

Draft Text Providing for Transparency and Prohibiting Certain Forms of Third-Party Funding in Investor–State Dispute Settlement¹

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¹ This document was submitted to UNCITRAL Working Group III on ISDS reform in accordance with paragraph 83 of document A/CN.9/970 (Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its 37th session (New York, 1–5 April 2019)). That paragraph, and the discussion it reflects, invited submissions by states and other stakeholders on reform options so as to inform UNCITRAL’s efforts identifying and prioritizing particular solutions WGIII will develop in the next phase of its work. The text was drafted by Brooke Güven (Columbia Center on Sustainable Investment), Lise Johnson (Columbia Center on Sustainable Investment), Nathalie Bernasconi-Osterwalder (International Institute for Sustainable Development), Lorenzo Cotula (International Institute for Environment and Development), Frank J. Garcia (Boston College Law School) and Jane Kelsey (University of Auckland).

Context and summary

States and other stakeholders in UNCITRAL’s Working Group III (WGIII) have widely recognized certain fundamental concerns with the existing investor–state dispute settlement (ISDS) system. One of these concerns is the role of third-party funding in ISDS. In future sessions, WGIII will proceed to identify solutions to address this concern.

Members of WGIII have identified various issues with third-party funding. These range from its potential to create or exacerbate conflicts of interests to its impacts on confidentiality, legal privilege and the disputing parties’ ability to recover costs. Members have also raised questions about the effect third-party funding may have on investors’ ability to initiate frivolous claims, and whether third-party funding, almost exclusively used on the side of claimants in treaty-based arbitration, exacerbates other issues that arise in an already asymmetrical legal regime.

A recent working paper released by the Columbia Center on Sustainable Investment (CCSI)² examines the issues that third-party funding raises in ISDS. The paper explores how the introduction of commercial, profit-driven investments into the financing of ISDS claims might impact, and potentially undermine, the economic development objectives states pursue in entering into international investment agreements.

Issues addressed in the CCSI paper include third-party funding’s impact on specific respondent states, specific industries (such as infrastructure and extractives), the number of cases, the nature and motives of claimants, foreign direct investment flows, the development of investment law, the settlement and outcomes of claims, and regulatory chill and overdeterrence. The CCSI paper concludes that third-party funding in ISDS may have serious and systemic effects that warrant further attention and analysis, and that incremental steps to increase transparency alone will not address those effects.

Given the issues at stake, CCSI and others³ have argued that precaution should govern policy approaches to third-party funding and that clearer international regulation is warranted. Further, a prohibition may be needed for certain forms of third-party funding that raise particularly difficult issues in ISDS—namely, non-recourse arrangements whereby financing has the objective of achieving a financial return through remuneration that is dependent on the outcome of the proceedings.⁴

In the context of WGIII, several states have called for international regulation and some referred to a possible ban on third-party funding. However, questions have been raised as to how an international policy instrument could be effectively structured in relation to a transnational industry that presents high degrees of complexity and sophistication. To support WGIII’s deliberations, this submission

² Brooke Guven and Lise Johnson, ‘The Policy Impacts of Third-Party Funding in Investor-State Dispute Settlement’ Working Paper (CCSI 2019) <<http://ccsi.columbia.edu/files/2017/11/The-Policy-Implications-of-Third-Party-Funding-in-Investor-State-Dispute-Settlement-FINAL.pdf>> accessed 20 August 2019.

³ Frank J. Garcia, ‘Third-Party Funding as Exploitation of the Investment Treaty System’ (2018) 59 B.C.L. Rev. 2911, 2930.

⁴ Non-recourse means that the funder does not have a right of action against the party to whom the financing was provided if the case is unsuccessful and does not have broader rights against the party if the amount of the award is insufficient to cover costs advanced.

contributes draft text to illustrate one possible way these calls for regulation could be given effect in technical terms. While drafted in a form that could provide the basis for discussions about a possible multilateral treaty, the text could also be tailored for use in arbitration rules, in domestic laws or via a multilateral instrument to amend existing international investment agreements.

