

THIRD-PARTY FUNDING IN INVESTMENT ARBITRATION: MISAPPROPRIATION OF ACCESS TO JUSTICE RHETORIC BY GLOBAL SPECULATIVE FINANCE

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Abstract: The United Nations Commission on International Trade Law (UNCITRAL) is considering changes to its rules governing international arbitration proceedings. UNCITRAL Working Group III is analyzing possible reforms of the arbitral rules to address the risks associated with the increased prevalence of third-party funded investment arbitration claims. Funders claim that existing regulation is sufficient, arguing in part that funding provides access to justice for impecunious claimants who otherwise would be unable to bring claims. This essay argues that funders' access to justice reasoning is flawed at best and dangerously misleading at worst. UNCITRAL must take immediate action to address the potential for exploitative practices by funders in the investment context.

INTRODUCTION

This essay intends to contribute to the international arbitration reform discussions in Working Group III of the United Nations Commission on International Trade Law (UNCITRAL). This essay analyzes 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 UNCITRAL's mission and the United Nations' "recogni[tion] [of] 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."¹ This essay recognizes that there may be

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¹ G.A. Res. 67/1, Declaration of the High-Level Meeting of the General Assembly on the Rule of Law at the National and International Levels, ¶ 8 (Nov. 30, 2012); see *About UNCITRAL*, UNITED NATIONS COMMISSION ON INT'L TRADE L., http://www.uncitral.org/uncitral/en/about_us.html [https://perma.cc/3CJ5-RHQS] ("UNCITRAL's business is the modernization and harmonization of rules on international business."). The current topic of UNCITRAL Working Group III is "Investor-State Dispute Settlement Reform." *Methods of Work*, UNITED NATIONS COMMISSION

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 because 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 because arguments for and against TPF occur against 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 TPF proponents is inexorably tied to this debate and relies on assumptions underlying the legitimacy of the ISDS system as a whole. This essay attempts to separate out the issues that are unique to TPF in the investment context and implicate the ATJ rationale.

I. WHAT DO WE MEAN BY ACCESS TO JUSTICE?

The United Nations 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* (“*Declaration*”), the United Nations General Assembly “recognize[s] 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 “emphasize[s] the right of equal access to justice for all, including members of vulnerable groups, and the importance of awareness-raising concerning legal rights.”⁴ In the *Declaration*, the General Assembly “commit[s] 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.”⁵

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 lend[ing], assisting in mortgage foreclosure

ON INT’L TRADE L., <http://www.uncitral.org/uncitral/en/about/methods.html> [<https://perma.cc/3PP7-ABUV>].

² G.A. Res. 67/1, *supra* note 1, ¶ 2.

³ *Id.* ¶ 8.

⁴ *Id.* ¶ 14.

⁵ *Id.*

proceedings [and] addressing landlord-tenant disputes.”⁶ 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 seek redress successfully.⁷

Proponents of TPF in the ISDS context have hijacked this rhetoric to justify speculation on investment claims with far-reaching financial implications for disadvantaged and developing states. As Part II argues, TPF proponents have manipulated the ATJ rationale to their purposes, distorting its traditional applications to fit questionable ends. Thus, in the context of third-party funding of investment claims, providing ATJ cannot be equated with providing financing for parties who lack the resources to litigate.

II. THIRD-PARTY FUNDING ACCESS TO JUSTICE RATIONALE

Traditionally, TPF proponents have contended that they provide funding chiefly to impecunious investors who otherwise would not be able to bring claims against bad-actor states.⁸ Under this view, TPF proponents consider investment arbitration an indispensable means by which investors may seek redress when governments violate applicable treaty-based protections for their investments. Proponents have argued that TPF is a valuable tool that facilitates ATJ for investors who wish to seek redress but are financially unable to bring claims, perhaps due to foreign governments expropriating their investments. As such, proponents frame TPF as a means by which claimants obtain ATJ, and thus, funders hail themselves as providing a valuable service that promotes global economic justice in a cost-prohibitive system.⁹

⁶ Kelly Goss, *Equal Access to Justice for the Poor*, AMERICAN CIVIL LIBERTIES UNION: SPEAK FREELY (Oct. 27, 2009), <https://www.aclu.org/blog/mass-incarceration/equal-access-justice-poor> [https://perma.cc/9PSF-A64E].

⁷ See *id.* (explaining that the LSC provides civil legal services to low-income individuals “to secure equal access to justice” and that the ACLU supports this cause).

