Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration

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INTRODUCTION

In February 2010, a court in northeastern Ecuador handed down an $18.2 billion judgment against Chevron Corporation on behalf of Ecuadorians living in areas affected by its drilling practices.[1] The plaintiffs had received funding from Burford Capital to finance the Ecuadorian litigation, but the plaintiffs' relationship with Burford only began "dribbling into public view [in] December [2010], thanks to a series of wildly improbable events" that eventually led to disclosure of the relationship.[2]

What were these wildly improbable events? Misconduct by Steven Donziger, the plaintiffs' attorney, led to twenty lawsuits in sixteen U.S. federal courts.[3] In a deposition for a federal racketeering suit brought in New York, Donziger was questioned about the company that had provided funds to the Ecuadorian plaintiffs.[4] Although Donziger's attorney argued that the issue was irrelevant, the special master assigned to the case, Max Gitter, required Donziger to answer in order to ensure that other judges did not have any conflicts of interest with the investor.[5] Upon Donziger's disclosure that the funder was Burford, "[b]y amazing coincidence, and as if to prove the wisdom of [his] ruling [requiring disclosure of funding]," Gitter disclosed that he formerly (and, in a technical manner, currently) served as co-counsel with John Molot, who founded Burford and who at one point sent Gitter a brochure about funding one of Gitter's cases.[6] Gitter was also friends with Burford's former general counsel.[7] Gitter did not recuse himself from the racketeering litigation, and the parties did not insist on his recusal, but as Gitter noted, the deposition "prove[d] . . . that it is imperative for lawyers to insist that clients disclose who the investors are."[8]

The Donziger deposition demonstrates how frequently conflicts of interest may arise as a result of third-party funding. If Gitter had not insisted on

1. Roger Parloff, *Have You Got a Piece of This Lawsuit?*, CNN MONEY, June 28, 2011, http://features.blogs.fortune.cnn.com/2011/06/28/have-you-got-a-piece-of-this-lawsuit-2.

2. *Id.*

3. Paul M. Barrett, *Amazon Crusader. Chevron Pest. Fraud?*, BLOOMBERG BUS. WK., Mar. 9, 2011, http://www.businessweek.com/magazine/content/11_12/b4220056636512.htm.

4. Parloff, *supra* note 1.

5. Steven Donziger—Chevron Applications: Donziger, Steven—Day02, Condensed Transcript of Deposition Testimony at 383–86, *In re* Application of Chevron, No. 10 MC 00002 (LAK) (S.D.N.Y. 2010), *available at* http://www.scribd.com/doc/47264957/11-29-10-12-29-10-Deposition-Transcripts-Steven-Donziger-Days-1-8. In the deposition, Gitter noted:

> It is very difficult for me to think of something that might be more important to a judge involved in the adjudication of a matter in terms of deciding whether he needs to recuse himself than to know the names of the significant investors in the suit who have a huge stake in the outcome. . . . [H]aving seen no case to the contrary, or any law to the contrary, and having in mind the important public interest in seeing to it that judges can make reasoned decisions about whether or not they ought to recuse themselves from litigation . . . .

Id. at 384–85.

6. *Id.* at 631–33.

7. *Id.* at 632–33.

8. *Id.* at 633, 635–36.

disclosure, the conflict may never have come to light or may have been discovered only after a judgment had been issued or a settlement had been reached. Even though the conflict here was waived by the parties, the conflict may be more serious in other cases.

The Donziger deposition occurred during litigation in national courts, a type of dispute resolution that is significantly more public than arbitration. Because of the confidential nature of arbitration,[9] there are few anecdotes akin to the Donziger deposition arising in the context of arbitration. All signs, however, indicate that conflicts of interest are arising with greater frequency in the arbitral process due to the growth of the third-party funding industry.

Although there is no hard data about the use of third-party funding in international commercial arbitration, due to the typical confidentiality of proceedings, there are several indications that its use is increasing. First, academia started to pay attention to the issue only a few years ago. Second, the use of third-party funding in domestic litigation has greatly increased in the past five years—particularly in Australia and England. The volume of disputes resolved in arbitration, the costs incurred during the arbitral process, and the availability of funding also point to its likely use. Finally, third-party funding issues have been raised in international investment arbitration awards, which, unlike commercial arbitration awards, are generally publicly available.

Current arbitral rules do not sufficiently address the independence of arbitrators, in light of the growing use of third-party funding. Like domestic laws regarding the independence of national judges,[10] arbitral rules uniformly require an arbitrator to be independent and impartial.[11] These two requirements complement each other to ensure full integrity in the arbitral proceeding.[12] Impartiality

9. Leon E. Trakman, *Confidentiality in International Commercial Arbitration*, 18 ARB. INT'L 1, 1 (2002). Agreements to arbitrate may include a confidentiality provision, and a party may request an order of confidentiality from the tribunal before, during, or after the arbitral proceedings. *Id.* at 2–3, 6. Such confidentiality is seen as one of the key advantages of arbitration. *Id.* at 4.

10. The law is unsettled in the United States as to whether arbitrators should be held to a higher or lower standard than judges. *Compare* Commonwealth Coatings Corp. v. Cont'l Cas. Co., 393 U.S. 145, 149 (1968) (Black, J.) ("[W]e should, if anything, be even more scrupulous to safeguard the impartiality of arbitrators than judges . . . ."), *with Commonwealth Coatings*, 393 U.S. at 150 (White, J., concurring) ("The Court does not decide today that arbitrators are to be held to the standards of judicial decorum of Article III judges, or indeed of any judges."). *See generally* Catherine A. Rogers, *Regulating International Arbitrators: A Functional Approach to Developing Standards of Conduct*, 41 STAN. J. INT'L L. 53, 79 (2005) (noting the "innumerable splits among courts" caused by *Commonwealth Coatings*).

11. *See, e.g.*, INT'L CHAMBER OF COMMERCE, ARBITRATION AND ADR RULES art. 11(1) (2011) [hereinafter ICC RULES]; INT'L CTR. FOR DISPUTE RESOLUTION, INTERNATIONAL DISPUTE RESOLUTION PROCEDURES art. 7 (2010) [hereinafter ICDR RULES]; LONDON COURT OF INT'L ARBITRATION, ARBITRATION RULES art. 5 (1998) [hereinafter LCIA RULES]; U.N. COMM'N ON INT'L TRADE LAW, UNCITRAL ARBITRATION RULES art. 12(1) (2011) [hereinafter UNCITRAL Rules]. Indeed, this requirement dates back to ancient Greece and Rome, where the term "arbitrator" meant an impartial third party. GARY BORN, KLUWER LAW INT'L, INTERNATIONAL COMMERCIAL ARBITRATION 1462 (2009) (citing D. ROEBUCK, ANCIENT GREEK ARBITRATION 164, 206, 207, 349 (2001), and D. ROEBUCK & B. DE FUMICHON, ROMAN ARBITRATION 51–52, 57, 61 (2004)).

12. *See* BORN, *supra* note 11, at 1463.

refers to the state of mind of the arbitrator, whereas independence looks at the arbitrator's relationships with other parties,[13] including a third-party funding corporation that provides financing to one of the parties in an arbitration.

Although the rules require an arbitrator to be independent and to disclose any conflicts of interest, an arbitrator may not know that he has been indirectly appointed by the same third-party funder in multiple arbitrations. If the arbitrator does not know that a claimholder receives funding from a third party, he may not disclose his holdings in the third-party funding corporation or his law firm's involvement in cases funded by such corporations. If such conflicts emerge during the arbitral process, a new arbitrator may have to be appointed, thereby disrupting the proceedings. If the award has already been issued, the conflict may cause the award to be annulled or to be denied recognition or enforcement. The potential effects of nonindependence are great.

Because of the potential disruption of the arbitration and the possibility of annulment, nonrecognition, and nonenforcement of the award, conflicts of interest should be addressed prior to the appointment of the arbitrator. This Note proposes a solution to problems raised by conflicts of interest caused by third-party funding. The proposal requires some modest alterations to the institutional arbitral rules to ensure the independence of arbitrators.[14] The four-prong proposal begins with a duty by the arbitrator to disclose any past and current relationships with third-party funders to the institution. Second, the arbitral rules should provide that any party receiving outside funding must disclose to the institution that relationship and any potential conflicts involving the third-party funder. Third, the arbitral rules should require automatic review of potential third-party funding conflicts that are triggered by the party's disclosure of a funding relationship. The institution would be required to keep all funding information confidential. Finally, in order to incentivize third-party funders to disclose the relationship, the arbitral rules should provide that such relationships cannot be considered in tribunal decisions for awards on costs or security for costs. The proposal is then slightly modified to adapt to ad hoc arbitration under the UNCITRAL Rules.

This Note addresses both ad hoc and institutional arbitration. Three of the most prominent institutions for international commercial arbitration are the

13. KAREL DAELE, KLUWER LAW INT'L, CHALLENGE AND DISQUALIFICATION OF ARBITRATORS IN INTERNATIONAL ARBITRATION 36 (2012).

14. Although alterations to institutional arbitral rules have been suggested before, this Note proposes more extensive recommendations and provides thorough analysis. *See, e.g.*, Marc J. Goldstein, *Should the Real Parties in Interest Have To Stand Up?—Thoughts About a Disclosure Regime for Third-Party Funding in International Arbitration*, 8 TRANSNAT'L DISP. MGMT., Oct. 2011, at 4, 8 (suggesting that institutions could "require parties and counsel to disclose the identity of any financer involved, and require arbitrator nominees to disclose to the institution the identity of any financers with whom they or their law firms have relationships" so that if a conflict of interest exists, "the institution could decline to confirm the arbitrator, without disclosure of the reasons to the parties").

International Chamber of Commerce (ICC) in Paris;[15] the International Center for Dispute Resolution (ICDR), a branch of the American Arbitration Association based in New York;[16] and the London Court of International Arbitration (LCIA).[17,18] Ad hoc arbitration is often conducted under the UNCITRAL Rules.[19] This Note will examine the effect of third-party funding in light of the arbitral rules of these four bodies: the ICC, ICDR, LCIA, and UNCITRAL.

Although the discussion in this Note is based primarily on the rules for international commercial arbitration, the analysis applies to domestic arbitration as well. The rise of a third-party funding industry in the United States, for example, will likely cause more arbitrations conducted under the AAA's Commercial Arbitration Rules to face conflicts of interest issues. Indeed, the American Bar Association already has begun to analyze comprehensively the professional responsibility issues arising from third-party funding.[20] The analysis in this Note focuses on international arbitration, but the underlying conflicts issues and the suggested proposal can be applied to domestic arbitral rules as well.

Part I of this Note will introduce the third-party funding industry. Part II will look at the rise of third-party funding in commercial arbitration, and Part III will explain why the current arbitral rules are insufficient to address issues arising from third-party funding. Finally, Part IV will propose amendments to the arbitral rules to ensure that arbitrators remain independent.

I. THE THIRD-PARTY FUNDING RELATIONSHIP

This Part will introduce the nature of the typical third-party funding relationship and the factors that a funding corporation considers when contemplating investment in a claim. It will then articulate how third-party funding—as referred to in this Note—differs from other financing options and how it affects various aspects of the dispute resolution process.

Third-party funding occurs when an unrelated third party provides monetary support to a party involved in a legal claim; in return, that third party receives a portion of the proceeds resulting from that claim—or nothing, if the claim is

15. The ICC has registered an average of 800 cases per year between 2009 and the end of 2011. *2011 Figures Show Steady Growth in ICC Arbitration*, INT'L CHAMBER OF COM. (Jan. 6, 2011), www.iccwbo.org/News/Articles/2012/2011-figures-show-steady-growth-in-ICC-Arbitration.

