

## Judging Third-Party Funding

Victoria Shannon Sahani



### ABSTRACT

Third-party funding is an arrangement whereby an outside entity finances the legal representation of a party involved in litigation or arbitration. The outside entity—called a “third-party funder”—could be a bank, hedge fund, insurance company, or some other entity or individual that finances the party’s legal representation in return for a profit. Third-party funding is a controversial, dynamic, and evolving phenomenon. The practice has attracted national headlines and the attention of the Advisory Committee on the Federal Rules of Civil Procedure (Advisory Committee). The Advisory Committee stated in a recent report that “judges currently have the power to obtain information about third-party funding when it is relevant in a particular case,” but the Committee did not provide any additional guidance on how to determine the relevance of third-party funding. What information should be obtained, and from whom? This Article offers that needed guidance by setting forth revisions and reinterpretations of procedural rules to provide judges and arbitrators with disclosure requirements and a framework for handling known issues as they arise. By revising and interpreting the procedural rules as suggested in this Article, judges and arbitrators will be able to gain a better sense of the prevalence, structures, and impact of third-party funding and its effects (if any) on dispute resolution procedures. Over time, these observations will reveal the true systemic impact of third-party funding and contribute to developing more robust third-party funding procedural regulations.

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## INTRODUCTION

On December 1, 2015, changes to eleven Federal Rules of Civil Procedure and the deletion of the Appendix of the Forms took effect.<sup>1</sup> Far more interesting than the changes, however, are several disruptive and paradigm-shifting phenomena that the Advisory Committee for the Federal Rules of Civil Procedure (Advisory Committee) has earmarked for future consideration.<sup>2</sup> Examples of such changes include implementing electronic filing and service of process for court documents and grappling with the question of whether attorney's fees are appropriate sanctions in light of deep concerns about cost shifting under the American Rule.<sup>3</sup> This Article proposes several more rule revisions to address a controversial and growing phenomenon: third-party funding. Third-party funding in litigation and arbitration is an arrangement where a party involved in a dispute seeks funding from an outside entity for its legal representation.<sup>4</sup>

The Advisory Committee stated in its December 2014 report that:

Discussion reflected concerns that third-party financing is a relatively new and evolving phenomenon. It takes many forms that may present distinctive questions. A study paper for the ABA 20/20 Commission on Ethics<sup>5</sup> expressed the hope that work will continue to study the impact of funding on counsel's independence, candor, confidentiality, and undivided loyalty. The Committee agreed that the questions

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1. For the full text of the revisions, see COMM. ON RULES OF PRAC. & PROC., REPORT OF THE JUDICIAL CONFERENCE COMMITTEE ON RULES OF PRACTICE & PROCEDURE 13–18 (summary of revisions), B-1 to B-77 (specific language of revisions) (2014), <http://www.uscourts.gov/file/14523/download> [<http://perma.cc/5PKM-AU48>]. See also *infra* note 71 for a complete explanation of the rules revision process; see generally U.S. COURTS, REDLINE OF CIVIL RULES AMENDMENTS (EFF. DEC. 1, 2015), [www.uscourts.gov/rules-policies/current-rules-practice-procedure/federal-rules-civil-procedure](http://www.uscourts.gov/rules-policies/current-rules-practice-procedure/federal-rules-civil-procedure).
  2. See DAVID G. CAMPBELL, REPORT OF ADVISORY COMMITTEE ON CIVIL RULES 3–12 (2014), <http://www.uscourts.gov/file/17932/download> [<http://perma.cc/T59D-GTZK>] (last visited Dec. 16, 2015).
  3. See *id.*
  4. See *id.* at 3–4 (discussing third-party funding).
  5. AM. BAR ASS'N COMM'N ON ETHICS 20/20, INFORMATIONAL REPORT TO THE HOUSE OF DELEGATES (2012), [http://www.americanbar.org/content/dam/aba/administrative/ethics\\_2020/20111212\\_ethics\\_20\\_20\\_alf\\_white\\_paper\\_final\\_hod\\_informational\\_report.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf) [<http://perma.cc/GD3B-RTDW>] [hereinafter ABA WHITE PAPER] (describing how a lawyer would handle a third-party funding arrangement within the existing Rules of Professional Responsibility).

