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The Impacts of Legal Provisions on Third-Party Funders in International Investment Arbitration

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Abstract— *In this article, the authors analyse legal provisions concerning the third-party funder in international investment arbitration by applying third-party funding (TPF). A TPF arrangement entails financiers covering the legal expenses of an investment treaty claim against a sovereign state. In return, they receive a portion of any eventual award. The current international law provisions do not extensively regulate TPF, as it is a relatively new trend in international arbitration. However, numerous studies have highlighted the necessity of supplementing regulations in this area to avoid ambiguities or inconsistent application in different cases, especially funders. Specifically, the arguments in this article focus more on the rights and obligations of the funders rather than procedural aspects, providing a foundation for proposing solutions to address persistent issues in future international investment arbitrations involving TPF*.

Keywords— *Investment arbitration, third-party funding, third-party funder, legislation*.

I. Introduction

Investment arbitration has seen significant growth in recent years. The International Centre for Settlement of Investment Disputes (ICSID) Convention, introduced in 1966, has seen a dramatic increase in the number of cases, with 58 ICSID arbitration cases registered in 2020. [1] The effects of the pandemic are likely to catalyse interest in and use of third-party funding as companies adopt new strategies for liquidity and risk management. The European Court of Justice (ECJ) has worked to further reduce investment protection within the EU. The landmark ruling in Achmea, which ruled that arbitration clauses in intra-EU BITs were unconstitutional with EU law, has been expanded by the ECJ to include intra-EU ECT arbitration as well as ad hoc arbitration clauses. These are just a few of the current trends and challenges in international investment arbitration. As always, the landscape continues to evolve in response to global events and changes in the legal and business environments. [2]

However, there are several issues and challenges facing international investment law and ICSID arbitration. The implementation of TPF in international investment arbitration is indeed a complex and significant subject. The latest provisions in international law have sought to provide greater clarity on this issue, but there are still many aspects that require further elucidation. The provisions are not specific with respect to any aspect of TPF, which is characteristic of international law and also aims to respect the agreement between the parties. Regulations on third-party funders are especially crucial, and there is a lack of current legal provisions on TPF in international investment arbitrations, while activities of third-party funders to achieve benefits through TPF are increasingly popular and vibrant. Therefore, the authors present the legal provisions applicable to the funders along with an analysis and commentary on the issues existing within these provisions.

II. Methodology

The paper is carried out using various research methods, including:

Analysis and synthesis: by researching legislations and case studies on TPF in international investment arbitration, we arrange collected contents to create a complete, extensive reasoning system on the research topic.

Logical research: logic applies to the paper as a whole. We ensure that assumptions are stated, the terms used are defined and used consistently throughout, and contradictory statements are avoided. Accordingly, ideas are presented in a rational manner without rushing to conclusions.

Concepts

Provisions on allocation of cost

According to Article 52 of the ICSID Arbitration Rules:

"(1) In allocating the costs of the proceeding, the Tribunal shall consider all relevant circumstances, including:
(a) the outcome of the proceeding or any part of it;
(b) the conduct of the parties during the proceeding, including the extent to which they acted in an expeditious and cost-effective manner and complied with these Rules and the orders and decisions of the Tribunal;
(c) the complexity of the issues; and
(d) the reasonableness of the costs claimed.
(2) If the Tribunal renders an Award pursuant to Rule 41(3), it shall award the prevailing party its reasonable costs unless the Tribunal determines that there are special circumstances justifying a different allocation of costs.
(3) The Tribunal may make an interim decision on costs at any time, on its own initiative or upon a party's request.
(4) The Tribunal shall ensure that all decisions on costs are reasoned and form part of the Award."