The draft text rests on the following main elements:

- A broad definition of third-party funding;
- Disclosure requirements applicable to all third-party funding;
- A prohibition of non-recourse, outcome-contingent third-party funding; and
- Enforcement mechanisms.

States may have different objectives in regulating third-party funding in ISDS, and the draft language could be tailored accordingly. For example, states wishing to permit third-party funding in certain circumstances (e.g., in cases of direct expropriation or demonstrated impecuniosity) could make carve-outs or adjustments to the text.

In providing a broad definition of third-party funding, the draft text extends disclosure requirements to philanthropic or non-profit funding, but it does not prohibit philanthropic or non-profit funding. However, philanthropic and non-profit funding may have undesirable impacts in specific cases—for example, to the extent a funder may be able to exert undue influence or control over the management of a claim. Because philanthropic and non-profit funding are not commercially viable, they are not currently viewed as scalable financial models to the funding of claims. As such, they do not appear, at present, to raise the same systemic concerns as commercially driven third-party funding. Nevertheless, states may wish to further regulate these funding models, beyond transparency, based on their potential impacts in specific claims.

Similarly, equity investments by third-party funders, while increasing in practice, would not be covered by the draft text. While not minimizing the impact that a third party providing funding via equity may have on a case, equity arrangements are in many ways different than debt or outcome-contingent financing, as they can more closely align the interests of the funders/equity holders with those of the claimant. Nonetheless, WGIII has separately identified shareholder reflective loss claims as an issue, and third-party funders can use equity to take advantage of these kinds of claims. These issues are assessed as best addressed separately in the context of discussions about reflective loss claims, rather than indirectly through regulation of third-party funding.

Appropriate sanctions, and the enforceability thereof, are also critically important aspects to consider when designing international regulation of third-party funding. It is often said that attempts to regulate or prohibit third-party funding would be futile because funders will simply restructure their investments. These challenges of regulatory effectiveness are neither unprecedented nor unsurmountable (or at least unmitigable), and approaches could be developed to discourage purposeful attempts to skirt the rules. The draft text provides some language on sanctions and their enforcement, including ways to deal with structures that have the effect or intent of avoiding third-party funding regulation.

Collective efforts by states, arbitral institutions, and other actors involved in policy making and enforcement can establish shared understanding of acceptable practices and produce rules that are in principle capable of achieving the desired regulatory objectives.

1. Definitions

“Affiliate” means a corporate affiliate, for a claimant, and a government entity, for a respondent.

“Proceeding” means any investor–state arbitration proceeding.

“Third-party funder” is a non-party to a dispute, not a representative of a party, who provides third-party funding.

“Third-party funding” is the provision of funds or equivalent support by a third-party funder to a party, its affiliate or its representative, for the pursuit or defense of a proceeding.⁵

2. Transparency Requirement for Third-Party Funding

(a) Disclosure requirement:⁶

- (i) Each disputing party that is benefitting or has benefitted from third-party funding with respect to the proceedings shall disclose in a written certification to (1) the secretariat of the administering arbitral institution, if any (prior to the constitution of a tribunal), (2) the tribunal (when and after constituted) and (3) each other party to the proceeding, that it has entered into a third-party funding arrangement, and it shall also state the name, address, jurisdiction of organization and beneficial owner(s)⁷ of the third-party funder.
- (ii) Disclosures required by subsection (i) shall be made: (1) upon transmission of the notice of arbitration or (2) immediately upon concluding a third-party funding arrangement after such notice has been transmitted.

(b) Continuing disclosure obligation: Each party to a dispute shall have a continuing obligation, in accordance with the requirements set forth in Section 2(a), to immediately disclose each and every change to the information described in such Section 2(a) and provided in a notice.

⁵ The definition provided is substantially based on Proposed Rule 13 [Notice of Third-Party Funding] of the Proposals for Amendment of the ICSID Rules, Working Paper #2, Volume 1 (March 2019), available at https://icsid.worldbank.org/en/Documents/Vol_1.pdf. This approach was taken because it may be desirable to have a definition for transparency purposes that could be applied and accepted broadly, with respect to various arbitration rules. Using broadly accepted transparency rules that apply to third-party funding would also make a prohibition (Section 3) easier to implement, as the prohibition could be included as a supplement to otherwise applicable transparency regulations.

