute Settlement, 2019, https://www.nyulawglobal.org/globalex/Third-Party_Funding_Investor-State_Dispute_Settlement.html#_3._Analysis_of, accessed on 10th August 2023

7 Erusalimsky, A. et al, *Litigation Funding: Third-party Funding in International Arbitration,* Woodsford (3 Feb 2021).

8 Xin Chen, S., Hough, K., n(6)

of the risk associated with litigation to the funder. This phenomenon possesses an ability to engender biased decision-making favouring arbitration, resulting in a scenario wherein investors may opt to pursue claims that would have otherwise been unattainable or unfeasible without the presence of third-party funding. Previous studies have demonstrated that litigation finance is indeed associated with a rise in the number of legal proceedings commenced. Furthermore, in the long run, the presence of TPF ISDS procedures has the capacity to negatively impact investor retention and the formation of stable and sustainable investor-state collaborations. The possible existence of TPF has the capacity to hinder collaborative endeavours between the parties, as it may promote the withdrawal and prompt an early financial resolution. The potential consequences of this situation may have adverse effects on the overall viability and longevity of an investment endeavour in the future.

Although the aforementioned implications can exist within ISDS and even without TPF, TPF has the potential to increase such implications. This is mostly owing to TPF introducing additional stakeholders into ISDS, who are tempted by anticipated damages. These financiers may be less interested in non-monetary settlements that could focus more on the investment project's sustainability.

Critics also argue that TPF in ISDS could alter the entire direction of investment law to benefit funders and claimants. This is fuelled by the fear that TPF would boost meritless claims. However, it is unlikely that funders who are financially driven would be risking their 'investment' in a 'frivolous' claim. Arguably, the analysis shall focus on whether the TPF promotes marginal claims, which has the potential of broadening investment law in an unanticipated and possibly adverse manner. They may challenge governmental actions done in good faith to advance genuine public interest goals, ultimately resulting in a disregard for host state interests. TPF may negatively impact the government's ability to regulate investment for sustainable development. Thus, understanding how TPF may escalate overdeterrence threats is crucial. This involves determining if TPF increases ISDS cases by targeting specific states or claims. It is also important to determine if TPF increases beneficial results for the funders. Critics of TPF argue that lower-income countries with weaker rules of law increase the likelihood of successful arbitration procedures against them, compared to claims taken against higher-income and more developed states. Thus, this dynamic encourages funders to engage in selective investment in cases targeting lower-income countries, worsening their already vulnerable position in the ISDS system.

Resources and insider information improve claimant outcomes in ISDS. Thus, financial entities can aid claimants by directly providing information and skills by hiring competent and specialised legal firms. Funders might also sponsor conflicts to influence legal principles that benefit them. Portfolio funding allows funders to incorporate creative, high-risk cases with promising legal reform prospects (including those with an expected value below the threshold for individual support) with less risky claims. Thus, the existence of TPF may influence specific legal outcomes and shape the law in a way that broadens the scope for claims and host state liability beyond the direct stakeholders (not including third-party financiers) of investments.

A third-party financier sponsoring the litigation may also unduly advantage the claimant and investors in general at a broader level. A governmental action when challenged (even if the measure is not abandoned) having to settle it with the investors would increase its implementation and maintenance expenses. These higher expenses may deter the government from taking similar initiatives later on. In these

circumstances, a decrease in enthusiasm may pose significant challenges, as strong government regulations (for instance on extractive industry and infrastructure investments) are crucial for maximising benefits and minimising drawbacks for the host state.

While the above downsides are practical in nature, TPF could also raise legitimacy concerns with unanticipated parties benefiting from international investment law. Indisputably, funders are unconnected to the investment and do not contribute to any resulting economic growth. However, TPF makes them the ultimate beneficiary of the ISDS system, although not contributing to any substantial goal of the international investment regime. Thus, it is argued that this could worsen the perception and validity of this already controversial system.

