Third-Party Funding in Investment Arbitration: Misappropriation of Access to Justice Rhetoric by Global Speculative Finance

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I. Introduction

This paper is intended as a contribution to the discussions in Working Group III of the United Nations Commission on International Trade Law (UNCITRAL). The aim of the paper is to analyze whether the access to justice (ATJ) rationale set forth by proponents of third-party funding (TPF) in the context of investor to state dispute settlement (ISDS) is in line with traditional conceptions of ATJ as well as with the Commission’s mission and the United Nation’s commitment to “promoting fair, stable and predictable legal frameworks for generating inclusive, sustainable and equitable development, economic growth and employment, generating investment and facilitating entrepreneurship.”¹ This paper recognizes that there may be other justifications for TPF in the ISDS context, but they are not taken up here. Instead, the scope here is limited to the ATJ rationale, as it appears to be the most commonly cited justification for TPF in the investment context.

TPF in the context of ISDS has become a topic of intense criticism. This is largely due to the fact that arguments for and against TPF occur with the backdrop of general disagreement over the efficacy and fairness of the ISDS system as a whole. It is important to remember that the ATJ rationale set forth by proponents of TPF is inexorably tied into this debate and relies upon assumptions underlying the legitimacy of the ISDS system as a whole. This paper attempts to separate out the issues that are unique to TPF in the investment context and which implicate the ATJ rationale.

II. What Do We Mean By Access to Justice?

The United Nations (UN) is committed to promoting ATJ and recognizes that all institutions and entities, public and private, are “accountable to just, fair and equitable laws.”\(^2\) In the *Declaration of the High-Level Meeting of the General Assembly on the Rule of Law at the National and International Levels*, the Assembly recognized, “the importance of fair, stable and predictable legal frameworks for generating inclusive, sustainable and equitable development, economic growth and employment, generating investment and facilitating entrepreneurship.”\(^3\) In addition, the *Declaration* specifically emphasizes the following, “the right of equal access to justice for all, including members of vulnerable groups, and the importance of awareness-raising concerning legal rights, and in this regard we commit to taking all necessary steps to provide fair, transparent, effective, non-discriminatory and accountable services that promote access to justice for all, including legal aid.”\(^4\)

Civil rights movements in the United States are also committed to conceptions of ATJ, which hinge on efforts by organizations such as the American Civil Liberties Union (ACLU) and the Legal Service Corporation (LSC) that focus on providing legal representation for poor and disadvantaged individuals, combating predatory lending, assisting in mortgage foreclosure proceedings and addressing landlord-tenant disputes\(^5\). The ATJ rhetoric harnessed by the legal aid community and civil rights movement in the United States has traditionally focused on the beneficial provision of legal services to indigent and disadvantaged parties who have meritorious claims but lack the financial resources or knowledge to successfully seek redress.

\(^2\) *Id.*
\(^3\) *Id.*
\(^4\) *Id.* at 3.
This rhetoric has been hijacked by proponents of TPF in the ISDS context to justify speculation on investment claims with far-reaching financial implications for disadvantaged and developing states. As we will see, TPF proponents have manipulated the ATJ rationale to their purposes, distorting its traditional applications to fit questionable ends. In the context of third-party funding of investment claims, providing access to justice thus cannot be equated with providing financing for parties who lack the resources to litigate.

III. TPF Access to Justice Rationale

Historically, TPF proponents have contended that the funding they provide is primarily utilized by impecunious or financially distressed investors, who would otherwise be unable to bring a claim against bad actor states.\(^6\) Under this view, since investment arbitration is considered an indispensable means by which investors may seek redress when governments violate applicable treaty-based protections for their investments, TPF is a valuable tool which facilitates ATJ for investors who wish to seek redress, but are financially unable, perhaps due to a foreign government’s expropriation of their investment. As such, TPF was framed as a means by which claimants obtained ATJ, and funders could hail themselves as providing a valuable service that promoted global economic justice in a cost prohibitive system.\(^7\)

Commentators have suggested that the dramatic increase in third-party funded investment claims was fueled by the economic downturn in 2008.\(^8\) While investors were seeking out unconventional investment opportunities, corporations experiencing liquidity problems were looking for alternative sources of funding because traditional sources (i.e. banks) were not