⁶ Broad disclosure requirements of third-party funding are consistent with the approach taken by other initiatives concerning third-party funding of ISDS proceedings.

⁷ A definition of beneficial owner should be provided in any implementing instrument and may be based, for example, on the Financial Action Task Force Definition (“Beneficial owner refers to the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement.”), the Global Forum EOIR Standard or another definition acceptable to the parties. See e.g., Inter-American Development Bank and Organisation for Economic Co-operation and Development, ‘A Beneficial Ownership Implementation Toolkit’ (March 2019) <<https://www.oecd.org/tax/transparency/beneficial-ownership-toolkit.pdf>> accessed 20 August 2019.

(c) **Tribunal power to request any funding arrangement:**⁸ A tribunal shall have the power to require disclosure to it and to each other party to the proceeding of all or a portion of any funding arrangement.

(d) **Transparency of disclosures:** All disclosures made pursuant to Sections 2(a) and 2(b) shall be subject to transparency rules applicable to the proceeding.

3. Prohibition on Non-Recourse, Outcome-Contingent Third-Party Funding

(a) **General prohibition:**⁹ Other than as provided in 3(b) and 3(c), a disputing party shall not accept or receive third-party funding provided to it on a non-recourse basis in exchange for a success fee or other form of monetary remuneration or reimbursement wholly or partially dependent on the outcome of the proceeding, or a portfolio of proceedings when such portfolio includes the proceeding.

(b) **Contingency arrangements:**¹⁰

(i) A disputing party may benefit from a contingency arrangement with its representative, which may be an individual or entity, to the extent permitted by applicable law; such representative shall not, however, accept or receive third-party funding provided to it on a non-recourse basis in exchange for a success fee or other form of monetary remuneration or reimbursement wholly or partially dependent on the outcome of the proceeding, or a portfolio of proceedings when the portfolio includes the proceeding.

(ii) Each disputing party shall certify to the tribunal (or the administering arbitral institution, prior to the constitution of the tribunal) in substantially the form provided in Exhibit A, together with the transmission of the notice of arbitration or upon obtaining a representative, that its representative is, to the extent of such party's knowledge and understanding, in

⁸ This provision specifically includes the ability of the tribunal to request all or some of the funding arrangement. The tribunal's express right to access and analyze the funding arrangement will give the tribunal and the parties a greater understanding of what rights the funder has (in particular, with respect to: contractual obligations to cover, or not cover, cost awards; termination rights; rights to receive information about the arbitral proceeding; and controlling certain aspects of how the claim is managed, such as decisions to settle, or not). In the context of the prohibition on certain forms of third-party funding proposed in Section 3, it will also allow the tribunal to understand whether the funding arrangement is in violation of the prohibition (see also Section 4(a)(iii)).

⁹ This paragraph prohibits the provision of commercial funding of investor-state arbitration that has the objective of achieving a financial return on the investment. This is a narrower category of third-party funding than is subject to the transparency requirement in Section 2, which means that all third-party funding must be disclosed but only this form is prohibited. This section applies to both claimants and states.

¹⁰ While legal contingency arrangements would otherwise fall under the prohibition included in Section 3(a), Section 3(b) makes it clear that parties can be financed through contingency arrangements with their representatives, but that representative cannot itself be receiving third-party funding with respect to the proceeding because this arrangement would raise the same concerns about third-party funding that have been more broadly identified. This section requires both the party (to the extent of its knowledge) and its representative to certify that the representative is not receiving third-party funding in respect of the proceeding. This certification will encourage greater diligence in ensuring that prohibited funding is not occurring, and it also facilitates enforcement.

compliance with this Section 3(b). Such obligation applies with respect to each representative engaged by such party.