⁸ See INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, REPORT OF THE ICCA-QUEEN MARY TASK FORCE ON THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION 20 (2018), https://www.arbitration-icca.org/media/10/40280243154551/icca_reports_4_tpf_final_for_print_5_april.pdf [https://perma.cc/AJY2-G4F4] [hereinafter ICCA-QUEEN MARY TASK FORCE REPORT] (stating that “[h]istorically, third-party funding was considered as being primarily a mechanism by which financially distressed claimants could obtain access to justice”).

⁹ See Kelsie Massini, *Risk Versus Reward: The Increasing Use of Third Funders in International Arbitration and the Awarding Security for Costs*, 7 Y.B. ARB. & MEDIATION 323, 325 (2015) (arguing that “[o]ne of the most important benefits of third party funding in international arbitration is that it allows for increased access to justice”).

Third-party-funded investment claims have dramatically increased in recent years, possibly “fuel[led] by the economic downturn in 2008.”¹⁰ 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 lending and potential lenders were carefully scrutinizing corporations’ assets.¹¹ Regardless of whether this proves to be a matter of causation or simply correlation¹², there is no doubt that TPF’s prevalence has increased dramatically in the investment arbitration context. According to a 2012 report, “[t]he number of investment arbitration cases . . . surged . . . from 38 cases in 1996 (registered at [the International Centre for Settlement of Investment Disputes], the World Bank’s body for administering such disputes) to 450 known investor-state cases in 2011.”¹³ As of April 6, 2017, there were 855 publicly known treaty-based investor-state arbitration claims.¹⁴ The actual number of claims is likely higher, however, because some cases are confidential and therefore not included in the public figures.¹⁵ The incentive to arbitrate privately is evident from examples of potential returns available, such as the 736% return on invested capital realized by Burford Capital following the sale of its interest in *Teinver S.A. v. The Argentine Republic*.¹⁶

¹⁰ See ICCA-QUEEN MARY TASK FORCE REPORT, *supra* note 8, at 18 (stating that “[i]t has been suggested that the rapid expansion of [dispute] funding was fuel[led] by the economic downturn in 2008”).

¹¹ See *id.* (“Many corporations and investors experienced economic instability and were unable to proceed with meritorious claims due to reduced cash flow. At the same time, investors were seeking alternative capital outlets, where returns would not be correlated to traditional markets.”).

¹² See *id.* (“It remains to be shown, however, whether there is any real as opposed to coincidental correlation between the 2008 crisis and the expansion of third-party funding in international arbitration.”).

¹³ PIA EBERHARDT ET AL., PROFITING FROM INJUSTICE: HOW LAW FIRMS, ARBITRATORS AND FINANCIERS ARE FUELLING AN INVESTMENT ARBITRATION BOOM 7 (2012), <https://www.tni.org/files/download/profitfrominjustice.pdf> [<https://perma.cc/2Z4D-PW8E>]. “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.” *Id.*

¹⁴ *Investment Dispute Settlement Navigator*, UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT: INVESTMENT POLICY HUB, <http://investmentpolicyhub.unctad.org/ISDS?status=0> [<https://perma.cc/37CB-CGED>].

¹⁵ See *id.* (follow “About” hyperlink) (“The Navigator includes information about publicly known [international investment agreement]-based international investor-State arbitration proceedings. As some proceedings (or certain aspects of proceedings) remain confidential, the information contained in the Navigator cannot be deemed exhaustive.”).

¹⁶ See BURFORD CAPITAL, 2017 ANNUAL REPORT 23 (2017), <http://www.burfordcapital.com/wp-content/uploads/2018/03/BUR-28711-Annual-Report-2017-web.pdf> [<https://perma.cc/ND7T-V9ER>] (“We have just announced the sale of our Teinver investment into the secondary market which we continue to develop for \$107 million, a \$94.2 million gain and a 736% return on invested capital.”). See generally Maria Florencia Sarmiento, *Argentina Ordered to Pay Over USD320 Million for Unlawful Expropriation in Airlines Case*, INT’L INST. FOR SUSTAINABLE DEV.: INV. TREATY NEWS (Sept. 26, 2017), <https://www.iisd.org/itm/2017/09/26/argentina-ordered-pay-over->

In addition to the increase in claims, it appears that the focus of the litigation finance market has shifted recently as well. Today, funders do not offer services primarily to those in precarious financial situations. Essentially, funding instead offers claimants the ability to reduce the risk associated with bringing a claim.¹⁷ The risk associated with bringing a claim in a pay-your-own-way system is precisely what deters claimants from bringing claims lacking sufficient merit in the first place. In fact:

