

# Investment Arbitration Reform: Third-Party Funding in Investment Arbitration

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## Abstract

This paper analyses the issue of “third-party funding”, something widely criticised in investment arbitration. It is an issue addressed both through UNCITRAL Working Group III and in the amendment of the ICSID Procedural Rules (in force since 1 July 2022). The author discusses the issue and why it has been seen as problematic, then focuses on proposals for solutions discussed in debates. Finally, she compares the proposals discussed in UNCITRAL Working Group III with the newly adopted amendment of the ICSID Procedural Rules.

## Keywords

Third-Party Funding; UNCITRAL Working Group III; ICSID; Reform; Investment Arbitration.

## 1 Introduction

Generally speaking, the primary purpose of international investment law is to provide foreign investors with protection for their investments from interference by the host state where the investor operates.<sup>1</sup> While investment law provides for substantive guarantees,<sup>2</sup> international investment arbitration is the procedural mechanism that secures the procedural guarantees.<sup>3</sup>

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<sup>1</sup> DOLZER, R., SCHREUER, C. *Principles of International Investment Law*. Oxford: Oxford University Press, 2008, pp. 1–3.

<sup>2</sup> For example, the specific standards are the national treatment, most favoured nation, fair and equitable treatment (“FET”), etc. – *Ibid.*, pp. 220–222.

<sup>3</sup> EUROPEAN COMMISSION. Factsheet on Investor-State Dispute Settlement. *SICE* [online]. 3.10.2013, 6 p. [cit. 7.5.2022]. Available at: [http://www.sice.oas.org/tpd/USA\\_EU/Studies/tradoc\\_151791\\_Investor-State\\_Dis\\_e.pdf10](http://www.sice.oas.org/tpd/USA_EU/Studies/tradoc_151791_Investor-State_Dis_e.pdf10)

There is debate about the current investment arbitration system because some involved states and other actors are disputing whether it fulfils its desired goals.<sup>4</sup> Investment arbitration is currently, again, being reformed. However, this seems to be a complex, determined debate, while some results have already been presented this time. This paper deals with one of the third-party concerns raised as part of the currently ongoing reform of investment arbitration. To understand why the actors in the debate raised it as a concern, the author believes that the readers need to understand what third-party funding is, and how it was developed – both generally and specifically – in investment arbitration.

Third-party funding is a fast-growing industry involving speculative investors who invest in arbitration proceedings and seek to control and participate in debt collection via such investment.<sup>5</sup> The third-party funders' investments in the proceedings are most likely to provide the funding or resources to finance international arbitration's legal costs and expenses.<sup>6</sup> To summarize the general introductory excursion, some states want to ban third-party funding, while others wish to regulate it. The investors, specifically small and medium-sized enterprises ("SMEs"), want to create a mechanism through which they can access justice without third-party funders disqualifying them from this. In other words, to reform it.

This paper provides a descriptive analysis of the concerns related to the presence of third parties and how they can be mitigated. The author firstly presents how third-party funding works in practice and how it was developed. Then, the criticism of third-party funding in the current system in UNCITRAL Working Group III, the ICSID and SMEs is described. The third chapter very briefly presents the current state of the regulation. That is followed by a description of the current initiation in UNCITRAL Working Group III and ICSID, and the possibilities presented by SMEs. The author concludes with her view on the presented solutions and a comparison of the presented solutions.

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<sup>4</sup> GIORGETTI, C. Reforming International Investment Arbitration: An Introduction. *The Law and Practice of International Courts and Tribunals*. 2019, Vol. 18, p. 306.

<sup>5</sup> STEINITZ, M. Whose Claim Is This Anyway? Third-Party Litigation Funding. *Minnesota Law Review*. 2011, Vol. 95, no. 4, p. 1268.

<sup>6</sup> *Ibid.*, pp. 1286–1291.

## 2 How Third-Party Funding Operates in the Current System

A third-party funder may be a lawyer or just a third person: a company sharing indirect interests in the success of the claim, which is interested in the outcome, and makes financial arrangements or provides material support for the costs of one of the parties in certain proceedings in exchange for remuneration – often a share of the award.<sup>7</sup>

This opportunity for investors who cannot afford arbitration proceedings became available in commercial proceedings around twenty years ago. Third-party funding was illegal under common law as a violation of the doctrines of maintenance and champerty, and virtually unknown in the civil law part of the world.<sup>8</sup> United Kingdom and Australian courts made the first move towards a slow but hastening process of legalization that has spread to Europe, the United States and Asia,<sup>9</sup> raising significant policy concerns.<sup>10</sup> With the global financial crisis after 2008, demand from speculators for new investment vehicles rose, and third-party funders discovered that the political economy of the investor-state dispute settlement system offered the possibility of very high returns with comparatively little risk. The high costs and potentially significant damages characteristic of investment arbitration proceedings have made it a new and attractive market for third-party funders.<sup>11</sup> For information, according to a survey from 2018, reproduced in the Report of the ICCA – Queen Mary Task Force on Third-Party

<sup>7</sup> BOURGEOIS, A. Third-Party Funding. *Jus Mundi* [online]. 23. 2. 2022 [cit. 7. 5. 2022]. Available at: <https://jusmundi.com/en/document/wiki/en-third-party-funding>

<sup>8</sup> STEINITZ, M. Whose Claim Is This Anyway? Third-Party Litigation Funding. *Minnesota Law Review*. 2011, Vol. 95, no. 4, p. 1268.

