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Possible reform of investor-State dispute settlement (ISDS)

Draft provisions on procedural reform

Note by the Secretariat

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I. Introduction

1. During the first and second phase of its work, the Working Group had identified concerns regarding ISDS for which reform would be desirable. These concerns were broadly categorized as those pertaining to the lack of consistency, coherence, predictability and correctness of arbitral decisions by ISDS tribunals, those pertaining to arbitrators and decision makers; and those pertaining to cost and duration of ISDS cases, which included concerns regarding third-party funding (A/CN.9/964 and A/CN.9/970). With regard to the last set of concerns, it was generally felt that improvements in the procedural framework would be desirable and that there were various ways to address those concerns as exemplified in recent investment treaties.

2. At its thirty-ninth session in October 2020, the Working Group considered issues relating to frivolous claims, security for costs and counterclaims based on notes prepared by the Secretariat (A/CN.9/WG.III/WP.192 and A/CN.9/WG.III/WP.193). With regards to frivolous claims, general support was expressed for developing a more predictable framework making it possible to dismiss such claims at an early stage of the proceeding and provide an expedited process (A/CN.9/1044, paras. 78, 84–89).[1]

3. The Working Group also reaffirmed the need to develop a more predictable and clearer framework for security for costs, which would protect States against a claimant's inability or unwillingness to pay and discourage frivolous claims. It was also underlined that a balanced approach would need to be taken as security for costs could limit access to justice for certain investors, particularly small and medium-sized enterprises (SMEs) (A/CN.9/1044, paras. 64, 74–77).

4. With regards to counterclaims, two distinct aspects were highlighted, one being the procedural aspect, or the admissibility of counterclaims and the jurisdiction of tribunals to examine them; and the other being the substantive obligations of investors, the breach of which would form the basis of the counterclaims (A/CN.9/1044, para. 57). The Working Group requested the Secretariat to continue to work on the topic of counterclaims with a focus on the procedural aspect and prepare options to clarify the conditions under which a counterclaim could be brought (A/CN.9/1044, paras. 61–62).

5. At the thirty-sixth session in October 2018, the Working Group concluded that it was desirable that reforms be developed to address concerns with respect to allocation of costs by arbitral tribunals in ISDS (A/CN.9/964, paras. 124–127). The Working Group considered questions relating to the impact of the parties' behaviour and third-party funding in allocating costs. Furthermore, the difficulty in allocating costs in proportion to the success of the disputing parties was mentioned.

6. On 2 and 3 September 2021, the Republic of Korea hosted the Fourth Intersessional Meeting of the Working Group on procedural rules reform.[2] The first three sessions of the Meeting considered a draft prepared by the Secretariat on early dismissal of claims, security for costs, and counterclaims. The fourth session was comprised of a series of presentations by delegates and observers on cross-cutting issues of procedural reform, including the assessment of damages, exhaustion of local remedies, regulatory chill, right to regulate, third-party participation, immunity of execution, and involvement of national courts.

7. At its thirty-seventh and thirty eighth sessions held respectively in April and October 2019, the Working Group considered the topic of third-party funding based

[1] As of the date of submission, the Commission is expected to consider, during the last week of its fifty-fifth session as part of the agenda item Working Programme, different legislative approaches to early dismissal and preliminary determination within the context of the UNCITRAL Arbitration Rules based on a note by the Secretariat (see document A/CN.9/1114).

[2] Additional information available at https://uncitral.un.org/en/content/uncitral-working-group-iii-isds-reform-intersessional-meeting-procedural-rules-reform. Summary of the meeting is contained in document A/CN.9/WG.III/WP.214.

on notes prepared by the Secretariat (A/CN.9/WG.III/WP.157 and A/CN.9/WG.III/WP.172). The Working Group concluded that it would be desirable to address the legal framework pertaining to third-party funding in ISDS in light of its impact on ISDS proceedings and the regime as a whole. Possible options for reform were discussed and the Secretariat was requested to prepare draft provisions on third-party funding (A/CN.9/970, paras. 17–25; A/CN.9/1004, paras. 80–94 and 97). The Secretariat prepared an initial draft on third-party funding, which was made available on 6 May 2021 for comments by delegations and various stakeholders.[3]

8. This Note compiles the above-mentioned reform options into a set of procedural rules. It contains draft provisions on early dismissal (draft provision A), security for costs (draft provision B), allocation of costs (draft provision C), counterclaims (draft provision D) and third-party funding (draft provision E), topics with regard to which the Working Group had the opportunity to provide concrete instructions to the Secretariat. Additional rules to address other concerns and so-called cross-cutting issues (for example, multiple proceedings and calculation of damages) will need to be prepared to complete this set of procedural rules. The Working Group may wish to provide guidance on the additional set of provisions to be prepared.

9. The draft provisions in this Note have been prepared for possible inclusion in investment treaties or a multilateral instrument on ISDS reform to provide for a coherent set of rules on procedural aspects, which could become applicable to proceedings under existing investment treaties. They would need to be adjusted if they were to become part of arbitration rules or domestic legislation. Furthermore, the term "arbitral tribunal" is used throughout the draft provisions and this Note for ease of reference only. That term would need to be adjusted depending on the means of dispute resolution as well as the entity to be endowed the respective authority.

10. This Note was prepared with reference to a broad range of published information on the topic and does not seek to express a view on the possible reform options, which is a matter for the Working Group to consider. Particular reference was made to the amendments to the ICSID Rules and Regulations which took effect on 1 July 2022.[4] Relevant provisions have been reproduced in the Annex to this Note.

II. Draft provisions on procedural rules reform

A. Early dismissal of claims manifestly without legal merit

11. Allowing for early dismissal of frivolous and manifestly unfounded claims has been viewed as an important tool to prevent abuse of the ISDS system and to guarantee effective access to justice for other claims. A number of institutional arbitration rules[5] and some recent investment treaties[6] provide mechanisms to address unmeritorious claims.

[3] The initial draft and the compilation of comments are available at https://uncitral.un.org/en/thirdpartyfunding.

[4] Available at https://icsid.worldbank.org/resources/rules-amendments.

[5] For example, 2022 ICSID Arbitration Rules, Rule 41; 2016 SIAC Investment Arbitration Rules, Rule 29; 2017 SCC Arbitration Rules, Article 39; 2018 HKIAC Administered Arbitration Rules, Article 43; 2017 CIETAC Investment Arbitration Rules, Article 26. Additional information about the ICSID practice can be found at https://icsid.worldbank.org/rules-regulations/convention/arbitration/manifest-lack-of-legal-merit/2022.

[6] For example, Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), Article 9.23(4)–(6) (Conduct of the Arbitration); Comprehensive Economic and Trade Agreement between Canada and the European Union (CETA), Articles 8.32 (Claims manifestly without legal merit) and 8.33 (Claims unfounded as a matter of law); Agreement between the United States of America, the United Mexican States, and Canada (USMCA), Article 14.D.7; Indonesia–Australia Comprehensive Economic Partnership Agreement (Indonesia-Australia) (2019), Articles 14.21 and 14.30; Colombia-United Kingdom BIT (2010), Article IX; Dominican Republic-Central America FTA (1998), Article 10.20; Slovakia – Iran BIT (2016), Article 20; Belarus-India BIT (2018),

12. The Working Group may wish to consider the following draft provision A on early dismissal of claims:

DRAFT PROVISION A

1. The arbitral tribunal, at the request of a disputing party or on its own initiative, may rule that a claim, a counterclaim, or a claim for the purposes of set-off (hereinafter called a "claim") is manifestly without legal merit.

2. A disputing party should make the request referred to in paragraph 1 as promptly as possible and no later than [...] days after the submission of the claim. The arbitral tribunal may admit a later request if it considers the delay justified.

3. The disputing party shall specify as precisely as possible the facts and the legal basis justifying its request. The disputing party shall also demonstrate that a decision by the arbitral tribunal will expedite the proceeding and be material to the outcome of the proceeding.

