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Third Party Funding in International Investor-State Arbitration

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Third-party litigation funding (TPF) is a rapidly expanding industry composed of speculative investors who finance legal claims in exchange for influence over case management and a contingency in the recovery.[1] The potentially high damage awards (recently averaging \$500 million per dispute) characteristic of investor-state arbitration (ISDS) under the bilateral investment treaty (BIT) regime[2] have made it a new and highly attractive market for TPF. While TPF funders generally prefer not to disclose their stake to the other parties in the dispute or to the adjudicators, available evidence suggests an already significant involvement, with 39 percent of respondents in a recent Queen Mary Survey having encountered TPF in practice,[3] and with TPF (actual or alleged) at issue in a growing number of recent ISDS cases. As many jurisdictions are beginning to consider the impact of TPF and its unique role in international investment

arbitration, this *Insight* first presents the operation of TPF in investment arbitration, and then assesses whether TPF is consistent with the goals of the investment law system and the values and interests of states. Lastly, it surveys some of the measures that have been or could be taken in domestic and international adjudicatory systems with respect to TPF.

What is TPF and How Does it Operate?

Common law jurisdictions have historically banned TPF under prohibitions against maintenance and champerty.[4] Starting with the 2006 judicial relaxation of these rules in Australia, TPF spread rapidly to the United Kingdom and the United States, and has recently expanded to Singapore, Hong Kong, China, Latin America, and Europe.

In its most basic form, TPF can be understood as a financing mechanism in which a third-party finances the costs of arbitral proceedings for a party in a dispute.[5] In return, the funder receives a percentage of the awarded compensation (if the claim is successful) and is able to gain some degree of control over the case and/or client.[6] If the claim fails, the funder receives no compensation and will bear the liability for any fees due to the claimant's legal team as well as other adverse costs.[7] The TPF industry includes specialized litigation firms, insurance companies, investment banks and hedge funds.[8]

Investment arbitration is attractive to TPF funders and traditional investor-claimants alike. The quantum of a claim and costs associated with investment arbitrations can be enormous, often exceeding millions of U.S. dollars, and the returns to TPF funders in such cases can be equally enormous, averaging 30–50 percent.[9] In deciding whether to enter into a funding agreement with a claimant, third-party funders weigh the merits of the case, the enforceability of the award against the host-state, the value of any possible compensation, potential adverse costs they may face in an unsuccessful claim, and the expertise of the legal team they will be funding.[10] The vast majority of funding goes to claimants since financing claimants yields a greater "upside" (or profit) as compared to the funding of respondent states (which gain no financial award under the current BIT rules). Investor-claimants enjoy a similar "upside" insofar as TPF can remove much of the financial risk of bringing a claim against a host-state.

TPF In the Context of the Law and Ethics of ISDS

The role of TPF in ISDS raises important concerns given the asymmetric structure of the BIT/ISDS regime. The funding model for TPF in ISDS is predicated on claimants having a direct voice in the selection of adjudicators, states having narrowly circumscribed substantive rights under the treaties, and no right of appeal.[11] Moreover, TPF investors can count on states settling or losing two-thirds of the time, and potential returns on investment as high as 700 percent.[12] TPF funders' only risks are the litigation costs, which they can spread through a portfolio investment model. TPF thus gives investor claimants additional resources to prosecute claims against a constrained state, risking a further unbalancing of the system for the benefit of third parties.

By contrast, the cost for states to defend claims and pay awards is ultimately borne by the public, who, as taxpayers, are the residual risk-bearers in the current system. Developing states are particularly vulnerable.[13] Research suggests the vast majority (88 percent) of all claimant investors are from high income countries, and developing countries win only half as often as developed countries, factors which TPF funders have admitted enter into their preliminary evaluation of a potential claim/investment.[14]

Proponents of third-party funding argue that TPF provides a number of benefits, including providing access to justice for investors who wish to seek redress but lack sufficient financial resources. However, this rationale is not supported by the evidence in the ISDS context, where TPF cannot be equated with providing financing for disadvantaged claimants.[15] TPF funders themselves acknowledge that the primary incentive for their ISDS clients is balance sheet management.[16]

TPF can thus be said to effect a wealth transfer to TPF funders and their investors from the citizens of respondent states through the operation of the arguably unbalanced BIT/ISDS system. Such transfers are not what the investment system was designed to achieve.

