

Third-Party Funding

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UNCITRAL Working Group III 37th Session Preparatory Meeting

March 29, 2019



Columbia Center
on Sustainable Investment

A JOINT CENTER OF COLUMBIA LAW SCHOOL
AND THE EARTH INSTITUTE, COLUMBIA UNIVERSITY



Outline

- ◆ **Defining Third-Party Funding (TPF)**
- ◆ Who are Funders?
- ◆ How do we evaluate TPF in ISDS?
- ◆ What is the case for TPF?
- ◆ How is TPF used in ISDS?
- ◆ Potential impacts of TPF in ISDS
- ◆ What are potential policy responses
- ◆ Discussions in Working Group III

Defining Third-Party Funding

- ◆ Definitions can be broader or narrower
- ◆ “Third-party funding” can compete with, resemble, or complement other forms of arbitration financing, including:
 - ◆ Contingency fee arrangements
 - ◆ Pro bono legal services
 - ◆ Financing without a financial interest in the outcome of a dispute
 - ◆ Litigation insurance
 - ◆ After-the-event insurance

Defining Third-Party Funding

- ◆ “An agreement by an entity (the “third-party funder”) that is *not a party to a dispute* to provide *funds or other material support* to a disputing party (usually *the claimant* or *a law firm representing the claimant*), in return for a *remuneration*, which is *dependent on the outcome of the dispute.*”
- ◆ UNCITRAL Secretariat Note WP. 157 ¶ 5

Defining Third-Party Funding

- ◆ An agreement by an entity that is *not a party to the dispute* to provide a *party*, an *affiliate of that party*, or a *law firm* representing that party,
 - ◆ (a) *funds or other material support* in order to finance part or all of the cost of the proceedings either individually or as part of a specific range of cases, and
 - ◆ (b) such support or financing is either *provided in exchange for remuneration or reimbursement* that is *wholly or partially dependent on the outcome* of the dispute, or provided through a *grant* or in return for a *premium payment*.
- ◆ **ICCA Queen Mary Task Force on Third Party Funding in International Arbitration**

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- ◆ Defining Third-Party Funding (TPF)
- ◆ **Who are Funders?**
- ◆ How do we evaluate TPF in ISDS?
- ◆ What is the case for TPF?
- ◆ How is TPF used in ISDS?
- ◆ Potential impacts of TPF in ISDS
- ◆ What are potential policy responses
- ◆ Discussions in Working Group III thus far
- ◆ Next steps

Who are Funders?

Funders: an overview

- ◆ Third-party funders are investment funds. ISDS claims are assets. Funders invest in the asset to generate a financial return.
- ◆ Some funders are public, some are private, but all have profit-focused fiduciary obligations to their shareholders
- ◆ Some investors look to litigation funding as a way to diversify their investment portfolio away from other investable assets (e.g. stock market)

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How do we evaluate TPF in ISDS?

- ◆ **Does funding advance the object and purpose of investment treaties?**
 - ◆ **Purpose: [Sustainable] Economic Development**
 - ◆ US – Argentina (1994): Recognizing that agreement upon the treatment to be accorded such investment will stimulate the flow of private capital and the economic development of the parties
 - ◆ Switzerland – Egypt (2012): Recognizing the need to promote and protect foreign investments with the aim to foster the economic prosperity and sustainable development of both States
- ◆ **What are the costs vs. benefits of TPF?**
- ◆ **What are desirable and appropriate policy responses?**

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What is the case for TPF in ISDS?

- ◆ **Access to Justice**
- ◆ **Creating Market Efficiencies**
- ◆ **Leveling the playing field to achieve more socially just outcomes**

What is the case for TPF in ISDS?

◆ Access to Justice

- ◆ E.g. the case of the expropriated small enterprise and the jailed and bankrupt business owner
- ◆ What do we mean by “access to justice”?
- ◆ Are other procedural remedies unavailable?
 - ◆ E.g. outside of claims for denial of justice after domestic exhaustion of remedies, in what cases have procedural remedies been denied?
- ◆ Are other financing methods that may have fewer costs available?
 - ◆ E.g. Claimant purchased political risk insurance?