4. Within [...] days from the date of the request by the disputing party and after inviting the disputing parties to express their views, the arbitral tribunal shall determine whether it will rule on the request.

5. If the arbitral tribunal determines that it will rule on the request, it shall indicate a period of time within which it will make the decision and invite the disputing parties to express their views.

6. The arbitral tribunal may rule by issuing an order or making an award.

7. A decision by the arbitral tribunal, including a determination not to consider the request by a disputing party, shall be without prejudice to the right of that disputing party to argue that a claim lacks legal merit in the course of the proceeding.

13. Paragraph 1 provides the general rule that the arbitral tribunal may dismiss a claim that is found to be manifestly without legal merit. The tribunal can do so upon the request of a disputing party or on its own initiative. While the paragraph addresses the dismissal of different types of claims (including counterclaims by respondent States), it does not apply to "defences" (A/CN.9/WG.III/WP.214, para. 10).

14. Paragraph 1 does not attempt to capture other types of pleas or objections that a party might raise during the proceeding (for example, that: (i) the issues of fact or law supporting a claim are manifestly without merit; (ii) certain evidence is inadmissible;[7] and (iii) no award could be rendered in favour of the disputing even if the claim was assumed to be correct) (A/CN.9/WG.III/WP.214, para. 11). The Working Group may, however, wish to consider whether a plea that the arbitral tribunal does not have jurisdiction or that the claim is manifestly beyond its jurisdiction should be covered under paragraph 1 (A/CN.9/WG.III/WP.214, para. 20).[8]

15. Paragraphs 2 to 6 indicate the procedure to be followed. A disputing party wishing to make a request for early dismissal has to do so within a fixed time frame, which commences with the submission of a claim. That party would need to justify its request and demonstrate that a decision by the arbitral tribunal would be material to the proceeding. It is foreseen that the arbitral tribunal would take a two-stage approach: first, it would determine whether it will rule on the request within a fixed period following the request and then it would rule on whether to dismiss the specific

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Article 21. The main changes contained in the agreement in principle on the modernization of the ECT, approved on 24 June 2022 (ECT Modernization) foresees a mechanism for (i) dismissal of claims that are manifestly without legal merits as a matter of substance or jurisdiction at the outset of proceedings and (ii) expedited dismissal of claims unfounded as a matter of law on merits. A special provision is envisaged for dismissal of claims submitted as a result of investment restructuring for the sole purpose of submitting a claim under the ECT.

[7] See article 9 of the IBA Rules on the Taking of Evidence in International Arbitration.

[8] See UNCITRAL Arbitration Rules, Article 23.

claim. When doing so, the arbitral tribunal is expected to issue an order or to make an award. The Working Group may wish to provide guidance on the adequacy of the procedure and the extent to which detailed provisions should be provided (for example, the time frames and the consequences of the other disputing party not challenging the request, see A/CN.9/1044, para. 86).

16. Paragraph 7 clarifies that the party that had made the request can continue to argue that the claim lacks legal merit at a later stage of the proceeding even if its request under draft provision A had been rejected by the arbitral tribunal.

17. The Working Group may wish to consider: (i) whether the existence of third-party funding (particularly, those that are not allowed under the regulations models, see section E below) should be taken into account by the arbitral tribunal in determining whether a claim is manifestly without legal merit and (ii) if so, whether and how it should be reflected in draft provision A.

18. In relation to draft provision C below, the Working Group may wish to consider whether it should be possible for the arbitral tribunal to allocate any cost arising from the request made in accordance with draft provision A to the disputing party that had made the request in case the request is denied (A/CN.9/WG.III/WP.214, para. 20).[9] This could be a safeguard against any misuse of the process by the disputing parties.

B. Security for costs

19. Considering the need to develop a more predictable and clearer framework for security for costs, the Working Group requested the Secretariat to prepare a draft provision, which would: (i) be separate from that on provisional or interim measures; (ii) primarily focus on making security for costs available for respondents against claimants; (iii) clarify that security for costs would only be available on request of a party; (iv) not apply against non-disputing parties; (v) cover the conditions and threshold and (vi) specify options for consequences in case of failure to comply (A/CN.9/1044, paras. 64, 65 and 74).

20. The Working Group may wish to consider the following draft provision B on security for costs:

DRAFT PROVISION B

1. At the request of a disputing party, the arbitral tribunal may order the other disputing party making the claim to provide security for costs.

2. A disputing party making the request referred to in paragraph 1 shall specify as precisely as possible the circumstances that justify the security for costs.

3. Within [...] days from the date of the request by the disputing party, the arbitral tribunal shall determine, after inviting the disputing parties to express their views, whether to order security for costs.

4. When determining whether to order a disputing party to provide security for costs, the arbitral tribunal shall consider all relevant circumstances of the case, including the following:

(a) that party's ability to comply with an adverse decision on costs;

(b) that party's willingness to comply with an adverse decision on costs;

(c) the effect that providing security for costs may have on that party's ability to pursue its claim;

(d) the conduct of the disputing parties; and

[9] See 2022 ICSID Arbitration Rules, Rule 52 (2), which reads: 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.

(e) the existence of third-party funding.

5. The arbitral tribunal shall specify the terms of the security for costs in its order, including the period of time within which the disputing party shall comply with the order. If the disputing party fails to comply, the arbitral tribunal may suspend the proceeding for a fixed period of time, after which it may order the termination of the proceeding.

6. A disputing party shall promptly disclose any material change in the circumstances upon which the arbitral tribunal made its determination whether to order security for costs.

7. The arbitral tribunal may at the request of a disputing party or on its own initiative, modify or terminate its order for security for costs.

21. Paragraph 1 provides that an order for security for costs shall be made only at the request of a disputing party and not on the arbitral tribunal's own initiative. Security for costs could be ordered against a party making a claim (including a counterclaim, or a claim for the purposes of set-off; see draft provision A(1)), which provides for equitable treatment of claimant investors and respondent States (A/CN.9/WG.III/WP.214, para. 25).

22. Paragraph 2 addresses how a disputing party should make the request for security for costs. Unlike draft provision A, there is no time limit within which the disputing party would need to make the request.

23. Paragraph 3 addresses how the arbitral tribunal should proceed with ordering security for costs. It foresees a short time period within which the arbitral tribunal will have to decide whether to order security for costs (for example, 30 days from date of the request), taking into account the views expressed by the disputing parties. The Working Group may wish to consider whether the draft provision should envisage a situation where the request for security for cost is made prior to the constitution of the tribunal and if so, to whom such request should be made and how to adjust the commencement of the time frame in paragraph 3.

24. Paragraph 4 provides a non-exhaustive list of circumstances to be considered by the arbitral tribunal when it decides to order security for costs. The Working Group may wish to consider whether to provide such a list or leave the determination to the full discretion of the arbitral tribunal in light of the circumstances of the case (A/CN.9/WG.III/WP.214, paras. 24 and 27).

25. The Working Group may also wish to consider whether the elements provided in the subparagraphs are appropriate, including whether they ensure: (i) a balance between effective rights of the respondent States on the one hand and access to justice on the other, and (ii) that the arbitral tribunal would not be required to prejudge the dispute (A/CN.9/1044, para. 75).

26. For example, subparagraphs (a) and (b) aim to address a situation where there are reasonable grounds to believe that there is a risk the disputing party may not be able to honour a potential award of costs against it.[10] If the impecuniosity and thus inability to comply with cost awards was due to act of the other party, that would also be taken into account. With regard to subparagraphs (d) and (e), the Working Group may wish to consider whether the elements therein are rather "evidence" to be considered by the arbitral tribunal in relation to the "circumstances" mentioned in

[10] See EU-Vietnam Investment Protection Agreement (EU–Vietnam) (2019), Article 3.48 and 2021 Canada Foreign Investment Promotion and Protection Agreement (FIPA) Model, Article 39. ECT Modernization foresees a new provision on security for costs in certain cases, such as risks of not honouring an adverse decision on costs.

subparagraphs (a) to (c).[11] This relates to how the arbitral tribunal should weigh the different factors as well as who bears the burden of proof.