On the contrary, TPF also brings in certain value additions. One such is that it makes the legal system more accessible. Arbitration is known for its high expenses, just as litigation. Yet, third-party funding allows claimants with strong and genuine cases to pursue legal claims that would otherwise be unaffordable. In its most extreme form, TPF should help financially disadvantaged investors, particularly the ones where their investments are wrongfully expropriated. Additionally, TPF would also assist small businesses with a valid claim to fight a long legal battle which could otherwise be prematurely and unfavourably settled.[9] The situation could be compared with the provision of 'legal aid' in a domestic setup, although the latter does not involve third-party funding per se. In the case of incapacitated and helpless parties, this will ensure access to justice. While it may be rare for states to be assisted by TPF, there is indeed a need, especially in the case of developing countries, to have support to maintain arbitral proceedings against private investors while safeguarding their economic interests. This way the legitimate concerns and rights of the states could be ensured and protected by affording them an opportunity to defend their legal position. Had this not been in place, the chances could be that the states may give into the demands of the investors (who are generally financially stronger than the host states and are also backed by the capital-exporting states) fearing for the exorbitant costs involved in the ISDS cases nowadays.[10] The case of ***Philip Morris v Uruguay***[11] demonstrates how TPF advances justice as claimed. Under its 'Campaign for Tobacco-Free Kids,' the Bloomberg Foundation helped Uruguay defend its pro bono tobacco plain packaging legislation in an investment arbitration dispute initiated by Philip Morris. This case is one of its kind since the funding was not motivated by profit and was provided merely for the maintenance of the case. It is also noteworthy that it was the respondent who received the funding and not the claimant. This illustrates that the availability of TPF itself is not detrimental to the investment regime and that its consequences depend upon the actions and intentions of the parties involved.

There is also a claim that a TPF has the motivation and ability to monitor the attorneys and law firms engaged in arbitration to minimise rising arbitration costs. Eliminating exclusive control attorneys may have will also increase efficiency.[12] In addition to improving arbitration efficiency, TPF has the effect of shifting the risk off the company's balance sheets, thereby being favourable for the

9 Steinitz, M., n(1) 7; Güven, B., Johnson, L., Third-Party Funding and the Objectives of Investment Treaties: Friends or Foes? 27 June 2019 https://www.iisd.org/itn/en/2019/06/27/third-party-funding-and-the-objectives-of-investment-treaties-friends-or-foes-brooke-guven-lise-johnson/ accessed on 01-08-2023

10 Chen, D. L. (2015). Can markets stimulate rights? On the alienability of legal claims *46*(1) *The RAND Journal of Economics* 23, 25, 33; See also Abrams, D. S., & Chen, D. L. (2012). A market for justice: A first empirical look at third-party litigation funding. 15 *University of Pennsylvania Journal on Business Law* 1075, 1078.

11 *Philip Morris Brand Sàrl (Switzerland), Philip Morris Products S.A. (Switzerland) and Abal Hermanos S.A. (Uruguay) v. Oriental Republic of Uruguay* (ICSID Case No. ARB/10/7)

12 Bogart, C. P., *Third-Party Financing of International Arbitration*, Global Arbitration Review, 14 Oct 2017.

company's accounts. It is also claimed that the funders could filter out frivolous and trivial claims. The American Bar Association's comments on WG III's Initial draft on TPF also confirmed that ISDS claims with funding are regularly the ones with a high success percentage.[13]

4. CURRENT REGULATORY FRAMEWORK

Although quite prevalent in ISDS set-up, many BITs are still silent on this practice of TFP. Without such, the institutions that deal with investment disputes are called on to regulate and standardise this practice. However, numerous institutions handling investment disputes appear to have chosen to wait and watch how this phenomenon unfolds rather than proactively regulate it. Others such International Chamber of Commerce (ICC), the Centre for Arbitration and Mediation of the Chamber of Commerce Brazil-Canada (CAM-CCBC), and the Hong Kong International Arbitration Centre (HKIAC) have third-party funding regulations. These regulations require parties to disclose TPF arrangements and the funders involved. Notably, the ICSID Arbitration Rules of 2022 also have similar provisions. This rule endeavours to assist in identifying potential conflicts of interest involved in the dispute. As another approach, certain institutions also regulate commercial and investment arbitrations separately. The China International Economic and Trade Arbitration Commission (CIETAC), Stockholm Chamber of Commerce (SCC), Singapore International Arbitration Centre (SIAC), Beijing Arbitration Commission (BAC), and the more recent VIAC Rules of Investment Arbitration and Mediation employ this method. Importantly, these regulations do not necessitate or imply the disclosure of the funding arrangement.[14] This, therefore, adds to the lack of consensus in terms of the approach taken with regard to TPF and its regulation.

According to the most recent ICSID Arbitration Rules 2022, Rule 14, it is mandatory for any party that has received third-party funding to provide a written notice during registration or promptly after entering into a third-party funding agreement. This notice should include the name and address of the funder. In the event that the third-party funder is a legal entity, it is necessary for the notice to disclose the identities of the individuals and entities that own, manage and supervise the said legal entity.

