A changing landscape

Jeunesse Mensier on security for costs in funded investment arbitration

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The appropriate balance between security for costs and access to justice is a frequent source of debate, none more so than in international investment treaty arbitration.

The leading institutions in this area, the International Centre for Settlement of Investment Disputes (ICSID) and the United Nations Commission on International Trade Law (UNCITRAL), do not currently have specific rules addressing security for costs; instead using broad powers to order such measures. Historically, tribunals have required 'exceptional' circumstances before ordering security, such as abuse of process, bad faith or 'breach that may cause an irreparable harm if the measure is not granted' (*South American Silver Limited v Bolivia*, PCA Case No. 2013-15). Where the claimant is impecunious, 'the existence of third-party funding may come into play in the decision of a Tribunal to order security for costs, and this may require disclosure of the TPF arrangements' (*South American Silver*).

Until recently, there had only been one reported decision in which an ICSID Tribunal had ordered security for costs against a claimant, namely *RSM Production Corporation v Saint Lucia*, ICSID Case No. ARB/12/10. There, the funded claimant had previously failed to comply with costs orders in separate arbitrations and the state was impoverished.

Last year, an ICSID Tribunal in *Eskosol S.p.A. in liquidazione v Italian Republic*, ICSID Case No. ARB/15/50, ruled against ordering security for costs, despite the fact that the claimant company was bankrupt (as a result of the state's actions) and the claim was funded. The claimant had obtained after the event insurance (ATE) for adverse costs, and as such Italy was unable to demonstrate that security for costs was '*necessary* to preserve identified rights' and 'urgently required for that purpose'. The tribunal also held that even if Italy's costs escalated beyond the policy's limit of indemnity, it would have to show that an order for security for costs was '*proportionate*' so as not to 'impose such undue burdens on the other party as to outweigh, in a balance of equities, the justification for granting them'.

These decisions are in line with our own experience where the standard to order security has been extraordinarily strict, with neither the claimant's impecuniosity, the existence of litigation funding,

nor the absence of an ATE policy being sufficient in themselves (or cumulatively) to justify it.

However, ten years on from the decision in *Libananco Holdings Co. Limited v Republic of Turkey*, ICSID Case No. ARB/06/8, where the ICSID Tribunal stated that 'it would only be in the most extreme case – one in which an essential interest of either party stood in danger of irreparable damage – that the possibility of granting security for costs should be entertained at all', it now looks like the landscape is shifting.

RULE CHANGES

ICSID has recently announced proposals for changes to its rules, currently undergoing consultation. Rule 21 'Disclosure of Third-party Funding' requires a funded party to disclose the existence and source of any litigation funding upon registration of the request for arbitration. Rule 51 'Security for Costs' codifies the process and requirements to order security for costs. It focuses on the claimant's ability to comply with an adverse costs order and 'any other relevant circumstances'. Therefore, the existence of litigation funding in itself will remain a factor, but will not be determinative of an order for security.

This is similar to the recommendation of ICCA (QM) Task Force on third-party funding, which reported this year. It recommended that 'third-party funding arrangements in and of itself is not sufficient indication that a claimant is impecunious and therefore the mere existence of a third-party agreement is not sufficient reason for a tribunal to order security for costs'. It also recommended that the tribunal may award the reasonable costs of posting the security where the claimant succeeded, which would address concerns of the tribunal assessing the merits of the claim at a premature stage.

The recent UNCITRAL Tribunal decision in the *Garcia Armas* family's claims against Venezuela (*Luis Garcia Armas v Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/16/1) has also enlivened the debate. The state sought an order for $5m of security in respect of parallel UNCITRAL and ICSID additional facility claims, following disclosure of the claimants' redacted funding agreement. The claimants were unable to demonstrate that they would be able to comply with an order for adverse costs, and the funding agreement itself excluded the funder's liability for these, a fact which the tribunal described as 'exceptional', and so the claimants were ordered to provide a guarantee for Venezuela's costs. In reaching its decision, the tribunal found that the claimants' funded position was not determinative in ordering security for costs, but was a factor to consider.

Some of those in the third-party funding market might not describe the funder's exclusion of funding and liability for adverse costs as 'exceptional' in investment treaty claims. While each funding agreement is bespoke and based on the parties' negotiation, it is logical for a claimant to avoid the added cost of an ATE premium or indemnity from the funder where there has been no appreciable risk up to now.

The analogy of David and Goliath is often used in litigation funding, but it is never more apposite than in the investment treaty claim space. It is a daunting prospect to pursue a state, and even significantly wealthy claimants may not have the means to do so through the expensive bilateral investment treaty process. Equally, having already sustained heavy losses, investors may not have the risk appetite for further exposure.

States of course may argue that they use taxpayer's money to defend claims (although in some cases they are also turning to litigation funders), and so protection by way of security for costs is appropriate where their ability to recover costs is unlikely.

But as noted by the *Eskosol* Tribunal, states are seeking an 'outcome-related' right as opposed to a 'procedural' right (which already exists). Claimants have similar concerns, and indeed enforcement risk forms a material part of a funder's due diligence process, yet no guarantee of payment of an award currently exists for their benefit. The *Eskosol* Tribunal stated that 'there is something analytically curious about the notion that an ICSID Tribunal, while not empowered to protect a claimant's ability to collect on a possible merits award, nonetheless should intervene to protect a state's asserted "right" to collect on a possible costs award'. And the tribunal in B*urimi SRL and Eagle Games SH.A v Republic of Albania*, ICSID Case No. ARB/11/18, noted that this 'poses a systemic risk to the arbitration of international investment disputes'. Interestingly, one of the proposed changes to the ICSID rules includes Rule 50 'Provisional Measures' which would permit a claimant to apply for security for damages if it is 'necessary and urgent' to 'maintain or restore the status quo pending determination of the dispute'. The implementation of this rule is likely to be limited in practice, but it is still a development the funding market will watch closely.

WIDER IMPACT

Industry news is filled with positive announcements of litigation funders' expansion, capital raises and profits, but there remains a degree of criticism from the legal profession. As a relatively young industry, third-party funding welcomes healthy and informed discourse, but the market often sees commentary such as in *RSM*, which describes funding as a 'gambler's Nirvana: heads I win and tails I do not lose'.

This only promulgates a view of litigation funding that shows a fundamental misunderstanding of the industry. If litigation funding is to be a factor in deciding whether or not to grant security for costs, then it must also be remembered that most litigation funding is non-recourse, and so while the funder cannot be ordered to pay adverse costs by a tribunal, if the case is unsuccessful, the entirety of the funder's investment will be lost. This is a sizeable risk in itself, as investment treaty claims typically cost many millions of pounds to run. One cannot help but feel that the industry's success in backing meritorious claims has now become a weapon in the arsenal of states to lobby the arbitration institutions, with the effect that funded claimants will bear more risk than unfunded claimants. This is illogical and inequitable and will undoubtedly impede access to justice.

Funders will adapt as required in order to continue to serve this growing market, but the reality is that funded claimants will now seek to protect themselves from this risk, either with an ATE policy or by seeking an indemnity from the funder. States will deploy security for costs as a strategic way of escalating costs (and therefore risk) and delaying proceedings in an attempt to stifle suits. The end result will be that litigation funders will have to take these additional risk factors into account when conducting due diligence and in agreeing the terms of the funding. Who will ultimately bear the cost of this? I'm afraid to say, it will be the claimant.

Jeunesse Mensier is an investment officer at Therium Capital Management, global provider of litigation and arbitration funding; see www.therium.com