27. Subparagraph (e) addresses the ordering of security for costs where a disputing party has received third-party funding. The subparagraph would need to be adjusted depending on how third-party funding is to be regulated (see section E below). One of the objectives is to address concerns regarding the respondent States' inability to recover their costs, particularly when an impecunious claimant had brought the claim with the support of third-party funding (A/CN.9/1004, para. 94).

28. Security for costs is mentioned in draft provision E-3 as one of the means to implement the regulation on third-party funding. With regard to third-party funding that would be prohibited, ordering security for costs may be considered in addition to other sanctions. On the other hand, with regard to the types of third-party funding that would be permissible, the Working Group may wish to confirm that the mere existence of third-party funding would not justify ordering security for costs as reflected in paragraph 4 (A/CN.9/1004, para. 94; A/CN.9/WG.III/WP.214, para. 28). This is particularly so as there may be instances where the ordering of security for costs might not be appropriate, for example, where: (i) the funded party is not able to pursue the claim without the third-party funding; (ii) the third-party funder expresses its ability and willingness to comply with an adverse decision against the funded party; or (iii) the respondent State is responsible for the impecuniosity of the funded party.

29. Paragraph 5 provides how the arbitral tribunal should order the security for costs (including a fixed time period for compliance) and the measures to be taken in case of non-compliance. The Working Group may wish to consider whether further guidance should be provided on the terms of the security for cost (for example, the amount, the method and duration) and whether the draft provision should provide a fixed time period of suspension (for example, 90 days).

30. Paragraph 6 requires the disputing parties to disclose any change in circumstances that led the arbitral tribunal to make the determination on security for costs. This would mean that the arbitral tribunal would need to state the reasons upon which it made its determination. Reference is made to the "determination" of the arbitral tribunal and not to the "order for security for costs" to cater for situations where the tribunal had not ordered security for costs, but where the circumstances have changed.[12] For example, this would be when the party is no longer able to comply with an adverse decision on costs and when third-party funding was sought after a decision by the tribunal to not order security for costs.

31. Paragraph 7 gives discretion to the arbitral tribunal to modify or terminate its order on security for costs. The Working Group may wish to consider whether this can be done only at the request of a disputing party or without such a request (in comparison, paragraph 1 requires a request by a disputing party to order security for costs). This would cater for any changes that might be disclosed in accordance with paragraph 6.

C. Allocation of costs

32. It was suggested that a clear rule on allocation of costs could have a positive impact in reducing the overall costs of the proceeding and could prevent inconsistencies (A/CN.9/964, paras. 125–126).

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[11] See 2022 ICSID Arbitration Rules, Rule 53, paragraph 4, which reads: The Tribunal shall consider all evidence adduced in relation to the circumstances in paragraph (3), including the existence of third-party funding.

[12] See 2022 ICSID Arbitration Rules, Rule 53, paragraph 7, which reads: A party shall promptly disclose any material change in the circumstances upon which the Tribunal ordered security for costs.

33. The Working Group may wish to consider the following draft provision on allocation of costs:

DRAFT PROVISION C

1. The costs of the proceeding shall in principle be borne by the unsuccessful disputing party or parties. However, the arbitral tribunal may allocate the costs between the disputing parties if it determines the allocation to be reasonable taking into account the circumstances of the case.

2. The costs of the proceeding include the legal and other costs incurred by the disputing parties to the extent that the arbitral tribunal determines the amount of such costs to be reasonable.

3. When allocating the costs of the proceeding, the arbitral tribunal shall consider all relevant circumstances of the case, including the following:

(a) the outcome of the proceeding or any parts thereof;

(b) the conduct of the parties during the proceeding;

(c) the reasonableness of the costs; and

(d) the existence of third-party funding.

4. The costs of the proceeding does not include expenses related to or arising from third-party funding incurred by a disputing party, unless determined otherwise by the arbitral tribunal.

5. Paragraph 1 applies to any costs of the proceeding arising from a request by a disputing party that a claim is manifestly without legal merit in accordance with draft provision A.

6. The arbitral tribunal shall in the final award, or if it deems appropriate, in any other award, determine the amount that a disputing party shall pay to another disputing party as a result of its decision(s) on allocation of costs.

34. Paragraph 1 provides the default rule that the unsuccessful disputing party should bear the costs of the proceeding in whole or in part ("costs follow the event").[13] An alternative rule would be that each disputing party bears its own legal costs and its proportion of the costs of the proceeding. Paragraph 1 further provides that the arbitral tribunal may allocate the costs of the proceeding when deemed reasonable. The Working Group may wish to consider whether such allocation should be limited to exceptional situations and whether further guidance should be provided on when to derogate from the default rule (A/CN.9/964, para. 126).[14]

35. The Working Group may wish to consider whether to include such a default rule in the draft provision or leave it to the applicable rules.[15] The ICSID Convention and the 2022 ICSID Arbitration Rules provide flexibility to the arbitral tribunal to allocate costs without a default rule.[16]

[13] See CETA, article 8.39(5) and EU-Singapore Investment Protection Agreement (EU-Singapore) (2018), Article 3.21(1), both of which read – The Tribunal shall order that the costs of the proceedings shall be borne by the unsuccessful disputing party.

[14] Ibid. - *In exceptional circumstances*, the Tribunal may apportion costs between the disputing parties if it determines that apportionment is appropriate in light of the circumstances of the case (*emphasis added*).

[15] See USMCA Annex 14-D, Article 14.D.13(4); Australia-Hong Kong Investment Agreement (2019), Article 35(3). With regard to the applicable rules, see Article 42 of the UNCITRAL Arbitration Rules.

[16] See ICSID Convention, Article 61(2) and 2022 ICSID Arbitration Rules, Rules 50 and 52.

36. Paragraph 2 clarifies that the "costs of the proceeding" include the legal fees and other expenses incurred by the disputing parties in relation to the proceeding.[17] It also limits such costs to an amount determined reasonable by the arbitral tribunal. The Working Group may wish to consider whether draft provision C should include a separate paragraph on the meaning and the scope of the costs of the proceeding (see paragraph 4 on expenses arising from third-party funding).[18]

37. Paragraph 3 lists the factors to be taken into account by the arbitral tribunal when allocating the costs.[19] Subparagraph (a) aims to cover the situation where only some parts of the claims were successful. Subparagraph (b) would allow the arbitral tribunal to consider whether the disputing parties complied with the applicable rules as well as the orders and decisions of the tribunal and whether they acted in a timely and cost-effective manner (A/CN.9/964, para. 125). It may also allow the arbitral tribunal to consider efforts by the parties to settle the dispute amicably. Subparagraph (c) would require the arbitral tribunal to consider whether the cost claimed by the disputing parties is reasonable and to limit it to that extent. The Working Group may wish to consider whether other factors should be mentioned in paragraph 3 (for example, excessiveness of the amount claimed and complexity of the issues).[20]

38. Subparagraph (d) requires the arbitral tribunal to take into account the existence of third-party funding when allocating costs.[21] The Working Group may wish to consider other issues arising from third-party funding with regard to allocation of costs.[22]

39. First is whether the costs arising from third-party funding (including any return paid to the third-party funder)[23], which is borne by the funded party, can be allocated to the other disputing party. Paragraph 4 reflects the view that costs related to third-party funding should not be allocated and thus not be recoverable (A/CN.9/1004, para. 93). However, discretion is provided to the arbitral tribunal to determine otherwise.

40. Second is whether the arbitral tribunal could allocate costs to a third-party funder, particularly where it is not possible to recover costs from a funded party

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[17] See UNCITRAL Arbitration Rules, Article 40(2), which reads: The terms "costs" includes only: …(e) The legal and other costs incurred by the parties in relation to the arbitration to the extent that the arbitral tribunal determines that the amount of such costs is reasonable. See also 2022 ICSID Arbitration Rules, Rule 50, which reads: The costs of the proceeding are all costs incurred by the parties in connection with the proceeding, including: (a) the legal fees and expenses of the parties…

[18] For example, UNCITRAL Arbitration Rules, Article 40; 2022 ICSID Arbitration Rules, Rule 50.