Even though it is stipulated that all decisions on costs must be reasonable, there are still some points that need to be clarified. *First*, the arbitrator has the right to decide on the allocation of costs to the parties. Still, there is no provision indicating that the arbitrator has the right to directly intervene in the third-party funder's funding. In the case of a cost shift, it is difficult to determine whether the third-party funder has to bear a portion of the costs for the winning state in the case of their claimant losing. *Second*, if there is already an agreement

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between the funder and the claimant on the issue of costs (such as paying all or part of the litigation costs), is this a factor to consider when the respondent state tries to persuade the Tribunal to decide on costs disadvantageous to the funded party during the proceedings? *Third*, if the funder bears all the litigation costs according to the agreement with the claimant, then if the claimant wins, does the losing state pay part of the costs that the claimant has paid to the third-party funder? These questions, so far, do not have an exact answer, as international legal documents have not yet regulated this issue.

In addition, the issue of cost shifting is a specific issue that needs to be noted.

Provisions on cost-shifting rules

The costs of conducting arbitration are reportedly high and may even amount to 60 per cent of the total cost of the case. [3] These include institutional administrative fees and charges, arbitrators' fees and expenses, and parties' costs. [4]

An important question to consider is who bears these costs. In European commercial arbitration, these costs are usually paid by the losing party, often referred to as the "English Rule". However, in practice, there is also the German rule where the winning party's costs are transferred to the losing party according to a fixed rate or a percentage corresponding to the compensation request. Conversely, in the United States, commercial arbitration cases tend to divide costs according to the American Rule that all parties must bear their costs, even if the parties have other agreements. This is also applied in international public law cases. Thus, these are three common cost-shifting models, and they carry different purposes and meanings. However, cost rulings in commercial arbitration are considered arbitrary and inconsistent. [5]

English and American rules are used interchangeably in international investment arbitration, with neither standing out. An arbitral award under the UNCITRAL arbitration rules made some considerations[1]. In this way, cost shifting operates in both ways, and this leads to unpredictability if the English rule is applied, as it is very difficult for the funder if costs are shifted from the winning party to the losing party (in the case where the respondent state wins). Moreover, as stipulated in Article 52(3) of the ICSID Arbitration Rules, the arbitration panel has the autonomy to decide the timing and level of cost shifting.

Provisions on funders' purpose determination

Many definitions refer to TPF as *"[...] finance part or all of the cost [...] in return for a remuneration [...]"*. [6] It shows that profit is a significant purpose of funders when funding a claim. Such as, according to Art. 8.1, Section A, Chapter 8 (Investment) of the Canada-European Union Comprehensive Economic and Trade Agreement (CETA), *"any funding provided by a natural or legal person who is not a party to the dispute but who enters into an agreement with a disputing party in order to finance part or all of the cost of the proceedings either through a donation or grant or in return for remuneration dependent on the outcome of the dispute"* is defined as TPF.

Furthermore, TPF is defined as *"any funding provided by a natural or legal person who is not a party to the dispute but who enters into an agreement with a disputing party in order to finance part or all of the cost of the proceedings in return for a remuneration dependent on the outcome of the dispute or in the form of a donation or grant"* under Art. 1.2, Section 3, Chapter II (Investment) of the Transatlantic Trade and Investment Partnership (TTIP).

It is clear that the approaches taken to implement financing differ between the two criteria mentioned above. TIPP restricts *"donation or grant*" to be used only for *"proceedings in return for a remuneration,"* but CETA specifies *"donation or grant, or in return for remuneration"* as three separate activities. Additionally, CETA's use of the term *"enters into an agreement to provide funding"* aims to include situations in which the donor has not yet given the disputed party the funding. Moreover, one limitation of these approaches is their primary emphasis on the financial outcome of the case, typically assuming the funded party to be the Claimant. It is essential to recognise that funders may not only invest in the claims of the party bringing the dispute but may also opt to finance the respondent's side of the conflict.

