

Bilateral Investment Treaties: Third Party Funding – The Financialisation of Justice

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- Bilateral Investment Treaties (BITs) are binding agreements between two countries that allow companies to sue governments in private tribunals for decisions or policy changes that negatively impact the profitability of their investments. Most UK BITs are with developing countries.
- Third party funding is where financiers cover the legal fees of a case to enable investors to sue governments, in exchange for a large cut of any eventual award.
- Third party funders win big if a company's claim is successful, but are not liable to pay legal fees if a government successfully defends itself against the claim. Governments have no equivalent funding source to cover their legal fees.
- Third party funding is poorly regulated internationally. The identity of third party funders is rarely public information and is sometimes even withheld from countries being sued.
- Rights granted to companies under BITs are a threat to the public interest and a government's right to regulate. The financialisation of BIT claims through deep pocketed third-party funders makes the situation worse, increasing the number of high cost suits that companies can launch, leading to higher costs for taxpayers and a greater likelihood that governments will cave in to company demands rather than expend limited resources defending a particular regulation.
- The UK is a hub for third party funding, home to big players like Burford Capital, Calunius Capital and Juridica Investments.
- Third party funding is behind an ongoing UK-BIT claim against Bolivia, relating to a mining application in a fragile ecosystem, opposition to which has led to the gassing of villagers and the killing of an indigenous activist.

A Booming Industry

The clause in a BIT which allows companies to sue governments is referred to as the investor-to-state dispute settlement mechanism (ISDS). Awards resulting from an ISDS claim can run to hundreds of millions, even billions of dollars and it is the taxpayer who foots the bill. BITs grant broad rights to investors to launch a claim, such as the right to a 'minimum standard of treatment', which obliges governments not to frustrate corporate expectations with policy changes.

ISDS claims are expensive to bring, with legal fees averaging \$8 million and often exceeding \$30 million. Third party funding enables companies without the capital to cover legal fees upfront, or companies that wish to keep legal fees off their balance sheets, to launch an ISDS claim at relatively low risk. In exchange, funders typically seek anything between 10 and 70 percent of a successful award and, in some cases, equity in the company.

An estimated 23 international arbitration funders operate in the UK. According to one study, £1.5 billion in assets is now under management by the UK's top funders of domestic and international litigation, representing a 743% growth in the industry between 2009 and 2015. London-based Burford Capital, which invests a quarter of funds in international investment cases, increased its profits nine-fold between 2010 and 2011 alone. The potential of ISDS to generate significant

income for funders was illustrated in April 2016, when New York based Tenor Capital received 35 percent of a \$1.4 billion ruling against Venezuela, in a case brought by Crystallex, a return of over 1,000 percent on the \$36 million that the funder had provided for the legal costs.

A stake in an ISDS claim is increasingly being treated as a derivative that can be marketised like any other – bought, sold or packaged with others. This has echoes of the sub-prime crisis and the financialisation of housing. Indeed, industry expectations are that ISDS claims will soon be traded on an industrial scale, as part of a sophisticated secondary market in claims. Given the low probability of a massive payout (the average is \$76 million, skewed upward by a few very large awards) third party funders have an incentive to inflate the number of cases in which they have a stake in order to effectively spread their bets. This is the logic of the market, which one leading arbitrator has termed 'a gambler's Nirvana'.

Public Protections Undermined

Third party funders are not responsible for the unfair rules in BITs that allow companies to sue governments for measures that increase social, environmental and other protections. But third party funders do allow suits to be launched at a far greater scale. Governments meanwhile must rely on public funds to cover their legal fees, as they have no potential winnings to leverage (governments never 'win' ISDS cases, they can only successfully defend suits against them).

In developing countries, which are at greater risk of ISDS suits because they are by their nature developing their policies in many areas, attorney general office budgets are measured in the tens of millions, rather than the hundreds of millions commanded by third party funders. Even where governments 'win' an ISDS case, they may not be awarded, or may not be able to recover, legal fees. Rather than risk an enormous payout, or the time and expense of fighting the legal case, there is evidence that developing country governments are simply caving in to investors' demands in the face of an ISDS threat or checking the likelihood of an ISDS challenge before going ahead with a policy measure.

Case Studies

1. Opposition to South American Silver's (SAS) proposed mine in Potosí, Bolivia, has resulted in the killing of an indigenous activist, the gassing of the homes of dissenting community members by local police, and the detention of police officers by community members. The mine would have threatened a fragile ecosystem of lagoons which are also the main source of drinking water for local communities. After an escalation of violence in 2012, the Bolivian government moved to restore calm by reverting the concession to the State. In response, SAS have brought a \$386 million ISDS claim against Bolivia under the UK-Bolivia BIT. SAS, which, according to Bolivia, is close to insolvency, is paying for its claim through the use of a third-party funder. SAS fought to keep the identity of its funder secret, but was eventually ordered to disclose 'for purposes of transparency'. However the identity of the funder is not in the public domain.

2. In 2008, UK-based arbitration funder Juridica entered into an agreement with S&T Oil to fund an ISDS suit against Romania over the privatisation of a chemical plant. There were serious financial and legal concerns with the case from the outset, and in 2009 S&T's law firm, King & Spalding, announced it wished to withdraw from the case, claiming that the company had not produced a 'critical piece of evidence'. Later that year, Juridica asserted that S&T Oil made 'material misrepresentations' about the facts underlying the case, and refused further funding. In 2010, Juridica filed an action against S&T Oil to retrieve its investment. Meanwhile, S&T Oil filed a complaint in a US district court (eventually dismissed) alleging that the funding agreement with Juridica violated attorney-client privilege and claiming that its lawyers, King & Spalding, improperly consulted

with Juridica. The case illustrates the tangled web of relationships and conflicts of interest that third party funding can give rise to.

There should be avenues for international investors, like other groups, to seek redress through affordable, national judicial systems. But a third-party funded ISDS model is the worst possible solution, creating a speculative, self-perpetuating industry based on the extraction of public resources.

A Secretive Industry

Neither the UK's BITs, nor the arbitration rules of tribunals like the International Centre for Settlement of Investment Disputes (ICSID) oblige companies using ISDS to disclose the identity, or even the existence, of a third party funder underwriting a case. Tribunals will sometimes order disclosure if pressed by the respondent government. But the lack of automatic disclosure rules creates a number of risks. There is a conflict of interest risk, not least because there is a revolving door between big law firms representing companies, ISDS tribunalists, and third party funders. It also raises the risk that legal costs will not be recoverable if a government successfully defends itself because third party funders are not obliged to pay costs and the claimant company may be insolvent. Finally, where the funder has a very large stake in the award and considerable control over the suit, funding arrangements prevent governments from knowing who exactly is behind a claim.

Even when the courts do order a disclosure, the identity of the third party funder is often not in the public domain, which is highly problematic given the sums of money and public policy issues often at stake.

What can MPs do?

MPs should:

- Call for an investigation to uncover the current scale of third party funding of ISDS cases by UK-based financial institutions;
- Call for an urgent review of the UK's investment protection regime with a view to ending third party funding;
- Oppose the ratification of any further UK BITs until the investment regime is reviewed and improved.

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More detailed information and reports are available at <http://bit.ly/1Xg5ov9>

