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THE EVOLVING LANDSCAPE OF SECURITY FOR COSTS IN INTERNATIONAL ARBITRATION: IMPLICATIONS OF THIRD-PARTY FUNDING

AUTHORED BY - GOVIND RAJ SUTHAR

+ Introduction

International arbitration serves as a vital mechanism for resolving cross-border disputes, especially in the realms of commercial and investment disputes. A notable evolution within this landscape is the rise of third-party funding (TPF). This funding model involves entities that are not party to the arbitration providing financial support to a disputing party, typically in exchange for a share of the proceeds from a favorable award. While TPF has democratized access to justice by enabling financially constrained parties to pursue legitimate claims, it has also introduced complexities, particularly concerning security for costs. This paper explores the interplay between TPF and security for costs, examining legal provisions, tribunal practices, and the underlying principles guiding such decisions.

+ Definition and Purpose of Third-Party Funding

Third-party funding in arbitration refers to the financial support provided by an external entity to a party involved in arbitration. This funding covers legal fees, arbitration costs, and potentially adverse costs if the funded party loses the case. The funder, in return, receives an agreed portion of the arbitral award or settlement. This arrangement aims to balance the scales of justice by allowing parties with valid claims but limited financial resources to pursue arbitration.

+ Security for Costs: Concept and Legal Framework

Security for costs is an interim measure in arbitration that requires a party to provide a financial guarantee to cover the opposing party's legal costs should they be unsuccessful. The intent is to protect respondents from the risk of non-recovery of costs if the claimant is unable to pay. In the context of TPF, security for costs orders is particularly pertinent, as they address concerns about the claimant's financial standing and the risk of funder insolvency or non-liability for adverse costs.

✚ International Legal Regimes

Several legal regimes address the issue of security for costs, including:

1. *ICSID Convention (Article 47)*: Provides tribunals with the authority to recommend provisional measures, including security for costs, to preserve parties' rights.

The rule reads: - Except as the parties otherwise agree, the Tribunal may recommend any provisional measures that may be necessary to preserve the parties' rights during the proceeding (Article 47 of the ICSID Convention, Arbitration Rule 39). A party may seek provisional measures at any time after proceedings have been instituted.

2. *UNCITRAL Rules (Article 26(2) (c))*: Allows tribunals to order interim measures to preserve assets for satisfying future awards.\

The rule reads:- An interim measure is any temporary measure by which, at any time prior to the issuance of the award by which the dispute is finally decided, the arbitral tribunal orders a party, for example and without limitation, to:

(c) Provide a means of preserving assets out of which a subsequent award may be satisfied;

3. *SCC Rules (Article 38)*: Explicitly empowers tribunals to order security for costs in exceptional circumstances, considering factors such as the prospects of success and the funded party's ability to comply with an adverse costs award.

✚ Disclosure of Funding

The transparency of TPF arrangements is critical for the integrity of the arbitration process. Various arbitration rules have incorporated provisions for the disclosure of third-party funding:

1. *Singapore International Arbitration Centre (SIAC) Rules*: Grant tribunals the authority to order disclosure of the existence and details of TPF arrangements (Rule 24(1)).
2. *ICC Rules*: Include provisions for the disclosure of funding arrangements, reflecting revisions made in 2021 (Article 11(7)).

The rule reads: – In order to assist prospective arbitrators and arbitrators in complying with their duties under Articles 11(2) and 11(3), each party must promptly inform the Secretariat, the arbitral tribunal and the other parties, of the existence and identity of any non-party which has entered into an arrangement for the funding of claims or defences and under which it has an economic interest in the outcome of the arbitration.

3. *ICSID Rules*: Mandate parties to disclose any third-party funder involved in funding the arbitration (Arbitration Rule 14(1)).

The rule reads:-

Notice of Third-Party Funding

- (1) A party shall file a written notice disclosing the name and address of any non-party from which the party, directly or indirectly, has received funds for the pursuit or defense of the proceeding through a donation or grant, or in return for remuneration dependent on the outcome of the proceeding ("third-party funding"). If the non-party providing funding is a juridical person, the notice shall include the names of the persons and entities that own and control that juridical person.
- (2) A party shall file the notice referred to in paragraph (1) with the Secretary-General upon registration of the Request for arbitration, or immediately upon concluding a third-party funding arrangement after registration. The party shall immediately notify the Secretary-General of any changes to the information in the notice.
- (3) The Secretary-General shall transmit the notice of third-party funding and any notification of changes to the information in such notice to the parties and to any arbitrator proposed for appointment or appointed in a proceeding for purposes of completing the arbitrator declaration required by Rule 19(3) (b).
- (4) The Tribunal may order disclosure of further information regarding the funding agreement and the non-party providing funding pursuant to Rule 36(3)

Tribunal Practices and Case Law

❖ Factors Influencing Security for Costs Decisions

Tribunals consider several factors when deciding on security for costs, including:

1. *Prospects of Success*: Evaluating the merits of claims and defenses.
2. *Financial Stability*: Assessing the claimant's ability to pay an adverse costs award.
3. *Exceptional Circumstances*: Identifying special conditions such as the claimant's history of non-payment or improper conduct.