<sup>9</sup> RICKARD, L. Third-party litigation funding in U.S. enters mainstream, leading to calls for reform. *Financier Worldwide* [online]. November 2016 [cit. 7. 5. 2022]. Available at: <https://www.financierworldwide.com/third-party-litigation-funding-in-us-enters-mainstream-leading-to-calls-for-reform#.YpN0py0Rqu4>

<sup>10</sup> BEISNER, J. H., RUBIN, G. A. Stopping the Sale on Lawsuits: A Proposal to Regulate Third Party Investments in Litigation. *U.S. Chamber Institute for Legal Reform* [online]. October 2012, pp. 1–2 [cit. 7. 5. 2022]. Available at: [https://instituteforlegalreform.com/wp-content/uploads/2020/10/TPLF\\_Solutions.pdf](https://instituteforlegalreform.com/wp-content/uploads/2020/10/TPLF_Solutions.pdf)

<sup>11</sup> GARCIA, F.J. The Case Against Third-Party Funding in Investment Arbitration. *IISD* [online]. 30. 7. 2018 [cit. 7. 5. 2022]. Available at: <https://www.iisd.org/itn/en/2018/07/30/the-case-against-third-party-funding-in-investment-arbitration-frank-garcia/>

Funding in International Arbitration created by the International Council for Commercial Arbitration, third-party funding is used in both commercial, investment and state-state arbitration.<sup>12</sup>

On the other hand, it is rather challenging to approximate the role of third-party funders because, as became apparent in some investment arbitration cases, they generally prefer not to disclose their role to the other parties or the arbitrators – even though, according to the available information from the mentioned cases, their actual or alleged role is significant.<sup>13</sup> Many jurisdictions are beginning to recognize the impact of third-party funding and its unique role in international investment arbitration. It is essential to consider whether third-party funding is consistent with the goals of the investment law regime and the values and interests states must advance and protect.

## 2.1 The Structure of Third-Party Funding

Suppose an investor is sure of their claim but does not have the funds to pay for investment arbitration proceedings. In such a case, they can turn to an external third-party company that provides claimants with the funds they need to conduct arbitration if they are convinced their case has a chance of success. This company will then recoup its investment in the claimants' dispute from the award. It might be a private company, an investment bank, a special investment fund (hedge funds) or an international law firm. However, such a third party will only provide funds if it likes the case and sees a possibility of winning. Usually, the third party through which the claimant

<sup>12</sup> Report of the ICCA – Queen Mary Task Force on Third-Party Funding in International Arbitration. *ICCA* [online]. April 2018, p. 1 [cit. 7. 5. 2022]. Available at: [https://cdn.arbitration-icca.org/s3fs-public/document/media\\_document/Third-Party-Funding-Report%20.pdf](https://cdn.arbitration-icca.org/s3fs-public/document/media_document/Third-Party-Funding-Report%20.pdf)

<sup>13</sup> Viz., e.g., Decision on Jurisdiction and Admissibility of 4. 8. 2011 and Dissenting Opinion, Georges Abi-Saad of 28. 10. 2011, *Abaclat and others vs. Argentine Republic Case*, ICSID Case No. ARB/07/5. In: *Cases Database ICSID* [online]. [cit. 7. 5. 2022]. Available at: <https://icsid.worldbank.org/cases/case-database/case-detail?CaseNo=ARB/07/5&tab=DOC>; Annulment Proceeding of 28. 4. 2011, *RSM Production Corporation vs. Grenada Case*, ICSID Case No. ARB/05/14. In: *Cases Database ICSID* [online]. [cit. 7. 5. 2022]. Available at: <https://icsid.worldbank.org/cases/case-database/case-detail?CaseNo=ARB/05/14>; Award of 3. 3. 2010, *Ron Fuchs vs. Georgia Case*, ICSID Case No. ARB/08/2. In: *Cases Database ICSID* [online]. [cit. 7. 5. 2022]. Available at: <https://icsid.worldbank.org/cases/case-database/case-detail?CaseNo=ARB/07/15>

secures funding will research the likelihood of winning, what the costs are likely to be, and other similarly important data before it makes its decision.<sup>14</sup>

### 2.1.1 Pros and Cons

The third-party funding system brings many advantages as well as disadvantages. One advantage is that the system fulfils the need for access to justice for investors who cannot afford costly proceedings. Furthermore, it offers division of risk management and some level of predictability of claim validity, since many third-party funders are only interested in “good claims” – those their research indicates have high potential to succeed. One disadvantage of third-party funding relates to the expenses because the successful claimant pays a massive amount to the third-party funder under the Funding Agreement.

Moreover, the claimant can lose control or influence over their own case, even though this is supposed to be prohibited. The costs of applying for third-party funding can also be relatively high. If the investor does not qualify, they can lose a lot of money and the possibility to access justice, while this is specifically true for SMEs.<sup>15</sup>

## 3 Criticism of Third-Party Funding in the Current System

Generally speaking, the current investment arbitration system is widely criticised, specifically in terms of its fairness, governance, asymmetry, legitimacy, the rule of law grounds, non-consistency, non-coherency, and non-correctness.<sup>16</sup> These structural insufficiencies of the system do not help promote the third-party funding model, and make investment arbitration a very attractive investment

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<sup>14</sup> Third-Party Funding: A Source of Capital for Any Company With a Good Legal Claim. *FTI Consulting* [online]. [cit. 7.5.2022]. Available at: <https://www.fticonsulting.com/emea/insights/articles/third-party-funding-source-capital-any-company-with-good-legal-claim>

<sup>15</sup> Third-Party Funding in International Arbitration. *Ashurst* [online]. 1.2.2022 [cit. 8.5.2022]. Available at: <https://www.ashurst.com/en/news-and-insights/legal-updates/quickguide---third-party-funding-in-international-arbitration/>

<sup>16</sup> GARCIA, F.J. Third-Party Funding as Exploitation of the Investment Treaty System. *Boston College Law Review*. 2018, Vol. 59, no. 8, p. 2913.

market for funders.<sup>17</sup> The involvement of third-party funders may have an impact on the jurisdiction of the arbitral tribunal, the possibility of obtaining security for costs, transparency and conflict of interests, and the determination of recoverable costs.<sup>18</sup> It may also impact other parts of investment arbitration proceedings, as the reader will see in the following chapters.

The current system is highly criticised, while one of the concerns raised relates to third-party funding itself. States criticise the non-regulative character and dangers inherent in third-party funding<sup>19</sup> for investors, specifically SMEs, and the possible lack of access to justice.<sup>20</sup>

There is debate on reform in several platforms. Therefore, this paper looks at several platforms where third-party funding is being discussed. The debate is taking place in UNCITRAL WG III, ICSID, and among investors, specifically SMEs.

### 3.1 What Has Been Seen as Problematic in UNCITRAL Working Group III?

UNCITRAL mandated its Working Group III in 2017 to identify concerns regarding investor-state dispute settlement and to develop potential reform solutions.<sup>21</sup> In this section, the author first presents the concerns raised at Working Group III sessions, and then analyses those concerns in more detail.

