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EXAMINING THE IMPACT OF THIRD-PARTY FUNDING IN INVESTOR-STATE DISPUTE SETTLEMENT AND POLICY OPTIONS

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Introduction

Third-Party Funding ["**TPF**"] is a type of funding method where investors or funders invest in a legal claim or dispute in exchange for a financial stake in the outcome of the dispute and control of the case. Financing a dispute through TPF may be the most effective use of financial resources that a party has access to. These claims may exceed the allotted budget restrictions or may be too expensive for corporate (or in some cases, individual) claimants to fulfil without funding.

In early times, TPF was considered a tort, and even a crime in some jurisdictions. However, modern dispute law has done away with the doctrines of champerty and maintenance, thereby making TPF an inextricable feature of modern litigation[1] and a catalyst in making our justice system more inclusive.[2] The doctrines of champerty and maintenance were designed to prevent third parties from intermeddling with disputes of other persons for personal gain. Champerty and maintenance were both regarded as illegal in many jurisdictions and were seen as a way of promotion of frivolous lawsuits by third parties. With time, however, the strict application of these doctrines has been relaxed. Owing to the global financial crisis, it has become an increasingly popular mode for funding dispute proceedings arising out of investment treaties.[3] Further, the high costs involved in Investment State

[1] *Exclaibar v Texas Keystone* [2014] EWHC 3436 (Comm).
[2] From Barretry, Maintenance and Champerty to Litigation Funding, Lord Neuberger, President of The Supreme Court Gray's Inn, 8 May 2013 <https://www.supremecourt.uk/docs/speech-130508.pdf> accessed February 04, 2023.
[3] International Council for Commercial Arbitration (ICCA) and Queen Mary University, London, Report of the ICCA–Queen Mary task force on third-party funding in international arbitration (2018) 4 < https://cdn.arbitration-icca.org/s3fs-public/document/media_document/Third-Party-Funding-Report%20.pdf> accessed 23 February 2023.

Dispute Settlement ["**ISDS**"], leading to potentially high damages, has made TPF an attractive avenue for claimants to explore.

Investment treaties include ISDS ostensibly as a means to advance rather than obstruct the larger goals of the treaties. The operation of ISDS, as well as the intent and purpose of investment treaties must be considered while examining TPF of ISDS matters. It is also critical to examine how this financing arrangement and the incentives offered by might create and affect these factors. Proponents of TPF point out that among other benefits, it improves access to justice in investor-state arbitration. On the contrary, its opponents argue that TPF will make it easier for meritless claims and frivolous lawsuits to enter into an already unbalanced system, adding burden on respondent governments who cannot benefit from TPF. Hence, it is essential to assess the feasibility of TPF with the objectives of the investment law regime, especially as many countries start to understand the potential of TPF and its distinctive position in ISDS.

Approach of Institutional Arbitration Centres and Tribunals

The European Union's proposal for Investment Protection and Resolution of Investment Disputes under the Transatlantic Trade and Investment Partnership (TIP) provides for TPF through a specific provision. The first investment agreement to address and regulate TPF was the draft of the EU-Vietnam Free Trade Agreement. Similarly, a precise definition of TPF was added to the EU-Canada Trade Agreement (CETA).

Recently, the Vienna International Arbitration Centre ["**VIAC**"] published the investment arbitration rules.[4] Article 13a of the rules provides for TPF and imposes an obligation to disclose the details of such funding arrangements.[5] Furthermore, UNCITRAL's Working Group III[6] and the International Centre for Settlement of Investment Disputes ["**ICSID**"] Secretariat,[7] in its working paper and proposed revisions, have recognised the provisions regarding disclosure of funding arrangements in

[4] VIAC Rules of Investment Arbitration and Mediation (VIAC Investment Arbitration Rules), 2021.
[5] VIAC Rules of Investment Arbitration and Mediation (VIAC Investment Arbitration Rules), 2021, Rule 13a.
[6] Possible Reform of Investor-State Dispute Settlement (ISDS) – Initial Draft Provisions on TPF, <https://uncitral.un.org/sites/uncitral.un.org/files/mediadocuments/uncitral/en/compilation_of_comments_tpf_1.pdf> accessed 04 February 2022.
[7] ICSID, Working Paper No. 5, Proposals for Amendment of ICSID Rules <https://icsid.worldbank.org/sites/default/files/publications/WP%205-Volume1-ENG-FINAL.pdf> accessed 05 February 2023.

investment arbitrations. The VIAC and ICSID have gone a step ahead and provided that the tribunal may call for the disclosure of specific details of the funding arrangements.