[19] See UNCITRAL Notes on Organizing Arbitral Proceedings, para. 48, which provides: In allocating costs, the arbitral tribunal may also consider certain conduct of the parties. Conduct so considered might include a party's: (a) failure to comply with procedural orders of the arbitral tribunal; or (b) procedural requests (for example, document requests, procedural applications and cross-examination requests), that are unreasonable, to the extent that such conduct actually had a direct impact on the costs of the arbitration and/or is determined by the arbitral tribunal to have unnecessarily delayed or obstructed the arbitral proceedings.

[20] 2022 ICSID Arbitration Rules, Rule 52(1)(c). It is however unclear how the complexity of the issues could be taken into account when allocating the costs between the successful and the unsuccessful parties.

[21] See SIAC Investment Arbitration Rules (2017).

[22] See Report of the ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration (August 2018) (2018 ICCA Report), Appendix, Principle C:

C.3. The question of whether any of the cost of funding, including a third-party funder's return, is recoverable as costs will depend on the definition of recoverable costs in the applicable national legislation and/or procedural rules, but generally should be subject to the test of reasonableness and disclosure of details of such funding costs from the outset of or during the arbitration so that the other party can assess its exposure.

C.4. In the absence of an express power, in applicable national legislation or procedural rules, a tribunal would lack jurisdiction to issue a costs order against a third-party funder.

[23] If successful, the funded party is typically obliged to pay the funder a return under the funding agreement and might seek to recover these funding costs from the unsuccessful party. The question of the recoverability arises when tribunals determine the scope of the costs incurred by a party to be shifted to the other party.

(A/CN.9/1004, para. 93). The rationale of ordering a third-party funder to pay adverse costs is that a funder who benefits financially from the proceeding should not be able to walk away without any responsibility for adverse decisions on costs rendered against the funded party.[24] However, without an express provision or the consent of the third-party funder, an arbitral tribunal would typically lack the authority to allocate costs to the third-party funder as it is not a party to the arbitration agreement. The Working Group may wish to consider this issue in conjunction with draft provision E-3, which requires the funded party to disclose whether the third-party funder agreed to cover the costs of an adverse cost award. A possible option would be to require the consent of the third-party funder to pay the costs allocated to the funded party as a condition for obtaining third-party funding.

41. In relation to draft provision A above, paragraph 5 clarifies that the default rule in paragraph 1 applies to the procedure determining whether a claim is manifestly without legal merit. This means that if the party making the request is unsuccessful, the costs arising therefrom should be borne by that party. On the other hand, if a claim is found to be manifestly without legal merit or the arbitral tribunal renders an award to the effect that all the claims are without legal merit, the costs of the proceeding would be borne by the disputing party raising such claim(s) (see para. 18 above).

42. Paragraph 6 provides that the arbitral tribunal does not have to wait until the final award to make an award on costs, which may be at the request of the disputing party or on its own initiative.

43. The Working Group may wish to consider whether any other aspects should be addressed in the draft provision (for example, any binding agreement on allocation of costs between the parties) and whether additional guidance should be provided to the arbitral tribunal and the disputing parties (for example, how to maintain an accurate and comprehensive record of the time and costs spent on the proceeding).

D. Counterclaims

44. A framework allowing for counterclaims by respondent States would reduce uncertainty, promote fairness and ultimately ensure a balance between the disputing parties. Such a framework would address concerns arising from the fact that investment treaties impose obligations on host States, whereas no or very limited obligations are imposed on investors. Allowing counterclaims to be heard together with the initial claim would also enhance procedural efficiency and possibly avoid multiple proceedings in different fora involving the same disputing parties.

45. Applicable procedural rules generally contemplate the possibility of the respondent raising counterclaims subject to certain conditions.[25] Recent investment treaties have included provisions allowing counterclaims.[26]

46. The Working Group requested the Secretariat to continue to work on the topic of counterclaims with a focus on the procedural aspect and to prepare options to clarify the conditions under which a counterclaim could be brought (A/CN.9/1044, paras. 61-62).

47. The Working Group may wish to consider the following draft provision on counterclaims.

[24] See 2018 ICCA Report, p. 161.

[25] UNCITRAL Arbitration Rules, Article 21(3); 2022 ICSID Arbitration Rules, Rules 48; SCC Arbitration Rules, Article 9(1)(iii); and ICC Arbitration Rules, Article 5.

[26] For example, CPTPP, Article 9.19(2); Slovakia-Iran BIT, Article 14(3); Argentina - United Arab Emirates BIT (Argentina-UAE) (2018), Article 28(4).

DRAFT PROVISION D

1. The respondent may make a counterclaim:

(a) arising directly out of the subject matter of the dispute;

(b) in connection with the factual and legal basis of the claim; or

(c) that the claimant has breached its obligations under [this or any other applicable treaty, international law, domestic laws or investment contracts].

2. For the avoidance of doubt, the consent of the respondent to the submission of a claim by the claimant is subject to the condition that the claimant consents to the submission of counterclaims referred to in paragraph 1.

48. Paragraph 1 affirms that the respondent State can make counterclaims and lists the possible conditions or grounds for raising counterclaims. Subparagraphs (a) and (b) require the counterclaim to be linked with the subject matter of the dispute[27] or to the factual or legal basis of the claim.[28] The Working Group may wish to consider whether both formulations should be retained.

49. Subparagraph (c), on the other hand, broadens the scope by allowing the respondent State to make counterclaims on the basis of any breach by the claimant investor of its obligations, which doesn't need to be linked with the subject matter of the dispute or the factual or legal basis of the claim.[29] Subparagraph (c) provides in square brackets a list of possible instruments containing such obligations.[30]

50. As noted (see para. 46 above), draft provision D does not aim to specify the obligations of investors (A/CN.9/1044, para. 59). Yet, in order to raise counterclaims in treaty-based investment disputes, the substantive obligations, the breach of which would form the basis of the counterclaims, would need to be included in the respective treaty. The Working Group may wish to consider recent investment treaties that impose such obligations[31] and consider whether similar provisions would need to be prepared.

51. Paragraph 2 aims to clarify that the counterclaims made by respondents in accordance with paragraph 1 fall within the jurisdiction of the arbitral tribunal (A/CN.9/1044, para. 61). This is because procedural rules typically limit counterclaims to those that fall within the jurisdiction[32] and arbitral tribunals have often dismissed counterclaims on grounds of lack of jurisdiction.[33]

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[27] See for example 2022 ICSID Arbitration Rules, Rule 48.

[28] See for example Art. 9.19 CPTPP.

[29] This is indicated by the word "or". In other words, the conditions in the subparagraphs are not cumulative (A/CN.9/WG.III/WP.214, para. 41).

[30] See for example Morocco Model BIT (2019), Article 28.4; See also Pan-African Investment Code (PAIC), Article 43.

[31] See PAIC, Articles 21–24; Argentina–Qatar BIT (2016), Articles 11 and 12; Morocco–Nigeria BIT (2016), Articles 18 and 24; Model Text for the Indian Bilateral Investment Treaty, Articles 9–12; Common Market for Eastern and Southern Africa (COMESA) Common Investment Area (CCIA) Revised Investment Agreement (2017), Part 4; Southern African Development Community (SADC) Model Bilateral Investment Treaty Template (2012), Part 3; Morocco Model BIT, Articles 18 and 28.

[32] See for example, UNCITRAL Arbitration Rules, Article 21(3), which states, "provided that the arbitral tribunal has jurisdiction over it" and 2022 ICSID Arbitration Rules, Rule 48, which states, "provided that such ancillary claim is within the scope of the consent of the parties and the jurisdiction of the Centre."