<sup>17</sup> GARCIA, F.J. Third-Party Funding as Exploitation of the Investment Treaty System. *Boston College Law Review*. 2018, Vol. 59, no. 8, p. 2914.

<sup>18</sup> BOURGEOIS, A. Third-Party Funding. *Jus Mundi* [online]. 23. 2. 2022 [cit. 7. 5. 2022]. Available at: <https://jusmundi.com/en/document/wiki/en-third-party-funding>

<sup>19</sup> KALICKI, J. Third-Party Funding in Arbitration: Innovations and Limits in Self-Regulation (Part 2 of 2). *Kluwer Arbitration Blog* [online]. 14. 3. 2012 [cit. 7. 5. 2022]. Available at: <http://arbitrationblog.kluwerarbitration.com/2012/03/14/third-party-funding-in-arbitration-innovations-and-limits-in-self-regulation-part-2-of-2/>; GARCIA, F.J. The Case Against Third-Party Funding in Investment Arbitration. *IISD* [online]. 30. 7. 2018 [cit. 7. 5. 2022]. Available at: <https://www.iisd.org/itn/en/2018/07/30/the-case-against-third-party-funding-in-investment-arbitration-frank-garcia/>

<sup>20</sup> Possible reform of investor-State dispute settlement (ISDS) – cost and duration, Working Group III (Investor-State Dispute Settlement Reform), Thirty-sixth session (Vienna, 29 October – 2 November 2018). *UNCITRAL* [online]. 31. 8. 2022, p. 3, para. 9 [cit. 8. 5. 2022]. Available at: <https://undocs.org/en/A/CN.9/WG.III/WP.153>; MILLER, S., HICKS, G.N. *Investor-State Dispute Settlement: A Reality Check*. Lanham: Rowman & Littlefield, 2015, 31 p.

<sup>21</sup> UNCITRAL Working Group III and Reform of Investor-State Dispute Settlement. *IISD* [online]. [cit. 13. 5. 2022]. Available at: <https://www.iisd.org/projects/uncitral-working-group-iii-and-reform-investor-state-dispute-settlement>

Within the Working Group III debate, third-party funding was raised as a concern that required further consideration at the 34<sup>th</sup> session.<sup>22</sup> It was observed that third-party funding had become a significant concern, creating a systemic imbalance, and that it has an impact on issues such as transparency, the appointment of arbitrators, the compensation of arbitrators, lack of accountability, conflicts of interest of arbitrators, costs of proceedings, a potential increase in frivolous claims, and outcome legitimacy.<sup>23</sup> At the 35<sup>th</sup> session, the delegates added other observations, including that domestic legislation generally did not prohibit double-hatting. It was also noted that “triple” or even “quadruple” hatting had been observed in practice, where certain individuals acted as party-appointed experts in certain investment arbitration cases or advisers to third-party funders.<sup>24</sup> According to the report from that session, such practices raise ethical issues and might have a negative impact on proceedings. Furthermore, it pointed to the fact that third-party funders might gain excessive control or influence over the arbitration process, leading to frivolous claims and discouragement of settlements.<sup>25</sup> Moreover, it was indicated that third-party funding was a complex area and that there were different forms or types of funding.<sup>26</sup>

On the other hand, Working Group III does not see only criticism. On the contrary, it mentioned that third-party funding could be a helpful tool to ensure access to justice, particularly for SMEs.<sup>27</sup>

The author adds that in UNCITRAL Working Group III sessions, states have raised concerns about third-party funding linked with outcome transparency and legitimacy, and cost issues. Ten states from thirty Member States have specifically raised concerns. This specific presentation concerned all the

<sup>22</sup> Third-party funding [online]. *UNCITRAL* [cit. 13. 5. 2022]. Available at: <https://uncitral.un.org/en/thirdpartyfunding>

<sup>23</sup> Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fourth session (Vienna, 27 November – 1 December 2017) Part I. *UNCITRAL* [online]. 19. 12. 2017, p. 13, para. 64 [cit. 13. 5. 2022]. Available at: <https://undocs.org/en/A/CN.9/930/Rev.1>

<sup>24</sup> Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fifth session (New York, 23–27 April 2018). *UNCITRAL* [online]. 14. 5. 2017, p. 12, para. 79 [cit. 13. 5. 2022]. Available at: <https://daccess-ods.un.org/tmp/6780042.64831543.html>

<sup>25</sup> *Ibid.*, para. 89.

<sup>26</sup> *Ibid.*, para. 90.

<sup>27</sup> *Ibid.*, para. 91.

already mentioned issues related to third-party funding, such as transparency, impartiality of arbitrators and conflicts of interest, systematic imbalance, the probability of more frivolous claims, costs, and award enforcement.<sup>28</sup>

<sup>28</sup> A fascinating point was raised by Nigeria, which stated: *“We find that third-party funders are attracted by high-level claims, the perceived finality of awards, and the enforcement regime. But it still raises moral, ethical, and policy issues. Why should a total stranger who has suffered no injury be allowed to benefit from injury caused to others? In our view, the danger of third-party funding is that the funders are not known to BITs.”* The Nigerian delegate proposed that transparency be enhanced or that third-party funding be banned. The Polish delegation commented on the relationship between third-party funding and frivolous claims: *“... the third-party funder runs a low risk of indemnifying the whole state for the incurred arbitration costs. Such a situation creates an obvious asymmetry between the investor and the state and can induce investors to bring unrelated claims.”* Singapore said that the issue of third-party funding is related to the costs *per se* as well as to the impartiality of the arbitrators. Furthermore, Singapore believes that *“the increasing prevalence of third-party funding [...] is something that is not being sufficiently addressed in the current ISDS framework, but it needs to be more fully addressed in order to safeguard the integrity and impartiality of ISDS proceedings.”* Australia commented on transparency and its relation to third-party funding: *“One of the areas to look at concerning ways of improving transparency is in relation to third-party funding.”* Italy stated, concerning the systemic issues, security costs, third-party funding and legitimacy of the system, that: *“Some issues on security for costs, of third-party financing, are also linked to the legitimacy of the system because transparency and conflicts are connected.”* With that comment, the author believes that the Italian delegation wanted to point out that all these concerns should be resolved together at some point. The Netherlands specifically commented: *“The issue of transparency is really a crosscutting one and [...] in view of this delegation needs a systemic holistic approach.”* India was concerned about the problem of pro-investor and pro-state arbitrators regarding impartiality and independence, and stated that: *“The mix of third-party funding, multiple hatting and lack of adequate ethical standards has the potential to derail the system.”* Canada stated that: *“... the perception is that third-party funding really benefits illegitimate investors, that it is a way of exploiting the system, and that it gives rise to claims that would not otherwise justifiably arise. [...] There is growing consensus, and a number of recent treaties look at the issue of transparency, security and costs, and the link to third-party funding.”* Uruguay commented on transparency, the impartiality of arbitrators, and third-party funding: *“Transparency of the proceedings is vital. We would suggest that there be a proper phase in arbitration whereby a group or committee would analyse the relevance of the documents brought forward as evidence, look at the claim, and then consider the costs. This could also look at the list of arbitrators in order to ascertain their skills, their professional ethics, and their links to the parties or third-party funders in order to avoid conflicts of interest.”* And lastly, the USA affirmed the need to better understand different types of third-party funding: *“We [...] note that third-party funding can encompass a number of different forms [...]. Others have noted that it plays an important role for access to justice for small and medium enterprises. [...] It’s important to have more information and a better inventory of these types of different forms available to the working group [...] that we can define it in order to be in a better position to assess what solutions may be appropriate, and what types of third-party funding may raise concerns.”*