What is the case for TPF in ISDS?

“Access to Justice” is usually not the reason for seeking funding

- ◆ Claimants are often not impecunious
- ◆ Well-resourced and sophisticated claimants seek to:
 - ◆ Manage risk
 - ◆ Move legal risk off-balance sheet
 - ◆ Reduce legal budgets or “turn legal departments into profit centers”
 - ◆ Take advantage of financing that may be on more attractive terms than elsewhere
 - ◆ Take advantage of funders “management consultancy” role

What is the case for TPF in ISDS?

Creating market efficiencies

- ◆ Funders create a market for legal risk where there wasn't one
 - ◆ they permit parties to transfer risk to the funder, who then has a right to the financial upside
 - ◆ Similar to other risk mitigation (e.g. insurance)

Leveling the Playing Field

- ◆ Funders can help to achieve socially efficient dispute outcomes
 - ◆ They “level playing fields” by aligning the risk tolerance, and bargaining power, of parties
 - ◆ This can ensure settlement that is based on merits rather than risk tolerance

But... is this the case in ISDS?

What is the case for TPF in ISDS?

- ◆ Respondents in ISDS may be but are not always in positions of strong bargaining power
 - ◆ Access to information and legal counsel matter
 - ◆ Filing of claims are damaging to respondent states
 - ◆ Risk tolerance in standards-based systems is reduced
- ◆ Respondent funding is frequently unavailable = only one side of the scale can be adjusted
- ◆ TPF in ISDS can exacerbate differences in bargaining power in situations where the respondent is not in a position of strength
 - ◆ Vast majority of respondents are low-, lower-middle, and upper-middle income countries
 - ◆ Vast majority of claimants are large and well-resourced enterprises

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How is TPF used in ISDS?

- ◆ What and when does funding occur?
 - ◆ Some funders fund only a portion of costs, some all
 - ◆ Funding can come in early or later in the process
- ◆ Role of funder varies:
 - ◆ Some will require influence or decision-making over the management of the claim (e.g. decisions to settle)
 - ◆ Some will take a hands-off approach

How is TPF used in ISDS?

- ◆ Claimant funding
 - ◆ Money placed into a “special-purpose vehicle”
 - ◆ Funding Agreement between funder and claimant
 - ◆ Secured interest in portion of outcome of claim
 - ◆ Termination rights
 - ◆ Sometimes rights to:
 - ◆ Information
 - ◆ management of claim

How is TPF used in ISDS?

- ◆ Factors considered by funders:
 - ◆ demonstration of healthy claim
 - ◆ margin of recovery somewhere higher than budget for funding
 - ◆ the value of the claim
 - ◆ the amount required to be advanced
 - ◆ jurisdictional obstacles
 - ◆ available defenses
 - ◆ the nature, length and type of the proceeding
 - ◆ the possibility of settlement
 - ◆ the creditworthiness of the client
 - ◆ the creditworthiness of the Respondent (collectability of award)
 - ◆ counsel that has been selected and how counsel will be compensated
 - ◆ any other obstacles to recovery of an award

How is TPF used in ISDS?

- ◆ Respondent funding
 - ◆ Very different from claimant funding because there is no financial upside
 - ◆ Can be similar to after the event insurance
 - ◆ Requires agreement on foreseeable outcome/liability (i.e. how will tribunal apply law to facts and what will award be?)
 - ◆ Permits risk limitation but not elimination
 - ◆ Respondent will pay a deductible for agreed amount, and higher amounts will be compensated by funder (and may be shared in some combination between funder and respondent)
 - ◆ May also be collateralized by other claims
- ◆ But: Under what circumstances can (or will) governments enter into arrangements that grant control of claim to funder?

How is TPF used in ISDS?