raised by third-party financing are important. But they have not been fully identified, and may change as practices develop further. In addition, the Committee agreed that judges currently have the power to obtain information about third party funding when it is relevant in a particular case. An attempt to craft rules now would be premature. These questions will not be pursued now.<sup>6</sup>

The Advisory Committee declared that federal judges clearly have the power to obtain information about third-party funding under the existing rules but did not give any guidance on how to implement this mandate.<sup>7</sup> This pronouncement generates a multitude of questions without providing ready answers. What is third-party funding? What are federal judges' responsibilities under the Federal Rules with respect to third-party funding? Which aspects of the Federal Rules are affected by third-party funding? How should judges determine what information to obtain regarding third-party funding and from whom should they obtain that information? This Article addresses these questions by providing guidance to federal judges on how to interpret the existing Federal Rules of Civil Procedure to address third-party funding now, and suggests rule revisions to the Advisory Committee for future consideration.<sup>8</sup> This Article also provides similar guidance to arbitrators and arbitral institutions on how to address third-party funding under the existing procedural rules and suggests future revisions to implement, as arbitration and litigation are inextricably intertwined.<sup>9</sup>

This Article proceeds as follows. Part I introduces and defines third-party funding before examining the problems that may arise because litigation and arbitration procedural rules do not mention third-party funding explicitly. Part I finishes by addressing the debate over whether to revise or reinterpret procedural rules and recommends that the most appropriate course of action at this time would be to combine three approaches: (i) reinterpreting certain rules, (ii) revising other rules, and (iii) collecting reports by judges and arbitrators on the

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6. CAMPBELL, *supra* note 2, at 4 (internal footnote added by this article's author).

7. *See id.* (“[T]he Committee agreed that judges currently have the power to obtain information about third-party funding when it is relevant in a particular case.”).

8. Why focus on the Federal Rules rather than state rules? State rules vary too widely for a realistic proposal of a model state rule. In addition, state court rules tend generally to follow trends in the Federal Rules. The Federal Rules set an example and, to that end, are quintessentially “model” state rules. Nevertheless, state laws govern evidentiary privileges, so this Article argues that they should be revised. *See infra* Part II.A.1 (discussing revisions to state laws governing the attorney-client privilege and the work-product doctrine).

9. *See infra* notes 72–74 and accompanying text.

results of implementing these revisions and reinterpretations in practice. Part II begins by proposing reinterpretations of the existing Federal Rules and rules of arbitral procedure—ones that judges and arbitrators can implement immediately when encountering third-party funding in a case. Part II also proposes targeted, appropriate rule revisions that the Advisory Committee and arbitral institutions should consider in the future. It concludes by asserting that the rule revisions and reinterpretations proposed in this Article provide for an interim regulatory structure, with the goal of gleaning more data about the prevalence, structures, and impact of third-party funding through disclosure and observation.

## I. THIRD-PARTY FUNDING AS A PARADIGM SHIFT IN DISPUTE RESOLUTION

### A. The Phenomenon: What Is Third-Party Funding?

Third-party funding<sup>10</sup> is an arrangement where a party involved in a dispute seeks funding from an outside entity for its legal representation.<sup>11</sup> The outside entity—a third-party funder—finances the party’s legal representation in anticipation of making a profit.<sup>12</sup> The third-party funder could be a bank, hedge fund, insurance company, or some other entity or individual.<sup>13</sup> If the funded party is the plaintiff, then the funder contracts to receive a percentage or fraction of the proceeds if the plaintiff wins the case.<sup>14</sup> Unlike a loan, the funded plaintiff does not have to repay the funder if it loses the case or does not recover any money.<sup>15</sup> If the funded party is the defendant, then the funder contracts to receive a predetermined payment from the defendant, similar to an insurance

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10. The Advisory Committee used the terms “third-party funding,” “third-party financing,” and “third-party litigation financing” in its report. CAMPBELL, *supra* note 2. Some scholars use the term “third-party litigation funding” or “litigation funding” to refer to this phenomenon. This Article intentionally uses the term “third-party funding”—without the word “litigation”—because this Article addresses funding of both litigation and arbitration, domestically and internationally.