[33] For example, *Spyridon Roussalis v. Romania*, ICSID Case No. ARB/06/1 (7 December 2011), Award, paras. 859–877; *Oxus Gold plc v. Republic of Uzbekistan* (17 December 2015), Award, paras. 906–959; and *Rusoro Mining Ltd. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/12/15 (22 August 2016), Award, paras. 618–629.

E. Third-party funding

1. Definitions

DRAFT PROVISION E-1 (Definitions)

1. "Third-party funder" means any natural or legal person who is not a party to the IID proceeding but enters into an agreement to provide or otherwise provides funding for the proceeding.

2. "Funded party" means a party to the IID proceeding, which benefits from third-party funding.

3. "Third-party funding" means any provision of direct or indirect funding or equivalent support to a party to the IID proceeding ("funded party") by a natural or legal person who is not a party to the proceeding ("third-party funder") in return for remuneration dependent on the outcome of the proceeding.

52. Draft provision E-1 provides definitions of key terminology, as the effectiveness of any regulation on third-party funding would depend on a clear definition thereof (A/CN.9/1004, para. 86). The definitions would need to be adjusted depending on the model and scope of the regulation.[34]

53. Paragraphs 1 and 2 define the two main actors involved in third-party funding, the funder and the funded party. Paragraph 1 intends to capture the meaning of a third-party (any natural or legal person who is not a party to the proceeding) and instances where the funding is yet to be provided ("enters into an agreement to provide").[35] The word "benefits" in paragraph 2 intends to capture "indirect" funding, where the funding is not provided directly to the disputing party but through its affiliate or representative (the funding agreement may itself be entered into by an affiliate or a representative for the benefit of the disputing party). It is the "funded party" that has the obligation to disclose under draft provision E-2.

54. The Working Group may wish to consider whether respondent States should be excluded from the notion of "funded party" thereby limiting the scope of the provision to claimant investors. If this approach is taken, consequential drafting changes may be required as the current version was prepared to apply to any funded party.

55. Paragraph 3 touches upon the key elements of third-party funding. The word "indirect" aims to cover a situation where the disputing party is not a party to the funding agreement nor the direct recipient of the funding but still benefits from the funding (see para. 53 above). The word "funding" refers to financial support,[36] whereas the words "equivalent support" aim to cover non-financial support.[37] The Working Group may wish to consider whether paragraph 3 should expressly mention that the funding or equivalent support is "to finance part or all of the cost of the proceeding", which is implied in the words "support to a party to the IID proceeding." Paragraph 3 provides a broad definition of third-party funding to ensure that any attempt with the intent or effect of circumventing the regulation on third-party funding would not be allowed.

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[34] For example, the CCSI/IIED/IISD Joint Submission provides a broad definition, based on which disclosure requirements apply to all third-party funding. The prohibition clause is then limited to non-recourse, outcome-contingent third-party funding.

[35] See 2018 ICCA Report, p. 50. See also CETA, Article 8.1; and Canada-Chile Free Trade Agreement ("CCFTA") (2017), Article G-23 bis (3).

[36] See 2022 ICSID Arbitration Rules, Rule 14; EU-Singapore, Article 3.1 (2)(f); and IBA Guidelines on Conflicts of Interest ("IBA Guidelines"), Explanation to General Standard 6(b): "contributing […] to the prosecution or defence of the case".

[37] See, for example, 2018 ICCA Report, p. 50; Another approach would be to add a phrase such as "and other equivalent funding mechanisms" as a catch-all phrase to prevent the undermining of the definition and guarantee the efficient implementation of any regulation; The IBA Guidelines defines funding as "contributing funds, or other material support".

56. The Working Group may wish to consider whether this broad definition is appropriate, as it could inadvertently result in regulating other types of support (for example, amicus curiae submissions in support of a position, pro bono legal services provided by a law firm and legal advice provided by an advisory centre). The last part of paragraph 3 clarifies that the underlying objective of the funding is to obtain in return a share or an interest in the outcome of the proceeding, which the disputing party would be entitled to obtain (often referred to as "commercial" financing).[38]

Proceeding

57. Draft provision E-1 makes reference to the phrase "International Investment Dispute (IID)" as being considered by the Working Group in the context of the draft Code of Conduct, which lists the legal basis of the disputes.[39] The word "proceeding" refers to any procedure to resolve an IID (arbitration, mediation and any other ADR mechanism).[40] The Working Group may wish to consider whether the scope should be limited to certain dispute resolution mechanisms.

Non-profit funding

58. The Working Group may wish to consider whether funding or equivalent support for non-profit purposes, usually in the form of a donation or grant, should also be covered by the definition of third-party funding (A/CN.9/1004, para. 87).[41] This is because non-profit funding and funding by development organizations[42] might not present the same concerns as commercial funding.

Other types of funding arrangements

59. There may be a wide range of funding arrangements, for example:

Funding provided by the disputing parties' legal or other representative;[43]

- Equity financing (for example, where the funder purchases shares of the disputing party or creates a special purpose vehicle with that party); and
- The funder owns or invests in a law firm representing a disputing party.[44]

60. The Working Group may wish to consider whether such funding arrangements should also be regulated and if so, whether the definition in paragraph 3 is broad enough to cover those arrangements.

61. Depending on the model and scope of regulation to be chosen, the Working Group may wish to consider formulating exclusions to the definition.

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[38] For EU-Singapore, Article 3.1 – "in return for a share or other interest in the proceeds or potential proceeds of the proceedings to which the disputing party may become entitled, or in the form of a donation or grant"; CCFTA, Article G-23 bis – "either through a donation or grant, or in return for remuneration dependent on the outcome of the dispute"; 2022 ICSID Arbitration Rules Rule 14 - "in return for remuneration dependent on the outcome of the proceeding".

[39] See A/CN.9/WG.III/WP.216, "International Investment Dispute" (IID) means a dispute between an investor and a State or a Regional Economic Integration Organization (REIO) … submitted for resolution pursuant to: (i) a treaty providing for the protection of investments or investors; (ii) legislation governing foreign investments; or (iii) an investment contract."

[40] See for example, the 2022 ICSID Conciliation Rules, Rules 12.

[41] For a broad definition, see CCSI/IIED/IISD Joint Submission. For an example of non-profit funding, see *Philip Morris v. Uruguay*, where the Bloomberg Foundation and its 'Campaign for Tobacco-Free Kids' provided funding for the Uruguayan government. See also 2018 ICCA Report, p. 96.

[42] For example, the African Legal Support Facility (ALSF), the International Development Law Organization (IDLO) and advisory centre as envisaged by the Working Group.

[43] See 2018 ICCA Report, p. 50; and draft provision 3 (b) in the CCSI/IIED/IISD Joint Submission.

[44] See 2018 ICCA Report, pp. 35 and 36.

2. Regulation models

62. The following sets forth the various modes of regulating third-party funding. The Working Group may wish to provide guidance on the model to be developed further taking into account a number of factors including but not limited to the need to ensure the integrity of the proceeding by preventing any abuse and the benefits that third-party funding could have for claimants with insufficient financial resources, particularly small and medium-sized businesses (A/CN.9/1004, para. 85).

(1) Prohibition model

63. One option would be to prohibit third-party funding entirely (A/CN.9/1004, para. 81).[45] This could respond to the concern that third-party funding aggravates the structural imbalance in the ISDS regime and increases the number of ISDS cases, frivolous claims as well as the amount of damages claimed.

64. The prohibition model could be implemented through different drafting options. One option would be to include a general provision prohibiting third-party funding (option W).[46] Another would be to require the non-existence of third-party funding as a condition for the submission of a claim (option X).[47] Yet another formulation would be to subject the consent of the respondent State to the IID to the non-existence of any third-party funding (option Y).[48] The existence of third-party funding under options Y and Z would likely result in the claim being dismissed or the tribunal deciding that it lacks jurisdiction. Yet another option would be to deny the benefits under the treaty to a claimant with third-party funding (option Z).[49]

Prohibition model

Option W – A claimant shall not enter into an agreement on, or receive, third-party funding.

Option X – A claim may be submitted only if the claimant has not entered into an agreement on, or received, third-party funding and refrains from doing so.