[M]uch of the focus of the litigation finance market today is on the growing corporate utilization of funding by large, well-resourced entities. These entities may be looking for ways to manage risk, to reduce legal budgets, take the cost of pursuing arbitration off-balance sheet, or to pursue other business priorities instead of allocating resources to financing an arbitration matter.¹⁸

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”¹⁹ Far from providing ATJ for impecunious claimants, the creative alternate financing arrangements offer companies the ability to free up cash to pursue other business opportunities.²⁰

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 ATJ. In a rhetorical maneuver that distorts traditional conceptions of the ATJ rationale, TPF proponents claim that true ATJ in the Western economy is a business “being able to compete while simultaneously litigating for justice.”²¹

usd320-million-for-unlawful-expropriation-airlines-case-maria-florencia-sarmiento/ [https://perma.cc/YU4H-EW2U] (describing the *Teinver* case). In *Teinver*, the arbitration tribunal awarded over \$325 million, but the appeal of this award is currently pending. BURFORD CAPITAL, *supra*, at 23 & n.7. Burford Capital “invested approximately \$13 million in the matter” and sold its interest on the secondary market “for \$107 million, a \$94.2 million gain.” *Id.* at 23.

¹⁷ See ICCA-QUEEN MARY TASK FORCE REPORT, *supra* note 8, at 20 (“Put simply, funding is not only for those that are impecunious. ‘The use of funding offers the client the ability to minimize risk, does not have any negative effect on their cash flow, and ensures payment of lawyers.’”).

¹⁸ *Id.*

¹⁹ Christopher P. Bogart, *Third-Party Financing of International Arbitration*, GLOBAL ARB. REV. (Oct. 14, 2016), <https://globalarbitrationreview.com/insight/the-european-arbitration-review-2017/1069316/third-party-financing-of-international-arbitration> [https://perma.cc/D2K4-839N]. Christopher P. Bogart is the CEO of Burford Capital. *Id.*

²⁰ See *id.* (“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)).

²¹ Ylli Dautaj & Bruno Gustafsson, *Access to Justice: Rebalancing the Third-Party Funding Equilibrium in Investment Treaty Arbitration*, KLUWER ARB. BLOG (Nov. 18 2017), <http://>

When funders choose which claims to fund, they employ an analysis that is unique to TPF. For TPF to provide ATJ, funders must fund meritorious claims. As such, TPF proponents claim that the decision to fund or not is based primarily on the merits of the case, the cost-benefit analysis, and the recoverability of damages.²² According to TPF proponents, funders have no incentive to fund claims that are frivolous or marginal because the promise of return is uncertain.²³

This incentive-based argument fails to recognize two important realities. First, the cost-benefit analysis performed by sophisticated funders necessarily involves analysis of the factors that contribute to the likelihood of success and, in turn, the likelihood of return on investment. This is concerning because empirical evidence points to a correlation between lower per capita income and weaker rule of law in the respondent state and increased likelihood of the investor-claimant's success.²⁴ The funder would necessarily factor this correlation into its risk analysis when selecting claims to fund, resulting in non-merit-based factors driving claim selection and more claims being directed at the least-developed countries ("LDCs"). Additionally, funders such as Burford Capital claim:

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.²⁵

arbitrationblog.kluwerarbitration.com/2017/11/18/access-justice-rebalancing-third-party-funding-equilibrium-investment-treaty-arbitration-2/ [https://perma.cc/7P5E-FH7Q].

²² See ICCA-QUEEN MARY TASK FORCE REPORT, *supra* note 8, at 25 (explaining that, when funders decide whether to fund a claim, they consider "the case merits, the economics of the proposed investment . . . and the enforceability of any award"); see also BURFORD CAPITAL, *supra* note 16, at 5 (stating that, when deciding whether to "invest capital or provide other services to corporate clients and law firms," Burford Capital "consider[s] the asset value of claims, or the potential impact of other legal or regulatory circumstances").

²³ See ICCA-QUEEN MARY TASK FORCE REPORT, *supra* note 8, at 208 (discussing concerns about frivolous claims, and stating that "[a]nother response is that funders' process for assessing claims and the typical terms and provisions in funding agreements reduces or eliminates the risks identified").

²⁴ See Julian Donaubauer & Peter Nunnenkamp, *International Arbitration of Investment Disputes: Are Poor and Badly Governed Respondent States More Likely to Lose?*, 25 APPLIED ECON. LETTERS 321, 325 (2017) (explaining that a study of the effects of a respondent state's per-capita income and the strength of domestic rule of law on ISDS found that "higher income and stronger than 'normal' rule of law reduce the probability of investor wins in international arbitration disputes").