11. See generally Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268 (2011) (defining third-party funding). A party may also engage both a contingency fee attorney and a third-party litigation funder to work together on its case.

12. See LISA BENCH NIEUWVELD & VICTORIA SHANNON, *THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION* 4–11 (2012) (describing the players in third-party funding, the types of funding relationships, and the effect of the type of funder on the attorney-client relationship).

13. See *id.* at 4.

14. See *id.* at 5.

15. See *id.* at 5–7.

premium, and the agreement may include an extra payment to the funder if the defendant wins the case.<sup>16</sup> This Article specifically addresses third-party funding provided directly to a party to a litigation or arbitration matter and does not address other types of funding.<sup>17</sup>

Third-party funding is rapidly increasing in prevalence around the world in both litigation and arbitration.<sup>18</sup> Banks, hedge funds, and other financial institutions are funding the legal representation of parties to litigation and arbitration cases as a type of investment.<sup>19</sup> This phenomenon is not only growing in importance, but is also estimated to be a multibillion-dollar industry both

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16. *See id.* at 4–11.

17. There are other types of third-party funding, such as lawyer lending, assignment, or insurance covering legal expenses. This Article limits its discussion, however, to third-party funding arrangements with the following three characteristics: (1) the funder contracts directly with the original party to the case and not with the client's attorney; (2) the original party remains a party to the case; and (3) the funder does not become a party in the case (because there is no assignment of the underlying claim or liability). Thus, this Article intentionally does not address assignment of claims (in which the original client sells the entire claim and walks away leaving the funder to pursue the claim as a party) or insurance arrangements that fund legal expenses (in which the insurer may be a willing co-party or may be impleaded as a third-party defendant under Rule 14 of the Federal Rules of Civil Procedure). The funder may become a party (or co-party) to the dispute through one of those types of arrangements, and the existing rules of litigation or arbitration procedure would apply directly to the funder as a party. This Article also does not address lawyer lending (in which the funding transaction is between the law firm and the funder without directly involving the client). For an in-depth treatment of assignment and insurance policies in the third-party litigation funding context, see, for example, Terrence Cain, *Third Party Funding of Personal Injury Tort Claims: Keep the Baby and Change the Bathwater*, 89 CHI.-KENT L. REV. 11 (2014); Anthony J. Sebok, *Betting on Tort Suits After the Event: From Champerty to Insurance*, 60 DEPAUL L. REV. 453 (2011); Marc J. Shukaitis, *A Market in Personal Injury Tort Claims*, 16 J. LEGAL STUD. 329 (1987); Paul Bond, Comment, *Making Champerty Work: An Invitation to State Action*, 150 U. PA. L. REV. 1297 (2002). For an in-depth treatment of lawyer lending, see, for example, Nora Freeman Engstrom, *Lawyer Lending: Costs and Consequences*, 63 DEPAUL L. REV. 377 (2014) [hereinafter Engstrom, *Lawyer Lending*]; Nora Freeman Engstrom, *Re-Re-Financing Civil Litigation: How Lawyer Lending Might Remake the American Litigation Landscape, Again*, 61 UCLA L. REV. DISCOURSE 110 (2013) [hereinafter Engstrom, *Re-Re-Financing*]. For an in-depth discussion of insurance that specifically covers legal expenses, see generally NIEUWVELD & SHANNON, *supra* note 12 (discussing after-the-event insurance, before-the-event insurance, and legal expenses insurance in various jurisdictions around the world).

18. *See* NIEUWVELD & SHANNON, *supra* note 12 (discussing the prevalence of third-party funding in international arbitration and the laws regulating it in over 30 countries); Cassandra Burke Robertson, *The Impact of Third-Party Financing on Transnational Litigation*, 44 CASE W. RES. J. INT'L L. 159, 162, 180–81 (2011) (discussing the prevalence third-party funding in transnational litigation).