Regulatory Responses to TPF

In light of TPF's rapid growth, proponents and critics alike have come to assume that TPF is an inevitable fact of litigation and arbitration alike. However, this need not be so. For example, as recently as May 2017, the Supreme Court of Ireland confirmed that third-party funding remains prohibited under Irish law doctrines of maintenance and champerty.[17] Additionally, while TPF is not explicitly prohibited under the law of many domestic jurisdictions, it also may not be explicitly recognized or adopted in litigation practice in such jurisdictions.[18] Thus, there exists a crucial window of opportunity to assess the role that TPF should play in international investment arbitration.

NGOs, academics, international organizations and arbitral bodies are currently taking steps to evaluate TPF and make recommendations. For example, the ICCA and Queen Mary Law School recently published the Report of their Task Force on Third Party Funding in International Arbitration, one of the few sources providing a framework to inform policy-makers on the matter. [19] Some international organizations have also undertaken a public discussion of TPF, including the United Nations Commission on International Trade Law (UNCITRAL) Working Group III, which identified TPF as a "significant concern [that] created a systemic imbalance and did not ensure a level playing field." [20] Others have already acted, including the International Centre for the Settlement of Investment Disputes (ICSID), which recently proposed new (but limited) disclosure rules when TPF is a factor in ICSID cases.[21]

Although there is currently no systemic requirement to disclose the presence or identity of third-party funders, recent trends favor increased transparency regarding the existence and identity of a TPF funder as well as the terms of funding agreements. While ICSID's proposed rules and the ICCA/Queen Mary Report stop at calls for limited disclosure, some commentators advocate going farther towards mandatory, expansive disclosure of third-party funding agreements,[22] and some jurisdictions are following suit. For instance, Article 8.26, of the Canada-EU Trade

Agreement includes mandatory disclosure of the presence and identity of TPF funders.[23] In a similar vein, Article 24(l) of the Singapore Investment Arbitration Commission rules gives the tribunal the discretionary authority to order disclosure of the details of the agreement.[24] Some TPF reform proposals also suggest imposing security for costs when a claimant is TPF funded, which could help disincentivize TPF funders from pursuing weak cases merely for their settlement value.[25]

It is critically important that states, their negotiators, academics, and civil society take a careful, public, and sustained look at the risks that TPF poses to the public and to the investment regime itself, rather than consider it a *fait accompli*. TPF as currently practiced represents a profound challenge to the fairness and legitimacy of the international investment regime, which, if not addressed effectively, could further compromise not only the public's faith in this system, but the viability of the system for states, traditional FDI investors and other stakeholders.

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[1] See generally Maya Steinitz, *Whose Claim Is This Anyway? Third Party Litigation Funding*, 95 Minn. L. Rev. 1268 (2011).

[2] *Special Update on Investor–State Dispute Settlement: Facts and Figures*, IIA Issues Note, UNCTAD, Issue 3, 2017, available at http://unctad.org/en/PublicationsLibrary/diaepcb2017d7_en.pdf (http://unctad.org/en/PublicationsLibrary/diaepcb2017d7_en.pdf).