- (iii) Each disputing party's representative(s) shall certify to the tribunal, upon engagement to represent the disputing party in the proceeding (or as soon as engaged following the commencement of such proceeding) in substantially the form provided in Exhibit B, that it is in compliance with Section 3(b). Such obligation applies with respect to each representative engaged by such party. Such certification shall also list each bar committee, legal ethics committee or law society, or similar organization or affiliation maintained by the individual signing the certification and the lead counsel of any entity engaged as a representative on the matter.
- (iv) Each party and such party's representative shall have a continuing obligation to immediately notify the tribunal of any change in circumstances that may reasonably call into question the accuracy of the certifications provided by such disputing party or representative.

(c) Third-Party Funding Provided by Affiliates:¹¹

- (i) A disputing party may receive third-party funding provided by an affiliate to the extent permitted by applicable law; the affiliate shall not, however, accept or receive third-party funding provided to it on a non-recourse basis in exchange for a success fee or other form of monetary remuneration or reimbursement wholly or partially dependent on the outcome of the proceeding, or a portfolio of proceedings when the portfolio includes the proceeding.
- (ii) Each disputing party shall certify to the tribunal, in substantially the form provided in Exhibit A, that each of its affiliates are, to the extent of such party's knowledge and understanding, in compliance with Section 3(c)(i).
- (iii) Each disputing party shall have a continuing obligation to immediately notify the tribunal of any change in circumstances that may reasonably call into question the accuracy of the certification provided.

4. Enforcement

(a) Required discontinuance:

- (i) If a party fails to comply with any requirements set forth in Section 2, the tribunal shall suspend the proceeding. If the proceeding is suspended for more than 90 days, during which

¹¹ While a party receiving funding from an affiliate (either a corporate affiliate, for claimants, or another government entity, for respondents) would otherwise fall under the ban included in Section 3(a), Section 3(c) makes it clear that parties can be financed by affiliates. However, such an affiliate cannot itself be receiving third-party funding with respect to the proceeding because that arrangement would raise the same concerns about third-party funding that have been more broadly identified. This section requires the party (to the extent of its knowledge) to certify that its affiliates are not receiving third-party funding in respect of the proceeding. Again, this certification encourages greater diligence in ensuring that prohibited funding is not occurring, and it also facilitates enforcement.

time failure to comply with each requirement set forth in Section 2 has not been remedied, the tribunal shall order the discontinuance of the proceeding.¹²

- (ii) A tribunal shall order the discontinuance of a proceeding if a party to such proceeding violates any provision of Section 3.¹³
- (iii) A tribunal has the power to evaluate each party's funding arrangements in accordance with the powers provided in Section 2 and pursuant to applicable law and rules. Should a tribunal determine that a party has structured its funding arrangements, whether through debt, equity or otherwise, with the intent or effect of avoiding the requirements of Section 2 or Section 3, the tribunal shall order the discontinuance of the proceeding.¹⁴
- (iv) In each case of discontinuance ordered pursuant to this Section 4(a), the tribunal shall state the reason for such order and ensure that such order is made publicly available either by posting it on its institutional website or sending it to the UNCITRAL Transparency Registry.¹⁵

(b) **Legal counsel penalties:**¹⁶ With respect to representatives violating the provisions of Section 3(b)(iii) or (iv), the tribunal shall refer the matter to any relevant ethics committee, bar committee, law society or similar organization as applicable, including each listed in such representative's certification described in Section 3(b)(iii).

(c) **Costs:**¹⁷ If a proceeding is ordered to be discontinued pursuant to Section 4(a), the disputing party in violation shall bear all legal costs and expenses as well as costs of the proceedings of each opposing party to the proceeding, and shall be ordered to reimburse such party or parties in accordance with this section.

(e) **Annulment or set aside:**¹⁸ If an award is rendered that orders monetary damages to be paid to the claimant and it is later alleged that a third-party funder received, or was assigned a right to receive, all

¹² For any party that fails to comply with the transparency requirements set forth in Section 2, there is a grace period for compliance, followed by discontinuance if the required information is not forthcoming.

¹³ Discontinuance is a strong enforcement mechanism that can encourage compliance with the prohibition on certain forms of third-party funding.