19. *See infra* note 20 for examples.

domestically and internationally.<sup>20</sup> In addition, depending on the structure of the funding arrangement, the funder may legally control or influence aspects of the legal representation or may completely take over the case and step into the shoes of the original party.<sup>21</sup> The United States is home to dozens of consumer litigation funders, including personal injury claims and other tort claims, as well as funders of large complex corporate disputes.<sup>22</sup> In light of its increasing

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20. See, e.g., Vanessa O'Connell, *Funds Spring Up to Invest in High-Stakes Litigation*, WALL ST. J. (Oct. 3, 2011), <http://www.wsj.com/articles/SB10001424052970204226204576598842318233996> [<http://perma.cc/MKY7-MFYJ>] ("The new breed of profit-seeker sees a huge, untapped market for betting on high-stakes commercial claims. After all, companies will spend about \$15.5 billion this year on U.S. commercial litigation and an additional \$2.6 billion on intellectual-property litigation, according to estimates by BTI Consulting Group Inc., a Wellesley, Mass., research firm that surveyed 300 large companies in 2011."); Jennifer Smith, *Investors Put Up Millions of Dollars to Fund Lawsuits*, WALL ST. J. (Apr. 7, 2013, 7:46 PM), <http://online.wsj.com/news/articles/SB10001424127887323820304578408794155816934> [<http://perma.cc/D34B-CN4E>] ("Gerchen Keller Capital LLC, a Chicago-based team that includes former lawyers . . . has raised more than \$100 million and says there is plenty of room for newcomers given the size of the U.S. litigation market, which they put at more than \$200 billion, measuring the money spent by plaintiffs and defendants on litigation."); Jennifer Smith, *Litigation Investors Gain Ground in U.S.*, WALL ST. J. (Jan. 12, 2014, 7:48 PM), <http://online.wsj.com/news/articles/SB10001424052702303819704579316621131535960> [<http://perma.cc/9Q44-7SRC>] (several funders have several hundreds of millions of dollars in assets under management); Press Release, *Excend Engaged as Advisory for Multi-Billion Dollar Judgment Litigation Funding*, EXCEND (May 1, 2012), <http://www.excend.com/press/2012-05-09-Excend-Engaged-as-Advisor-for-Multi-Billion-Dollar-Judgment-Litigation-Funding.pdf> [<http://perma.cc/5PM3-RGH6>].
21. See NIEUWVELD & SHANNON, *supra* note 12, at 8 (explaining that some third-party funding arrangements are structured as an assignment in which the third-party funder becomes the claimant in the case and the original party is no longer involved). This Article does not address assignment of legal claims to third-party funders for the reasons explained *supra* note 17. For an in-depth treatment of assignment and insurance policies in the third-party funding context, see generally Cain, *supra* note 17; Sebok, *supra* note 17; Shukaitis, *supra* note 17; Bond, *supra* note 17. It is important to note, however, that third-party funders cannot buy a claim in investment treaty arbitration and pursue it separately from the original claimant due to jurisdictional requirements in the treaty regarding the nationality of the investor-claimant and the claimant's specific investment in the territory of the host state. For an explanation of this concept, see generally Christoph Schreuer, *Jurisdiction and Applicable Law in Investment Treaty Arbitration*, 1 MCGILL J. DISP. RESOL. 1 (2014), <http://mjdrc.mcgill.ca/issue/viewIssue/1/1> [<http://perma.cc/L8F2-F4W4>].
22. See, e.g., *Facts About ALFA*, AM. LEGAL FIN. ASS'N, <http://www.americanlegalfin.com/FactsAboutALFA.asp> [<http://perma.cc/4788-P5RQ>] (last visited Dec. 16, 2015) (establishing that there are over 30 third-party funding companies funding consumer claims, as well as several other active third-party funding companies that are not members of ALFA). For a discussion regarding commercial disputes, see *supra* note 20. Most of the existing literature addresses consumer and commercial third-party funding separately. This Article does not make that distinction because both types of disputes use the same rules for procedure and evidence in litigation, so revisions to those rules would affect both types of funding. In addition, both commercial and consumer arbitration borrow rules of evidence from litigation. The sole exception may be that international and domestic arbitrations typically operate under different sets of rules. International arbitration is usually commercial, while domestic arbitration may be consumer or

prevalence, there is a continuing debate over the place of third-party funding in both the American legal system and the international dispute resolution regime.<sup>23</sup>

There are four main drivers of the third-party funding industry worldwide. First, funders help individuals bring claims that they could not otherwise afford to bring, which—although not the funder’s primary goal—tends to increase access to the court system for indigent or disadvantaged persons.<sup>24</sup> Second, many insolvent companies and small companies seek third-party funding as a means to pursue valid claims they could not otherwise afford to pursue, and that are usually too risky for a contingency fee attorney to accept.<sup>25</sup> Third, many large companies that are frequently sued (such as insurance companies or manufacturers of

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commercial. Nevertheless, this Article proposes the same interpretations and revisions for all types of arbitration rules because the changes proposed in this Article would be appropriate for both consumer and commercial funded arbitrations.

23. See, e.g., Courtney R. Barksdale, *All That Glitters Isn't Gold: Analyzing the Costs and Benefits of Litigation Finance*, 26 REV. LITIG. 707, 735 (2007); Susan Lorde Martin, *Litigation Financing: Another Subprime Industry That Has a Place in the United States Market*, 53 VILL. L. REV. 83, 83–85 (2008) [hereinafter Martin, *Another Subprime Industry*]; Susan Lorde Martin, *The Litigation Financing Industry: The Wild West of Finance Should Be Tamed Not Outlawed*, 10 FORDHAM J. CORP. & FIN. L. 55, 56–57, 68–69, 72, 74, 77 (2004) [hereinafter Martin, *The Wild West*]; Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367, 377–80 (2009) (proposing defense-side funding in the United States that would be similar to after-the-event insurance in Europe); Max Radin, *Maintenance by Champerty*, 24 CALIF. L. REV. 48, 74–75 (1935) (arguing for the regulation of contingency fees in a way similar to today’s arguments for regulating third-party funding); Anthony J. Sebok, *The Inauthentic Claim*, 64 VAND. L. REV. 61, 72 n.36, 139 (2011); Yifat Shaltiel & John Cofresi, *Litigation Lending for Personal Needs Act: A Regulatory Framework to Legitimize Third Party Litigation Finance*, 58 CONSUMER FIN. L. Q. REP. 347, 350–61 (2004) (proposing a statute to regulate third-party funding for individual consumers); Steinitz, *supra* note 11, at 1325–36; Jason Lyon, Comment, *Revolution in Progress: Third-Party Funding of American Litigation*, 58 UCLA L. REV. 571, 608–09 (2010); Mariel Rodak, Comment, *It's About Time: A Systems Thinking Analysis of the Litigation Finance Industry and Its Effect on Settlement*, 155 U. PA. L. REV. 503, 504, 508, 513–23, 523 n.113, 526–27 (2006); see also *infra* note 130 and accompanying text.
24. See David S. Abrams & Daniel L. Chen, *A Market for Justice: A First Empirical Look at Third Party Litigation Funding*, 15 U. PA. J. BUS. L. 1075, 1076 n.3, 1077 n.6–7 (2013) (reporting the results of their study on public data on third-party funding available in Australia).
25. See James D. Dana, Jr. & Kathryn E. Spier, *Expertise and Contingent Fees: The Roles of Asymmetric Information in Attorney Compensation*, 9 J. L. ECON. & ORG. 349, 365–66 (1993); Doug Jones, *Third-Party Funding of Arbitration*, in THIRD PARTY FUNDING OF INTERNATIONAL ARBITRATION CLAIMS: THE NEWEST “NEW NEW THING” 119, 130 (photo. reprint 2011) (2008) (on file with the author); Martin, *Another Subprime Industry*, *supra* note 23, at 83–85; Martin, *The Wild West*, *supra* note 23, at 67 n.93; Steinitz, *supra* note 11, at 1275–76, 1283–84; Ralph Lindeman, *Third-Party Investors Offer New Funding Source for Major Commercial Lawsuits*, FULLBROOK CAP. MGMT., LLC (Mar. 5, 2010), <http://www.fullbrookmanagement.com/third-party-investors-offer-new-funding-source-formajor-commercial-lawsuits> [<http://perma.cc/9GNV-GE3K>]; *Raconteur on Legal Efficiency*, RACONTEUR MEDIA 8–9 (Mar. 25, 2010), <http://np.netpublicator.com/netpublication/n89269938> [<http://perma.cc/RN99-3AQD>].