However, the sensitive character of funding arrangements has been acknowledged by ISDS panels.[8] Generally, the tribunals have held that the conditions of the funding agreement were not important and that TPF had no bearing on the proceedings.[9]

Impact on Access to Justice

Since investment arbitration awards are largely paid through public funds, its legal environment (asymmetric treaties) creates significant implications about TPF in the context of investment arbitration. For a system as uneven as the investment law regime, TPF may plainly be categorised as exploitation by some. TPF is specifically created to benefit speculative finance by utilising the asymmetric structure of the current investment regime. The funding model is based on a system where claimants directly choose the arbitrators, there is no right to appeal, and states have no substantive rights under the treaties.

Any state which is concerned about its investment reputation may consider disregarding an arbitral ruling as a dangerous course of action, given the current status of the global financial market. Through TPF, a select group of investors now may have even more money to pursue unjustified claims against developing nations. The public, who as taxpayers, are the "residual risk-bearers" in the current system, would ultimately be responsible for paying for these claims, placing a considerable financial burden on host nations and their populations. Most claimant investors come from high-income nations, and poor nations win only around half as frequently as wealthy nations.[10]

By utilising the Bilateral Investment Treaties (BIT)/ISDS regime, TPF transfers wealth from the inhabitants of responder states to TPF funders and their investors, which the investment regime did not intend to achieve. Infact, these transfers appear to be in direct contradiction to the fundamental investing tenet of "no expropriation without compensation". Furthermore, these wealth transfers

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[8] Kristin Dodge, Can Third-Party Funding Find the Right Place in Investment Arbitration Rules? < https://arbitrationblog.kluwerarbitration.com/2022/01/31/can-third-party-funding-find-the-right-place-in-investment-arbitration-rules/> accessed 01 March 2023.

[9] *Oxus Gold Plc v Republic of Turkmenistan* UNCITRAL Award, 17 December 2015.

[10] Frank J. Garcia, "Third-Party Funding as Exploitation of the Investment Treaty System" (2018) <https://core.ac.uk/download/pdf/200222523.pdf> accessed on 19 February 2023.

appear to go against a generally acknowledged standard of fairness, unjustly stealing from the weaker sections of society in order to benefit the wealthy few.

Impact on Respondent States and their Governance

The availability of TPF in ISDS has the effect of facilitating and encouraging suits against governments because a profit-seeking industry is able to generate returns by taking a financial interest in the outcome of claims and has an incentive to ensure qualifying ISDS cases are brought (and that the law is developed in the funding industry's favour). Controversially, in many cases third-party funders may be profiting from the financing of claims against governments that have engaged in good faith conduct taken in the public interest. It is unclear if the ISDS system should affirmatively encourage such suits by maintaining permissive rules on TPF. The impact of this funding on respondent states and their governance can be both positive and negative.

a. Improved governance accruing from TPF in ISDS

By providing access to justice, TPF can help to increase investment in countries with a history of unreliable governance. Furthermore, the threat of TPF can provide an incentive for states to improve their governance, making it less likely that disputes will arise in the first place. The threat of third-party funded ISDS claims can provide an incentive for states to improve their governance practices. This can include measures to increase transparency and accountability, to reduce corruption and arbitrary decision-making, and to improve the rule of law.

By providing access to justice, TPF can help to increase investment in countries with a history of unreliable governance. This can help to improve governance by bringing in new resources and by putting pressure on states to maintain stable and predictable investment environments. TPF can provide access to justice for investors who might not have the resources to bring a claim against a state otherwise. This can help to hold states accountable for their actions and can serve as a deterrent against poor governance practices.