Option Y – The consent of the respondent requires that the claimant has not entered into an agreement on, or received, third-party funding and shall refrain from seeking third-party funding.

Option Z – A Party may deny the benefits of this treaty to an investor of another Party that raises a claim if the investor has entered into an agreement on, or received, third-party funding.

65. Under the prohibition model, it might be necessary to exclude from the definition of third-party funding in draft provision E-1(3) certain types of third-party funding (for example, non-profit funding, legal aid, contingency arrangements and funding provided by an affiliate of the disputing party,[50] see para. 58 above). This

[45] See Submissions from the Government of South Africa (A/CN.9/WG.III/WP.176) and the Government of Morocco (A/CN.9/WG.III/WP.161,). See also A/CN.9/WG.III/WP.172 - Third-party funding, paras. 15–19.

[46] See Argentina–UAE, Article 24 – "Third party funding is not permitted".

[47] See EU–Vietnam, Article 3.35, Australia–Hong Kong Investment Agreement (Australia–HK) (2019), Articles 26–27; USMCA, Article 14.D.3.

[48] See EU–Vietnam, Article 3.36; Australia–HK, Article 24; USMCA, Article 14.D.5.

[49] Through denial of benefit clauses, States have denied the benefits under investment treaties to certain categories of investors that the investment treaties did not intend to protect, for example, claimants that are "controlled by nationals of a third State" and/or "do not have a real economic connection with the home State" See 'Denial of Benefits' Clause in Investment Treaty Arbitration by Loukas Mistelis and Crina Baltag, Queen Mary University of London, School of Law Legal Studies Research Paper No. 293/2018, pp. 1–2. A denial of benefit clause has been used by States to "counteract strategies that seek the protection of particular treaties by acquiring a favourable nationality", in other words, to prevent forum shopping and freeriding of the benefits under the investment treaty. See Rudolf Dolzer, Ursula Kreibaum and Christoph Schreuer, Principles of International Investment Law (3rd edition, 2022), p. 74.

[50] For a drafting example, see CCSI/IIED/IISD Joint Submission.

would address the concern that the prohibition model could limit SMEs and impecunious claimants from raising claims.

(2) Restrictive model

66. Another model would be to prohibit third-party funding except in certain circumstances.

Access to justice exception model

Third-party funding is prohibited unless the claimant demonstrates that it is not in a position to pursue the claim without third-party funding.

Sustainable development exception model

Third-party funding is prohibited unless the claimant demonstrates that its investment is in compliance with [the applicable sustainable development provisions].

67. Under the access to justice exception model, a claimant would be allowed to seek third-party funding if the funding is necessary to bring the claim. This is particularly geared for SMEs or other claimants facing financial difficulties (A/CN.9/1004, paras. 82 and 83). Under this approach, third-party funding obtained merely for business purposes (for example, to manage risks or to deduct the cost of the proceeding from its balance sheet) would not be allowed. However, it may be difficult for the claimant to demonstrate its impecuniosity (A/CN.9/1004, para. 83)[51] or that the funding is necessary to pursue the claim.

68. Under the sustainable development exception model, a claimant would be allowed to seek third-party funding only if its investment meets pre-defined sustainable development requirements or relevant laws or regulations of the respondent State. This reflects efforts deployed by States, in particular developing States, to balance the protection of investors and the sustainable development agenda in their investment treaties. By allowing only those investors that contribute to sustainable development to obtain third-party funding, this model could assist States in prioritizing and promoting such investments (for example, those with the aim of mitigating climate change). On the other hand, this model may create a difference in treatment with investments that would otherwise equally qualify for protection under the investment treaty.

69. In both models, the burden would be on the claimant to justify the third-party funding. Additional requirements could be imposed on the claimant. For example, the claimant may be required to demonstrate that: (i) it is pursuing the claim in good faith; (ii) it is likely to succeed in the proceeding; or (iii) the funding sought would not unjustifiably interfere with the proceeding.

70. In order to implement these exceptions, further procedural rules would need to be prepared stipulating, for example: (i) how and when the claimant should apply for permission (including to whom), (ii) the information to be provided in the application (in light of draft provision E-2), (iii) the authority that would grant the permission (for example, the arbitral tribunal), (iv) the consequence of the permission not being granted and (v) possible sanctions in case the claimant proceeds to obtain third-party funding (see draft provision E-3).

(3) Permissive model

71. Under the permissive model, third-party funding would generally be allowed except for certain types thereof. The types of third-party funding that would not be allowed would be specified in a list. Compared to the restrictive model, this model would provide more flexibility to the claimant in obtaining third-party funding for different purposes.

[51] See 2018 ICCA Report, p. 20.

Permissive model

Third-party funding is permitted unless:

(a) the funding is provided on a non-recourse basis in exchange for a success fee and other forms of monetary renumeration or reimbursement wholly or partially dependent on the outcome of a proceeding or portfolio of proceedings;

(b) the expected return to be paid to the third-party funder exceeds a reasonable amount;

(c) the number of cases that the third-party funder funds against the respondent State with regard to the same measure exceeds a reasonable number; or

(d) ...

72. Some examples of third-party funding that would not be allowed under the permissive model are presented above. The Working Group may wish to consider whether these examples are appropriate and whether other types of funding should be listed, for instance, claims that are frivolous or without legal merit, in bad faith or with political purposes (A/CN.9/1004, para. 82)).

73. Subparagraph (a) aims to prohibit speculative funding (A/CN.9/1004, para. 82). However, this may result in limiting most types of commercial funding. Subparagraph (b) aims to cover third-party funding where the amount of the expected return is excessive or exceeds a certain threshold. An alternative regulation would be to limit the amount or percentage of return.[52] Subparagraph (c) aims to cover situations where the funder has already provided funding for a number of claims against the same respondent State regarding the same measure. This would limit the number of proceedings that a specific third-party funder can finance against a particular State. This was viewed as increasing the existing imbalance to the detriment of those States, as the third-party funder could have a significant influence on the outcome of the cases.

74. Similar to the restriction model, procedural rules would need to be prepared to implement the permissive model (see para. 70 above). Whether the third-party funding falls within the prohibited category could be determined based on information disclosed in accordance with draft provision E-2. However, procedural rules would need to stipulate, for example: (i) the authority that would make the determination or approve the third-party funding, (ii) whether the determination would be made at the request of a disputing or on the authority's own initiative, (iii) if only at the request of a disputing party, time frames to be followed; (iv) the consequence of the authority determining that the third-party funding is not allowed, and (v) possible sanctions in case the claimant proceeds to obtain third-party funding (draft provision E-3).

3. Disclosure

75. Disclosure is a way of preventing conflicts of interests and enhancing transparency. A number of existing investment treaties and arbitration rules include rules on disclosure of third-party funding.[53]

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[52] Submission by the Government of Turkey (A/CN.9/WG.III/WP.174), p. 3 – "… [T]he amount of the return that would be taken by the funder should be limited to a reasonable portion of compensation".

[53] 2022 ICSID Arbitration Rules, Rule 14 and 2022 ICSID Conciliation Rules, Rules 12. See also ICC Arbitration Rules, Article 11(7), which 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. In addition, the ECT Modernization project foresees a new provision requiring both disputing parties to disclose information on a third party financing its litigation costs.

76. Requiring disclosure could be a regulation model on its own. However, the implementation of other regulation models mentioned in section 2 requires the disclosure of certain information in order to determine whether the third-party funding is permissible or not.

77. Draft provision E-2 reflects the understanding of the Working Group that the existence of third-party funding and the identity of the third-party funder should be disclosed at an early stage of the proceeding or as soon as the funding agreement is concluded and that the requirement should continue throughout the proceeding (A/CN.9/1004, para. 89).

DRAFT PROVISION E-2 (Disclosure)

1. The funded party shall disclose to the arbitral tribunal and the other disputing parties the following information:

(a) the name and address of the third-party funder;

(b) the name and address of the beneficial owner of the third-party funder and any natural or legal person with decision-making authority for or on behalf of the third-party funder in relation to the proceeding; and

(c) the funding agreement or the terms thereof.