ROBERTS, A., BOURAOUI, Z. UNCITRAL and ISDS Reforms: Concerns about Costs, Transparency, Third-Party Funding and Counterclaims. *EJIL: Talk* [online]. 6. 6. 2018 [cit. 14. 5. 2022]. Available at: <https://www.ejiltalk.org/uncitral-and-isds-reforms-concerns-about-costs-transparency-third-party-funding-and-counterclaims/>



The author now also expands on the points raised within the debate in more detail. The lack of transparency concerning third-party funding related to the fact that a party can be secretly financed by a third party that has a conflict of interest with the arbitrators not specified during the proceedings. Since the third-party system is not sufficiently transparent, no one will ever know of this. Furthermore, the lack of transparency could mean the tribunal was not impartial or independent because of the conflict of interest, and therefore the whole proceedings are unjust. This issue is also related to the “multiple-hatting” of the arbitrators.

An improperly regulated system also raises the issue of payment, and the allocation and apportionment of the costs of proceedings. As already pointed out in the first chapter of this paper, the third-party funders pay part of the total costs of the proceedings. If the claimant is successful, the third-party funder gets a significant payout. Therefore, when the tribunal is assigning the costs, there is a knowledge gap regarding who should get them. Furthermore, states see the payment of costs and part of the allocated damages to a third, non-involved, party, which was involved just to profit from the proceedings, as problematic.

Furthermore, some states pointed out that third-party funding increases frivolous claims and can incentivise claimants to bring claims – and funders to finance such claims – that lack strong merits. Critics argue that this trend of financing frivolous claims is increasing legal costs for states, while investors/claimants bear little of the risk in bringing such claims.<sup>29</sup>

The concern relating to system imbalance through third-party funding was firstly raised at the 34<sup>th</sup> session of UNCITRAL Working Group III.<sup>30</sup> According to the debaters, third-party funding creates a systematic imbalance between investors and states.<sup>31</sup>

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<sup>29</sup> XIN CHEN, S., HOUGH, K. Researching Third-Party Funding in Investor-State Dispute Settlement. *NYU Law Globalex* [online]. May 2019 [cit. 14. 5. 2022]. Available at: [https://www.nyulawglobal.org/globalex/Third-Party\\_Funding\\_Investor-State\\_Dispute\\_Settlement.html#\\_6.4.\\_Frivolous\\_Claims](https://www.nyulawglobal.org/globalex/Third-Party_Funding_Investor-State_Dispute_Settlement.html#_6.4._Frivolous_Claims)

<sup>30</sup> Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fourth session (Vienna, 27 November – 1 December 2017) Part I. *UNCITRAL* [online]. 19. 12. 2017, p. 10, para. 64 [cit. 13. 5. 2022]. Available at: <https://undocs.org/en/A/CN.9/930/Rev.1>

<sup>31</sup> *Ibid.*

In conclusion, the reader may see that the lack of transparency of third-party funding is most problematic as it is related to a higher probability of conflicts of interest and costs, specifically the allocation and security of costs. Furthermore, some states raised a systematic concern, with some debaters wanting to ban it, others just to reform it. Moreover, because third-party funding is the only option for some SMEs, Working Group III further developed these concerns into a possible solution, as the reader may see in Chapter 5.

### **3.2 The Debate Within ICSID Amendment Proceedings**

Between October 2016 and January 2022, the ICSID amended its rules of procedure. The amended rules have been in force since 1 July 2022. As a part of the amendment proceedings, third-party funding was raised as one of the concerns.<sup>32</sup> As part of the amendment proceedings, six “Working Papers” were initiated.<sup>33</sup> Additionally, the issue of third-party funding was included in the first Working Paper issued on 2 August 2018, where the authors stated that the increase in third-party funding meant that the related concerns increased as well.

The ICSID received two types of comments, similarly to UNCITRAL. One group of states wanted to prohibit third-party funding entirely because, according to these states, it promotes frivolous claims and is inadaptable to disputes involving states.<sup>34</sup> On the contrary, the other group, including states and other actors, wanted to include a rule for the mandatory disclosure of information concerning third-party funding.<sup>35</sup> Such disclosure would cover concerns like lack of transparency, conflict of interests, and issues related to costs. Hence, the main criticism within this platform stems from the fear of frivolous claims piling up and the fact that it is not sufficiently regulated.

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<sup>32</sup> About the ICSID Rule Amendments. *ICSID* [online]. [cit. 15. 5. 2022]. Available at: <https://icsid.worldbank.org/resources/rules-and-regulations/amendments/about>

<sup>33</sup> ICSID Rules and Regulations Amendment. *ICSID* [online]. [cit. 15. 5. 2022]. Available at: <https://icsid.worldbank.org/resources/rules-amendments>

<sup>34</sup> ICSID. Proposals for Amendment of the ICSID Rules – Working Paper. *ICSID* [online]. P. 131, para. 241 [cit. 15. 5. 2022]. Available at: [https://icsid.worldbank.org/sites/default/files/publications/WP1\\_Amendments\\_Vol\\_3\\_WP-updated-9.17.18.pdf](https://icsid.worldbank.org/sites/default/files/publications/WP1_Amendments_Vol_3_WP-updated-9.17.18.pdf)

<sup>35</sup> *Ibid.*, p. 131, para. 241, 243.