dangerous products) would like a way to even out the litigation line item on their balance sheets, and funders can offer them a fixed payment system for managing their litigation costs as defendants.<sup>26</sup> Fourth, the worldwide market turmoil over the past several years has caused many investors to seek investments that do not dependent upon financial markets, stock prices, or company valuations.<sup>27</sup> Each litigation or arbitration matter is a discrete investment and is independent from market conditions in terms of the value of the plaintiff's claim or defendant's liability.<sup>28</sup> This independence shields the third-party funder's investment and potential profit from the general uncertainty present in global financial markets.<sup>29</sup>

Since litigation and arbitration have become attractive investment vehicles, unsurprisingly, both reputable as well as deceitful third-party funders have flocked to this market.<sup>30</sup> Despite the existence of so many funders, however, there is little

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26. See, e.g., Kevin LaCroix, *What's Happening Now? Litigation Funding, Apparently*, THE D&O DIARY (Apr. 9, 2013), <http://www.dandodiary.com/2013/04/articles/securities-litigation/whats-happening-now-litigation-funding-apparently> [<http://perma.cc/SL5K-3TXY>] (“Litigation funding proponents contend that the funding arrangements helps to level the playing field by allowing litigants to pursue lawsuits against better financed opponents, or simply allowing litigants to keep litigation costs off their balance sheet. It seems clear that as the litigation funding field grows, the funding companies are offering new approaches—for example, the defense side option that the Gerchen Keller firm will be offering, or the ‘defense costs cover’ that provided protection for prospective RBS claimants sufficient for them to be able to take on litigation in the U.K. notwithstanding the ‘loser pays’ litigation model that prevails there.”); David Lat, *Litigation Finance: The Next Hot Trend?*, ABOVE L. (Apr. 8, 2013), <http://abovethelaw.com/2013/04/litigation-finance-the-next-hot-trend> [<http://perma.cc/A8SE-P5HH>] (“Ashley Keller [of Gerchen Keller Capital]: You’re certainly right that a lot of these clients have balance sheet capacity and could fund out of pocket. Notwithstanding their balance sheet capacities, there might be institutional constraints. If a company has a \$5 billion claim, it will pursue it. But what if it has a \$50 million or \$100 million claim? If you’re a general counsel, a lot of C-suite executives are viewing your office as a cost center. It’s not that easy to walk to the CFO’s office and ask for \$5 million or \$10 million to finance offensive litigation. That will immediately hit the P&L of the company and affect earnings per share, but the outcome is uncertain and contingent. We think a fair number of meritorious claims are being left on the table notwithstanding balance sheet capacity.”); Financier Worldwide, *Third-Party Litigation Funding*, FULBROOK CAP. MGMT. LLC (May 2012), <http://www.fulbrookmanagement.com/third-party-litigation-funding> [<http://perma.cc/5PX8-6C22>] (“Third-party funding offers corporate clients the opportunity to move the financial risk and cost of litigation off their balance sheets.”).

27. See Steinitz, *supra* note 11, at 1283–84.

28. See NIEUWVELD & SHANNON, *supra* note 12, at 12.

29. See *id.*

30. It is important to note that whether a third-party funder is reputable or deceitful is not tied to its profit-making motive but rather whether the funder's business practices involve swindling or tricking the client into making a bad deal. For example, reputable funders make clear disclosures to the client, have reasonable fee structures, and ensure that clients understand the terms of the agreement before they sign it. Deceitful funders, on the other hand, may not disclose the full terms of the fee structure to the client, may have excessive or inappropriately accelerated fee