- ◆ Portfolio funding = financial interest in a basket of claims
 - ◆ Around a single claimant
 - ◆ Around a law firm
- ◆ Permits risk diversification for funder
- ◆ Can result in lower cost of funding for claimants
- ◆ Permits secondary market for institutional investors
 - ◆ Not robust right now, but starting to exist

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Potential impacts of TPF in ISDS

- ◆ Impacts on:
 - ◆ Conflicts of Interest
 - ◆ Costs and Security for Costs
 - ◆ Confidentiality and Legal Privilege
 - ◆ The number and kind of ISDS cases
 - ◆ Select respondent states
 - ◆ The quality of cases: frivolous and marginal claims
 - ◆ The substantive development of investment law
 - ◆ The outcome of disputes and decisions to settle claims
 - ◆ The retention of foreign direct investment
 - ◆ State conduct: regulatory chill

Potential impacts of TPF in ISDS

- ◆ ISDS is a system of standards, and not rules
 - ◆ The party whose behavior is expected to conform to the vague standards generally bears the cost
- ◆ Standards-based legal systems can work
 - ◆ precedent or appellate mechanism can inform, ex ante, what behavior is expected
 - ◆ ISDS does not have these features
- ◆ ISDS awards are rarely set aside, are not subject to appellate review
- ◆ TPF in ISDS is asymmetric (available only to claimant) and thus may often results in an amplification of other asymmetries

Potential impacts of TPF in ISDS

Conflicts of Interest and disclosure

- ◆ Conflicts between funders and arbitrators
 - ◆ Where arbitrators act as advisors to funders
 - ◆ Where an arbitrator or his/her law firm has a recurring relationship with funders
- ◆ Questions surrounding:
 - ◆ to what extent and by/to whom disclosure should be made in order to ensure that actual or potential conflicts of interest are assessed and addressed
 - ◆ What kind of conflict should require action (e.g. recusal)

Potential impacts of TPF in ISDS

- ◆ Extent of disclosure:
 - ◆ The extent of disclosure that is desirable really depends on the framing of the concern about TPF
- ◆ Arguments against disclosure:
 - ◆ Name and identity of funder generally not considered privileged
 - ◆ Arguments that funding agreement:
 - ◆ is subject to contractual confidentiality
 - ◆ may give opposing party leverage in settlement discussions

Potential impacts of TPF in ISDS

Costs and Security for Costs

- ◆ **Costs of proceedings:** The link between third-party funding and increased costs for ISDS remains untested, but concerns have been raised
- ◆ **Amount of claims:** Concerns that TPF increases claim
- ◆ **Recoverable costs:** Should costs of legal representation and other costs paid by funder be recoverable? Should cost of funding itself be recoverable?
- ◆ **Security for costs:** Under what circumstances should a funder need to post security for costs?
- ◆ **Adverse costs:** Under what circumstances should (and can) a funder be on the hook for adverse costs?
 - ◆ Note: jurisdictional hurdles are not necessarily insurmountable

Potential impacts of TPF in ISDS

Confidentiality and Legal Privilege

- ◆ Obtaining funding requires sharing with the funder information that is often confidential
- ◆ Funders are not bound by confidentiality obligations (e.g. ethics rules)
 - ◆ E.g.. they are not prohibited from using this information in another funded claim, even if there is a conflict
- ◆ Disclosure of confidential information may result in a waiver of confidentiality and susceptible to disclosure
 - ◆ Most arbitration rules are silent; arbitrator discretion and/or domestic law

Potential impacts of TPF in ISDS

Impacts on the number and kind of ISDS cases

- ◆ Funders claim they only fund 10% of claims presented to them
- ◆ **Bigger concern: Are some kinds or sectors of cases being funded more than others?**
 - ◆ 60% of cases registered at ICSID are infrastructure and extractives
 - ◆ High damages awards, expectation damages possible
 - ◆ Extensive social and environmental complications in these sectors
 - ◆ Controversial claims because they often stem from complicated balancing of competing interests among different stakeholders