2. In addition, the arbitral tribunal may require the funded party to disclose the following information:

(a) whether the third-party funder agrees to cover the costs of an adverse cost award;

(b) the expected return amount of the third-party funder;

(c) any right of the third-party funder to control or influence the management of the claim or the proceeding as well as to terminate the funding arrangement;

(d) the number of cases for which the third-party funder has provided funding for claims against the respondent State;

(e) any agreement between the third-party funder and the legal counsel or firm representing the funded party; and

(f) any other information deemed necessary by the arbitral tribunal.

3. The funded party shall disclose the information listed in paragraph 1 when submitting its statement of claim, or if the funding agreement is entered into after the submission of the statement claim, as promptly as possible after the agreement is entered into. The funded party shall disclose the information requested by the arbitral tribunal in accordance with paragraph 2 as promptly as possible after the request.

4. If there is any new information or any change in the information disclosed in accordance with paragraphs 1 and 2, the funded party shall disclose such information to the arbitral tribunal and the other disputing parties as promptly as possible.

5. If the funded party fails to comply with the obligations in this provision, the arbitral tribunal shall take appropriate and necessary measures referred to in draft provision E-3.

The obligation of the funded party to disclose

78. Paragraph 1 requires a funded party to disclose certain information. The Working Group may wish to consider whether the respondent State should be subject to the same requirement (see para. 54 above), as States may be subject to other disclosure requirements under domestic law (A/CN.9/1004, para. 84).

79. Paragraph 1 further reflects the view that disclosure should be made to the arbitral tribunal and the other disputing parties (A/CN.9/1004, para. 91).[54]

Scope of disclosure

80. Paragraph 1 also reflects the understanding of the Working Group that the existence of third-party funding and the identity of the third-party funder should be disclosed (A/CN.9/1004, para. 89). Accordingly, subparagraph (a) requires the disclosure of the name and address of the third-party funder.[55]

81. Subparagraph (b) requires the disclosure of the name and address of the beneficial owner of the third-party funder as well as the name and address of any person with decision-making authority for or on behalf of the third-party funder (for example, an investment manager or advisor). This is to assist in identifying potential conflicts of interest, particularly when the funding is channelled through a special purpose vehicle (A/CN.9/1004, para. 89).[56] The Working Group may wish to consider the extent to which such information would be available to the funded party and should be the subject of disclosure.

82. Subparagraph (c) requires the disclosure of the funding agreement or the terms thereof.

83. The Working Group may wish to consider whether to limit the circumstances that would require disclosure under paragraph 1 (for example, the likeliness of a conflict of interest). On the other hand, it would be difficult for the funded party to know whether a conflict of interests exists until the information is disclosed to the arbitral tribunal and the other disputing parties.

84. The Working Group may wish to further consider whether there should be any exceptions to the disclosure requirement, for example, pro bono assistance arrangements, contingency arrangements, inter-corporate financing agreements (A/CN.9/1004, para. 87), or third-party funding arrangement that may be subject to other disclosure requirements.[57]

85. Paragraph 2 reflects the view that the arbitral tribunal should have the authority to require disclosure beyond that required in paragraph 1 based on the circumstances of the case (A/CN.9/1004, para. 90).[58] It also reflects that depending on the regulation models, the information required by the tribunal in making a determination would differ. For example, under some regulation models, the funded party might be incentivized to provide more information to the tribunal to ensure that the third-party funding is permitted.

Timing and means of disclosure

86. Paragraph 3 reflects the view that disclosure should be made at the early stage of the proceeding or as soon as the funding agreement is concluded (A/CN.9/1004, para. 89). Provisions in recent investment treaties generally require that disclosure

[54] The 2018 ICCA Report suggests disclosure only to the tribunal, the arbitral institution and appointing authority (if any). See 2018 ICCA Report p. 14. CETA, Article 8.26; EU–Vietnam, Article 3.37; EU–Singapore, Article 3.8.

[55] See 2022 ICSID Arbitration Rules, Rule 14(4), which states: "(4) The Tribunal may order disclosure of further information regarding the funding agreement and the non-party providing funding pursuant to Rule 36(3)."

[56] See Victoria Shannon Sahani, *Judging Third-Party Funding*, 63 UCLA L. Rev. 388 (2016).

[57] See 2018 ICCA Report, p. 96, referring to the example of General Standard 7(a) of the IBA Guidelines, which provides that disclosure for the purpose of assessing conflicts applies not only to a party, but also to "another company of the same group of companies [as the party], or an individual having a controlling influence on the party in the arbitration"; See also draft provision 3(c) in the CCSI/IIED/IISD Joint Submission.

[58] See EU–Singapore, Article 3.8; CCFTA, Article G-23 bis; Argentina-Chile Free Trade Agreement (Argentina–Chile) (2017) Article 8.27; Indonesia–Australia, Article 14.32; CETA, Article 8.26; EU–Vietnam, Article 3.37. 2022 ICSID Arbitration Rules, Rule 14, requires the "name and address" of the third-party funder to be disclosed.

should be made at the time of the submission of the claim or immediately after the funding is received or a funding agreement is concluded.[59]

87. The Working Group may wish to consider whether rules should be prepared for disclosing the information prior to the constitution of the tribunal, for example, in the notice of arbitration to the other party or in a notice to an administering institution, appointing or other authority. In that case, the entity that received the information would be required to transmit the information to potential candidates and the arbitral tribunal once it is constituted.

88. Paragraph 4 reflects the view that the disclosure obligation should continue throughout the proceeding (A/CN.9/1004, para. 89). It further requires the funded party to notify the arbitral tribunal and the other disputing parties of any change in the information already disclosed or any new information.

89. Paragraph 5 provides the measures to be taken when there is a breach of the disclosure obligation.

Linkage with disclosure requirements of the arbitral tribunal

90. The Working Group may wish to consider draft provision E-2 also in light of draft article 10 of the Code of Conduct in document A/CN.9/WG.III/WP.216, which requires a candidate and an arbitrator to disclose any financial, business, professional, or personal relationship in the past five years with an entity identified by a disputing party (subparagraph 2(a)(i)) and any entity identified by a disputing party as having a direct or indirect interest in the outcome of the IID proceeding, including a third-party funder. Such disclosure is to be made prior to or upon accepting appointment in accordance with article 10(5). The Working Group may wish to consider this interplay as it relates to when the disclosure under draft provision E-2 can be made, as a candidate would likely not be aware of the identity of the third-party funder.

Public disclosure

91. The UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration do not address the publication of information or documents about third-party funding. The Working Group may wish to consider whether a mechanism should be developed to make any of the information disclosed in accordance with draft provision E-2 also available to the public similar to the Transparency Rules.[60]

4. Legal consequences and sanctions in case of non-compliance

92. The range and types of third-party funding that would be prohibited under each regulation model will differ. In any case, it would be necessary to set out the consequences of a party entering into such third-party funding agreement or being provided with such funding.

93. In light of views that clearly defined and strictly applied sanctions for non-compliance of the disclosure requirement would ensure an effective enforcement of those requirements (A/CN.9/1004, para. 92), the same consequences could apply when the disputing parties do not comply with the disclosure requirement in draft provision E-2.[61] Recent investment treaties provide that the arbitral tribunal could

[59] For example, EU–Vietnam, Article 3.37; EU–Singapore, Article 3.8; Indonesia–Australia, Article 14.32 (2).

[60] See CCSI/IIED/IISD Joint Submission, p. 5.

[61] See for example Indonesia–Australia, Article 14.32 (3), which reads: If a disputing investor fails to disclose third party funding under this Article, the tribunal may order the suspension or termination of the proceedings.

suspend or terminate the proceeding,[62] take into account the non-compliance in its decision on costs,[63] or take any measure to be determined by it.[64]

94. The Working Group may wish to consider the following provision indicating possible measures that the arbitral tribunal could take.