¹⁴ It is often stated that attempts to regulate or prohibit third-party funding would be futile because funding arrangements can simply be constructed in ways that get around the wording, but not the intent, of the regulation. This provision is intended to capture funding structures that are constructed to avoid the spirit of the prohibition contained in Sections 2 and 3, and is reinforced by the express ability of the tribunal to access and analyze all third-party funding arrangements, provided for in Section 2(c).

¹⁵ In order to bring greater transparency into the use of third-party funding, and violation of prohibitions thereof, the tribunal is to publish orders of discontinuance that stem from violations.

¹⁶ Referral to a representative's bar committee, legal ethics committee or law society (or similar organization), as applicable, is a mechanism included here to encourage representatives to comply with, and encourage compliance by the parties with, the prohibition on third-party funding.

¹⁷ A requirement for cost shifting is a penalty intended to discourage violation of the third-party funding prohibition.

¹⁸ To the extent that prohibited third-party funding is not disclosed or discovered during the course of the proceeding, but it later is alleged that such prohibited funding occurred, it is suggested here that such actions are grounds to initiate an action to challenge the award or its enforcement, and, if found to be true, require annulment or set aside of the award.

or some of those funds through conduct in violation of Section 2(a) or 3(a), such allegation can be raised in support of an action challenging the award or resisting enforcement of the award. A finding that there had been an agreement to provide third-party funding, or that third-party funding had been provided, in violation of Section 2(a) or 3(a) shall be deemed to establish that the award was issued in manifest contravention of a fundamental rule of procedure agreed by the parties.

EXHIBIT A

Third-Party Funding Disclosure

Pursuant to [Rules on Third-Party Funding]

[Disputing Party]

In the matter of an arbitration between _____ (“Claimant”) and _____ (“Respondent”), Case No. _____ (the “proceeding”), the undersigned makes the following disclosure and certification pursuant to [Rules on Third-Party Funding]. All terms used herein and not defined have the meaning provided for in the [Rules on Third-Party Funding].

A. Party certification pursuant to Section 2(a) of [Rules on Third-Party Funding]

The undersigned hereby certifies that it [is/is not] benefitting and [has/has not] benefitted from third-party funding with respect to the proceeding.

Information of the third-party funder:¹⁹

Name:	
Address:	
Jurisdiction of Organization:	
Beneficial Owner(s):	

B. Party certification pursuant to Section 3(b) [Contingent arrangements]²⁰

The undersigned hereby certifies that, to the extent of the undersigned’s knowledge and understanding, its representative [Name of Representative] is in compliance with Section 3(b) of [Rules on Third-Party Funding].

C. Party certification pursuant to Section 3(c)(i) [Third-party funding by affiliates]

The undersigned hereby certifies that, to the extent of the undersigned’s knowledge and understanding, each of its affiliates is in compliance with Section 3(c)(i) of [Rules on Third-Party Funding].

The undersigned hereby certifies that all information herein provided and any supporting documents appended hereto are true, accurate and complete.

[Disputing Party]

By:

Name:

Title:

Date:

¹⁹ This certification and disclosure shall be duplicated for each third-party funder.

²⁰ This certification shall be duplicated for each representative.

EXHIBIT B

Third-Party Funding Disclosure

Pursuant to [Rules on Third-Party Funding]

[Party Representative]

In the matter of an arbitration between _____ (“Claimant”) and _____ (“Respondent”), Case No. _____ (the “proceeding”), the undersigned makes the following disclosure and certification pursuant to [Rules on Third-Party Funding]. All terms used herein and not defined have the meaning provided for in the [Rules on Third-Party Funding]. The undersigned represents [Claimant/Respondent] in the proceeding.

The undersigned hereby certifies that [Name of Representative] is in compliance with Section 3(b) of the [Rules on Third-Party Funding].

The undersigned maintains affiliations or membership in the following: [list each bar committee, legal ethics committee or law society, or similar organization or affiliation maintained by the individual signing the certification and, if not the undersigned, also list the same for the lead counsel].

1. [_____]

The undersigned hereby certifies that all information herein provided and any supporting documents appended hereto, are true, accurate and complete.

Name:

Title:

Date: