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Research Report

The case against third-party funding in investment arbitration

Columbia FDI Perspectives, No. 253

Provided in Cooperation with:

Columbia Center on Sustainable Investment (CCSI) - A joint center of Columbia Law School and the Earth Institute, Columbia University

Suggested Citation: Garcia, Frank J.; Hough, Kirrin (2019) : The case against third-party funding in investment arbitration, Columbia FDI Perspectives, No. 253, Columbia University, Columbia Center on Sustainable Investment (CCSI), New York, NY

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Columbia Center
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A JOINT CENTER OF COLUMBIA LAW SCHOOL
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Columbia FDI Perspectives

Perspectives on topical foreign direct investment issues

No. 253 June 3, 2019

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The case against third-party funding in investment arbitration*

by

Frank J. Garcia and Kirrin Hough**

Third-party funding (TPF) of investment disputes is rapidly increasing, as investors discover the high returns to be made by funding claimants in investor-state dispute-settlement (ISDS) cases. In exchange for covering related costs, funders stand to gain not only a significant share of the award, but also some influence over case management by requiring progress reports, monitoring fees, approving expenditures, seeking direct access to clients' attorneys, and influencing both the process of appointing the claimants' arbitrators and tailoring settlement decisions.¹ However, irrespective of any benefit brought by TPF in other dispute settings, TPF in ISDS differs in key respects and should be regulated, if not banned outright.

First, the financial risks are unbalanced. Under the current ISDS regime, governments generally cannot assert counter-claims offsetting an award. Moreover, claims are paid or settled by states two-thirds of the time.² Procedurally, claimants have a direct voice in the selection of adjudicators, and there is no right of appeal. These factors enable funders to make sizeable profits, which can reach as high as a 700+% return on investment,³ while risking nothing but costs. This has led one arbitrator to characterize TPF in the area of ISDS as a gambler's paradise: "heads I win, tails I do not lose."⁴

Second, the funding opportunities are unbalanced. As states cannot win any financial awards in ISDS cases, TPF generally funds only claimants. Moreover, evidence suggests that TPF is contributing to a rise in investment claims, facilitated by the increasingly common portfolio model of dispute funding that may encourage claimants to bring more (and potentially less meritorious) claims against states. Therefore, TPF increases available resources for FDI investors while intensifying budgetary pressures on states, thus skewing the system.

Finally, the source of the award differs fundamentally. In ISDS, TPF profits come from respondent states and their citizens, not shareholders as in commercial disputes, since host countries' tax-payers—not shareholders—are the residual risk-bearers in ISDS. Moreover, a substantial portion of the award flows to TPF funders, who are neither stakeholders nor

beneficiaries of the system, but nevertheless are in a position to influence case management and case law. From a fairness perspective, TPF could be seen as effecting uncompensated wealth transfers through ISDS from the public, often in developing countries, to speculative investors.⁵

Proponents argue that TPF promotes access to justice and filters out unmeritorious cases. However, any social benefits in other dispute settings are unlikely to occur in ISDS. ISDS TPF is not about capacity-building for social justice but, as funders have acknowledged, about balance-sheet management, allowing well-resourced claimants to minimize risks associated with bringing claims.⁶

For all these reasons, TPF in its current form threatens to intensify the investment regime's legitimacy crisis and does not play a constructive role in investment arbitration. States should at least regulate, if not ban, TPF in investment agreements and in the arbitral rules of the International Centre for Settlement of Investment Disputes and the United Nations Commission on International Trade Law. Any access to justice concerns can be covered by political risk insurance or non-contingent commercial dispute funding.

As long as TPF remains in play, there should be mandatory, expansive disclosure of TPF agreements and their terms, so that parties know who is controlling the case and sharing in its proceeds, while empirical evidence is generated for more comprehensive regulatory schemes. Mandatory security for costs in TPF cases can also disincentivize funders from pursuing cases with little merit only for settlement value or a possible pro-investor precedent.

It is critically important that investors, stakeholders, academics, and civil society take a careful, sustained look at the risks that TPF poses to the public and to the investment regime itself, while effective regulation is still possible.

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¹ [International Council for Commercial Arbitration, "Report of the ICCA-Queen Mary task force on third-party funding in international arbitration" \(2018\), p. 28.](#)

² [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* \(2018\).](#)

³ Returns generally average 30-50%; [Willem H. van Boom, "Third-party financing in international investment arbitration \(2011\), p. 30.](#) However, in *Teinver v. Argentina* (ICSID Case No. ARB/09/1), Burford Capital realized a 736% return on its US\$13 million investment against Argentina; Burford Capital, Annual Report 2017 (2017), p. 23.

⁴ Gavan Griffith draws this analogy in *RSM Production Corporation v. St. Lucia* (ICSID Case No. ARB/12/10).

⁵ [Frank J. Garcia, "Third-party funding as exploitation of the investment arbitration system," *Boston College Law Review*, vol. 59 \(2018\).](#)

⁶ In the words of the Burford Capital CEO, "it 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). See generally [Tara Santosuosso and 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* \(2018\).](#)

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