### 3.3 Other Remarks

So far, the author has presented the views of the states and political actors in two vital platforms – UNCITRAL Working Group III and the ICSID. Nevertheless, there is another point of view – the investors’ one. Third-party funding was integrated into investment proceedings during the 2008 financial crisis with the intention of improving access to justice in investment arbitration proceedings for enterprises that could not afford the expensive proceedings. These were and are still most likely SMEs. For them, the current system is also not very favourable. Third-party funding has gradually become popular with these enterprises as it improves access to justice. Yet the third-party funders get the majority of the potential profit, and thus criticise SMEs for often not having the access to justice they should, and therefore want the system to be more accessible.<sup>36</sup>

## 4 How Is Third-Party Funding Regulated Today?

After the criticism of the current system, the author believes it is also important to understand how it is regulated – both now and in the past. The current regulation is mainly based on international treaties and the procedural rules of the arbitration institutions.

Some states and international organisations have expressed concern about the impact on the investor-State dispute settlement system and expressed a willingness to regulate it. Therefore, they have started to regulate third-party funding within the newly negotiated treaties. Some of the first agreements were the regulation of third-party funding included in the EU-Canada Comprehensive Economic and Trade Agreement<sup>37</sup> and in the EU-Vietnam Free Trade Agreement.<sup>38</sup> On the other hand, some modern bilateral initiatives have expressly banned third-party funding, for example, the Argentina-United Arab Emirates BIT.<sup>39</sup>

<sup>36</sup> BUTLER, P., HERBERT, C. Access to Justice vs Access to Justice for Small and Medium-Sized Enterprises: The Case for a Bilateral Arbitration Treaty. *New Zealand Universities Law Review*. 2014, Vol. 26, no. 2, p. 189.

<sup>37</sup> Art. 8.26 EU-Canada Comprehensive Economic and Trade Agreement (“CETA”).

<sup>38</sup> Art. 3.37 EU-Vietnam Free Trade Agreement (“EVFTA”).

<sup>39</sup> Art. 24 Argentina – United Arab Emirates Bilateral Investment Treaty (2018).

Also, some arbitration institutions have started to include third-party funding provisions in their rules of procedure. For example, in 2021, the ICC included specific provisions on third-party funding in the 2021 ICC Arbitration Rules.<sup>40</sup>

Even though some states are seeking to regulate this issue at a bilateral level and some arbitral institutions are moving forward and trying to incorporate provisions regulating third-party funding, the issue has begun to be addressed at multilateral level only in the last five to six years. These efforts are examined in more detail in the following chapter.

## **5 Third-Party Funding as Part of Investment Arbitration Reform**

Based on the analysis of the concerns and how third-party funding is currently ineffectively regulated, the author provides insights into the proposals and solutions in investment arbitration reform in this chapter. According to the findings, the main issues are the systemic imbalance, transparency, appointment of arbitrators and concerns about the compensation of arbitrators, conflicts of interest, the lack of accountability, frivolous claims, and legitimacy of the outcome. In addition, however, the approach of SMEs themselves, who need help with the financing, seems to be a problem. Therefore, to be an ideal solution, it should cover as many of the problems addressed as possible.

### **5.1 UNCITRAL Working Group III**

The following two models were firstly suggested for further consideration at its 35<sup>th</sup> session: (i) prohibiting third-party funding entirely in ISDS cases<sup>41</sup>

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<sup>40</sup> DODGE, K. et al. Can Third-Party Funding Find the Right Place in Investment Arbitration Rules? *Kluwer Arbitration Blog* [online]. 31. 1. 2022 [cit. 16. 5. 2022]. Available at: <http://arbitrationblog.kluwerarbitration.com/2022/01/31/can-third-party-funding-find-the-right-place-in-investment-arbitration-rules/>

<sup>41</sup> Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fifth session (New York, 23–27 April 2018). *UNCITRAL* [online]. 14. 5. 2017, p. 14, para. 92 [cit. 13. 5. 2022]. Available at: <https://daccess-ods.un.org/tmp/6780042.64831543.html>; Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-seventh session (New York, 1–5 April 2019). *UNCITRAL* [online]. 9. 4. 2019, pp. 5–6, para. 20 [cit. 16. 5. 2022]. Available at: <https://daccess-ods.un.org/tmp/3092404.00791168.html>

or (ii) regulating third-party funding.<sup>42</sup> It was also suggested that a clear definition of third-party funding be developed.<sup>43</sup>

After several more sessions, it was presented at the 38<sup>th</sup> session that third-party funding should be regulated. Furthermore, the general thought was that flexibility should be provided, as third-party funding could open access to justice for those with insufficient resources, particularly SMEs and – to a more limited extent – states. It was also stated that prohibition of third-party funding could lead to the development of other forms of funding that might not be subject to regulation.<sup>44</sup>

UNCITRAL Working Group III initiated an “Initial Draft” concerning the regulation of third-party funding based on the issues raised in the 34<sup>th</sup>, 35<sup>th</sup>, and 36<sup>th</sup>, but mainly the 37<sup>th</sup> and 38<sup>th</sup> sessions. The Member States and other involved actors can comment on this Initial Draft until 30 July 2022.<sup>45</sup> The draft provisions have been prepared for inclusion in investment treaties and would need to be adjusted if they were to be part of a different type of instrument.<sup>46</sup> To ensure the structure of the article is clear, the author has divided this section in accordance with the Initial Draft.