16. *About the ICDR*, 3 ICDR INT'L ARB. REP., July 2012, at 9, *available at* http://www.adr.org/cs/idcplg?IdcService=GET_FILE&dDocName=ADRSTG_019805&RevisionSelectionMethod=LatestReleased. The ICDR administered 994 cases in 2011. *ICDR Statistics*, 3 ICDR INT'L ARB. REP., July 2012, at 2.

17. The LCIA registered 224 cases in 2011. ADRIAN WINSTANLEY, LCIA DIRECTOR GENERAL'S REPORT 2011, at 1 (2011), *available at* http://www.lcia.org/LCIA/Casework_Report.aspx.

18. *See* BORN, *supra* note 11, at 148.

19. *Id.*

20. *See* ABA COMMISSION ON ETHICS 20/20: INFORMATIONAL REPORT TO THE HOUSE OF DELEGATES (2012), *available at* http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf.

unsuccessful.[21] Also known as "claim funding,"[22] "alternative litigation funding,"[23] and "third party litigation finance,"[24] third-party funders may provide funding to a defendant or to the party bringing the claim.[25] For ease of terminology and because third-party funding is traditionally conceptualized as funding a plaintiff claimholder,[26] this Note will use the term "claimholder" to refer to the party that has received monetary support from a third-party funder.

The third-party funding relationship involves a contract between the third-party funding corporation and the claimholder. The funder provides money to allow the claimholder to pursue the claim in exchange for a share of a successful claim, whether by settlement, a court's judgment, or an arbitrator's award. After being reimbursed for its costs, the funding corporation generally receives between one-third and two-thirds of the claim.[27] As a nonrecourse loan, however, the claimholder does not have to repay the third-party funder for its investment if the claim is unsuccessful.[28]

When investing in a claim, the third-party funder considers a variety of factors: the probability of a successful claim, the potential liability for an unsuccessful claim, the amount of the claim and investment, the time until recovery, the legal merits, the collection risk, and the business context.[29] Third-party funders may become involved in the claim before a claim is filed and even before the claimholder has hired an attorney.[30] Alternatively, the funders may become involved later in the process.[31]

Although some claims may be entirely delegated to the funder via an agency

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21. Michele DeStefano, *Nonlawyers Influencing Lawyers: Too Many Cooks in the Kitchen or Stone Soup?*, 80 FORDHAM L. REV. 2791, 2818 (2012); Marco de Morpurgo, *A Comparative Legal and Economic Approach to Third-Party Litigation Funding*, 19 CARDOZO J. INT'L & COMP. L. 343, 352 (2011); Stuart L. Pardau, *Alternative Litigation Financing: Perils and Opportunities*, 12 U.C. DAVIS BUS. L.J. 65, 66 (2011).

22. DeStefano, *supra* note 21, at 2818.

23. STEVEN GARBER, RAND CORP., ALTERNATIVE LITIGATION FINANCING IN THE UNITED STATES: ISSUES, KNOWNS, AND UNKNOWNS 1 (2010).

24. Pardau, *supra* note 21, at 66.

25. Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268, 1275–76 (2011).

26. The literature on third-party funding focuses almost exclusively on the funding of a claimholder. For a brief overview of funding options for a defendant, see Bernardo M. Cremades, Jr., *Third Party Litigation Funding: Investing in Arbitration*, 8 TRANSNAT'L DISP. MGMT., Oct. 2011, at 16–25.

27. MICHAEL LEGG, U.S. CHAMBER INST. FOR LEGAL REFORM, LITIGATION FUNDING IN AUSTRALIA: IDENTIFYING AND ADDRESSING CONFLICTS OF INTEREST FOR LAWYERS 5 (2012). IMF (Australia) Ltd. states on its website that its commission typically ranges from 20% to 45%. *Apply for Funding*, IMF (AUSTL.) LTD., http://www.imf.com.au/funding.asp (last accessed Nov. 10, 2012).

28. Pardau, *supra* note 21, at 66.

29. *See, e.g.*, JOHN BEISNER, JESSICA MILLER & GARY RUBIN, U.S. CHAMBER INST. FOR LEGAL REFORM, SELLING LAWSUITS, BUYING TROUBLE: THIRD-PARTY LITIGATION FUNDING IN THE UNITED STATES 2 (2009); LEGG, *supra* note 27, at 5; Cremades, *supra* note 26, at 15; *Investment Policy*, JURIDICA INVS., LTD., http://www.juridicainvestments.com/about-juridica/investment-policy.aspx (last accessed Nov. 10, 2012).

30. *See* Mark Kantor, *Third-Party Funding in International Arbitration: An Essay About New Developments*, 24 ICSID REV. 65, 74 (2009).

31. *See, e.g.*, *How We Work*, JURIDICA INVS., LTD., http://www.juridicainvestments.com/juridica-capital-management/how-we-work.aspx (last visited Apr. 14, 2013).

relationship (similar to subrogation of an insurance claim), the focus of this Note is on relationships where the claimholder retains some control over the claim.[32] In such circumstances, and depending on national laws, the third-party funder may exercise any range of control.[33] Some third-party funding agreements provide that the funder shall not exercise any control over the litigation.[34] These contracts, however, should not be treated differently from contracts that require some level of funder involvement. Regardless of the contractual level of control exercised, the funder always retains the power of the purse—the ability to refuse further funding payments if the claimholder makes a decision contrary to the wishes of the funder. By controlling future payments, the funder can influence various aspects of claim management—including the appointment of an arbitrator.

A survey of Australian funding corporations revealed that funders did not invest in commercial claims with a "human element," such as cases involving family law, defamation, or injuries to the claimholder.[35] Funders exercised different levels of control, ranging from receiving regular progress reports to receiving detailed reports with timelines and budgets, appointing attorneys, and conducting settlement talks.[36] The earlier the funder made its investment in its claim, the more involved it was in case management.[37] When the funder exercised a good amount of control over the claim, it did so to monitor its investment—not to pursue the interests of the claimholder.[38]

Third-party funding is but one source of financing available to a claimholder. Contingency fees—defined as any arrangement whereby the lawyer's fee depends in whole or in part on the success of the claim[39]—are common throughout the United States,[40] with lawyers generally receiving between one-third and one-half of any successful claims in exchange for the lawyer's services.[41] In many other countries, however, contingency fees are prohibited or are not frequently used. Australia, for example, boasts a flourishing third-party funding industry but prohibits contingency fee arrangements.[42] Contingency fees are distinguished from third-party funding because the financing is provided by a party already involved in the litigation: the lawyer. In contrast, third-party funding adds another party—the third-party funder—to the litigation. The addi-

32. *See* Vicki Waye, *Conflicts of Interests Between Claimholders, Lawyers and Litigation Entrepreneurs*, 19 BOND L. REV. 225, 249–50 (2007).

33. *Id.*

34. *Litigation Finance: An Introduction*, BURFORD 8 (2012), http://www.burfordcapital.com/wp-content/uploads/2012/10/Burford-LitFinanceAnIntroduction-09-19-122.pdf.

35. Waye, *supra* note 32, at 252.

36. *Id.* at 253–54.

37. *Id.* at 254.

38. *Id.* at 255.

39. Adam Shajnfeld, *A Critical Survey of the Law, Ethics, and Economics of Attorney Contingent Fee Arrangements*, 54 N.Y.L. SCH. L. REV. 773, 775 (2009/2010).

40. *See, e.g.*, *id.* at 774–76.

41. *Id.* at 775; *see also* BLACK'S LAW DICTIONARY 362 (9th ed. 2009) (defining "contingent fee").

42. *See infra* section III.A.

tion of a third party adds a layer of complexity to several aspects of litigation or arbitration that are absent in the contingency fee context.[43] Furthermore, lawyers are governed by ethics rules and bar associations,[44] whereas the third-party funding industry is largely unregulated.[45]

Third-party funding is also distinguished from legal expenses insurance, which covers a party from risks associated with a lawsuit.[46] Insurance may be purchased either before or after the occurrence of the incident that gives rise to the litigation.[47] In this context, claimholders and defendants purchase policies from insurance companies, rather than from third-party funders discussed in this Note. Many insurance policies require the claimholder to surrender a significant amount of control over the case to the insurance company, including control over decisions about how vigorously to pursue the case and whether and when to settle.[48]

Finally, third-party funding as referred to in this Note is differentiated from "litigation loans," largely based on the size of the loans offered to a litigant.[49] The litigation loan market is most frequently used to provide small loans to needy plaintiffs in exchange for a portion of a successful claim.[50] In contrast, third-party funding generally involves disputes with larger claims arising between corporations.[51]

Third-party funding has been described as both a panacea and a plague.[52] It has generally been touted as promoting access to justice by providing claimants

43. *See infra* section IV.B. Funding in arbitration raises questions of privilege, awards of costs, and counterclaims, among others. Kantor, *supra* note 30, at 76–78.

44. In the United States, for example, attorneys are governed by state bar associations, which often base their codes of ethics on the ABA Model Rules of Professional Responsibility. LISA BENCH NIEUWVELD & VICTORIA SHANNON, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION 90, 133–34 (2012). The Law Council of Australia similarly issues the Model Rules on Professional Conduct and the Model Legal Profession Act, which have been adopted in Australian states and territories. *Id.*

45. Only Australia has promulgated regulations requiring disclosure of the funding relationship to the courts. *See id.* at 92. England's funding industry has promulgated its own self-regulation measure. *See* ASS'N OF LITIG. FUNDERS OF ENG. AND WALES, CODE OF CONDUCT FOR LITIGATION FUNDERS (2011), *available at* http://www.judiciary.gov.uk/JCO%2FDocuments%2FCJC%2FPublications%2FCJC+papers%2FCode+of+Conduct+for+Litigation+Funders+(November+2011).pdf.

46. de Morpurgo, *supra* note 21, at 353.

47. *Id.*

48. NIEUWVELD, *supra* note 44, at 5–6.

49. Jason Lyon, Note, *Revolution in Progress: Third-Party Funding of American Litigation*, 58 UCLA L. REV. 571, 578 (2010) (noting that "[l]oans to individuals with tort claims are typically measured in thousands or tens of thousands of dollars, offset by damages awards that tend to peak in the low hundred thousands").

50. de Morpurgo, *supra* note 21, at 356–57.

51. Lyon, *supra* note 49, at 578 (noting that "funding can reach up to $15,000,000 on cases valued at $100,000,000 or more").

52. Susanna Khouri et al., *Third Party Funding in International Commercial and Treaty Arbitration—A Panacea or a Plague? A Discussion of the Risks and Benefits of Third Party Funding*, 8 TRANSNAT'L DISP. MGMT., Oct. 2011, at 1.

with otherwise-unavailable financial means to bring a claim[53] and as a way to manage the risks associated with bringing a claim to litigation or arbitration.[54] Through the due diligence undertaken by third-party funders, claimants gain the benefit of an objective assessment of their claim.[55] Depending on the extent that the funder is involved in case management, the funder may bring experience to the case or be able to assist in selecting counsel.[56] Others have argued, however, that third-party funding leads to excess litigation and frivolous claims as well as unnecessarily prolonged litigation.[57] In the arbitration context particularly, third-party funding raises complex questions involving conflicts of interest, attorney–client privilege, awards of costs, and professional responsibility.[58]

The interests of the claimholder may diverge from those of the funder. For instance, the claimholder may wish to pursue a strategy that the funder refuses to finance.[59] In settlement talks, a funder may want to settle when the claimholder does not, or a claimholder may want to settle for an amount that the funder views as insufficient in comparison with its investment.[60] A claimholder may wish to settle for an agreement in kind, such as products or assets, but the funder may refuse given the difficulty in converting that settlement into cash.[61] A claimholder may want to withdraw from proceedings in order to rehabilitate its relationship with the defendant but may be refused permission to do so by the funder.[62]

Funding arrangements also implicate the relationship between the attorney and his client (the claimholder). The funder may provide in the funding contract that the claimholder's attorney must maintain a duty of care and a fiduciary duty towards the funder, in addition to the claimholder.[63] Conflicting duties may raise professional responsibility and ethical issues.[64] In a recent Australian case, the court indicated that although a funder could control the day-to-day litigation of a claim, the lawyer could not fully relinquish his duty to faithfully represent the claimholder's interests.[65]

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53. Steinitz, *supra* note 25, at 1276; *Litigation Funding From Burford*, BURFORD 4, http://www.burfordfinance.com/docs/default-document-library/litigation-funding-brochure.pdf (last visited Mar. 16, 2013).

54. Khouri, *supra* note 52, at 4; *Litigation Funding From Burford*, *supra* note 53, at 4.

55. Khouri, *supra* note 52, at 5.

56. *Id.*

57. BEISNER, *supra* note 29, at 4; U.S. CHAMBER INST. FOR LEGAL REFORM, THIRD PARTY FINANCING: ETHICAL & LEGAL RAMIFICATIONS IN COLLECTIVE ACTIONS 2 (2009).

58. *See* Kantor, *supra* note 30, at 76–79.

59. *See* Waye, *supra* note 32, at 237.

60. BEISNER, *supra* note 29, at 6–7.

61. Waye, *supra* note 32, at 238.

62. *Id.* at 238.

63. *Id.* at 237.

64. *See generally* ABA COMMISSION ON ETHICS 20/20: INFORMATIONAL REPORT TO THE HOUSE OF DELEGATES, *supra* note 20.

65. Waye, *supra* note 32, at 241–42 (citing *Fostif Party Ltd. v Campbells Cash & Carry Party Ltd.* [2005] 63 NSWLR 203 (Austl.)).

The relative benefits of third-party funding and the potential problems that it raises can be debated ad nauseam, but regardless of one's views—and as will be demonstrated in the following Part—the third-party funding industry is no temporary phenomenon.

II. THE RISE OF THIRD-PARTY FUNDING IN COMMERCIAL ARBITRATION

No data exists regarding the use of third-party funding in commercial arbitration.[66] Its prevalence, however, can only be growing. As one commentator recently noted, "the use of third-party funding in major arbitration cases is a development that is here to stay."[67] Academics and practitioners have begun to pay more attention to potential problems raised by third-party funding,[68] and conferences and workshops have been organized in recent years solely around the issue of third-party funding in international arbitration.[69] Beyond increased academic discussion of the issue, several other factors point to the growth in use of third-party funding in commercial arbitration. This Part will examine each of the following three factors:

First, increased use of such funding in domestic litigation may influence its rise in arbitration throughout the world. As common law nations such as the United Kingdom, the United States, and Australia loosen restrictions on third-party funding in domestic litigation, third-party funding corporations have become more prevalent, with some even traded on public stock exchanges.[70]

Second, third-party funders explicitly state in marketing materials that they offer funding for international and domestic arbitration. Given the availability of third-party funding, the large volume of cases in arbitration, and the high cost of the arbitral process, at least some (and likely an increasing number of) parties will seek to use this financing option.

Finally, issues involving third-party funding have recently appeared in awards for investment treaty arbitration. Such arbitrations are more transparent and provide a glimpse into how parties may be using funding in more confidential commercial arbitration.

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66. *See* Khouri, *supra* note 52, at 1.

67. Jean E. Kalicki, *Third-Party Funding in Arbitration: Innovations and Limits in Self-Regulation (Part 2 of 2)*, KLUWER ARB. BLOG (Mar. 14, 2012), http://kluwerarbitrationblog.com/blog/2012/03/14/third-party-funding-in-arbitration-innovations-and-limits-in-self-regulation-part-2-of-2.

68. Khouri, *supra* note 52, at 1–2. A forerunning article addressing third-party funding was published in 2009. *See generally* Kantor, *supra* note 30 (based on a presentation from that year).

69. *See, e.g.*, *32nd Annual Meeting of the ICC Institute of World Business Law: Third Party Funding in International Arbitration*, INT'L CHAMBER OF COM. (Nov. 26, 2012), http://www.iccwbo.org/Data/Documents/Training-and-Events/Events/2012/32nd-Annual-Meeting-Third-Party-Funding-Brochure/; *A Roundtable on Third Party Funding in International Arbitration Claims: The Newest "New New Thing,"* N.Y. STATE BAR ASS'N (June 15, 2011), http://www.nysba.org/AM/Template.cfm?Section=Home&ContentID=50366&Template=/CM/ContentDisplay.cfm.

70. *See infra* section III.A.

A. GROWTH IN THE USE OF THIRD-PARTY FUNDING IN DOMESTIC LITIGATION

Third-party funding is a form of the ancient doctrines of maintenance and its subset, champerty.[71] Champerty is defined as "[a]n agreement between an officious intermeddler in a lawsuit and a litigant by which the intermeddler helps pursue the litigant's claim as consideration for receiving part of any judgment proceeds";[72] maintenance is defined more broadly as any interference in a lawsuit, including assistance of counsel, by a party other than the litigants and the adjudicator.[73] The original English laws against champerty were aimed at feudal lords using investments in others' lawsuits to expand their land holdings.[74] Common law nations have imposed these doctrines to varying extents, with a general decline in their application over the centuries. Some of these laws are still active; however, and like feudal lords centuries before them, third-party funders fit squarely within the definitions of maintenance and champerty.

This section will examine the countries in which third-party funding is most commonly used: Australia, England, and the United States.[75] Although Germany, Austria, and Switzerland have each developed markets for third-party litigation funding, the use of such funding is "virtually nonexistent" in other civil law nations.[76]

Australia boasts the largest third-party funding industry, having generally permitted some form of the practice for over fifteen years.[77] Although at first limited to bankruptcy cases, the use of funding has since spread to civil litigation[78] and may be more pronounced because Australia does not allow

71. *See generally* Max Radin, *Maintenance by Champerty*, 24 CALIF. L. REV. 48 (1935) (providing a history of maintenance and champerty, dating back to Ancient Greece and Rome).

72. BLACK'S LAW DICTIONARY 262 (9th ed. 2009). Blackstone described champerty as "a species of maintenance . . . being a bargain with a plaintiff or defendant *campum partire*, to divide the land or other matter sued for between them, if they prevail at law; whereupon the champerter is to carry on the party's suit at his own expense." 4 WILLIAM BLACKSTONE, COMMENTARIES *136.

73. Blackstone defined maintenance as "being an officious intermeddling in a suit that no way belongs to one, by maintaining or assisting either party with money or otherwise, to prosecute or defend it." 4 WILLIAM BLACKSTONE, COMMENTARIES *136. As one author wrote in 1861, "[t]he intervention of an extraneous person in a litigation, between parties to a contest, with which the stranger has no concern, if considered apart from artificial circumstances, is repugnant to our sentiments of propriety." WILLIAM JOHN TAPP, AN INQUIRY INTO THE PRESENT STATE OF THE LAW OF MAINTENANCE AND CHAMPERTY PRINCIPALLY AS AFFECTING CONTRACTS 1 (V. & R. Stevens and Sons 1861).

74. Radin, *supra* note 71, at 64 (noting that the original English laws against maintenance—the Star Chamber Act of 1487 and the Statute of Liveries of 1504—were directed at "the support given by a feudal magnate to his retainers in all their suits, without any reference to their justification. This type of support became in fact one of the means by which powerful men aggrandized their estates and the background was unquestionably that of private war. The movement against maintenance was, therefore, part of the attempt to liquidate this characteristic feudal institution.").

75. *See* Cassandra Burke Robertson, *The Impact of Third-Party Financing on Transnational Litigation*, 44 CASE W. RES. J. INT'L L. 159, 165–66 (2011); Steinitz, *supra* note 25, at 1278.

76. de Morpurgo, *supra* note 21, at 399–400.

77. Robertson, *supra* note 75, at 165–66.

78. Steinitz, *supra* note 25, at 1278–1279.

contingency fee arrangements.[79] In 2006, the Australian High Court, in *Campbells Cash & Carry Party, Ltd. v. Fostif Party, Ltd.*,[80] further opened the door to the use of such funding and allowed third-party funders to exercise a large degree of control over the litigation.[81] The decision led to an increase in class action lawsuits in Australia and raised concerns regarding the dearth of regulation over the third-party funding industry, the amount of fees earned by the funders, and the unfairness in negotiating funding contracts,[82] in addition to complications in the lawyer–client relationship.[83] In 2011, the Federal Court of Australia issued Practice Note CM 17, a rule that requires parties to disclose a third-party funding relationship at or prior to the initial case management conference.[84]

England follows closely behind Australia in its use of third-party funding.[85] Although England statutorily eliminated its prohibition on champerty in 1967,[86] uneasiness about champerty remains because public policy may lead to non-enforcement of a contract due to a third-party funding relationship, depending on factors such as the extent of the funder's involvement and the funder's share of any successful claim.[87] The English funding industry has dramatically expanded since a 2005 decision by the English Court of Appeal.[88] In *Arkin v. Borchard Lines, Ltd.*,[89] the court upheld the use of third-party funding so long as "[s]uch funding [leaves] the claimant as the party primarily interested in the result of the litigation and the party in control of the conduct of the litigation."[90]

In November 2011, the Association of Litigation Funders of England and Wales released a code of conduct for the industry.[91] The code is the first effort at self-regulation by litigation funders in any country and may apply to funders

79. *See* BEISNER, *supra* note 29, at 9.

80. (2006) 229 ALR 58 (Austl.).

81. *Id.* ¶¶ 91–93.

82. *See* BEISNER, *supra* note 29, at 11.

83. *See* Waye, *supra* note 32, at 225.

84. FED. COURT OF AUSTL., PRACTICE NOTE CM 17, ¶ 3.6, *available at* http://www.fedcourt.gov.au/law-and-practice/practice-documents/practice-notes/cm17 ("At or prior to the initial case management conference each party will be expected to disclose any agreement by which a litigation funder is to pay or contribute to the costs of the proceeding, any security for costs or any adverse costs order. Any funding agreement disclosed may be redacted to conceal information which might reasonably be expected to confer a tactical advantage on the other party.").

85. DeStefano, *supra* note 21, at 2822.

86. Criminal Law Act, 1967, c. 58, §§ 13(1), 14(1) (U.K.).

87. DeStefano, *supra* note 21, at 2821 (citing *Queen ex rel. Factortame v. Sec'y of State for Transp.*, [2002] EWCA (Civ) 932 [31], [2003] Q.B. 381 [399] (Eng.)).

88. Steinitz, *supra* note 25, at 1281; Nicholas Dietsch, Note, *Litigation Financing in the U.S., the U.K., and Australia: How the Industry Has Evolved in Three Countries*, 38 N. KY. L. REV. 687, 699 (2011).

89. (2005) 1 W.L.R. 3055 (Eng.).

90. *Id.* at 3070.