[3] James Egerton Vernon, *Taming the "Mercantile Adventurers": Third Party Funding and Investment Arbitration - A Report from the 14th Annual ITA-ASIL Conference*, Kluwer Arbitration Blog (Apr. 21, 2017), <http://arbitrationblog.kluwerarbitration.com/2017/04/21/taming-the-mercantile-adventurers-third-party-funding-and-investment-arbitration-a-report-from-the-14th-annual-ita-asil-conference/> (<http://arbitrationblog.kluwerarbitration.com/2017/04/21/taming-the-mercantile-adventurers-third-party-funding-and-investment-arbitration-a-report-from-the-14th-annual-ita-asil-conference/>) (citing to the 2015 Queen Mary/White & Case International Arbitration Survey).

[4] Caroline Kenny, QC, Address at the Hong Kong Summit on Commercial Dispute Resolution (Oct. 14, 2017), <http://www.ciarb.org/news/ciarb-news/news-detail/features/2017/11/01/third-party-funding-of-international-arbitrations> (<http://www.ciarb.org/news/ciarb-news/news->

detail/features/2017/11/01/third-party-funding-of-international-arbitrations). Historically, there appears to be no extensive prohibition of TPF in civil law jurisdictions. Wieger Wielinga, Hannah Van Roessel, Kees Visser, & Gian Marco Solas, *Third Party Litigation Funding in Civil Law Jurisdictions*, *Litigation Finance J.* (Apr. 23, 2018), <https://litigationfinancejournal.com/third-party-litigation-funding-civil-law-jurisdictions/> (<https://litigationfinancejournal.com/third-party-litigation-funding-civil-law-jurisdictions/>).

[5] Eric De Brabandere & Julia Lepeltak, *Third Party Funding in International Investment Arbitration* 5 (Grotius Ctr., Working Paper No. 2012/1, 2012), <http://ssrn.com/abstract=2078358> (<http://ssrn.com/abstract=2078358>).

[6] *Id.* at 5–8.

[7] *Id.* at 5.

[8] Catherine A. Rogers, *Gamblers, Loan Sharks & Third-Party Funders*, in *Ethics in Int'l Arbitration* 177 (2014); Pia Eberhardt & Cecilia Olivet, *Profiting From Injustice: How Law Firms, Arbitrators And Financiers Are Fueling An Investment Arbitration Boom* 57, (2012), available at <https://www.tni.org/en/briefing/profitting-injustice> (<https://www.tni.org/en/briefing/profitting-injustice>).

[9] Willem H. van Boom, *Third-Party Financing in International Investment Arbitration*, 30 (2011), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2027114. (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2027114.)

[10] De Brabandere & Lepeltak, *supra* note 5, at 5–6.

[11] See Rachel Denae Thrasher, *The Regulation of Third Party Funding: Gathering Data for Future Analysis and Reform* (Boston College Law School Law and Justice in the Americas Working Paper No. 9, 2018), <http://lawdigitalcommons.bc.edu/ljawps/9/> (<http://lawdigitalcommons.bc.edu/ljawps/9/>).

[12] In *Teinver v. Argentina* (ICSID Case No. ARB/09/1) Burford Capital funded the claim against Argentina and realized a 736 percent return. Appeal is currently pending following an arbitration tribunal award in excess of \$325 million. Burford Capital invested approximately \$13 million in the matter and sold their interest on the secondary market for \$107 million for a gain of \$94.2 million. *Burford Annual Report 2017*, 23 (2017), <http://www.burfordcapital.com/wp-content/uploads/2018/03/BUR-28711-Annual-Report-2017-web.pdf> (<http://www.burfordcapital.com/wp-content/uploads/2018/03/BUR-28711-Annual-Report-2017-web.pdf>). See Tara Santosuosso & Randall Scarlett, *Third-Party Funding in Investment Arbitration: Misappropriation of Access to Justice Rhetoric by Global Speculative Finance* (Boston College Law School Law and Justice in the Americas Working Paper No. 8, 2018), <http://lawdigitalcommons.bc.edu/ljawps/8/> (<http://lawdigitalcommons.bc.edu/ljawps/8/>).

[13] Thomas Schultz & Cédric Dupont, *Investment Arbitration: Promoting the Rule of Law or Over-Empowering Investors? A Quantitative Study*, 25 *Eur. J. Int'l L.* 1147, 1154 (2015).