### 5.1.1 Definitions

The Initial Draft firstly provides provisions concerning some key definitions. Specifically, the first provision regulates “proceedings”, “third-party funder”,

<sup>42</sup> Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fifth session (New York, 23–27 April 2018). *UNCITRAL* [online]. 14. 5. 2017, p. 14, para. 92 [cit. 13. 5. 2022]. Available at: <https://daccess-ods.un.org/tmp/6780042.64831543.html>; Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-seventh session (New York, 1–5 April 2019). *UNCITRAL* [online]. 9. 4. 2019, pp. 5–6, para. 20 [cit. 16. 5. 2022]. Available at: <https://daccess-ods.un.org/tmp/3092404.00791168.html>

<sup>43</sup> Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-seventh session (New York, 1–5 April 2019). *UNCITRAL* [online]. 9. 4. 2019, p. 6, para. 21 [cit. 16. 5. 2022]. Available at: <https://daccess-ods.un.org/tmp/3092404.00791168.html>

<sup>44</sup> Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-eighth session (Vienna, 14–18 October 2019). *UNCITRAL* [online]. 23. 10. 2019, p. 16, para. 81 [cit. 16. 5. 2022]. Available at: <https://daccess-ods.un.org/tmp/8651513.45729828.html>

<sup>45</sup> Possible reform of investor-State dispute settlement (ISDS) – Draft provisions on third-party funding. *UNCITRAL* [online]. 14 p. [cit. 16. 5. 2022]. Available at: <https://uncitral.un.org/en/thirdpartyfunding>

<sup>46</sup> *Ibid.*, p. 2, para. 3.

“funded party”, and “third-party funding”.<sup>47</sup> The authors stated that their goal was to provide clear definitions. However, commentators may create other key terminology that might need to be added.<sup>48</sup>

The author believes that the definitions are most likely sufficiently clear, except for one critique. The definition of third-party funding includes generally direct or indirect findings. Even though the definition seems to be sufficient, the two key adjectives could be elaborated further. Why? One of the comments raised as a concern about third-party funding was that it might have many forms. Also, if the authors wish to prepare multilateral regulation of third-party funding, it must be crystal-clear.

### 5.1.2 Regulation Models

After these definitions, the Initial Draft provides two possible regulation models of third-party funding for states in their agreements. One is the “Prohibition Model” and the other is the “Restriction Model”. Furthermore, this section includes a provision for legal consequences and possible sanctions for both these models.<sup>49</sup>

The author sees it as quite refreshing that the states, as sovereign actors in the international field, will be able to choose which model suits them better.

As some states desired, the Prohibition Model is supposed to address the prohibition of third-party funding. Such prohibition may address the concerns that third-party funding increases structural imbalance and frivolous claims.<sup>50</sup> The Initial Draft offers four options.<sup>51</sup> One is that third-party funding is generally prohibited.<sup>52</sup> The second is that investors cannot submit their claims if they entered into a funding agreement or received third-party funding.<sup>53</sup> The third possible model is based on the given consent of the

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<sup>47</sup> Possible reform of investor-State dispute settlement (ISDS) – Draft provisions on third-party funding. *UNCITRAL* [online]. P. 2, provision 1 [cit. 16. 5. 2022]. Available at: <https://uncitral.un.org/en/thirdpartyfunding>

<sup>48</sup> *Ibid.*, p. 3–4, para. 9.

<sup>49</sup> *Ibid.*, p. 4, para. 10.

<sup>50</sup> *Ibid.*, p. 4, para. 11.

<sup>51</sup> *Ibid.*, p. 4, provision 2.

<sup>52</sup> *Ibid.*, p. 4, para. 12.

<sup>53</sup> *Ibid.*, p. 4, para. 13.

respondent, which means that the respondent will give consent to the investment arbitration only if the claimant has not received any form of third-party funding.<sup>54</sup> The last model concerns the denial of benefits to the claimants that receive third-party funding. According to the UNCITRAL Working Group III's proposal, denying claimant's benefits with third-party funding could prevent the abuse of rights and safeguard the economic development objectives states pursue in investment treaties.<sup>55</sup>

Even though the author believes that it should be up to the states if they want to regulate or prohibit third-party funding, these provisions seem to cover every limitation. As mentioned in the UNCITRAL Working Group III debate, sometimes third-party funding is the only option for some SMEs to gain access to justice. Therefore, according to the author, the states should prohibit third-party funding only in some justifiable cases.

Then there is the Restriction Model or, more precisely, possible forms of it – the access to justice model, the sustainable development model, and the restriction list model. The first mentioned model is developed around the good faith of investors and their declaration that they do not have the means to pursue their claim without third-party funding.<sup>56</sup> The sustainable development model allows third-party funding for claimants only when the investment complies with sustainable development requirements.<sup>57</sup> Such requirements would be pre-defined. Also, this seems to support the current trend with states seeking, during treaty negotiations and renegotiations, to balance the protection of investors with their sustainable development agendas.<sup>58</sup> According to the author, it seems quite possible that this goal can be achieved. On the other hand, Working Group III should develop in more detail the pre-defined requirements because, for now, the terms seem quite devoid of meaning. The last presented model – the restriction list model – brings to the mix the possibility that the contracting states can include a list of prohibited forms of third-party funding in investment treaties.<sup>59</sup>

<sup>54</sup> Possible reform of investor-State dispute settlement (ISDS) – Draft provisions on third-party funding. *UNCITRAL* [online]. P. 4, para. 13 [cit. 16. 5. 2022]. Available at: <https://uncitral.un.org/en/thirdpartyfunding>

<sup>55</sup> *Ibid.*, p. 5, para. 14.

<sup>56</sup> *Ibid.*, p. 6, para. 19.

<sup>57</sup> *Ibid.*, p. 6, para. 22–25.

<sup>58</sup> *Ibid.*, p. 6, para. 22.

<sup>59</sup> *Ibid.*, p. 7, para. 26.

This seems quite a reasonable option for those states that want to prohibit or at least regulate some forms of third-party funding but also do not want to deny justice to SMEs.