TPF benefits funders since when any of the monetary awards comes out, they receive a share of it. Scholars even came up with the theory that financialisation may benefit some industries. [7] According to an interview made by Florence Dafe and Zoe Williams, a case in an investment treaty claim can be remarkably larger than one in litigation in the UK, which was noted that "a $100 million case is pretty standard in a treaty. If you look at a $100 million case in English litigation, it would be two per year". [8] These awards are also easily enforced in foreign jurisdictions. [9] Also, funders do not need to wait until the end of the case to profit from their investment because they can sell their entitlement on a secondary market, which can create instant cash for their further investment. [10]

On the other hand, it plays a crucial role to admit that the practice showed several other reasons why funding is extremely attractive to funders. Access to justice is another purpose. TPF is a useful tool to facilitate access to justice and improve security for costs. [11] Funders also use this reasoning when being asked for their purposes in many interviews. They argue that funding provides impecunious claimants, who could not afford on their own, better access to justice as arbitration is "notoriously expensive". According to the OECD, legal fees constitute 82% of the total costs of an average case, while arbitrator fees average 16%, and institutional fees make up the remaining. [12] When legal battles are often pretty long, and there is also a chance of a force "to settle early at a steep discount of the true value of its claim," even if the claim is

[1] *"It is also debated whether "the loser pays" (or "costs follow the event") rule should be applied in international investment arbitration. It is indeed true that in many cases, notwithstanding the fact that the investor is not the prevailing party, the investor is not condemned to pay the costs of the government. The Tribunal fails to grasp the rationale of this view, except in the case of an investor with limited financial resources where considerations of access to justice may play a role. Barring that, it appears to the Tribunal that the same rules should apply to international investment arbitration as apply in other international arbitration proceedings."* (see: *International Thunderbird Gaming Corporation v The United Mexican States* (NAFTA award January 26, 2006), at 214.)

highly meritorious, it may still lack the necessary capital to endure. [13]

In other scenarios, funders decide to make a fund for a somewhat different purpose. For example, a business has conflicts with a state, which could be on any aspect they feel hinders their benefits. Meanwhile, this business realises an international investment arbitration with a similar situation taking place between that state and an investor. This business decides to fund that investor during the arbitration process with the vision that:

(i) Setting a precedent: If the investor wins the case, it could set a legal precedent that the business could use in its dispute with the state,
(ii) Influencing state policy: The state might change its policy in response to the arbitration outcome, which could be in favour of the business;
(iii) Undermining state prestige: Repeated funding of investors suing the state could potentially damage the state's reputation.

This is a scenario where a business uses TPF in international investment arbitration to indirectly influence state policy and potentially gain an advantage in its conflict with the state.

However, it's important to note that such actions could also have negative consequences. They could escalate conflicts, lead to legal repercussions, and potentially harm the business's relationship with the state and its standing in the international community. It's a strategy that involves significant risks and should be considered carefully. The regulation of TPF typically does not differentiate based on the funder's purpose.

Provisions on third-party funder's benefit optimisation

Third-party funders can benefit from funding in several ways:

(i) Risk Management: Funders can diversify their risk by funding multiple cases, which spreads their risk evenly across their investment portfolio, meaning the impact of a single "bad" result is minimised on the funder's overall profit. They can also establish a litigation strategy to help them manage risk. However, the financial risk of litigation is transferred to the funder in cases of TPF, meaning that if the case is unsuccessful, the funder bears the loss. [14]
(ii) Validation: Third-party funders have the right to choose whether or not to fund a claim. For instance, they will only be engrossed in good claims which they think will be successful. [15]
(iii) Return on Investment: When a claim that has received TPF is successful, the funder gets back the money they spent, along with an additional amount based on their investment. This extra amount, often a percentage of the total award or settlement, is predetermined in the funding agreement. Each agreement can have different terms so the specifics can vary. Third-party funders mainly profit from their activities through this return on investment. The uplift is remarkably high, as it can vary up to 500%. [16]
(iv) Non-recourse Finance: The distinctive characteristic of TPF is its non-recourse nature. If the claimant is victorious, the funder recoups their investment and a portion of the award. However, if the claimant is unsuccessful or unable to recover from the opposing party, the funder will be unable to recoup their investment. This is a risk that funders willingly take on in these arrangements. It's a unique aspect of TPF that differentiates it from other types of financial arrangements. [17]

However, it's important to note that TPF also has associated risks. For instance, a third-party funder of an unsuccessful litigant may be liable to contribute towards the other side's costs, though currently, such contribution is limited to the amount of funding provided. Also, TPF arrangements may result in undisclosed conflicts of interest. Therefore, a party seeking funding must undertake due diligence on its funder.