[14] Round Table Discussion on Third Party Funding in Investor-State Dispute Settlement with ICCA/Queen Mary Task Force on Third-Party Funding in International Arbitration, Columbia Ctr. for Sustainable Inv., in N.Y.C., N.Y (Oct. 17, 2017).

[15] See Santosuosso & Scarlett, *supra* note 12.

[16] In the words of a prominent funder, "[I]t is increasingly the case that more complex arrangements are becoming the norm, with companies using external capital out of choice, not necessity." Christopher P. Bogart, *Third-Party Financing of International Arbitration*, Global Arbitration Review (Oct. 14, 2016), <https://globalarbitrationreview.com/insight/the-european-arbitration-review-2017/1069316/third-partyfinancing-of-interna...> (<https://globalarbitrationreview.com/insight/the-european-arbitration-review-2017/1069316/third-partyfinancing-of-international-arbitration>). Christopher Bogart is the co-founder and CEO of Burford Capital.

[17] *Persona Digital Telephone Ltd. and Sigma Wireless Networks Ltd v The Minister for Public Enterprise & Ors* [2017] IESC 27 (Ir).

[18] *At What Cost? A Lovell's Multi-Jurisdictional Guide to Litigation Costs*, Hogan Lovells, (2010), <http://www.chrysostomides.com/assets/modules/chr/publications/16/docs/LitigationCostsReport.pdf> (<http://www.chrysostomides.com/assets/modules/chr/publications/16/docs/LitigationCostsReport.pdf>).

[19] ICCA & Queen Mary University of London, *Report of the ICCA-Queen Mary Task Force on Third Party Funding in International Arbitration* (2018), available at <https://www.arbitration-icca.org/publications/Third-Party-Funding-Report.html> (<https://www.arbitration-icca.org/publications/Third-Party-Funding-Report.html>). However, the ICCA/Queen Mary Report has been criticized for failing to effectively come to grips with the risks TPF poses to investment arbitration in particular. See Frank J. Garcia, *Third Party Funding as Exploitation of the Investment Arbitration System*, BC L. Rev. (2018) (forthcoming).

[20] UNCITRAL, *Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fourth session (Vienna, 27 November - 1 December 2017)*, at 10, http://www.uncitral.org/pdf/english/workinggroups/wg_3/WGIII-34th-session/930_for_the_website.pdf (http://www.uncitral.org/pdf/english/workinggroups/wg_3/WGIII-34th-session/930_for_the_website.pdf).

[21] See *Proposals for Amendment of the ICSID Rules – Synopsis*, ICSID (Aug. 2, 2018), https://icsid.worldbank.org/en/Documents/Amendments_Vol_One.pdf (https://icsid.worldbank.org/en/Documents/Amendments_Vol_One.pdf).

[22] See Thrasher, *supra* note 11.

[23] *Comprehensive Economic and Trade Agreement (CETA)*, Can.-EU, art. 8.26, Oct. 30, 2016, O.J. 11, 23 (EU).

[24] SIAC Investment Arbitration Rules 2017, Article 24(l).

[25] Garcia, *supra* note 19. Dr. Gavan Griffith, Q.C. argued for this in *RSM Production Corporation v. St. Lucia*, ICSID Case No. ARB/12/10. The proposed ICSID rules have made it easier to impose security for costs in a range of situations, including TPF. Luke Eric Peterson, *A First Look at ICSID's Proposed Rule Changes*, IA Reporter (Aug. 03, 2018), <https://www.iareporter.com/articles/a-first-look-at-icsids-proposed-rules-changes-including-in-relation-to-provisional-m...> (<https://www.iareporter.com/articles/a-first-look-at-icsids-proposed-rules-changes-including-in-relation-to-provisional-measures-third-party-funding-security-for-costs-and-arbitrator-disqualification/>).

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