The authors of the Initial Draft added a subsection about the regulation models at the end of the section and together with a subsection about the legal consequences and possible sanctions.<sup>60</sup> This provision is supposed to be a list of possible consequences if the claimants do not comply with the settled model.<sup>61</sup>

### 5.1.3 Disclosure of Third-Party Funding

One significant provision is about the disclosure of third-party funding. The authors of the Initial Draft presented a rather detailed list of the information to be disclosed in order to prevent conflicts of interest,<sup>62</sup> which is one of the biggest concerns raised about third-party funding. According to the provision, the funded party<sup>63</sup> should disclose information about the name and address of the third-party funder<sup>64</sup> as well as the name and address of the beneficial owner of the third-party funder and any legal or natural person with decision-making authority.<sup>65</sup> Lastly, the author adds that the funded party should disclose the funding agreement.<sup>66</sup> In the comments, the authors encourage the debaters to think whether they would like to establish some exceptions. Due to the detailed nature of the list of mandatory disclosed information, the author welcomes this approach because it may help resolve some of the transparency and conflicts of interest concerns, or at least reduce them. Furthermore, in the second paragraph the authors added a list of other information that the tribunal may require.<sup>67</sup>

Even though the authors see it as positive that the tribunal would have the possibility, if the circumstances so require, to order the disclosure of other

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<sup>60</sup> Possible reform of investor-State dispute settlement (ISDS) – Draft provisions on third-party funding. *UNCITRAL* [online]. Pp. 7–8, para. 31–35 [cit. 16. 5. 2022]. Available at: <https://uncitral.un.org/en/thirdpartyfunding>

<sup>61</sup> *Ibid.*, p. 7, para. 31.

<sup>62</sup> *Ibid.*, p. 9, para. 36–49.

<sup>63</sup> *Ibid.*, p. 10, para. 38.

<sup>64</sup> *Ibid.*, p. 9, provision 7, para. 1, letter a).

<sup>65</sup> *Ibid.*, p. 9, provision 7, para. 1, letter b).

<sup>66</sup> *Ibid.*, p. 9, provision 7, para. 1, letter c).

<sup>67</sup> *Ibid.*, p. 9, provision 7, para. 2.



information, and that the list should not be overly burdensome, the tribunal should be able to have more flexibility on a case-by-case basis. As regards the time limits for filing, the parties should disclose the information with their statement of claim or afterwards when the funding agreement enters into force.<sup>68</sup> In addition, if any new information comes into light or there is any change to information, the funded party must inform the tribunal immediately.<sup>69</sup> This looks quite reasonable, although the author has one comment: the word “immediately” in paragraph 4 should be discussed in more detail so that one tribunal cannot decide it means “the day after it is found out” but another thinks it means “within a month or so”. The provision also reflects the new sanctions provision and includes the failure to comply and possible sanctions.<sup>70</sup>

#### 5.1.4 Other Provisions

Finally, the Initial Draft includes other provisions<sup>71</sup> concerning the scope of covered investor and investment,<sup>72</sup> security for costs,<sup>73</sup> allocation of costs<sup>74</sup> and a code of conduct for third-party funders.<sup>75</sup>

The scope of the covered investor and investment seems very reasonable since it only states, *“for the avoidance of doubt, third-party funding shall not be considered as covered investment under this [Agreement] and a third-party funder shall not be considered an investor of a Party.”*<sup>76</sup> This will create security for the other party to the proceedings, especially considering that some third-party funders seek control over the proceedings without a legitimate title.

The author also welcomes the provision that allows the tribunal to order the third-party funder to provide security for costs, addressing states’ concerns about inability to recover their costs.<sup>77</sup> The authors of the Initial Draft

<sup>68</sup> Possible reform of investor-State dispute settlement (ISDS) – Draft provisions on third-party funding. *UNCITRAL* [online]. P. 9, provision 7, para. 3 [cit. 16. 5. 2022]. Available at: <https://uncitral.un.org/en/thirdpartyfunding>

<sup>69</sup> *Ibid.*, p. 9, provision 7, para. 4.

<sup>70</sup> *Ibid.*, p. 9, provision 7, para. 5.

<sup>71</sup> *Ibid.*, pp. 12–14.

<sup>72</sup> *Ibid.*, p. 12, provision 8.

<sup>73</sup> *Ibid.*, pp. 12–13, provision 9.

<sup>74</sup> *Ibid.*, pp. 13–14, provision 10.

<sup>75</sup> *Ibid.*, p. 14.

<sup>76</sup> *Ibid.*, p. 12, provision 8.

<sup>77</sup> *Ibid.*, p. 12, para. 51.

have left open the question whether the tribunals should have more strict guidelines concerning the amount of the security for costs to be ordered or let the mechanism be flexible.<sup>78</sup> In the author's point of view, the system should remain more flexible. However, recommended guidance would not be a burdensome option either.

As for the allocation of costs provision, the author considers it positive that the Initial Draft regulates that the costs arising or related to third-party funding will not be included in the costs of the proceedings.<sup>79</sup> This answers one concern related to the fact that some third-party funders only enter proceedings because of the high costs and tend to create even higher costs.

### 5.1.5 Some Reflections by the Author on the Initial Draft

Even though this Initial Draft seems to cover all the raised concerns and provides the debaters with at least one solution for each, it still seems relatively unpolished. The author believes that the possibilities raised are good, though the Initial Draft has only been prepared for implementation into investment treaties. This would require the creation of a multilateral instrument for all the states that want to include the provision in their treaties. Alternatively, all the states who want to include these provisions must renegotiate their old treaties, etc. The logistics behind the implementation are quite complex. Therefore, the author believes that UNCITRAL Working Group III should develop a multilateral solution to avoid all the additional issues. On the other hand, the next Working Group III session concerning third-party funding will show more development.

## 5.2 ICSID Amendment Proceedings

As discussed above, third-party funding has been addressed as part of the ICSID amendment proceedings, resulting in the newly accepted rules of procedure in force from 1 July 2022. When this article was being written they were not yet in force. Hence the author does not include any practical references.

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<sup>78</sup> Possible reform of investor-State dispute settlement (ISDS) – Draft provisions on third-party funding. *UNCITRAL* [online]. Pp. 12–13, para. 52 [cit. 16. 5. 2022]. Available at: <https://uncitral.un.org/en/thirdpartyfunding>

<sup>79</sup> *Ibid.*, p. 9, provision 10.

One of the many innovations introduced by the amendment is the obligation to report third-party funding. According to the first working paper, the states' comments were divided into two groups. One party wanted to ban third-party funding entirely, while the other only to regulate it effectively.<sup>80</sup> The ICSID decided to include a provision for notification of third-party funding rather than for a complete repeal, recognizing that some investors would not have the means to have access to justice and have their claims heard without third-party funding.<sup>81</sup>

Rule No. 14 of the ICSID Arbitration Rules governs the details of the notice of third-party funding of proceedings. When giving notice, the parties must disclose the name and address of the third party that will fund the proceedings. If the third party financing the proceedings is a legal person, a list of persons and entities owned and controlled by that third party must also be attached.<sup>82</sup> The funding agreement is not strictly included in the list, unlike with the Initial Draft from UNCITRAL Working Group III.<sup>83</sup> This may be a good thing because at least some part of the arrangement between the funded party and third-party funder can stay confidential between them. On the other hand, some other information may arise from that agreement, and can prevent conflicts of interest. However, how it will work in practice will be apparent after 1 July 2022.

