Third Party Funding in Investment Arbitration: Time to Change Double Standards Employed for Awarding Security for Costs?

Kluwer Arbitration Blog
July 29, 2018

Umika Sharma

Please refer to this post as: Umika Sharma, 'Third Party Funding in Investment Arbitration: Time to Change Double Standards Employed for Awarding Security for Costs?', Kluwer Arbitration Blog, July 29 2018,
http://arbitrationblog.kluwerarbitration.com/2018/07/29/third-party-funding-investment-arbitration-time-change-double-standards-employed-awarding-security-costs/

Introduction

Security for costs is a controversial territory in international arbitration, especially in investment arbitration. On one side is the respondent State which seeks security for defending a claim with the taxpayers' resources. However, on the other side, there is the claimant who might become financially incapable of accessing justice if it is asked to put up security for costs. Add a Third-Party Funder to the mix, and a tribunal's challenges get multiplied. Moreover, the unclear standards as to an award for the security of costs adds more layers to the considerations that any tribunal needs to keep in mind while making an award for security for costs.

It is possible that the existence of a TP Funder might be a red flag and has the potential to raise concerns as to the claimant's poor financial situation that might affect its ability to pay an award for costs. Also, the presence of a TP Funder might create an imbalance in the arbitration equation because of the possibility of an "arbitral hit and run". [fn]Nadia Darwazeh and Adrien Leleu, "Disclosure and Security for Costs or How to Address Imbalances Created by Third-Party Funding', Journal of International Arbitration" (2016) 33 (2) Kluwer Law International 125[/fn]

Higher Threshold for awarding of security for costs in the ICSID mechanism

ICSID tribunals tend to employ a higher threshold for awarding security for costs and rely on exceptional considerations, broadly including abuse of process or bad faith in addition to the impecuniosity of the claimant. It is possible to argue that the presence of TPF may be taken as the exceptional considerations that a tribunal requires to award security for costs. [fn]Report of ICCA-QM Task Force on Third-Party Funding in International Arbitration (2018) [/fn]

There has been only one case where the presence of TPF influenced the awarding of security for costs. [fn]*RSM Production Corporation v Saint Lucia* [2014] ICSID Case No. ARB/12/10[/fn] In the case, the claimant's conduct and the fact that the identity of the TP Funder was not revealed were essential issues that were noted. The Tribunal also doubted the unknown funder's willingness to comply with a cost award. The case was peculiar because the Tribunal, while holding the claimant liable for security

for costs, referred to the conduct of the claimant in two unrelated previous ICSID arbitrations, noting that the claimant had defaulted on a cost award [fn]*Rachel S. Grynberg, Stephen M. Grynberg, Miriam Z. Grynberg* and *RSM Production Corporation v Grenada* [2010] [/fn] and had also failed to pay an advance on costs. But there are cases where Tribunals have shown a tendency not to attach value to the presence of TPF. [fn]*South America Silver Limited v The Plurinational State of Bolivia,* [2016] PCA Case No. 2013-15[/fn]

The fact that Tribunals set up a high threshold for the award of security for costs can be easily attributable to its awareness in ensuring that the claimant's access to justice is not hampered. At the same time, the Tribunal also needs to consider that the respondent State needs protection against frivolous and unmeritorious claims and is likely to spend vast resources in defending the claim. It is particularly onerous for States that have limited resources that could be better employed elsewhere.

Why the standards for awarding security for costs need to be lowered down?

The first reason why there is a need to lower the standards is that it levels the playing field for the respondent. If tribunals readily award security for costs, the respondent gets a shield against a disbalanced situation where the claimant can go scot-free against an adverse costs award if it is funded by a TP Funder who has no liability to meet such costs.

Secondly, the respondent might also be protected from frivolous claims if the tribunal more readily awards security for costs. It is so because, if the claimant or its funder is asked to put up security for costs, the odds of a funder still supporting a worthless claim gets lowered down because once a financial liability is imposed, it is only prudent for an investor to support claims that are strong on merits.

Lastly, lower and set standards will also result in predictability. An impecunious claimant who has relied on TPF to bring a claim can now reasonably be expected to put up security for costs. It might also affect the terms with the TP Funder and might lead to the desired result of the funder being prepared to put up security for costs.