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\(^8\) See ICCA-Queen Mary Draft Report at 12.
lending, and assets were being carefully scrutinized.9 Regardless of whether this proves to be a matter of causation or simply correlation, there is no doubt that TPF has dramatically increased in prevalence in the investment arbitration context. “The number of investment arbitration cases, as well as the sum of money involved, has surged in the last two decades from 38 cases in 1996 (registered at ICSID) to 450 known investor-state cases in 2011. The amount of money involved has also expanded dramatically. In 2009/2010, 151 investment arbitration cases involved corporations demanding at least US$ 100 million from states.”10 As of April 6, 2017, there were 855 publicly known treaty-based investor-state arbitration claims; yet, the actual number is likely much higher as many cases are arbitrated privately and therefore not included in the public figures.11 The incentive is evident by examples of potential returns available such as the 736% return on invested capital realized by Burford Capital following the sale of their interest in the Teinver v. Argentina claim.12

It appears the focus of the litigation finance market has shifted. Funders do not offer services primarily to those in precarious financial situations. Put simply, funding, instead offers claimants the ability to minimize the risk associated with bringing a claim.13 Yet, the risk associated with bringing a claim in a ‘pay your own way system’ is precisely what helps deter claims lacking sufficient merit from being brought in the first place. In fact, “much of the focus of the litigation finance market today is on the growing corporate utilization of funding by large,

9 But see Id.: “It remains to be shown, however, that there is any real as opposed to coincidental correlation between the 2008 crisis and the expansion of TPF in investment arbitration.”
13 See Id. at 4.
well-resourced entities, who are looking for ways to manage risk, reduce legal budgets or take
the cost of pursuing arbitration off-balance sheet, or other business reasons for not wanting to
allocate resources to financing an arbitration matter.”¹⁴ In the words of a prominent funder, “... it is increasingly the case that more complex arrangements are becoming the norm, with
companies using external capital out of choice, not necessity. ...”¹⁵ Far from providing ATJ for
an impecunious claimant, the “creative” alternate financing arrangements offer companies the
ability to free up cash to pursue other business opportunities.¹⁶

Thus, in the context of third-party funding of investment claims, this kind of financing
cannot be equated with the traditional ATJ goal of providing financing for parties who lack the
resources to litigate. Even so, some TPF proponents still argue that funding provides “access to
justice.” In a rhetorical maneuver that distorts traditional conceptions of the ATJ rationale, TPF
proponents claim, that true ATJ in the western economy means a business being able to retain its
competitive position while simultaneously litigating for justice.¹⁷

The methodology employed by funders choosing which claims to fund, however, is
unique to the issue of TPF. In order for TPF to provide “access to justice,” funders must fund
meritorious claims. As such, TPF proponents claim that, the decision of whether to fund or not is
primarily based on the merits of the case, the benefit-cost analysis, and the enforceability of the

¹⁵ Christopher P Bogart, Third-Party Financing of International Arbitration Global Arbitration Review - GAR
financing-of-international-arbitration (last visited Apr 9, 2018). - Christopher Bogart is the co-founder and CEO of
Burford Capital.
¹⁶ See Bogart “Rurelec was pursuing an arbitration claim against Bolivia for the expropriation of one of its power
plants. It did not need capital to pay its lawyers. Rather, it needed capital to continue to grow its business...”
(emphasis added)
¹⁷ Ylli Dautaj, Bruno Gustafsson & Danilo Ruggiero Di Bella, Access to Justice: Rebalancing the Third-Party
http://arbitrationblog.kluwerarbitration.com/2017/11/18/access-justice-rebalancing-third-party-funding-equilibrium-
investment-treaty-arbitration-2/ (last visited Apr 8, 2018).
award.\textsuperscript{18} They have no incentive to fund claims that are frivolous or marginal, as the promise of return is uncertain, it is said.\textsuperscript{19} This argument fails to recognize two important realities. First, the cost-benefit analysis performed by sophisticated funders necessarily involves analysis of the factors which contribute to the likelihood of success and in turn the likelihood of return on investment. This is concerning because empirical evidence points to correlations between lower per capita income and weaker rule of law in the respondent state and the likelihood of success by the investor-claimant.\textsuperscript{20} The funder would necessarily factor this correlation into their risk analysis when selecting claims to fund, resulting in non-merit based factors driving claim selection and more claims being directed at LDCs. Additionally funders, such as Burford Capital, claim that “part of the secret of litigation investing is having a large, diversified portfolio so that [they] always have some cases going to trial, with the potential of high returns but the presence of binary risk of complete loss, while benefiting from the tendency of matters to settle and produce desirable returns from the majority of the portfolio without litigation risk.”\textsuperscript{21} By implication, permitting investment into a portfolio of claims, some very high risk (i.e. low probability of success/less meritorious) claims will likely be brought in order to ‘diversify’ the portfolio as only a few of them need to succeed in order to reap large rewards; similar to including a few junk bonds in an otherwise lower-risk bond portfolio. This practice could easily translate into an increase in the number of frivolous claims brought. This brings to mind the

\textsuperscript{18} See ICCA-Queen Mary Draft Report at 17; See also Burford Capital 2017 Annual Report at 5.