regulation of the industry at present, and the existing regulations are not comprehensive.<sup>31</sup> The lack of regulation or guidelines creates a situation in which parties looking to secure third-party funding have no way of knowing which funders are reputable and which are untrustworthy.<sup>32</sup> Market regulation would help inform consumers about the baseline requirements for a compliant third-party funder.<sup>33</sup> It would also inform noncompliant funders of what they need to do to become compliant—assuming that they want to keep the business of well-informed clients or at least avoid sanctions.<sup>34</sup> Scholars, legislators, judges, attorneys, and even funders themselves have called for regulation of the third-party funding industry.<sup>35</sup> As a first step, the Advisory Committee has authorized judges to gather information about third-party financing in light of Rule 1’s mandate that the Federal Rules “should be construed, administered, and employed by the court and the parties to secure the just, speedy, and inexpensive determination of every action and proceeding.”<sup>36</sup> An extra step, however, needs to

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structures, and may pressure a client to sign the agreement without (or against) the advice of the client’s attorney. For an example of a deceitful third-party funding situation, see *Weaver, Bennett & Bland, P.A. v. Speedy Bucks, Inc.*, 162 F. Supp. 2d 448, 450–52 (D.N.C. 2001) (awarding treble damages to a law firm against a third-party funder for tortious interference with the law firm’s retainer agreement with its client due to the funder’s secret third-party funding agreement with the client that calculated the funder’s compensation in a way that negated the contingent fee agreement that the law firm had previously entered into with the same client).

31. See NIEUWVELD & SHANNON, *supra* note 12, at 144–59 (conducting a 51-jurisdiction survey of existing state laws as of early 2012). See generally Richard A. Blunk, *Have the States Properly Addressed the Evils of Consumer Litigation Finance?*, MODEL LITIG. FIN. CONT. (Jan. 20, 2014), <http://litigationfinancecontract.com/have-the-states-properly-addressed-the-evils-of-consumer-litigation-finance> [<http://perma.cc/CP5F-MFXK>] (describing the third-party funding statutes in Maine, Ohio, Nebraska and Oklahoma); Heather Morton, *Litigation or Lawsuit Funding Transactions 2014 Legislation*, NAT’L CONF. ST. LEGIS. (June 13, 2014), <http://www.ncsl.org/research/financial-services-and-commerce/litigation-funding-transactions-2014-legislation.aspx> [<http://perma.cc/J638-9FAA>] (listing proposed and passed legislation state by state). As of June 2014, the states that have passed legislation either allowing or prohibiting third-party funding of consumer claims are Maine, Indiana, Ohio, Oklahoma, Nebraska, New York (allowed for large commercial disputes), and Tennessee. The states that have proposed legislation in this area are Alabama, Georgia, Illinois, Indiana (other bills proposed), Iowa, Kansas, Louisiana, Missouri, North Carolina, Rhode Island, South Carolina, and Vermont. Most other states either have case law or attorney ethics opinions addressing third-party funding.
32. See generally Victoria A. Shannon, *Harmonizing Third-Party Litigation Funding Regulation*, 36 CARDOZO L. REV. 861 (2015) (explaining why existing regulations are insufficient and confusing and why the third-party funding industry needs harmonized regulations for the procedure, transaction, and ethics areas).
33. See *id.* at 865, 867–68, 889, 908–09.
34. See *id.*
35. See *supra* notes 4 & 23.
36. FED. R. CIV. P. 1 (quoting December 1, 2015 revision adding duty on the parties in addition to the court); see CAMPBELL, *supra* note 2 and accompanying text.

be taken to ensure an equitable administration of the rules. Indeed, an inequitable administration of the Federal Rules or of the rules of arbitration procedure could lead to undesirable inconsistencies, inefficiencies, and injustices. Thus, this Article offers a template for administering the existing rules of litigation and arbitration procedure and for revising those rules in the future to address legitimate concerns relating to third-party funding.