It is important to note that while TPF can have positive impacts on governance, it can also have negative impacts if it leads to regulatory chill or overdeterrence, as discussed in previous answers. Therefore, it is important to carefully consider the potential impacts of TPF on governance when deciding whether to allow or restrict TPF in ISDS.

b. Potential issues to respondent states associated with third party funding in ISDS

Regulatory chill and overdeterrence are the primary issues associated with TPF in ISDS. Regulatory chill refers to the phenomenon of states becoming less likely to regulate in the public interest due to the threat of ISDS claims. TPF can exacerbate this problem by providing investors with greater resources to bring claims against states. This can result in states being more cautious in their regulatory activities, potentially leading to decreased protection for public health, the environment, and other important public interests. Overdeterrence moreover, occurs when the threat of ISDS claims leads states to adopt overly restrictive policies that stifle innovation and economic growth. TPF can increase the likelihood of overdeterrence by providing investors with greater resources to bring claims against states. This can result in states becoming overly cautious in their policymaking, leading to missed opportunities for economic growth and development.

Overall, the impact of TPF in ISDS on respondent states and their governance depends on the specific circumstances of each case and the way in which the funding is used. It is important for states to consider the potential impacts of TPF when deciding whether to sign treaties that provide for ISDS.

Way forward: policy options

The policy options for regulating TPF in investor-state disputes are as under:

1. Regulation: Governments can regulate TPF by setting standards for the activities of funding firms and the terms of funding agreements. This can include guidelines on disclosure, ethics, and conflict of interest.
2. Ban: Governments can ban TPF in investor-state disputes, either completely or in certain cases, such as in cases involving human rights violations.
3. Self-regulation: The TPF industry can establish self-regulatory standards, such as codes of conduct, to govern their activities and ensure that funding is provided in a responsible and transparent manner.
4. Encouragement: Governments can encourage the use of TPF in investor-state disputes as a means of promoting access to justice and facilitating the resolution of disputes.
5. Neutrality: Governments can maintain a neutral stance towards TPF, allowing market forces to determine the use of funding and ensuring that disputes are resolved on their merits.

It is important to note that the policy options available for regulating third-party funding in investor-state disputes can vary depending on the legal framework and the specific circumstances of each case. However, it is considered more favourable to explore avenues of setting up regulatory standards or placing a ban on such practices, as compared to the other options, because they would better be able to simplify and demonstrate governments' stance.

a. How can TPF in ISDS be efficiently regulated?

Efficient regulation of TPF in ISDS requires a balance between promoting the benefits of TPF and mitigating its potential negative impacts.[11] The following steps can be taken to regulate TPF in a manner that is efficient and effective:

i. Transparency: Establishing clear disclosure requirements for TPF agreements and ensuring that the parties involved in a dispute are aware of the role of the funding firm can increase transparency and reduce the risk of conflicts of interest.
ii. Ethics: Setting ethical standards for TPF firms can ensure that funding is provided in a responsible and transparent manner and that the rights of the parties involved in a dispute are protected.
iii. Conflict of interest: Addressing potential conflicts of interest is crucial to ensure that TPF does not unduly influence the outcome of a dispute. This can be done by requiring funding firms to disclose any potential conflicts of interest and by establishing guidelines for when funding should be declined.
iv. Cooperation with relevant organizations: Regulators can work with relevant organizations, such as investment treaty tribunals and international organizations, to ensure that TPF is regulated in a consistent and effective manner.
v. Review and evaluation: Regular review and evaluation of the regulatory regime for TPF can help to identify areas for improvement and ensure that the regulations are updated to reflect changes in the investment landscape and the needs of the parties involved in a dispute.

[11] Frank J. Garcia and Kirrin Hough, "Third Party Funding in International Investor-State Arbitration" (2018) Vol 2 Issue 6 https://www.asil.org/insights/volume/22/issue/16/third-party-funding-international-investor-state-arbitration accessed 13 February 2023.

Through this, regulators can create a regulatory framework that effectively balances the benefits and potential risks of TPF in ISDS and ensures that disputes are resolved in a fair and impartial manner.[12]

b. Why should TPF in ISDS be banned, and how can it be done?