²⁵ BURFORD CAPITAL, *supra* note 16, at 4.

By implication of permitting investment into a portfolio of claims, some very high-risk (i.e., low probability of success and/or less meritorious) claims likely will be brought to diversify the portfolio.²⁶ A funder needs only a few high-risk claims to succeed to reap large rewards, like including a few junk bonds in an otherwise lower-risk bond portfolio. This practice easily could translate to an increase in the number of frivolous claims brought. This situation recalls the original justification for prohibiting third-party funding—concern that the involvement of investors with profit-driven interests adulterates the judicial system.²⁷

This kind of analysis is the hallmark of speculation. This analysis not only conflicts with the United Nations' goal of promoting equal access to justice—including to members of vulnerable groups, such as LDCs—sustainable development, and economic growth, but it also creates a paradoxical result. 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.²⁸ As “the investment arbitration system is becoming increasingly integrated with the speculative financial world,” it is expected that funders will continue to “further fuel the boom in arbitrations [and] increase costs for cash-strapped governments,” among other concerns (e.g., conflicts of interest).²⁹ “This financialization of investment arbitration has even ex-

²⁶ See, e.g., Bogart, *supra* note 19, at n.9 (“According to its 2015 Annual Report, 87 per cent of Burford’s capital committed in 2015 financed portfolios and other complex vehicles . . .”).

²⁷ See Caroline Kenny, *Third Party Funding of International Arbitrations*, CIARB NEWS (Nov. 1, 2017), <http://www.ciarb.org/news/ciarb-news/news-detail/features/2017/11/01/third-party-funding-of-international-arbitrations> [<https://perma.cc/HFZ7-EC9E>] (discussing the reasons for the historical prohibition of third-party funding in common law jurisdictions). Historically, common law jurisdictions prohibited third-party funding for the following reasons:

[T]hird party funding . . . 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.

Kenny, *supra*.

²⁸ See ICCA-QUEEN MARY TASK FORCE REPORT, *supra* note 8, at 3, 5, 7, 8 n.21 (discussing current attempts at regulation and lack thereof at the international and national levels).

²⁹ EBERHARDT ET AL., *supra* note 13, at 9.

tended 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.”³⁰

Although 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. As a matter of public policy, however, 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 there are limited circumstances where claimants actually are impecunious and thereby granted ATJ through a funder’s involvement. Similar to the ethical rules prohibiting an attorney from representing a high-profile criminal defendant in a murder trial in exchange for publicity rights if the defendant is acquitted, speculation in the ISDS context also raises clear public policy concerns that trump the benefit of ATJ 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 system, where investors are incentivized to bet on weak economies, to go unregulated would directly conflict with the United Nations’ stated goals.³¹ Allowing the status quo of unregulated TPF in ISDS to continue would perversely promote unfair and unpredictable legal frameworks that exacerbate economic instability and exploit disadvantaged states. Given the well-founded concerns regarding the efficacy and fairness of the ISDS system as a whole, 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.³² At a minimum, policy-makers must seriously consider implementing interim cost awards and mandating funder submission to the jurisdiction of the tribunal to ensure enforceability of the cost award. As it stands, TPF proponents’ use of ATJ rhetoric is disingenuous at best and dangerously misleading at worst.

CONCLUSION

UNCITRAL Working Group III needs to critically evaluate justifications for the proliferation of TPF in the context of investment arbitration. TPF pro-

³⁰ *Id.*

³¹ See G.A. Res. 67/1, *supra* note 1, ¶¶ 7, 8, 9, 14, (describing the United Nations’ commitment to “the advancement of the rule of law at the national and international levels” and to “the right of equal access to justice for all”).

³² See generally Frank J. Garcia, *Third-Party Funding as Exploitation of the Investment Treaty System*, 59 B.C. L. REV. (forthcoming November 2018) (arguing that TPF should be banned from ISDS).

ponents' claims that funding provides ATJ for impecunious claimants are misleading because the world of litigation finance is more focused on large, well-resourced claimants and creative accounting that allows corporations to keep the costs of litigation off-balance sheet.

The issues TPF raises in this context are inexorably tied to the overarching debate over the efficacy and effectiveness of the investment arbitration system as a whole. At a minimum, however, UNCITRAL must take immediate steps to prevent exploitative speculation by funders given the implications for developing and less-developed states.