5. PROPOSED WAY FORWARD

As it could be deduced from the above analysis that TPF not only complicate ISDS and raises legitimate concerns but also brings about some benefits to the regime, it is advisable to identify and recognise the same. Needless to say, this recognition should also take a proactive regulatory approach rather than '*wait and watch'* and react to the negativities it could bring in later. The former is strongly recommended in the background of potential harm TPF could bring about (even without any empirical evidence) as it could only strengthen the wider legitimacy concerns raised against ISDS. Thus, the sensible way forward is to regulate TPF to minimise its inherent issues and to accommodate it to reap its benefits.

To that effect, it is suggested that the stakeholders arrive at a multilateral consensus as to what amounts to TPF and how it should be regulated. Plausibly, this will only be achievable if the larger arbitration-related institutions such as ICISD, ICC, UNCITRAL and other regional yet influential institutions such as SIAC, HKIAC etc. start adopting the same approach. The rules thereby should uniformly provide,

13 Dodge, K., Barnett, J., Macedo, L., Kulig, P., Gomez, M. V., Can third party funding find the right place in Investment Arbitration Rules, 31 January 2022 https://arbitrationblog.kluwerarbitration.com/2022/01/31/can-third-party-funding-find-the-right-place-in-investment-arbitration-rules/ accessed on 01-08-2023

14 ibid.

1. a definition of TPF.
2. The criteria for which entities can offer funding (as found in HKIAC and SIAC rules[15]).
3. the requirement for the parties to disclose the existence of a third-party financing arrangement and the parties involved in it (to maintain transparency and thereby avoid any conflict of interest)
4. that it should be disclosed at the earliest available opportunity.
5. The power of the arbitral tribunal to order the financing agreement be disclosed if it deems necessary.[16]
6. The power of the arbitral tribunal to treat the third-party financier as a party subject to the tribunal's jurisdiction for the purpose of issuing any adverse cost orders directly against the funder should if necessary (as in the case of Australia[17]).
7. Security of costs[18] (to discourage any impecunious or frivolous claims and to secure the cost of the proceedings from the initiation).

Moreover, the Bilateral and Multilateral Investment Treaties should also make provisions for at least defining TPF and promote the need for transparency in such matters. Thereby to deal with the matter expressly at the state level itself solidifying the disclosure duties of the parties involved in ISDS.

15 International Council for Commercial Arbitration (ICCA), Report Of the ICCA-Queen Mary Task Force On Third-Party Funding In International Arbitration: The ICCA Reports No. 4, April 2018 https://cdn.arbitration-icca.org/s3fs-public/document/media_document/Third-Party-Funding-Report%20.pdf accessed on 01-08-2023, 208

16 SIAC Investment Rules (2017), Article 24(l)

17 *Traderight Pty Ltd v. Bank of Queensland Ltd* [2010] NSWSC 1502

18 International Council for Commercial Arbitration (ICCA), n(15) 221

6. CONCLUSION

The aim of this paper was to study the implications of TPF involvement in ISDS matters and to recommend possible ways forward.

The study suggests that despite the negative implications there is a potential positive impact TPF has brought into the investment regime. It is however acknowledged that the negative implications cannot be merely disregarded due to the fact that they run to the very root of ISDS and the international investment objectives which could shake the validity of the entire system. Arguably, TPF has the potential to increase the number of ISDS cases although there may be a lack of any empirical evidence to support the same. This is raised in connection to its potential to encourage investors to bring claims that may be marginal as the financial risks involved are diminished and transferred to the funders. Questionably, it is also argued that it could motivate to initiate frivolous and spurious claims although however, a third-party funder is unlikely to invest in a case where there is no return on investment. More pertinently, it is argued that the increased motivation to initiate claims against states could have a deterrent effect on governmental action and could also have undue implications on the legitimate regulatory space of the states. On the contrary, TPF is legal aid for those small-scale entities that may have been wronged by oppressive state actions and also states who are defending themselves to upkeep their macro-economic, social and cultural objectives. The knowledge and resources available to funders could be a good check and balance for attorneys involved in disputes who could otherwise prolong the proceedings and increase the cost in the name of *due diligence*, as they command the control of the case.

It is, however, acknowledged that some of these drawbacks are not limited to TPF but inherent in ISDS itself. Nevertheless, it cannot be forgotten that TPF has a definite effect of fuelling the same.

In the circumstances, the paper suggests adopting the recommendations made in order to retain TPF but minimise the other drawbacks. It would also require a multilateral effort of the parties involved which could bring consistency to the system. This is in addition to the current rules aiming at disclosure and transparency, despite these provisions being quite limited. It is believed that this would effectively contribute to addressing the legitimacy crisis faced by ISDS, at least to a certain extent.

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