A party must file a notice of third-party funding of their dispute with the secretary-general of the ICSID upon registration of the request for arbitration, or immediately upon the conclusion of the third-party funding agreement after registration. In addition, the tribunal may require the

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<sup>80</sup> ICSID. Proposals for Amendment of the ICSID Rules – Working Paper. *ICSID* [online]. P. 131, para. 241 [cit. 15. 5. 2022]. Available at: [https://icsid.worldbank.org/sites/default/files/publications/WP1\\_Amendments\\_Vol\\_3\\_WP-updated-9.17.18.pdf](https://icsid.worldbank.org/sites/default/files/publications/WP1_Amendments_Vol_3_WP-updated-9.17.18.pdf)

<sup>81</sup> *Ibid.*, p. 131, para. 242.

<sup>82</sup> Proposed Amendments to the Regulations and Rules for ICSID Convention Proceedings. *ICSID* [online]. P. 33, Rule No. 14, para. 1 [cit. 22. 5. 2022]. Available at: [https://icsid.worldbank.org/sites/default/files/publications/rule\\_amendment\\_proposals\\_convention.pdf](https://icsid.worldbank.org/sites/default/files/publications/rule_amendment_proposals_convention.pdf)

<sup>83</sup> *Viz.* Investor or state that is not specified in more detail. – Possible reform of investor-State dispute settlement (ISDS) – Draft provisions on third-party funding. *UNCITRAL* [online]. P. 10, para. 38 [cit. 16. 5. 2022]. Available at: <https://uncitral.un.org/en/thirdpartyfunding>

disclosure of further information regarding the funding agreement or the settlor if it deems necessary.<sup>84</sup>

The inclusion of a mandatory notice of third-party funding in the rules of procedure reflects a trend whereby the issue of third-party funding of disputes is currently widely criticised, and arbitral institutions include a modification in their rules. Depending on how the new provision is adopted, it has the potential to regulate this issue at least partially.

## **6 Conclusion – ICSID vs UNCITRAL Working Group III**

To conclude, the author considers that the states constantly addressed the same concerns in the criticism – systemic imbalance, transparency, conflicts of interest of arbitrators, costs of the proceedings, a potential increase in frivolous claims, and legitimacy of the outcome. On the other hand, the investors, mainly SMEs,<sup>85</sup> may view it as undermining the system since the profit-seeking investors only fund the claims if they see the likelihood of sufficient profit. Both UNCITRAL Working Group III and the ICSID address this concern as part of the reform debate. In the context of the ICSID discussion, new rules with high potential to correct the system’s deficiencies have already been accepted. Quite a long debate still lies ahead for UNCITRAL Working Group III. However, it is already possible to compare the implementation of the two proposals at this point. Not from the practice point of view, but only the wording.

The UNCITRAL Initial Draft provides a rather extensive regulation that at first sight offers states choices and flexibility. Problematically, however, the Draft is currently only developed for the possibility of being incorporated into investment treaties. That is an imperfect solution, as states already add a provision to investment treaties if they want to regulate third-party funding. Moreover, the question arises as to how UNCITRAL Working Group III would envision implementing the Initial Draft provisions in existing treaties. In the author’s view, the development of the Initial Draft

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<sup>84</sup> Proposed Amendments to the Regulations and Rules for ICSID Convention Proceedings. *ICSID* [online]. P. 34, Rule No. 14, para. 4 [cit. 22. 5. 2022]. Available at: [https://icsid.worldbank.org/sites/default/files/publications/rule\\_amendment\\_proposals\\_convention.pdf](https://icsid.worldbank.org/sites/default/files/publications/rule_amendment_proposals_convention.pdf)

<sup>85</sup> For which it is sometimes the only option to get funding for their proceedings.

is still in its early stages and will need some time to evolve before it is ready to be tested in practice. The author appreciates that the Initial Draft has so far included funding agreements in the disclosure of information. The question is whether there will be the political will to keep it that way.

As for the new ICSID Amendment Rules, it must be noted that they have indeed turned out quite well overall. In a relatively short amount of time,<sup>86</sup> they have managed to address and, therefore, possibly fix the problematic points in terms of the procedural aspects. How this will work in practice remains to be seen. Nevertheless, the wording is very promising.<sup>87</sup> As for the rule on notice of third-party funding itself, all the concerns are covered with a single rule, with the rules of procedure further elaborating on the points raised (such as dealing with frivolous claims – Rule 41 – Manifest Lack of Legal Merit,<sup>88</sup> or Rule 53 – Security of Costs).<sup>89</sup> The author likes the grasp of the whole issue and especially the omission of the possibility of prohibiting third-party funding, as it helps recreate structural balance.

As a final note, the author would like to add that in the context of investment arbitration, it is indispensable to take into account how the changes will work in practice, and this will first be seen with the ICSID rules from 1 July 2022 and with the UNCITRAL Working Group Draft hopefully as soon as possible.

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<sup>86</sup> More or less the same time that UNCITRAL Working Group III has been in operation.

<sup>87</sup> With a few minor exceptions. There is more about this in the author's forthcoming article: KUDRNA, J., ŠEVČÍKOVÁ, T. *Změny ICSID procesních pravidel – jak budou vypadat řízení u ICSID od července 2022*.

<sup>88</sup> Proposed Amendments to the Regulations and Rules for ICSID Convention Proceedings. *ICSID* [online]. P. 45, Rule No. 41 [cit. 22. 5. 2022]. Available at: [https://icsid.worldbank.org/sites/default/files/publications/rule\\_amendment\\_proposals\\_convention.pdf](https://icsid.worldbank.org/sites/default/files/publications/rule_amendment_proposals_convention.pdf)

<sup>89</sup> *Ibid.*, pp. 53–54, Rule No. 53.

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