91. *See* ASS'N OF LITIG. FUNDERS OF ENG. AND WALES, CODE OF CONDUCT FOR LITIGATION FUNDERS (2011).

when the seat of the arbitration is located in that jurisdiction.[92] Although many have applauded the code as a first attempt at self-regulation by litigation funders in any country,[93] others (notably the European Justice Forum and the U.S. Chamber of Commerce Institute for Legal Reform) have argued that it lacks sufficient detail and is not an adequate substitute for binding legislation.[94]

The third-party funding industry in the United States lags behind those in Australia and the United Kingdom.[95] The industry began to develop in the 1990s as funding for small-scale consumer cases and has since developed a market for commercial investments.[96] The American Bar Association has started to pay attention to issues arising from third-party funding in litigation, commissioning a Working Group to address the impact of such funding on the attorney–client relationship and the ethical and professional duties of attorneys.[97]

The doctrines of maintenance and champerty have slowly declined in the United States since the mid-nineteenth century.[98] Thirty-two states and the District of Columbia still prohibit champerty in some form.[99] Other states, such as Massachusetts, New Jersey, and Arizona, have abolished the doctrine of champerty entirely.[100] As one commentator noted, litigation funding in the United States is governed "by a patchwork of relatively weak laws, cases, rules, and regulations—and they are only in force in a handful of states."[101]

The potential market for litigation funding in the United States is vast, with some estimates that it could be a billion-dollar industry.[102] As of 2010, there were six companies that invested in commercial claim litigation in the United States.[103] These corporations primarily finance antitrust, intellectual property, and contract disputes of corporate plaintiffs against defendant corporations.[104] Investments by these funding corporations typically range from a few

92. Jean E. Kalicki, *Third-Party Funding in Arbitration: Innovation and Limits in Self-Regulation (Part 1 of 2)*, KLUWER ARB. BLOG (Mar. 13, 2012), http://kluwerarbitrationblog.com/blog/2012/03/13/third-party-funding-in-arbitration-innovation-and-limits-in-self-regulation-part-1-of-2.

93. *Id.*

94. Kalicki, *supra* note 67; *see also U.S. Chamber Institute for Legal Reform Comments on the Code of Conduct for Litigation Funders*, U.S. CHAMBER INST. FOR LEGAL REFORM 2–6 (Dec. 22, 2011), http://www.instituteforlegalreform.com/sites/default/files/CJC_Code_of_Conduct_Comments.pdf (detailing concerns with the Code).

95. DeStefano, *supra* note 21, at 2823.

96. de Morpurgo, *supra* note 21, at 362.

97. ABA COMMISSION ON ETHICS 20/20: INFORMATIONAL REPORT TO THE HOUSE OF DELEGATES, *supra* note 20.

98. Lyon, *supra* note 49, at 581–82.

99. *Id.* at 583.

100. *See* Dietsch, *supra* note 88, at 694.

101. BEISNER, *supra* note 29, at 4 (noting that only Ohio and Maine have enacted legislation pertaining to third-party funders, and that there exists no "nationwide consensus, or even a nationwide conversation," on champerty or regulation of third-party funding).

102. *See* N.Y. CITY BAR ASS'N, FORMAL OPINION 2011–2: THIRD PARTY LITIGATION FINANCING (2011), *available at* http://www.nycbar.org/index.php/ethics/ethics-opinions-local/2011-opinions/1159-formal-opinion-2011-02.

103. Garber, *supra* note 23, at 14–15.

104. *Id.* at 13.

to several million dollars.[105]

Third-party funding is generally absent in civil law countries, although industries have emerged, to some extent, in Germany, Austria, and Switzerland.[106] Lack of such funding has been attributed to structural reasons such as costs and procedural rules, a less litigious atmosphere, and the traditionally more personal nature of a claim.[107] At least one commentator has argued that the third-party funding industry in civil law countries will likely grow due to expected economic growth, Germany's favorable experience, the benefits of such funding, and high costs of litigation in some civil law nations.[108]

Third-party funding of domestic litigation in Australia, the United Kingdom, and the United States has expanded in the past few decades. Given its rise in domestic litigation, such funding will likely increase in commercial arbitration as well.

B. AVAILABILITY OF THIRD-PARTY FUNDING GIVEN THE IMMENSE COSTS AND VOLUME OF ARBITRATION

Commercial arbitration is commonly used throughout the world, with arbitral institutions administering thousands of cases per year. This Note discusses three of the largest institutions that administer international arbitration: the ICC, the ICDR, and the LCIA. Given the number of cases heard by these institutions, the high costs of arbitration, and the availability of third-party funding in arbitration, the use of third-party funding in arbitration will likely increase in the coming years.

In the international context, the ICC registered an average of 800 cases per year from 2009 through 2011.[109] Of the disputes heard in 2009, 29.4% involved amounts over $10 million, while less than a quarter of the disputes involved amounts less than $1 million.[110]

The ICDR has seen an increase in its caseload over the past five years; 621 cases were administered in 2007, rising to 994 cases in 2011.[111] In 2011, parties and arbitrators came from ninety countries, with caseloads ranging from small manufacturer/supplier claims to claims of over $1 billion.[112]

A smaller institution, the LCIA received 224 new disputes in 2011, a 9% decrease from the previous year.[113] Of these claims, 21.5% were valued at less

105. *See id.* at 16.

106. *See* de Morpurgo, *supra* note 21, at 399–405 (detailing the relevant laws in eleven civil law countries and describing Germany's experience with third-party litigation funding).

107. *See id.* at 405–08.

108. *See id.* at 408–11.

109. *Statistics on ICC Arbitration*, INT'L CHAMBER OF COM., http://www.iccwbo.org/Products-and-Services/Arbitration-and-ADR/Arbitration/Introduction-to-ICC-Arbitration/Statistics/ (last visited Mar. 16, 2013).

110. *ICC Statistical Report 2009*, 28 SWISS ARB. ASS'N BULL. 891, 891–92 (2010).

111. *About the ICDR*, *supra* note 16, at 2.

112. *Id.*

113. ADRIAN WINSTANLEY, *supra* note 17, at 1.

than $1 million, 17% at $1–5 million, 8.5% at $5–10 million, 6% at $10–20 million, and 16% at over $20 million.[114]

Although international arbitration has been touted as a way to minimize the costs of a dispute as compared to domestic litigation,[115] parties often incur substantial costs during the arbitral process.[116] In addition to legal fees, expert fees, and discovery costs associated with domestic litigation, parties in arbitration must pay an hourly rate to compensate the arbitrators, a registration fee to the administering institution, and institutional fees arising during the arbitration (such as time spent on the case by the secretariat or registrar).[117] International arbitral tribunals additionally are given discretion to shift the costs of the arbitration or the legal fees of the winning party to the losing party,[118] further increasing the cost of arbitration.

Numerous third-party funding corporations explicitly make their services available to arbitration claims. Juridica Investments lists arbitration (domestic and international) as one of its eight claim sectors.[119] Burford Capital advertises that it is "engaged in significant litigation and arbitration around the world."[120] The homepage of Calunius Capital touts that it retained "£40 million of capital to invest in litigation and arbitration cases" and that it funds "large-scale commercial litigation and arbitration claims in both domestic and international contexts under a wide range of applicable laws."[121] Harbour Litigation Funding's homepage also promotes international arbitration funding,[122] and the corporation recently created a new fund with £40 million expected to be spent over three years.[123] Vannin Capital also experienced a recent increase in funding from £25 million to £100 million, and a representative noted that the company is "seeing a good number of international arbitration cases."[124]

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114. *Id.*

115. *See, e.g.*, Folkways Music Publishers, Inc. v. Weiss, 989 F.2d 108, 111 (2d Cir. 1993).

116. *See* BORN, *supra* note 11, at 84 ("[B]oth international arbitration and international litigation can involve significant expense and delay, and it is unwise to make sweeping generalizations about which mechanism is necessarily quicker or cheaper.").

117. *See id.*

118. *See, e.g.*, ICC RULES, *supra* note 11, art. 37; ICDR RULES, *supra* note 11, art. 31; LCIA RULES, *supra* note 11, art. 28. The "loser pays" model, also known as the English rule, is used in both the United Kingdom and Australia. George R. Barker, *Third-Party Litigation Funding in Australia and Europe*, 8 J.L. ECON. & POL'Y 451, 468 (2012).

119. *Claim Sectors*, JURIDICA INVS., LTD., http://www.juridicainvestments.com/juridica-capital-management/how-we-work/claim-sectors.aspx (last visited Mar. 16, 2013).

120. *Interim Report 2012*, BURFORD i, http://www.burfordfinance.com/docs/default-document-library/burford_interim_2012.pdf (last visited Mar. 16, 2013).

121. CALUNIUS CAPITAL LITIGATION FUNDING, http://www.calunius.com/ (last visited Mar. 16, 2013).

122. HARBOUR LITIGATION FUNDING, http://www.harbourlitigationfunding.com/ (last visited Mar. 16, 2013).

123. *Hundreds of Millions of Pounds Pour into Third-Party Litigation Funding*, LEGAL FUTURES (May 9, 2012), http://www.legalfutures.co.uk/latest-news/hundreds-of-millions-of-pounds-pour-into-third-party-litigation-funding.

124. Ben Rigby, *Vannin Capital Quadruples Investment in Litigation*, COM. DISP. RESOL. (May 9, 2012), http://www.cdr-news.com/categories/jackson-review/vannin-capital-quadruples-investment-in-litigation.

The heavy use of commercial arbitration between corporations, the marketing of third-party funding to those corporations, and the substantial cost of the arbitral process indicate that the use of third-party funding in arbitration will increase in the near future.

C. THIRD-PARTY FUNDING IN INVESTMENT TREATY ARBITRATION

Questions involving third-party funding have arisen in several international investment arbitrations over the past few years, indicating the probable use of third-party funding in the international commercial arbitration context as well. In international investment arbitration, the dispute arises between the investor of one country and the host state in which the investor made an investment.[125] Such arbitrations are based on either a treaty (such as a bilateral investment treaty or free-trade agreement), a contract between the state and the investor, or national legislation by the host state.[126] Because international investment arbitration generally is not subject to the same level of confidentiality as is international commercial arbitration, investment awards are often publicly available.[127]

Several available investment awards and decisions indicate the use of third-party funding in international arbitration;[128] other discoveries of its use have arisen only in subsequent cases in domestic courts.[129] One arbitration involved an express announcement by a claimant that it had received financing from a third-party funding corporation.[130] Other arbitrations have also involved the use of third-party funding, as reported by academics.[131]

Given the smaller number of investment arbitration claims that are brought

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125. *See* ANDREW NEWCOMBE & LLUIS PARADELL, LAW & PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT 91 (Kluwer Law Int'l 2009).

126. *See* Carlos J. Bianchi, *A Look at Some Recurring Issues in Investment Arbitration*, 67 DISP. RESOL. J. 62, 64 (2012).

127. *See* R. DOAK BISHOP ET AL., FOREIGN INVESTMENT DISPUTES 1 (2005); *see also* Alexis Mourre, *Arbitral Jurisprudence in International Commercial Arbitration: The Case for a Systematic Publication of Arbitral Awards in 10 Questions . . .* , KLUWER ARB. BLOG (May 28, 2009), http://kluwerarbitrationblog.com/blog/2009/05/28/arbitral-jurisprudence-in-international-commercial-arbitration-the-case-for-a-systematic-publication-of-arbitral-awards-in-10-questions%E2%80%A6/.

128. *See, e.g.*, ATA Constr., Indus. & Trading Co. v. Hashemite Kingdom of Jordan, ICSID Case No. ARB/08/02, Order Taking Note of the Discontinuance of the Proceeding, ¶ 34 (July 11, 2011); RSM Prod. Corp. v. Grenada, ICSID Case No. ARB/05/14, Order of the Committee Discontinuing the Proceeding and Decision on Costs, ¶ 48 (Apr. 28, 2011); Kardassopoulos v. Georgia, ICSID Case Nos. ARB/05/18, ARB/07/15, Award, ¶ 691 (Mar. 3, 2010).

129. *See, e.g.*, S&T Oil Equip. & Mach., Ltd. v. Juridica Invs. Ltd., No. H–11–0542, 2011 WL 1565996, at *1 (S.D. Tex., Apr. 25, 2011); Roger Parloff, *Have You Got a Piece of This Lawsuit?*, FORTUNE (June 13, 2011), *available at* http://features.blogs.fortune.cnn.com/2011/06/28/have-you-got-a-piece-of-this-lawsuit-2/ (describing how a plaintiff's relationship with a third-party funder was disclosed due to litigation against the plaintiff's attorney).

130. *See* Press Release, Oxus Gold, Litigation Funding (Mar. 1, 2012), *available at* http://online.hemscottir.com/servlet/HsPublic?context=ir.access&ir_option=RNS_NEWS&item=931851136975129&ir_client_id=4252.

131. Cremades, *supra* note 26, at 25 (noting the use of "outside financing" in Funnekotter v. Republic of Zimbabwe, Gustav F.W. Hamester GmbH & Co. KG v. Republic of Ghana, and Siag & Vecchi v. Arab Republic of Egypt (citations omitted)).

each year compared to commercial arbitration claims,[132] the presence of third-party funding arising from investment treaty arbitration indicates a rise in the use of third-party funding in international commercial arbitration.

III. CURRENT RULES REGARDING INDEPENDENCE OF THE ARBITRATOR

Arbitral rules uniformly require arbitrators to be independent.[133] Challenges to arbitrators may be made before the arbitrators have been appointed; however, if new information or circumstances arise during the course of the arbitration, the parties may challenge the arbitrators' independence at any stage of the process.[134] The current rules, however, do not sufficiently address the issue of third-party funding. Third-party funding may cause a conflict of interest with an appointed arbitrator due to multiple appointments indirectly made by the same third-party funder, a relationship between the funder and the arbitrator's law firm, or shares held by the arbitrator in a third-party funding corporation. Should that conflict later be discovered, the arbitrator may be disqualified (if proceedings are ongoing) or the award may be denied recognition and enforcement.[135] Without disclosure of the funding relationship, the independence of an arbitrator under current rules cannot be assured.

This Part will first look at the current rules that mandate arbitrator independence, explain why independence is important, and then demonstrate why the current rules are insufficient to address problems involving conflicts of interest raised by third-party funding.

A. CURRENT RULES REQUIRE ARBITRATOR INDEPENDENCE

The arbitral rules uniformly require arbitrators to remain independent and, subject to varying standards, to disclose situations that implicate their independence. All of the rules permit challenges to the independence of an arbitrator prior to his appointment or during the arbitral process. This section will examine the nuances of the rules implicating the independence of an arbitrator.

When an arbitration is conducted under the auspices of the ICC, the ICDR, or the LCIA, prospective arbitrators must disclose information about their independence to the ICC Secretariat,[136] the ICDR administrator,[137] or the LCIA Regis-

132. Although the number of investment disputes in the International Centre for Settlement of Investment Disputes (ICSID), the primary forum for investment arbitration, has grown immensely in the past decade, only 368 arbitrations have been filed in the ICSID since 1972. Gary Born, *A New Generation of International Adjudication*, 61 DUKE L.J. 775, 839 (2012). ICSID registered 36 new arbitration cases in fiscal year 2012. INT'L CENTRE FOR SETTLEMENT OF INV. DISPUTES, ICSID 2012 ANNUAL REPORT 25 (2012), *available at* https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDPublicationsRH&actionVal=ViewAnnualReports&year=2012_Eng.

133. *See, e.g.*, ICC RULES, *supra* note 11, art. 11(1); ICDR RULES, *supra* note 11, art. 7; LCIA RULES, *supra* note 11, art. 5.2, 5.3; UNCITRAL RULES, *supra* note 11, art. 12(1).

134. *See, e.g.*, ICC RULES, *supra* note 11, art. 14(2); ICDR RULES, *supra* note 11, art. 8(1); LCIA RULES, *supra* note 11, art. 10.4; UNCITRAL RULES, *supra* note 11, art. 13(1).

135. *See infra* section III.B.

136. ICC RULES, *supra* note 11, art. 11(2) ("Before appointment or confirmation, a prospective arbitrator shall . . . . disclose in writing to the Secretariat any facts or circumstances which might be of

trar,[138] respectively. The duty to disclose is an ongoing one.[139]

Of note, however, is the difference in standards under the varying rules. Under the UNCITRAL Rules, the arbitrator must disclose circumstances "*likely* to give rise to justifiable doubts" about the arbitrator's independence.[140] The LCIA Rules likewise provide that the arbitrator shall disclose circumstances "*likely* to give rise to any justified doubts" about his independence.[141] The ICDR Rules require disclosure of "any circumstance *likely* to give rise to justifiable doubts."[142]

Under the IBA Guidelines, however, the arbitrator must disclose circumstances that "*may*, in the eyes of the parties, give rise to doubts" about the arbitrator's independence.[143] The ICC Rules similarly require disclosure of "any facts or circumstances which *might* be of such a nature as to call into question the arbitrator's independence in the eyes of the parties."[144]

The ICC Secretariat provides any disclosed information to the parties,[145] whereas the ICDR administrator provides such information to the parties and the other arbitrators.[146] Under the ICC Rules, a party may submit a challenge to the Secretariat;[147] decisions about admissibility and merits are ultimately made by the ICC court.[148] The challenged arbitrator, as well as the other arbitrators and parties, may submit comments on the challenge to the court.[149] In the ICDR, a party submits the challenge to the ICDR Administrator, who then decides the issue without soliciting comments by the other parties.[150] In the LCIA, a party submits the challenge to the LCIA court and provides its reasoning to the court, as well as to the other parties and arbitrators.[151] The court then decides the challenge.[152]

The UNCITRAL Rules also require independence of an arbitrator, who must "disclose any circumstances likely to give rise to justifiable doubts as to his or

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such a nature as to call into question the arbitrator's independence in the eyes of the parties, as well as any circumstances that could give rise to reasonable doubts as to the arbitrator's impartiality.").

137. ICDR RULES, *supra* note 11, art. 7(1).

138. LCIA RULES, *supra* note 11, art. 5.3.

139. *See* ICC RULES, *supra* note 11, art. 11(3); ICDR RULES, *supra* note 11, art. 7(1); LCIA RULES, *supra* note 11, art. 5.3.

140. UNCITRAL RULES, *supra* note 11, art. 11 (emphasis added).

141. LCIA RULES, *supra* note 11, art. 5.3 (emphasis added).

142. ICDR RULES, *supra* note 11, art. 7 (emphasis added).

143. INT'L BAR ASS'N, IBA GUIDELINES ON CONFLICTS OF INTEREST IN INTERNATIONAL ARBITRATION gen. std. 3(a) [hereinafter IBA GUIDELINES] (emphasis added).

144. ICC RULES, *supra* note 11, art. 11(2).

145. *See id.*

146. *See* ICDR RULES, *supra* note 11, art. 7(1).

147. *See* ICC RULES, *supra* note 11, art. 14(1).

148. *Id.* art. 14(3).

149. *Id.*

150. *See* ICDR RULES, *supra* note 11, art. 9.

151. LCIA RULES, *supra* note 11, art. 10.4.

152. *Id.*

her impartiality or independence" to the parties and other arbitrators.[153] A party may challenge an arbitrator, and, in doing so, must send its reasons for the challenge to the other parties and arbitrators.[154] Should the other party not agree to the challenge, the appointing authority will render a decision on the challenge.[155] The appointing authority may be designated by the parties; if the parties cannot agree, the appointing authority is designated by the Secretary-General of the Permanent Court of Arbitration.[156]

Under ad hoc and institutional rules, a challenge can be made upon appointment of the arbitrator, or later on if new facts emerge.[157] In practice, however, parties are more likely to succeed in a challenge at the beginning of the arbitration.[158]

Challenges to arbitrators are fairly common in international commercial arbitration. In the ICC, for example, a potential arbitrator must submit a qualified or unqualified Statement of Independence and a curriculum vitae.[159] Unqualified statements are generally uncontroversial; of the 4,775 arbitrators who submitted unqualified Statements from 1998–2006, 99.2% were confirmed.[160]

The court is more likely to uphold a challenge when an arbitrator submits a qualified statement which includes the following declaration:

> I am independent of each of the parties and intend to remain so; however, in consideration of Article 7, paragraphs 2 & 3 of the ICC Rules of Arbitration, I wish to call your attention to the following facts or circumstances which I hereafter disclose because they might be of such a nature as to call into question my independence in the eyes of any of the parties.[161]

Even with this declaration, most arbitrators are still confirmed by the court; from 1998 to 2006, 87.7% of the 1,055 arbitrators who submitted a qualified statement were confirmed.[162] These challenges can be made on any grounds, and the ICC does not release its reasons for disqualification of an arbitrator.[163] As one author noted, however, "[b]y far, the largest number of challenges that

153. UNCITRAL RULES, *supra* note 11, art. 11.
154. *Id.* arts. 12(1), 13(2).
155. *Id.* art. 13(4).
156. *Id.* art. 6(1).
157. MARGARET L. MOSES, THE PRINCIPLES AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION 147 (2d ed. 2012).
158. *Id.* at 151.
159. Anne Marie Whitesell, *Independence in ICC Arbitration: ICC Court Practice Concerning the Appointment, Confirmation, Challenge and Replacement of Arbitrators*, *in* INDEPENDENCE OF ARBITRATORS 7, 11–12 (ICC Int'l Ct. of Arb. Bulletin eds., 2008).
160. *Id.* at 14.
161. *Id.* at 11–12.
162. *Id.* at 13.
163. *Id.* at 27–28.

have been accepted were brought on grounds of independence."[164] The large proportion of successful challenges based on independence highlights the importance of independence in dispute resolution, which will be addressed in the following section.

B. THE IMPORTANCE OF ARBITRATOR INDEPENDENCE

If a conflicts check is not adequately conducted prior to the appointment of the arbitrator, then the possibility of a conflict arising during the arbitration or after the award has been issued increases. This section will address the effect of a challenge during the arbitral process, and the effect of a nonindependent arbitrator on the annulment, recognition, and enforcement of an award.

If the third-party funder decides not to disclose that it is involved in the arbitration, the information may never come out: a potentially nonindependent arbitrator will serve on the tribunal and the award will be upheld in court. However, the third-party funding relationship may be discovered at some point. If the arbitration is currently in process, the other party may bring a challenge to the arbitrator to the institution.[165]

A challenge may also be brought to the court in the seat of the arbitration (the territorial location where the arbitration was held).[166] The English Arbitration Act, for example, allows a court to remove an arbitrator if "circumstances exist that give rise to justifiable doubts as to his impartiality."[167] Under the UNCITRAL Model Law, if a party loses a challenge in the institution, it may then challenge the arbitrator in court.[168] If the arbitrator is then disqualified, the arbitration will have to start over again with a newly appointed arbitrator.

The award might be annulled by national courts in the seat of the arbitration[169] if the relationship is discovered after the award has been issued. Under the U.S. Federal Arbitration Act, for example, an award resulting from either domestic or international arbitration may be vacated "where there was evident partiality or corruption in the arbitrators."[170] This arguably includes cases where an arbitrator had a significant relationship with a third-party funding corporation.[171]

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164. *Id.* at 28.

165. *See, e.g.*, ICC RULES, *supra* note 11, art. 14(1); ICDR RULES, *supra* note 11, art. 9; LCIA RULES, *supra* note 11, art. 10.4; UNCITRAL RULES, *supra* note 11, art. 13.

166. *See* BORN, *supra* note 11, at 1562.

167. *See* Arbitration Act, 1996, c. 23, § 24 (U.K.).

168. UNCITRAL MODEL LAW ON INT'L COMMERCE ARBITRATION art. 13(3) (2006) [hereinafter UNCITRAL MODEL LAW].

169. BORN, *supra* note 11, at 2616–17; *see* Vladimir Pavic, *Annulment of Arbitral Awards in International Commercial Arbitration*, *in* INVESTMENT AND COMMERCIAL ARBITRATION—SIMILARITIES AND DIVERGENCES 131, 133–34 (Christina Knahr et al. eds., 2010). *But see id.* at 141 ("It is questionable whether this ground [of irregular constitution of the tribunal] can be used to annul a decision based on alleged bias of the arbitrator.").

170. 9 U.S.C. § 10(a)(2) (2006).

171. *See* BORN, *supra* note 11, at 2616–17.

A party may seek recognition and enforcement of an international arbitral award in national courts other than the legal seat of the arbitration.[172] If an annulment challenge has already been rejected by the courts in the seat of the arbitration, the award will likely—but not necessarily—be recognized and enforced in other jurisdictions.[173] The U.N. Convention on the Enforcement and Recognition of Foreign Arbitral Awards—also known as the New York Convention—has been adopted by 148 countries, including the United States, and permits a national court to deny recognition and enforcement of a nondomestic arbitral award on several grounds that potentially implicate arbitrator independence.[174] First, a lack of independence on behalf of the arbitrator may cause recognition and enforcement of the award to "be contrary to the public policy of that country."[175] Second, it may be grounds for nonrecognition and nonenforcement under Article V(1)(b) for "deny[ing] the opposing party the opportunity to present its case."[176] Finally, although less likely, nonindependence may implicate Article V(1)(d) of the Convention,[177] which allows states to deny recognition if the tribunal was not constituted "in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place."[178]

The independence of arbitrators is not a merely theoretical problem. A conflict of interest has the potential to disrupt the arbitral proceedings or annul the entire award, thereby forcing the parties to begin the dispute resolution process all over again. Because third-party funding implicates arbitrator independence, the potential conflicts that it raises cannot be underestimated and will be further explored in the following section.

C. THIRD-PARTY FUNDING IMPLICATES ARBITRATOR INDEPENDENCE

Although arbitral rules uniformly require that arbitrators be independent, none of the rules define independence. The IBA Guidelines on Conflicts of Interest in International Arbitration supplement the arbitral rules by providing lists of specific situations that may give rise to questions about an arbitrator's independence and impartiality.[179] The Guidelines were created by a working

172. Pavic, *supra* note 169, at 133–34.
173. *See id.* at 133–34, 148.
174. *See* United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards art. V, June 10, 1958 [hereinafter New York Convention]. Third-party funding itself could be grounds for nonrecognition. In a country or state that still recognizes the doctrines of maintenance and champerty, a party could argue that upholding an award that involved a third-party funder violates the public policy of that country. Cases concerning the annulment, recognition, or enforcement of an award based on a third-party funding relationship have not yet arisen in the United States, and the validity of such arguments remains theoretical—yet entirely possible.
175. *Id.* at art. V(2); *see* BORN, *supra* note 11, at 1530.
176. BORN, *supra* note 11, at 1530; *see* New York Convention, *supra* note 174, at art. V(1)(b).
177. *See* BORN, *supra* note 11, at 1530.
178. New York Convention, *supra* note 174, art. V(1)(d).
179. IBA GUIDELINES, *supra* note 143, at 17–27.

group of the International Bar Association, composed of nineteen experts from fourteen countries, in an effort to minimize the number of arbitrator challenges and provide consistency in decision making on those challenges.[180] Specific situations are divided into Red, Orange, and Green lists, indicating the level of concern associated with certain circumstances.[181] The Guidelines are not binding in arbitration but instead are used to help an arbitrator determine what information must be disclosed.[182] They are "increasingly seen as representing good practice" for determining the independence of an arbitrator.[183] This section will examine how third-party funding implicates various situations enumerated in the Guidelines, and why funding corporations may be hesitant to disclose their relationships with claimholders.

When a third-party funder contracts with a claimholder to provide funding for the arbitration, the funder becomes an affiliate of the claimholder due to the control that the funder may exercise over the party's dispute.[184] As an affiliate, the third-party funder's relationship with an arbitrator may be implicated by several circumstances enumerated in the IBA Guidelines.

The waivable Red List (as opposed to the nonwaivable Red List of "severe" conflicts) lists "serious" conflicts of interest that may be waived only if all parties are aware of the conflict and expressly permit the arbitrator to continue serving on the arbitral tribunal.[185] Third-party funding potentially implicates two situations on this list. First, a conflict arises when "[t]he arbitrator's law firm currently has a significant commercial relationship with . . . an affiliate of one of the parties."[186] Thus, if the third-party funder is providing funding to a client of the arbitrator's law firm on another case, parties in the arbitration should be aware of that relationship.[187] Second, a conflict may arise if the arbitrator holds shares in a privately held third-party funding corporation.[188]

Situations on the Orange List may give rise to a conflict of interest that must be disclosed but do not necessarily warrant disqualification of the arbitrator.[189] Several situations are implicated by third-party funding relationships. First, an arbitrator must disclose if he "has within the past three years been appointed as

180. *Id.* at 4.

181. *See id.* at 17–27.

182. *Id.* at 5.

183. Audley Sheppard, *Arbitrator Independence in ICSID Arbitration*, *in* INTERNATIONAL INVESTMENT LAW FOR THE 21ST CENTURY: ESSAYS IN HONOUR OF CHRISTOPH SCHREUER 131, 136 (Christina Binder et al. eds., 2009).

184. *See* BLACK'S LAW DICTIONARY 67 (9th ed. 2009) (defining "affiliate" as "[a] corporation that is related to another corporation by shareholdings or other means of control"). See *supra* Part II, regarding the control exercised by third-party funders over a case.

185. IBA GUIDELINES, *supra* note 143, at 17.

186. IBA GUIDELINES, *supra* note 143, Situation 2.3.6.

187. In the suit against Chevron, for example, Burford Capital leased space in the New York office of the plaintiffs' law firm. Parloff, *supra* note 1.

188. IBA GUIDELINES, *supra* note 143, Situation 2.2.1.

189. *Id.* at 18.

arbitrator on two or more occasions by . . . an affiliate of one of the parties"[190] or if "[t]he arbitrator's law firm has within the past three years acted for . . . an affiliate of one of the parties in an unrelated matter without the involvement of the arbitrator."[191] Given the proliferation of third-party funding in recent years[192] and the control and influence that may be exercised by the third-party funder regarding appointments of arbitrators,[193] these conflicts will increasingly arise in arbitration.

Disclosure is also required when the arbitrator has a material holding of shares in a publicly-traded affiliate of one of the parties.[194] Given that several third-party funding corporations are now publicly traded in England and Australia,[195] this situation has also become a growing concern.

Any one of these situations may lead to a conflict of interest that the arbitrator should disclose. However, in many circumstances, the arbitrator may not know that a claimholder is being funded by a third party and thus may not know that he should disclose any prior involvement with third-party funders.

For example, imagine that in three different arbitrations, a funder guides three different claimants (Claimants A, B, and C) to appoint the same arbitrator, within three years of each other. The arbitrator thus has a conflict of interest under Situation 3.1.3 on the Orange List of the IBA Guidelines, requiring disclosure of appointments by an affiliate of the parties in the case of two or more appointments in the past three years.[196]

If neither Claimant A nor Claimant B discloses that it is being funded by a third-party funder, the arbitrator will not know about it. Therefore, the arbitrator will not disclose that he was appointed by the same third-party funder in multiple arbitrations. Claimant C likely does not know that the third-party funder has also encouraged Claimants A and B to appoint that arbitrator; thus Claimant C will not disclose that information. Furthermore, Claimants A, B, and C might all have a provision in their funding contract providing that they shall not disclose the funding relationship without permission from the funder.

In another situation, the appointed arbitrator may hold a material amount of shares in a third-party funding corporation. If the arbitrator has no reason to believe that any of the parties are using third-party funding by that corporation, then the arbitrator has no reason to believe that disclosure of that information is necessary.

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190. IBA GUIDELINES, *supra* note 143, Situation 3.1.3.

191. IBA GUIDELINES, *supra* note 143, Situation 3.1.4.

192. *See supra* Part II.

193. *See supra* Part I.

194. IBA GUIDELINES, *supra* note 143, Situation 3.5.1. An arbitrator holding only an insignificant amount of shares would fall under the Green List. IBA GUIDELINES, *supra* note 143, Situation 5.5.2.

195. *See supra* Part II for details on third-party funding corporations listed on public stock exchanges.

196. *See* IBA GUIDELINES, *supra* note 143, Situation 3.1.3.

Third-party funding implicates several situations enumerated in the waivable Red List and the Orange List of the IBA Guidelines. These situations can only be resolved by disclosure of the fact that a party has received third-party funding; however, the current arbitral rules do not require parties to make this disclosure. The third-party funder is not part of the arbitration, and thus the tribunal has no authority over it.[197] Furthermore, the claimholder is often precluded from disclosing its relationship with the funder due to a confidentiality provision in the funding contract.[198]

There are several reasons why a third-party funder may want to keep its relationship confidential. First, the funder may be concerned that the tribunal may consider that relationship in its decision about security for costs or for fee-shifting in the cost of the arbitration. Indeed, the opposing parties in three recent investment arbitrations argued that a third-party funding relationship should have an effect on costs.[199]

Second, the funder might want to keep its relationship with the claimholder confidential for strategic reasons. Knowledge of the funding relationship may affect the other side's position on settlement or other aspects of the arbitration. For example, the opposing side may try to stall the litigation to deplete the funder's investment in the dispute.[200]

At a recent conference, one funder acknowledged that it may be necessary to disclose the relationship in limited circumstances.[201] Such disclosures, however, are based on the good faith of the third-party funders. No country currently regulates the behavior of the third-party funding industry, and only England's third-party funding industry has issued a code of conduct as a form of self-regulation.[202] Given the impact that disclosures of relationships may have on their claims, third-party funders will likely keep relationships confidential absent express disclosure requirements.

The problems posed to the independence of arbitrators cannot be solved by relying on the good faith of third-party funders. The arbitral rules require independence, but such independence cannot be assured under the current rules, given the rise of third-party funding. Part IV will propose a solution to

197. In general, treaties, national laws, and arbitral rules only apply to the "parties" that are bound by the agreement to arbitrate. *See, e.g.*, New York Convention, *supra* note 174, art. II; UNCITRAL MODEL LAW, *supra* note 168, art. 7(1); ICC RULES, *supra* note 11, art. 6(1); UNCITRAL RULES, *supra* note 11, art. 1(1).

198. *See* Parloff, *supra* note 1.