TPF raises concerns about potential conflicts of interest. The presence of a funding firm with a financial stake in the outcome of a dispute can create the appearance of bias and undermine the impartiality of the dispute resolution process. Critics also argue that TPF can limit access to justice by making it more difficult for developing countries and small states to participate in investment disputes. This is because the cost of funding can be prohibitively high for these countries, and the terms of funding agreements may not be favourable.

TPF may further increase the risk of a dispute being influenced by factors other than the merits of the case, thereby posing risks to the aim of the international investment agreement (IIA) system itself.[13] This can compromise the integrity of the dispute resolution process and create the perception that the outcome of a dispute has been predetermined. Moreover, some people view TPF as a form of speculative investment that profits from the disputes of others and question the morality of funding firms profiting from the resolution of disputes. There is additionally the risk of widespread use of TPF could have unintended consequences, such as increasing the number of investment disputes and making it more difficult for countries to attract foreign investment.

While TPF can play a role in promoting access to justice and facilitating the resolution of disputes, the potential risks associated with this form of financing must be carefully considered and addressed in order to ensure that disputes are resolved in a fair and impartial manner.

There are several ways in which TPF in ISDS can be banned:

i. National legislation

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[12] Aratrika Deb, "Third Party Funding in Investment Arbitration: The India Story" <https://gitarattan.edu.in/wp-content/uploads/2020/02/Gibs-Law-journal-Vol.1-P3-Full-Paper.pdf> accessed 10 February 2023.
[13] Brooke Güven and Lise Johnson, 'Third-Party Funding and the Objectives of Investment Treaties: Friends or foes?' (Investment Treaty News, 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 10 February 2023.

Governments can pass laws that prohibit TPF in investment disputes within their jurisdiction. This can be done by including provisions in national investment laws or by enacting standalone legislation specifically addressing TPF.

ii. International treaties

Governments can agree to ban TPF through international treaties and agreements. For example, a ban on TPF could be included as a provision in investment treaties or as part of a multilateral agreement on investment dispute resolution.

iii. Investment tribunal rules

Investment tribunals and dispute resolution mechanisms can adopt rules that prohibit or restrict the use of TPF in investment disputes. This can be done by requiring the parties to disclose any funding agreements and by establishing ethical guidelines for the activities of funding firms.

iv. Self-regulation

The TPF industry can establish self-regulatory standards that include a ban on certain types of funding or limit the use of funding in certain circumstances.

Implementing a ban on TPF in ISDS requires a coordinated effort between governments, international organizations, and the TPF industry. A ban must be carefully crafted to ensure that it effectively addresses the potential risks associated with TPF while preserving access to justice and the ability of parties to resolve disputes.

Conclusion

According to research,[14] TPF is abused as a vehicle to facilitate quicker access to investment arbitration, particularly for baseless claims driven by political agenda. This unfavorable bias may not always be accurate. Prior due diligence by the funders on the merits and likelihood that the claim will

[14] International Council for Commercial Arbitration (ICCA) and Queen Mary University, London, Report of the ICCA–Queen Mary task force on third-party funding in international arbitration (2018) 4 < https://cdn.arbitration-icca.org/s3fs-public/document/media_document/Third-Party-Funding-Report%20.pdf> accessed 23 February 2023.

succeed shows that this may not be the case, as the business of funding claims with no legal foundation and those that are likely to be rejected by an arbitral tribunal, would not be viable or sustainable.

Both, at the treaty level and in accordance with applicable arbitration rules, TPF in ISDS claims is largely unregulated. However, governments, arbitral tribunals, civic society, academics, attorneys, investors, and funders are becoming more and more interested in it as the use spreads quickly. Misinformation about funding is a major contributor to the present discussion about TPF regulation in investment arbitration.

Overall, TPF has had a significant impact on ISDS. While it can provide access to justice for claimants who would otherwise be unable to pursue their claims, it also creates potential ethical concerns such as conflicts of interest and lack of transparency. The policy options available to address these concerns include increased disclosure requirements, ethical guidelines for third-party funders, and the creation of an independent regulatory body. Ultimately, the use of TPF in ISDS should be carefully balanced against its potential benefits and risks to ensure that the system remains fair and effective for all parties involved.