Potential impacts of TPF in ISDS

Impacts on select respondent states

- ◆ Are certain countries, or country profiles bearing an outsized burden of funded claims?
 - ◆ E.g. developing and middle income countries?
 - ◆ E.g. countries reliant on resource extraction?
- ◆ International investment law already has an outsized impact on developing states?
 - ◆ Primary targets of claims (relative to GDP)
 - ◆ Have paid more in damages than advanced economies
- ◆ **What does this mean for inequality and the ability of these states to regulate and take steps in the public interest?**

Potential impacts of TPF in ISDS

Impacts on the quality of cases: Frivolous and Marginal Claims

- ◆ ISDS is a standards-based legal system: claims are rarely declared frivolous
 - ◆ Arbitrators also have systemic incentives to accept jurisdiction
- ◆ **Bigger concern: Marginal claims intended to push the boundaries of the law**

Potential impacts of TPF in ISDS

Impacts on the Substantive Development of Investment Law

- ◆ Defense of ISDS and TPF often focuses on upholding “the rule of law” = but many cases are less clear
 - ◆ E.g. good faith ban or moratoria on extractives projects
 - ◆ E.g. domestic common law patent protection is inadequate
- ◆ Many ISDS cases involve highly complex questions of public policies, preferences and competing rights and obligations
- ◆ But, only investors initiate claims
- ◆ Claims that are outside the intent of treaty parties but accepted at the jurisdictional phase are only likely to move the contours of investment law in a more investor-friendly direction and away from state-party intent
 - ◆ Australia: Chen found that TPF leads to more claims; claims raise riskier and novel issues and constantly push boundaries of law; these cases are cited more and have more impact on legal developments
- ◆ **Funders have long-term interests in shaping the contours of the law but there is currently no transparency around when they are involved or who they are**

Potential impacts of TPF in ISDS

Impacts on Outcomes of Disputes and Decisions to Settle Claims

- ◆ Funders financial interest may prefer settlement over seeing a claim through to an award
 - ◆ E.g. fiscal year profits
 - ◆ E.g. balancing risk profile of a portfolio
- ◆ Settlement raises public policy issues that are often regulated in domestic legal systems but not in ISDS:
 - ◆ Government accountability
 - ◆ Transparency
 - ◆ Rule of law
- ◆ **How does funding impact risk tolerance and bargaining position of states in settlement discussions? Should funders be able to influence or control settlement?**

Potential impacts of TPF in ISDS

Impacts on the retention of FDI

- ◆ FDI can help long-term development (e.g. commitments of capital, technology transfer)
- ◆ Investment treaties should help to **attract** and **retain** FDI
- ◆ No clear evidence that they attract FDI
- ◆ TPF may exacerbate concerns about ISDS
 - ◆ Damages often higher than under domestic law
 - ◆ May undermine long term contractual relationship with incomplete terms if investor can sue, (settle) and walk away

Potential impacts of TPF in ISDS

Impacts on State conduct: regulatory chill and overdeterrence

- ◆ Investment treaties go beyond other constraints on government powers
- ◆ They unduly discourage (or require compensation for) good faith actions taken by governments in the public interest
- ◆ Standards of investment law make it difficult for states to understand what actions will violate treaties
- ◆ TPF exacerbates situations of regulatory chill and overdeterrence of government behavior
- ◆ TPF eliminates claimant risk so permits more marginal claims to be advanced

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Potential policy responses

Questions that should guide policy-making:

- ◆ How and under what circumstances is TPF being used?
- ◆ Absent information, what assumptions should be made?
- ◆ Evaluated in light of economic development objectives:
 - ◆ What are costs of TPF in ISDS?
 - ◆ What are benefits of TPF in ISDS?
- ◆ Under what circumstances, if any, should TPF be permitted?
- ◆ What regulations should be in place to reduce costs and advance benefits?