199. ATA Constr., Indus. & Trading Co. v. Hashemite Kingdom of Jordan, ICSID Case No. ARB/08/02, Order Taking Note of the Discontinuance of the Proceeding, ¶ 34 (July 11, 2011); RSM Prod. Corp. v. Grenada, ICSID Case No. ARB/05/14, Order of the Committee Discontinuing the Proceeding and Decision on Costs, ¶ 48 (Apr. 28, 2011); Kardassopoulos v. Georgia, ICSID Case Nos. ARB/05/18, ARB/07/15, Award, ¶ 691 (Mar. 3, 2010).

200. *See* Parloff, *supra* note 1.

201. Lisa Bench Nieuwveld, *To Disclose or To Not Disclose—That Is the Question*, KLUWER ARB. BLOG (Apr. 17, 2012), http://kluwerarbitrationblog.com/blog/2012/04/17/to-disclose-or-to-not-disclose-that-is-the-question/.

202. *See* Kalicki, *supra* note 92.

address conflict-of-interest problems created by third-party funding in commercial arbitration.

IV. PROPOSAL ON DISCLOSURE OF THE THIRD-PARTY FUNDING RELATIONSHIP

The arbitral institutions should adopt rules to require disclosure of third-party funding in arbitration because the proliferation of funding in both domestic litigation and in international arbitration creates too great of a potential for conflicts of interest. This Note proposes a four-part solution to the problems raised by third-party funding relationships and involves minimal changes to the current arbitral rules and system:

A. *Information pertaining to an arbitrator's independence and impartiality shall include information regarding the arbitrator's relationships with third-party funding corporations.*
B. *A party shall disclose to the institution the fact that it is receiving third-party funding. This disclosure shall include conflicts that may arise from other investments made by the funder.*
C. *If the institution receives notification from a party that it is receiving funding, the institution shall automatically complete a conflicts check. The institution shall keep confidential all third-party information that it receives from the parties.*
D. *The arbitral tribunal shall not be permitted to consider the existence of a third-party funding relationship itself in any decision regarding costs or security for costs.*

Under both the current rules and this proposal, the claimholder and the third-party funder may choose to disclose their relationship to the arbitrators and the opposing party at any point before or during the arbitration.[203] However, there are many instances when the funder prefers the relationship to remain confidential. This proposal is a viable means to ensure that the third-party funder and the claimholder may keep their relationship confidential should they choose to do so.

If the relationship is made known to the arbitrators, the proposed rules provide that the relationship shall have no effect on the tribunal's decision making. This proverbial carrot incentivizes the third-party funder and the claimholder to disclose their relationship in the first place, thereby preventing conflicts questions that may arise before or after the issuance of the award.

This proposal does require the third-party funding corporation to release the claimholder and its attorneys from the confidentiality provisions of the contract. This release relies on the good faith of the funding corporation itself. A funding corporation may prefer to keep its relationship with the claimholder silent; however, the incentives to keep the relationship confidential are diminished by

203. *See, e.g.*, Press Release, *supra* note 130.

another carrot: the prohibition on considering the funding relationship in costs or security for costs, offered in Provision D of the proposed rule.

Under this proposal, the arbitral institution requires disclosure of the funding relationship. As a result, the funding corporation will know—before it makes its investment—that the applicable rules require disclosure of the relationship to the institution. The funding corporation can thus consider this factor in its initial assessment of whether to invest in the claim. Although the required disclosure may be a negative factor in determining whether to invest in the claim, it is balanced by the prohibition on considering the relationship in costs or security for costs.

This proposal is directly applicable to arbitration conducted under the auspices of an institution, and the following four sections of this Note will address each provision of the proposed rule in regard to institutional arbitration. The fifth and final section will propose a similar rule that is slightly modified for ad hoc arbitration under the UNCITRAL Rules.

A. DUTY OF THE ARBITRATOR TO DISCLOSE

Information pertaining to an arbitrator's independence and impartiality shall include information regarding the arbitrator's relationships with third-party funding corporations.

Under the current institutional rules, arbitrators are required to disclose information regarding conflicts of interest to the ICC Secretariat, the IDCR administrator, or the LCIA Registrar.[204] Theoretically, at least, arbitrators are already required to disclose third-party funding information to the institution because such relationships implicate independence concerns.[205] In practice, however, third-party funding is a relatively recent phenomenon, and arbitrators may not think to include such information in their disclosures.

In order for an arbitrator to make this disclosure, he will have to seek a release of any confidentiality provisions in the funding agreements between his law firm's clients and the funding corporation. As provided in Provision C of the proposed rule, however, the institution is required to keep this information confidential, thereby incentivizing the funder to allow disclosure of the information to the institution.

LCIA and ICDR Rules require an arbitrator to disclose information that is *likely* to cause justifiable doubts about his independence. [206] ICC Rules and IBA Guidelines require disclosure of information that *may*[207] or *might*[208] give rise to such doubts, respectively. These standards would be retained in rules pertaining to disclosure of third-party funding relationships by the arbitrators.

204. *See* ICC RULES, *supra* note 11, art. 11(2); ICDR RULES, *supra* note 11, art. 7(1); LCIA RULES, *supra* note 11, art. 5.3.

205. *See supra* section III.A.

206. *See* ICDR RULES, *supra* note 11, art. 7(1); LCIA RULES, *supra* note 11, art. 5.3.

207. ICC RULES, *supra* note 11, art. 11(2).

208. IBA GUIDELINES, *supra* note 143, gen. std. 3(a).

Some institutions provide a standard form that arbitrators use to make disclosures. The LCIA form, for example, includes two statements regarding the arbitrator's independence and impartiality: one for when the arbitrator has no pertinent disclosures and one for when he does.[209] In order to ensure that information pertaining to third-party funding is disclosed, the LCIA could simply include a statement reminding arbitrators that pertinent third-party funding information should also be disclosed when likely to cause justifiable doubts about independence.

B. DUTY OF A PARTY TO DISCLOSE

A party shall disclose to the institution the fact that it is receiving third-party funding. This disclosure shall include conflicts that may arise from other investments made by the funder.

Under current arbitral rules, the parties are not required to disclose any third-party funding information to the institution. In addition, the parties are often subject to confidentiality provisions in the funding contract, which prevents them from disclosing the relationship to any other party.

The arbitral rules should therefore be altered to require a party to disclose the fact that it is being financed by a third party. This duty should apply to both the claimant and the respondent in arbitration. Advance knowledge that the funding relationship would have to be disclosed to the institution would allow the funder to incorporate disclosure into its initial decision to invest in an arbitral claim. By imposing a mandatory duty to disclose, third-party funders may be more willing to release a claimholder from a confidentiality provision in a contract, particularly because such information would be kept confidential by the institution. The structure of arbitration is already designed with a view towards confidentiality, and by disclosing the relationship solely to the institution, the third-party funder can be secure in its knowledge that only the institution will learn of the funding relationship.

Mandatory disclosures of third-party funding relationships are already required in the national courts of Australia, although any "information which might reasonably be expected to confer a tactical advantage on the other party" may be redacted.[210] Australia is home to the largest and most robust third-party funding industry in the world,[211] and given that third-party funding corporations are already required to disclose relationships in Australian courts, it is reasonable to require third-party funders to do so in arbitration as well.

C. AUTOMATIC CONFLICTS CHECK BY THE ARBITRAL INSTITUTION, TRIGGERED BY PARTY DISCLOSURE

If the institution receives notification from a party that it is receiving funding, the institution shall automatically complete a conflicts check. The institution

209. DAELE, *supra* note 13, at 37.
210. FED. COURT OF AUSTL., *supra* note 84, art. 3.6.
211. *See supra* section II.A.

shall keep confidential all third-party information that it receives from the parties.

Upon notice by a party of a funding relationship, the arbitral institution shall conduct an automatic conflicts check. Because the arbitrators are required automatically to disclose information pertaining to third-party funding upon prospective appointment, the institution will have all information necessary to complete the check.

Under current arbitral rules, arbitrator disclosures relating to independence and impartiality are provided to all parties[212] and, under some rules, to the other arbitrators.[213] Because of the unique problems presented by disclosure of third-party funding, the institution must keep all such disclosures confidential.

Conflict checks initiated by the institution are already in accord with the ICC Rules, which permit the ICC Secretary General to submit or refer an arbitrator challenge to the ICC court if he believes that the arbitrator should not be confirmed.[214] The process of submitting a challenge to the ICC court would be identical to this established practice, except that the parties would not submit comments about the challenge.

If an institution determines that an arbitrator should be disqualified due to a conflict arising from a third-party funding relationship, the institution could state either (1) that the disqualification is due to a *conflict* arising from a third-party funding relationship involving one of the parties or (2) that an arbitrator has been disqualified, without providing the reason. However, if the latter option was implemented, parties may assume that it resulted from a third-party funding relationship *itself*, due to the nature of the rules. Because of the possibility of this assumption and because of the need for some transparency in the process, the institution should state explicitly that the reason for disqualification is a conflict arising from third-party funding. Although this would involve disclosure that one party is being financed by a third-party funder (a fact that some parties may wish to keep confidential), such disclosure is inevitable and can be addressed by including rules regarding how tribunals may consider third-party funding in their decisions on costs.[215] Such a rule may also contribute to due diligence by the claimholder and the funder in ensuring that the appointed arbitrator is in fact independent.

Sua sponte review by the institution may impose more costs on the parties at the outset; however, the cost of not reviewing conflicts arising from third-party funding becomes exponentially larger if the arbitral award is annulled for lack of an independent arbitrator and the entire arbitral process must begin anew.

212. *See, e.g.*, ICC RULES, *supra* note 11, art. 11(2); ICDR RULES, *supra* note 11, art. 7(1).
213. *See, e.g.*, ICDR RULES, *supra* note 11, art. 7(1).
214. *See* ICC RULES, *supra* note 11, art. 13(2).
215. *See infra* section IV.D.

D. PROHIBITION ON CONSIDERATION OF A THIRD-PARTY FUNDING RELATIONSHIP BY THE TRIBUNAL

The arbitral tribunal shall not be permitted to consider the existence of a third-party funding relationship itself in any decision regarding costs or security for costs.

Third-party funders may be more willing to disclose their relationships with parties involved in litigation if rules are in place to ensure that tribunals will not use the relationships against them. Thus, institutions should expressly provide that the tribunal may not consider third-party funding in any decisions on costs or security for costs.

International arbitral tribunals are given significant discretion in determining awards for *costs* when the parties do not otherwise specify the allocation.[216] Costs of the arbitration include the arbitrator fees, administrative expenses by the court, fees incurred by the arbitrator in appointing its own experts, and potentially the legal fees of the successful party.[217] The ICC Rules allow the tribunal to "take into account such circumstances as it considers relevant, including the extent to which each party has conducted the arbitration in an expeditious and cost-effective manner."[218] The ICDR Rules similarly allow that the arbitrators "may apportion such costs among the parties if it determines that such apportionment is reasonable, taking into account the circumstances of the case."[219] The LCIA Rules provide that the tribunal "shall make its orders on both arbitration and legal costs on the general principle that costs should reflect the parties' relative success and failure in the award or arbitration, except where it appears to the Arbitral Tribunal that in the particular circumstances this general approach is inappropriate."[220] Under these rules, third-party funders may fear that the relationship may be considered in the tribunal's decision on costs. By expressly providing that a funding relationship cannot be considered by the tribunal, the proposed amendment to the arbitral rules incentivizes disclosure to the arbitral institution and introduces one element of certainty into the decision.