DRAFT PROVISION E-3 (Sanctions)

If a party enters into an agreement on, or receives, third-party funding, [which are not permissible under these provisions] or if a funded party fails to disclose the information in accordance with [draft provision E-2], the arbitral tribunal may:

(a) order the party to terminate the agreement and to return any funding received;

(b) suspend or terminate the proceeding;

(c) order security for costs in accordance with [draft provision B]

(d) take this fact into account when allocating costs in accordance with [draft provision C].

95. The measure to be taken by the arbitral tribunal would likely vary depending on the regulation model. Under options X and Y of the prohibition model, the tribunal may decide that the claim is inadmissible or that it lacks jurisdiction to consider the claim.

96. It should be possible for the arbitral tribunal to take more than one measure outlined in draft provision E-3. The measures may also need to be adjusted depending on how and when the determination that the third-party funding is not allowed is made. Furthermore, the measures to be taken if the party proceeds to obtain third-party funding despite a determination to the contrary would need to be considered.

97. The Working Group may wish to consider whether the measures outlined above are appropriate and whether additional measures should be added, for example, requiring an irrevocable commitment by the third-party funder to be responsible for any adverse decision on costs.

98. Like other provisions on third-party funding, procedural rules would need to be developed stipulating whether a party has to make a request to the arbitral tribunal for it to take any of the measures as well as factors to be taken into account when choosing a measure (for example, prejudice to the other party).

99. While draft provision E-3 focuses on measures that can be taken by the arbitral tribunal, it is also possible that non-compliance with the third-party funding provisions could result in the award or decision being set aside or annulled.

5. Third party funders as investment

100. The Working Group may wish to consider whether a draft provision should be prepared to clarify that third-party funding does not construe an investment protected under investment treaties and that a third-party funder is not considered an investor under investment treaties. Such a provision would preclude third-party funders from raising claims against a State on the basis of any loss or damage suffered by funding another claimant.

[62] See Indonesia–Australia, article 14.32 (3).

[63] See EU–Vietnam, Article 3.37 (3); CIETAC International Investment Arbitration Rules (2017), Article 27 (3).

[64] See Argentina–Chile, Article 8.27(2).

6. Code of conduct for third-party funders

101. The Working Group may wish to consider whether a code of conduct for third-party funders should be prepared based on existing initiatives.[65] Some issues that could be addressed in such a code are: (i) disclosure, particularly of any conflict of interest; (ii) transparency requirements with regard to the conduct of their business; (iii) limitation on the return to be paid to the funder (for example, a maximum percentage of the amount awarded or claimed); (iv) limitation on the control that the funder could have over the proceeding; (v) limitation on the number of claims that a funder could provide to support claims against the same State; and (vi) due diligence on claims to prevent the funding of frivolous claims.

[65] See Hong Kong Code of Practice for Third Party Funding of Arbitration (7 December 2018) available at https://gia.info.gov.hk/general/201812/07/P2018120700601_299064_1_1544169372716.pdf; Code of Conduct for Litigation Funders by the Civil Justice Council of the UK's Ministry of Justice available at https://associationoflitigationfunders.com/code-of-conduct/.

Annex

2022 ICSID ARBITRATION RULES

ICSID Member States approved the amended rules on 21 March 2022, and the updated rules went into effect on 1 July 2022. The following are excerpts of the 2022 ICSID Arbitration Rules relevant for the discussion.

Rule 14

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 defence 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).

Rule 41

Manifest Lack of Legal Merit

(1) A party may object that a claim is manifestly without legal merit. The objection may relate to the substance of the claim, the jurisdiction of the Centre, or the competence of the Tribunal.

(2) The following procedure shall apply:

(a) a party shall file a written submission no later than 45 days after the constitution of the Tribunal;

(b) the written submission shall specify the grounds on which the objection is based and contain a statement of the relevant facts, law and arguments;

(c) the Tribunal shall fix time limits for submissions on the objection;

(d) if a party files the objection before the constitution of the Tribunal, the Secretary-General shall fix time limits for written submissions on the objection, so that the Tribunal may consider the objection promptly upon its constitution; and

(e) the Tribunal shall render its decision or Award on the objection within 60 days after the later of the constitution of the Tribunal or the last submission on the objection.

(3) If the Tribunal decides that all claims are manifestly without legal merit, it shall render an Award to that effect. Otherwise, the Tribunal shall issue a decision on the objection and fix any time limit necessary for the further conduct of the proceeding.

(4) A decision that a claim is not manifestly without legal merit shall be without prejudice to the right of a party to file a preliminary objection pursuant to Rule 43 or to argue subsequently in the proceeding that a claim is without legal merit.

Rule 43

Preliminary Objections

(1) A party may file a preliminary objection that the dispute or any ancillary claim is not within the jurisdiction of the Centre or for other reasons is not within the competence of the Tribunal ("preliminary objection").

(2) A party shall notify the Tribunal and the other party of its intent to file a preliminary objection as soon as possible.

(3) The Tribunal may at any time on its own initiative consider whether a dispute or an ancillary claim is within the jurisdiction of the Centre or within its own competence.

(4) The Tribunal may address a preliminary objection in a separate phase of the proceeding or join the objection to the merits. It may do so upon request of a party pursuant to Rule 44 or at any time on its own initiative, in accordance with the procedure in Rule 44(2)-(4).

* See also Rules 44 (Preliminary Objections with a Request for Bifurcation) and 45 (Preliminary Objections without a Request for Bifurcation)

Rule 48

Ancillary Claims

(1) Unless the parties agree otherwise, a party may file an incidental or additional claim or a counterclaim ("ancillary claim") arising directly out of the subject-matter of the dispute, provided that such ancillary claim is within the scope of the consent of the parties and the jurisdiction of the Centre.

(2) An incidental or additional claim shall be presented no later than in the reply, and a counterclaim shall be presented no later than in the counter-memorial, unless the Tribunal decides otherwise.

(3) The Tribunal shall fix time limits for submissions on the ancillary claim.

Rule 50

Costs of the Proceeding

The costs of the proceeding are all costs incurred by the parties in connection with the proceeding, including:

(a) the legal fees and expenses of the parties;

(b) the fees and expenses of the Tribunal, Tribunal assistants approved by the parties and Tribunal-appointed experts; and

(c) the administrative charges and direct costs of the Centre.

Rule 52

Decisions on Costs

(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.

Rule 53

Security for Costs

(1) Upon request of a party, the Tribunal may order any party asserting a claim or counterclaim to provide security for costs.

(2) The following procedure shall apply:

(a) the request shall include a statement of the relevant circumstances and the supporting documents;

(b) the Tribunal shall fix time limits for submissions on the request;

(c) if a party requests security for costs before the constitution of the Tribunal, the Secretary-General shall fix time limits for written submissions on the request so that the Tribunal may consider the request promptly upon its constitution; and

(d) the Tribunal shall issue its decision on the request within 30 days after the later of the constitution of the Tribunal or the last submission on the request.

(3) In determining whether to order a party to provide security for costs, the Tribunal shall consider all relevant circumstances, including:

(a) that party's ability to comply with an adverse decision on costs;

(b) that party's willingness to comply with an adverse decision on costs;

(c) the effect that providing security for costs may have on that party's ability to pursue its claim or counterclaim; and

(d) the conduct of the parties.

(4) The Tribunal shall consider all evidence adduced in relation to the circumstances in paragraph (3), including the existence of third-party funding.

(5) The Tribunal shall specify any relevant terms in an order to provide security for costs and shall fix a time limit for compliance with the order.

(6) If a party fails to comply with an order to provide security for costs, the Tribunal may suspend the proceeding. If the proceeding is suspended for more than 90 days, the Tribunal may, after consulting with the parties, order the discontinuance of the proceeding.

(7) A party shall promptly disclose any material change in the circumstances upon which the Tribunal ordered security for costs.

(8) The Tribunal may at any time modify or revoke its order on security for costs, on its own initiative or upon a party's request.