The ICSID Arbitration Rules, as well as the ICC Arbitration Rules, do not directly stipulate how to optimise the profit of funders in TPF. The rules mainly focus on disclosing such funding arrangements to avoid potential conflicts of interest. Aside from that, the funder's profit or return on investment is typically agreed upon in the funding agreement between the funder and the funded party. The rules do not regulate the terms of the funding agreement, including provisions related to the funder's profit. Therefore, the optimisation of profit would largely depend on the terms of the TPF agreement.

Provisions on for-profit funder and non-profit funder

Both for-profit and non-profit funders exist in the realm of TPF.

For-profit third-party funders are commercial entities that offer financial support to parties (typically plaintiffs) engaged in legal disputes. In return, they receive a share of the case's proceeds if successful. Their primary objective is to gain a return on their investment. [18]

Conversely, non-profit third-party funders accumulate funds and generate financial surpluses to invest in social, environmental, or cultural goals. They often collaborate with or work alongside government agencies and may receive government funding or commissions. [19] Third-party fundraising is an effective method for non-profit organisations to raise additional funds. This occurs when an individual outside of the organisation who is passionate about the organisation's mission organises a fundraiser on behalf of the organisation and donates all the proceeds to the organisation. [20]

It is crucial to remember that both for-profit and non-profit third-party funders are subject to regulations and must adhere to certain legal requirements. Nonetheless, the regulations for for-profit and non-profit third-party funders do differ. For instance, in England, a non-profit organisation is smaller; it is not mandatory to register with a regulatory body. Yet, most non-profit organisations must register with the Charity Commission if they report an income over £5,000 annually. Even if Charitable Incorporated Organizations (CIOs) earn less than £5,000 annually, they must register. [21] Entities that are for-profit, like unincorporated associations, can generate profit if they initiate trading or have other sources of income, such as from investments. In such cases, they must pay Corporation Tax and submit a Company Tax Return, similar to a limited company. [22] These regulations retain their legal effects when applied to TPF. In general, the differences in regulations for these two types of funders in different legal systems are basically as follows:

(i) *Taxation:* Taxes apply to for-profit entities based on their profits and business activities, per federal and state laws. [23] Non-profits, however, are typically exempt from certain taxes.
(ii) *Use of profit:* Profits in for-profit entities can be shared among owners or shareholders. In contrast, non-profits must use extra funds or profits to advance their mission. [24]
(iii) *Regulatory Oversight:* Non-profits often face more regulatory scrutiny, including adhering to charitable solicitations and fundraising laws. [25] For-profits are mainly regulated through business and trade laws.
(iv) *Disclosure Requirements*: Both types of funders may need to disclose their funding arrangements, but the specifics can vary based on the jurisdiction and the nature of the case.

Fundraising Activities: Non-profit funders engaged in fundraising must comply with state-specific charitable solicitation laws and registration requirements. Failure to comply can risk their non-profit status. [26]

III. Conclusion

In conclusion, this paper has already analysed provisions on subjects in international investment arbitration that applied the TPF mechanism. In this way, the chapter first contributed to evaluating the provisions impacting the investing activities of third-party funders, such as allocation of costs, cost-shifting rules, purpose determination, benefit optimisation, and for-profit and non-profit funders. Currently, provisions directly regulating investment activities of third-party funders do not appear in the international investment arbitration because of the novelty of this mechanism, the diversity of investments and the respect for the freedom to enter into contracts in civil law relations. Nevertheless, third-party funders may follow these provisions mentioned in the chapter to ensure their investments engage their final purposes.

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Competing Interests
The authors declare that there is no conflict of interest regarding the publication of this article.

Ethics
No sensitive or personal data was collected or used in the research associated with this paper.

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