Such a prohibition accords with recent case law in the international investment arbitration context. In the past three years, three tribunals have considered what effect, if any, a third-party funding relationship should have on an award for costs.[221] The effect of funding was first addressed by an International Centre

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216. *See, e.g.*, ICC RULES, *supra* note 11, art. 37; ICDR RULES, *supra* note 11, art. 31 (providing simply that "[t]he tribunal shall fix the costs of the arbitration," which "may include" specified expenses); LCIA RULES, *supra* note 11, art. 28.

217. *E.g.*, ICC RULES, *supra* note 11, art. 37(1); ICDR RULES, *supra* note 11, art. 31.

218. ICC RULES, *supra* note 11, art. 37(5).

219. ICDR RULES, *supra* note 11, art. 31.

220. LCIA RULES, *supra* note 11, art. 28(4).

221. *See* ATA Constr., Indus. & Trading Co. v. Hashemite Kingdom of Jordan, ICSID Case No. ARB/08/02, Order Taking Note of the Discontinuance of the Proceeding (July 11, 2011); RSM Prod. Corp. v. Grenada, ICSID Case No. ARB/05/14, Order of the Committee Discontinuing the Proceeding

for Settlement of Investment Disputes (ICSID) tribunal, in *Kardassopoulos v. Georgia*, in 2010.[222] Georgia argued that the third-party funding relationship should be considered in determining what party should bear the costs of the arbitration; because of the financing relationship, Georgia should not be forced to bear the claimholder's costs of the proceedings.[223] The tribunal held that a third-party funding relationship should not be treated any differently than an insurance contract, which the applicable bilateral investment treaty prevented the tribunal from considering in its decision on damages.[224] The tribunal further noted that it knew "of no principle why any such third party financing arrangement should be taken into consideration in determining the amount of recovery by the Claimants of their costs."[225] This reasoning was cited in orders by two separate ad hoc committees, in ICSID annulment proceedings *ATA Construction v. Jordan* and *RSM Production v. Grenada*.[226]

Because of the cost-shifting potential in arbitration, *security for costs* allows a party to ensure that it can recover costs if it succeeds in arbitration.[227] Both claimants and respondents may seek security.[228] The availability of security for costs depends on the arbitral rules, the national laws at the seat of arbitration, and, if applicable, the agreement of the parties.[229] The ICC, ICDR, LCIA, and UNCITRAL each give the tribunal authority to order such measures.[230]

Although virtually all commentators and tribunals agree that security for costs should be granted only in exceptional circumstances, the relevant factors to determine whether the application for security should be granted are controversial.[231] Such factors include the financial circumstances of the responding party, the presence of bad faith in the party's actions, the timeliness of the application, and the requesting party's prospect of success on the merits.[232]

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and Decision on Costs (Apr. 28, 2011); Kardassopoulos v. Georgia, ICSID Case Nos. ARB/05/18, ARB/07/15, Award (Mar. 3, 2010).

222. *See Kardassapoulos*, ICSID Case Nos. ARB/05/18, ARB/07/15.

223. *See id.* ¶ 691.

224. *See id.*

225. *Id.*

226. *ATA Constr. Indus. & Trading Co.*, ICSID Case No. ARB/08/02 ¶ 34; *RSM Prod. Corp.*, ICSID Case No. ARB/05/14 ¶ 68.

227. Maxi Scherer, *Expert View: Third-Party Funding in Arbitration: Out in the Open?*, COM. DISP. RESOL. 56, May 2012.

228. JEFF WAINCYMER, PROCEDURE AND EVIDENCE IN INTERNATIONAL ARBITRATION 641 (2012).

229. *See id.* at 621–22.

230. *See* ICC RULES, *supra* note 11, art. 28(1); ICDR RULES, *supra* note 11, art. 21; LCIA RULES, *supra* note 11, art. 25.1; UNCITRAL RULES, *supra* note 11, art. 26.

231. *See* Jean E. Kalicki, *Security for Costs in International Arbitration*, 3 TRANSNAT'L DISP. MGMT., Dec. 2006, at 1.

232. WAINCYMER, *supra* note 228, at 648–50; *see* Scherer, *supra* note 227, at 56.

Although two of the leading third-party funding corporations expressly provide for the funder to post security, such provisions in the funding agreement are not in universal practice.[233] Commentators are divided on whether third-party funding should be considered when determining whether to grant security for costs. On the one hand, third-party funding has been rejected as part of the calculus for determining awards of costs; a logical extension of this rejection mandates that funding should not be considered in security for costs either.[234] Furthermore, if a funding relationship is a required factor for security-for-costs determinations, the opposing party would likely apply for security automatically, thereby delaying the arbitral process and causing genuine claims to be stifled.[235] Finally, in accordance with the proposal in this Note, the need to prevent conflicts of interest speaks in favor of eliminating funding relationships from the security-for-costs determination.

Others, however, argue that third-party funding should be considered for security for costs. One concern is with the so-called "hit-and-run" scheme, whereby the claimant abuses the system via the funding relationship: the claimant will gain by succeeding in the arbitration, but if it is unsuccessful, it lacks the financial ability to pay for costs.[236] Admittedly, this is a concern that is not solved by the proposed disclosure rule. Second, the existence of a funding relationship may indicate that the claimant has few available finances for the arbitration. Some commentators argue that it should therefore be disclosed.[237] However, many tribunals have required more than a poor financial situation by also requiring a fundamental change in circumstances; this concept is based on the idea that the other party has already accepted the financial position of that party when it agreed to enter the business relationship.[238]

Given the uncertainty of relevant factors in security-for-costs applications and the arguments that third-party funding should not be considered in these applications, the institutions should adopt the proposed rule to prevent tribunals from considering third-party funding in awards for security for costs. The benefit of this rule—providing third-party funders with incentive to disclose the fact of the funding relationship—outweighs the possibility of claimants performing a "hit-and-run" in bad faith.

The prohibition against a tribunal considering the funding relationship in awards on costs and security for costs ensures that the funders will disclose the

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233. *See* William Kirtley & Koralie Wietrzykowski, *Should an Arbitral Tribunal Order Security for Costs When an Impecunious Claimant Is Relying upon Third-Party Funding?*, 30 J. INT'L ARB. 17, 17–18 (2013).

234. *See id.* at 22 (citing Kardassopoulos v. Georgia, ICSID Case Nos. ARB/05/18, ARB/07/15, Award (Mar. 3, 2010)).

235. *Id.* at 23–24.

236. Kalicki, *supra* note 231, at 1.

237. Kirtley & Wietrzykowski, *supra* note 233, at 28.

238. Joe Tirado & Max Stein, *Security for Costs in International Arbitration—A Briefing Note*, 9 TRANSNAT'L DISP. MGMT., Aug. 2012, at 1, 3.

relationship to the arbitral institution in the first place, thereby preventing the arbitral process from being disrupted or the final award from being annulled or denied recognition and enforcement.

E. APPLICATION TO THE UNCITRAL ARBITRATION RULES

By definition, ad hoc arbitrations do not have a supervising institution to conduct conflicts checks. This proposal should be slightly modified to assure arbitrator independence in such arbitrations:

> *A. A party shall disclose that it is receiving third-party funding to the appointing authority. This disclosure shall include conflicts that may arise from other investments made by the funder.*
>
> *B. If the appointing authority receives such notification, the appointing authority shall request information from the arbitrators related to their relationships with third-party funding corporations.*
>
> *C. Upon receipt of the arbitrators' disclosures, the appointing authority shall complete a conflicts check. The appointing authority shall keep all third-party funding information confidential.*
>
> *D. The arbitral tribunal shall not be permitted to consider a third-party funding relationship in any decision regarding costs or security for costs.*

As with the proposal for amendments to the institutional rules, all disclosed information must be kept confidential, and arbitrators may not consider third-party funding relationships in decisions on costs. However, the nature of ad hoc arbitration makes disclosure of the relationship to the arbitrators inevitable, and disclosure of the relationship to the opposing party possible.

Under the current UNCITRAL Rules, parties may bring challenges of an arbitrator to an appointing authority.[239] The appointing authority may be specified in the agreement to arbitrate; if not, the parties may request the Secretary-General of the Permanent Court of Arbitration to specify the appointing authority.[240]

If the appointing authority has been specified in the arbitration agreement, a party that receives funding should disclose the fact of its relationship to that authority. The appointing authority should then request information from the arbitrators and conduct a conflicts check. Because arbitrators do not disclose pertinent information to the appointing authority prior to their appointments, third-party funding information must be specifically requested by the appointing authority. Unlike in the proposal for institutional arbitration, arbitrators in an ad hoc arbitration would inevitably learn that one of the parties has received funding. However, the arbitrators are still precluded from considering the funding relationship in their decisions on costs, thereby providing an extra layer

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239. UNCITRAL RULES, *supra* note 11, art. 13(4).
240. *Id.* art. 6.

of protection to parties that disclose their funding relationship.

A problem would arise if the appointing authority was not specified in the agreement to arbitrate. By requesting that the Secretary-General of the PCA designate an appointing authority, the party would implicitly inform its adversary that it is receiving funding—without a funding relationship, there would be no need for a conflicts check. Thus, the funding relationship would be known to both the opposing party and the arbitrators—although the party would still be protected by the prohibition on arbitrators considering funding in decisions on costs. In such a case, the party that has received funding may prefer to simply inform its adversary and the arbitrators of the fact of its relationship to avoid the expense of having the Secretary-General appoint the appointing authority to run a conflicts check.

The proposal for an amendment to the UNCITRAL Rules is not as smooth as the proposal for the institutional rules due to the nature of ad hoc arbitration. Without an institution in place to conduct an automatic conflicts check, parties are faced with greater risk in disclosing the third-party funding relationship in an ad hoc arbitration. Parties can reduce this risk, however, by designating an appointing authority in their agreement to arbitrate or by agreeing to arbitration under institutional rules. At the very least, the United Nations Commission on International Trade Law (the body that creates and amends the UNCITRAL Arbitration Rules) should begin to consider these issues the next time it seeks to modify the Rules.

CONCLUSION

If a conflicts check had been undertaken prior to the deposition following the Chevron case, special master Max Gitter may not have been forced to stop the deposition to reveal that he had a relationship with executives of the corporation that provided funding to the Ecuadorian plaintiffs.[241] The parties would have been assured that the supposedly neutral party presiding over the deposition did not have any relationships with the corporation that financed the dispute and would have been able to consider Gitter's relationships before the deposition began. This high-profile example demonstrates the potential prevalence of third-party funding in dispute resolution and the importance of conducting a conflicts check prior to the proceedings, whether they be litigation or arbitration. The parties in the Donziger deposition got lucky, so to speak; the conflict was relatively minor and could be waived. In other situations, however, the conflict of interest may be more serious and result in the proceedings being forced to start anew.

The confidential nature of both commercial arbitration and the third-party funding industry presents too many problems to allow the issue of arbitrator conflicts of interest to remain unresolved. The use of third-party funding in

241. *Cf. supra* INTRODUCTION.

international commercial arbitration is rising, and the current arbitral rules on independence and disclosure are insufficient to adequately address these problems. As a result, the arbitral institutions and creators of the ad hoc arbitration rules should take it upon themselves to require disclosure by both the arbitrators and the funded parties. By mandating that the institution keep the disclosed information confidential and by prohibiting the tribunal from considering funding relationships in awards for costs and security for costs, third-party funders may be more inclined to disclose their relationships to arbitral institutions. As a result, all parties involved in arbitrations can feel more secure with the knowledge that truly independent arbitrators are resolving their disputes.