❖ Key Cases

➤ *RSM v. Saint Lucia*

- I. Facts: RSM Production Corporation initiated arbitration against Saint Lucia, seeking damages for alleged breaches of contract and investment treaty obligations. Saint Lucia requested security for costs, arguing that RSM had a history of non-payment and was funded by a third party.

- II. Arguments: Saint Lucia contended that RSM's financial instability and the presence of a third-party funder justified security for costs. RSM argued that security for costs would impede access to justice.
- III. Decision: The tribunal granted the request for security for costs, highlighting RSM's past conduct and the exceptional circumstances of the case.
- IV. Reasoning: The tribunal emphasized that RSM's failure to pay previous costs awards and the risk posed by third-party funding warranted protective measures for Saint Lucia.

➤ ***Garcia Armas v. Venezuela***

- I. Facts: The claimants, Spanish investors, filed a claim against Venezuela under the Spain-Venezuela BIT. Venezuela sought security for costs, citing the claimants' insolvency and third-party funding.
- II. Arguments: Venezuela argued that the claimants' financial difficulties and the lack of coverage for adverse costs in the funding agreement necessitated security for costs. The claimants countered that their financial situation was a result of Venezuela's actions.
- III. Decision: The tribunal granted Venezuela's request, ordering the claimants to provide security for costs.
- IV. Reasoning: The tribunal found that the claimants' insolvency and the structure of the third-party funding arrangement created significant risks, justifying the imposition of security for costs.

➤ ***Herzig v. Turkmenistan***

- I. Facts: Investor Herzig brought a claim against Turkmenistan under the Germany-Turkmenistan BIT. Turkmenistan requested security for costs, highlighting Herzig's financial instability and third-party funding.
- II. Arguments: Turkmenistan argued that the claimant's financial instability and the lack of coverage for adverse costs warranted security for costs. Herzig maintained that TPF alone did not justify such an order.
- III. Decision: The tribunal denied the request for security for costs.
- IV. Reasoning: The tribunal concluded that neither the presence of TPF nor the claimant's financial difficulties alone constituted exceptional circumstances sufficient to order security for costs.

❖ Notable Denials

➤ *Eskosol v. Italy*

- I. Facts: Eskosol, an Italian solar energy company, brought a claim against Italy under the Energy Charter Treaty. Italy requested security for costs, arguing that Eskosol was insolvent and funded by a third party.
- II. Arguments: Italy contended that Eskosol's insolvency and the involvement of TPF warranted security for costs. Eskosol argued that its financial difficulties were due to Italy's wrongful actions.
- III. Decision: The tribunal denied Italy's request for security for costs
- IV. Reasoning: The tribunal found that Eskosol's financial instability resulted from Italy's alleged misconduct, and imposing security for costs would unjustly hinder Eskosol's access to justice.

➤ *Tennant Energy v. Canada*

- I. Facts: Tennant Energy, a U.S. renewable energy company, filed a claim against Canada under NAFTA. Canada requested security for costs, citing Tennant Energy's financial instability and TPF.
- II. Arguments: Canada argued that Tennant Energy's financial instability and third-party funding necessitated security for costs. Tennant Energy countered that such an order would impede access to justice.
- III. Decision: The tribunal denied Canada's request for security for costs.
- IV. Reasoning: The tribunal emphasized the access to justice issues posed by security for costs orders, particularly in cases involving TPF.

➤ *Hope Services LLC v. Republic of Cameroon*

- I. Facts: Hope Services LLC, a U.S. company, brought a claim against Cameroon under the U.S.-Cameroon BIT. Cameroon requested security for costs, citing Hope Services' financial instability and TPF.
- II. Arguments: Cameroon argued that Hope Services' financial instability and the presence of TPF warranted security for costs. Hope Services maintained that TPF alone did not justify such an order.
- III. Decision: The tribunal denied the request for security for costs.
- IV. Reasoning: The tribunal found that the high threshold for security for costs orders was not met, as neither TPF nor financial instability alone constituted exceptional circumstances.

Theoretical and Practical Implications

❖ Access to Justice

A core argument against security for costs in the context of TPF is its potential to restrict access to justice. Requiring security may disproportionately impact claimants whose financial distress results from the respondent's alleged misconduct.

❖ Balancing Interests

Tribunals must balance the claimant's right to pursue arbitration with the respondent's interest in securing potential costs. This involves assessing the comparative harm to both parties, considering factors such as insolvency risk, bad faith, and the integrity of the arbitration process.

❖ Inherent Powers of Tribunals

Tribunals often derive their authority to order security for costs from their inherent powers to ensure the integrity of proceedings, even in the absence of explicit rules. This underscores the broad discretion tribunals possess in managing interim measures.

Conclusion

The intersection of third-party funding and security for costs in international arbitration presents a nuanced and evolving challenge. While TPF enhances access to arbitration, it raises legitimate concerns about cost recovery and the financial integrity of claimants. Tribunals, guided by established legal frameworks and case law, must navigate these complexities, balancing fairness and procedural integrity. As TPF becomes more prevalent, continued refinement of disclosure requirements and security for costs provisions will be essential to uphold the principles of justice and equity in international arbitration.

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