Explaining the rise of third-party funding in investment arbitration*  
by Florence Dafe and Zoe Williams**

The practice of third-party funding (TPF) of investment arbitration is the subject of heated debate. Proponents argue that TPF increases “access to justice” in the form of investor-state dispute settlement (ISDS). Detractors worry, among other things, about the increase in (frivolous or marginal) claims. What much of the current debate lacks is an empirical analysis of the factors driving the development of this practice and shaping its outcomes. Examining what has contributed to the rise of TPF allows us better to understand how it affects arbitration and how it may develop in the future.

What explains the rise of TPF in investment arbitration? One necessary, if not sufficient, condition is the legality of the practice in certain domestic jurisdictions that are important centers of international arbitration. Historically, common law systems prohibited the funding of legal claims by third parties, but legal changes in the UK eased these restrictions.1 This was necessary for the growth of the industry, and its spread to other jurisdictions, including the US, Hong Kong (China) and Singapore. While some of these changes centered on the legality of funding domestic claims, they also ensure the enforceability of contracts and awards associated with ISDS, which funders told us gives them greater confidence when funding treaty and contract claims. However, these changes alone do not explain the rapid growth and development of the industry.

Proponents claim that TPF’s emergence can be explained as a response to a widely recognized problem—the high costs of arbitration. TPF is thus framed as a way to increase “access to justice” for claimants, including by the UK’s Ministry of Justice in 2009. However, in practice, funders of ISDS claims actively and successfully promote TPF to non-financially distressed claimants, and one funder told us “I don’t think any funder is in the business of providing access to justice.”

With the rise of TPF, investment arbitration has gone through a process of “financialization,” referring to the increasing role of financial markets, actors and institutions in domestic and international economies. TPF thus reflects broader trends toward a finance-led economic growth regime that has increased the amount of capital that institutional investors such as pension funds and insurance companies and their asset managers control, hold and seek to deploy. TPF became an attractive investment outlet because it yields high returns and is an uncorrelated asset class. As a result, money has poured into the TPF industry, which has now billions of dollars available to it.
Our interviews suggest that this “financialization” of investment arbitration has several observable indicators, including:

- A growing acceptance and more frequent consideration of TPF by arbitration lawyers, despite initial distrust and concerns about the legality of the practice.
- An institutionalization of relationships between law firms and funders. As one funder described it, firms are “linking up with funders and becoming a partner.”
- An alignment of the interests of law firms whose clients need funding and financial actors who feel pressured to deploy capital.
- The reliance on financial logics to determine which cases receive funding. As the funders we spoke to explained, they routinely rule out funding cases they consider legally meritorious if the size of the potential return is too low and if not funded as part of a portfolio of claims.

These findings are relevant for important debates regarding TPF. First, the increasing closeness of funders and law firms suggests a need for greater transparency to avoid conflicts of interest, such as funders encouraging lawyers not to settle under specific amounts. However, an open question is whether, if the TPF industry continues to grow, the pressure to deploy capital will result in an increase in less meritorious or more marginal claims funded. Already, a situation has emerged in which funders are, in the words of one lawyer, “all fighting for the same cases”—and hence may be tempted to settle for marginal claims.

Second, rather than worry about an increase in frivolous claims, as some observers do, we should focus on the ways in which funding might skew the system in favor of large investors. As expected, returns determine which cases receive funding, smaller investors may not be able to acquire TPF, which undermines the access-to-justice narrative of TPF proponents. Of course, TPF also increases resources available to investors making use of ISDS while doing nothing to address the concerns of states with the system.

TPF has been a focus in the ongoing UNCITRAL meetings on ISDS reform. Along with some states involved in this process, we argue that, as a first step, there should be a push for greater transparency regarding the use of TPF in ISDS. While this would not address all concerns associated with the practice, greater transparency would both reduce potential conflicts of interest and allow researchers, states and other interested parties better to understand how TPF affects arbitration proceedings and outcomes.

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1 Milestones were, for instance, the 2005 Court of Appeal ruling in *Arkin v Borchard Lines Ltd.* [EWCA] Civ 655, and the UK Ministry of Justice’s *Justice Rupert Jackson, Review of Civil Litigation Costs: Final Report (2009).*