How can standards for awarding security of costs be lowered?

Clear principles for security for costs

Investment arbitral tribunals are still in the process of evolving set standards and principles for an award of security for costs. A move from the traditional 'pay your own way' to the 'costs follow the event' mindset is becoming common in investment arbitration. But there are no definite rules or principles that guide tribunals in deciding the question of awarding security for costs and often, a cautious approach is adopted and that too in exceptional circumstances. This approach might then turn into reluctance in a situation where a TP Funder is present.

To tackle unclear standards, it is possible to use tests that clarify the standards for awarding security for costs. Tribunals ought to attach value to the presence of TPF and order security for costs readily in such scenarios. A two-stage test can be developed that might be useful in shifting the burden of proof concerning awarding security for costs from the respondent to the claimant[fn]Nadia Darwazeh and Adrien Leleu, "Disclosure and Security for Costs or How to Address Imbalances Created by Third-Party Funding', Journal of International Arbitration" (2016) 33 (2) Kluwer Law International, 132[/fn] and ought to be taken as meeting the exceptional circumstances requirement. At the first stage, the tribunal should take into account the presence of TPF. It is largely dependent on the claimant's disclosure and could be the starting point for the tribunal. Secondly, the claimant's unwillingness or inability to satisfy an adverse costs award may be a relevant issue. Inability can be gauged through

‘appearance of mere insolvency’ or ‘lack of assets of the claimant’.[fn]Ibid, at 133[/fn] It is here that the tribunal should consider ordering security for costs. Further, the unwillingness of the claimant can be established through its previous conduct or through terms of the TPF arrangement which protect the funder from any adverse costs liability. Once both of these criteria are met, the burden of proof ought to be shifted to the claimant to prove as to why security for costs should not be awarded. The claimant can always discharge such a burden by disclosing its financial position to establish that it is willing and able to pay a security for costs award.[fn]Ibid, at 134[/fn]

Limited disclosure of third-party funding

A cautionary tale where the respondent was at the receiving end of a possible arbitral hit and run is the case of *S&T Oil v Romania*, ICSID case no. ARB/07/13 [2010]. In the case, the claimants had filed an expropriation claim against the respondent. The claim was filed after the backing of a TP Funder. Issues arose when the counsel for the claimant resigned after the TP Funder’s withdrawal. After another arrangement between the claimant and the funder, the case was revived. However, the TP Funder withdrew again, and consequently, the claimant was unable to pay advance on costs leading to discontinuation of the arbitration. The whole saga came to light because of the litigation between the claimant and the funder. The respondent was not aware of the claimant’s difficult financial position or the existence of TPF and thus never applied for security for costs. Such a case could have quickly turned into a scenario where the respondent State could not have been able to recover its costs because of the impecuniosity of the claimant.

Limited disclosure can be the way out of such a risky proposition. The disclosure of the existence of a TP Funder could be a pre-requisite for investment arbitration. The idea has recently been incorporated by the Singapore International Arbitration Centre in Rules 24(1) of its Investment Arbitration Rules. It provides that the tribunal has additional powers to order disclosure of third-party funding arrangements. Furthermore, it also provides for the tribunal to seek disclosure of the funder’s commitment towards adverse costs liability. A similar provision can be found in newer generation BITs like the Iran-Slovakia BIT [Article 21(6)] which expressly provides for the circumstances in which the tribunal may order security for costs if it considers that there is a reasonable doubt that claimant would be not capable of satisfying a costs award or consider it necessary because of other reasons. Such provisions are a move toward ensuring that the presence of a TP Funder does not unduly affect a party and its ability to seek security for costs. It is also essential to ensure that there are safeguards against respondents using disclosure of TPF as a weapon instead of a shield. For instance, it is unnecessary to seek disclosure of all the aspects of the TPF agreement. The liability as to the costs for the TP Funder should be the focal point for disclosure.

Therefore, the presence of a TP Funder has the possibility of creating disbalances in the arbitral process which tilts the scales against a respondent who faces the danger of being stuck with a worthless costs award. These disbalances need to be corrected by the Tribunal to ensure that the arbitral process remains fair through awarding security for costs.