\textsuperscript{19} See ICCA-Queen Mary Draft Report at 160.

\textsuperscript{20} See Julian Donaubauer & Peter Nunnenkamp (2018) International arbitration of investment disputes: are poor and badly governed respondent states more likely to lose?, Applied Economics Letters, 25:5, 321-325, Available at: https://doi.org/10.1080/13504851.2017.1319557. Study of the effects of respondent state’s per-capita income and the strength of domestic rule of law on ISDS found that higher income and stronger rule of law reduce the probability of investor wins in investor-state arbitration.

\textsuperscript{21} Burford Capital 2017 Annual Report at 4.
original justification for prohibiting third-party funding as the profit driven interests of investors served to adulterate the judicial system by their involvement. 22

This kind of analysis is the hallmark of speculation, and not only conflicts with the UN’s goal of promoting equal access to justice, including to members of vulnerable groups (such as LDCs), sustainable development and economic growth; but it creates a paradoxical result as less developed and developing countries are disproportionately affected and in turn subjected to the risk of ruinously high investment arbitration awards and consequent economic hardship.

This situational irony on its own is enough to raise serious concerns about allowing TPF in ISDS at all. Making matters worse, there is a complete lack of regulation. As “the investment arbitration system is becoming increasingly integrated with the speculative financial world,”23 it is expected that funders will continue to “further fuel the boom in arbitrations, increase costs for cash-strapped governments”24 among other concerns (conflicts of interest etc.). “This financialization of investment arbitration has even extended to proposals to sell on packages of lawsuits to third parties, in the vein of the disastrous credit default swaps behind the global financial crisis.”25

While not the primary focus of the litigation finance market today, there very well may be examples where TPF provides access to recourse for impecunious claimants. But as a matter

22 See Caroline Kenny QC Hong Kong, 14 October 2017 discussing the reasons for the historical prohibition of third party funding in common law jurisdictions “because it was said to offend the medieval torts and crimes of maintenance and champerty. Maintenance refers to an unconnected third party assisting to maintain litigation by providing financial assistance. Champerty is where a third party pays some or all of the costs associated with litigation in return for a share of the proceeds. The prohibition against funding arrangements was historically intended to prevent the abuse of judicial process by wealthy English noblemen who would associate themselves with fraudulent or vexatious claims, thereby strengthening the credibility of the claims, and, in return, receiving a share of the profits,” Available at http://www.ciarb.org/news/ciarb-news/news-detail/features/2017/11/01/third-party-funding-of-international-arbitrations (last visited Apr 9, 2018); see also Bogart at footnote 9, “According to its 2015 Annual Report, 87 per cent of Burford’s capital committed in 2015 financed portfolios and other complex vehicles . .”

23 Pia Eberhardt et al. at 9.

24 Id.

25 Id.
of public policy, it seems morally objectionable to allow speculation in the context of ISDS, where outcomes can result in devastating economic implications for developing nations, even if in limited circumstances a claimant actually is impecunious and thereby granted access to justice through the involvement of a funder. Similar in reasoning to prohibiting an attorney from representing a high-profile criminal defendant in a murder trial in exchange for publicity rights if the defendant is acquitted; the clear public policy concerns raised by such practices trump the benefit of access to justice for the defendant. Not only are funders not subject to the ethical rules binding attorneys, but their presence shifts the focus from justice to financial returns, apart from claimant’s damages. On balance, it is evident that the risks posed by unregulated funder involvement in ISDS substantially outweigh the potential benefits provided to individual, impecunious claimants.

To allow this type of behavior, where investors are incentivized to bet on weak economies, to go unregulated, would be in direct conflict to the UN’s stated goals.26 Allowing the status quo of unregulated TPF in ISDS to continue, would perversely serve to promote unfair and unpredictable legal frameworks that exacerbate economic instability and promote the exploitation of disadvantaged states. Given the well-founded concerns regarding the efficacy and fairness of the ISDS system as a whole, it is argued that regulation of TPF at this stage is not a viable solution, and only a ban of TPF in ISDS is sufficient to ensure that exploitative speculation does not continue.27 At a minimum, policy makers must seriously consider the implementation of interim cost awards and mandating funder submission to the jurisdiction of the tribunal to ensure enforceability of the cost award. As it stands, the use by TPF proponents of ATJ rhetoric is disingenuous at best, and dangerously misleading at worst.

27 See Frank J Garcia, Third-Party Funding as Exploitation of the Investment Treaty System.