Potential policy responses

Full Ban on TPF in ISDS

- ◆ Whatever its merits elsewhere, TPF has no place in an ISDS system that is deeply asymmetrical and fundamentally flawed
- ◆ Permitting speculative finance to take a stake in the outcome of these cases, and to have a voice in or influence over critical issues (e.g. selection of arbitrators, decisions to settle) exploits deep-rooted flaws at expense of governments, taxpayers and citizens

Potential policy responses

Partial Ban on TPF in ISDS

- ◆ Are there certain situations in which TPF should never be permitted?
- ◆ Are there certain situations in which TPF should be permitted?
- ◆ Who should bear the burden of demonstrating criteria for TPF?

Potential Policy Responses

Regulate TPF in ISDS

- ◆ There are a wide range of possibilities
- ◆ Regulatory response should address what the problem with third party funding is understood to be.
- ◆ E.g. **If conflicts of interests with arbitrators and/or experts is of concern**, disclosure of existence of funding and funder (including beneficial ownership) may be desirable.
- ◆ E.g. **If enforcement of awards for costs is a concern**, rules on security for costs may be desirable (particularly in the case of impecunious claimants), may wish to understand:
 - ◆ Whether funder has an obligation for adverse cost awards
 - ◆ What termination rights the funder has

Potential Policy Responses

For concerns beyond conflicts of interests or enforcement of cost awards, more extensive policy responses may be desirable:

- ◆ Ethical rules
 - ◆ E.g. to address confidentiality, settlement
- ◆ Tribunal supervision over funding relationship
 - ◆ E.g. to ensure it is not exploitative, to enforce ethical obligations, to facilitate awards for costs
- ◆ Place a burden on party seeking funding to
 - ◆ Provide information on termination rights and nature of funding arrangement (e.g. does it cover adverse costs)
 - ◆ demonstrate a prima facie valid claim and need for funding (e.g. demonstrate impecuniosity)

Potential Policy Responses

Practical steps to bans or regulation:

- ◆ A multipronged approach
 - ◆ Arbitration rules
 - ◆ Domestic jurisdictions
 - ◆ Treaties
- ◆ This may take time but can be accomplished
 - ◆ E.g.: Consider in context of multilateral investment court – include rules in organizing treaty

Potential Policy Responses

Examples:

- ◆ ICSID rule revision process
 - ◆ Has identified the problem to be addressed as conflicts of interests between counsel and arbitrators
 - ◆ Proposed rule thus requires disclosure of (1) existence of funding and (2) funder

- ◆ Hong Kong
 - ◆ Requires disclosure of (1) existence of funding, (2) funder
 - ◆ Disclosure of funding agreement only as required by the agreement, by the tribunal, or by law
 - ◆ Permits control over case management to extent permitted by law

- ◆ Singapore
 - ◆ Requires disclosure of (1) existence of funding, (2) funder
 - ◆ Disclosure of funding agreement “where appropriate, details of the third-party funder’s interest in the outcome of the proceedings, and/or whether or not the third-party funder has committed to undertake adverse costs liability

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Discussions in WGIII Thus Far

- ◆ Third-party funding has come up while discussing other concerns (e.g. independence and impartiality of arbitrators) but has not been discussed as its own concern
- ◆ At the 37th Session the Working Group will consider the issue of third-party funding on the basis of WP. 157

Discussions in WGIII Thus Far

- ◆ States have raised:
 - ◆ Conflicts of interest concerns
 - ◆ The extent to which funders should be able to control or influence the management of claims and proceedings
 - ◆ Concerns surrounding confidentiality
 - ◆ Concerns about how security for costs should be treated when there is a funder involved
 - ◆ Whether funders should and can be on the hook for adverse cost awards
 - ◆ Whether funding increases speculative, marginal or frivolous claims
 - ◆ How a funder impacts settlement discussions
 - ◆ Concerns surrounding increased funding of non-impecunious claimants
 - ◆ The impact on the value of claims being funded
 - ◆ Targeting of certain profiles of countries

Discussions in WGIII Thus Far

- ◆ Policy responses suggested thus far:
 - ◆ Disclosure of existence of funding
 - ◆ Disclosure of identity of funder
 - ◆ Disclosure of terms of funding agreement
 - ◆ Ethical requirements on funders
 - ◆ Partial ban
 - ◆ Complete ban

Thank you

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