This Article builds on prior scholarly work that proposes a framework for harmonizing (i) procedural, (ii) transactional, and (iii) ethical regulations for third-party funding.<sup>37</sup> A harmonized regulatory framework would include key regulations within each of these three categories and link those regulations together through cross-references.<sup>38</sup> This approach weaves a regulatory safety net, providing minimum standards for the behaviors and interactions of the major players in third-party funding arrangements.<sup>39</sup> It also ensures the integrity of a dispute resolution system that involves funders and stabilizes any financial products that may derive from third-party funding.<sup>40</sup>

As set forth in this Article, regulations in the procedural category address the ways in which funders can participate in or influence the procedure of litigation or arbitration. This includes, for example, addressing conflicts of interest or potential waivers of evidentiary privileges for information disclosed to a funder.<sup>41</sup> Proposed regulations in the transactional category would address the structure of a third-party funding transaction and promulgate requirements to ensure the viability of the funder—notably, capitalization requirements, licensure, and disclosures to potential clients.<sup>42</sup> Regulations in the ethical category would address issues relating to conflicts of interest that may arise during the negotiation of the funding arrangement, and the funder's effect on the attorney-client relationship.<sup>43</sup> Ultimately, this Article focuses on procedural regulations and suggests that regulatory bodies take into account the existence and participation of third-party funders when they revise and reinterpret litigation and arbitration rules, as well as certain evidentiary privileges.

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37. See Shannon, *supra* note 32, at 861–62.

38. See *id.*

39. See *id.*

40. See *id.*

41. See *id.* at 896–902; see also *infra* Part II.

42. See Shannon, *supra* note 32, at 889–96.

43. See *id.* at 902–07.

## B. The Problem: Rules of Procedure Are Silent Regarding Third-Party Funding

Third-party funders are indirect participants in litigation and arbitration, yet direct participants—judges, juries, and arbitrators, as well as opposing parties and attorneys—may all be unaware of the funder’s involvement.<sup>44</sup> Like other indirect participants in dispute resolution, however, third-party funders should be subject to the rules of litigation and arbitration procedure.<sup>45</sup> How should judges treat their participation in litigation or arbitration as a matter of procedure? Funders do not fit neatly into any of the typical roles outlined in litigation or arbitration rules. They are intentionally not parties or co-parties (in order to avoid liability),<sup>46</sup> not legal counsel (although they are often lawyers),<sup>47</sup> and not

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44. Parties often employ other entities to assist them in litigation without the opposing side’s knowledge, such as nontestifying consultants, nontestifying experts, accountants, and other agents. Several types of such entities are listed as party “representative[s]” in FED. R. CIV. P. 26(b)(3)(A). See *infra* note 153 and accompanying text. Based on the substance of their activities during the litigation, funders likely fall within the definition of those “representative[s]” enumerated in the rules. See *id.*

45. See *supra* note 44. Since many entities that are not direct participants in litigation are enumerated or referenced in the Federal Rules of Civil Procedure, third-party funders should also be referenced explicitly to clarify their role and responsibilities.

46. Furthermore, a third-party funder usually should not be joined as party. A claim-side funder is not a “real party in interest” under FED. R. CIV. P. 17, unless the funder buys the claim outright and takes an assignment. See FED. R. CIV. P. 17(a)(1) (“An action must be *prosecuted* in the name of the real party in interest.”) (emphasis added). The rule requires that the party possessing the substantive right at issue must prosecute the case. The rule applies only to plaintiffs and is intended to prevent defendants from having to face multiple lawsuits over the exact same legal right or interest. See, e.g., *Curtis Lumber Co. v. Louisiana Pac. Corp.*, 618 F.3d 762, 771 (8th Cir. 2010) (stating that the purpose of FED. R. CIV. P. 17(a) is to ensure that the defendant will face only one suit and will obtain the benefit of *res judicata* against any future action based on the exact same legal interest); *Marina Mgmt. Serv. v. Vessel My Girls*, 202 F.3d 315, 318 (D.C. Cir. 2000) (“Rule 17(a) protects a defendant against a subsequent claim for the same debt underlying a previously entered judgment.”). If the funder takes an assignment of the claim, then the funder should be the plaintiff on record in the case. Since such a funder would pursue the claim or defense in its own name as the real party in interest, the funder in such an instance would be treated as a party already under the existing rules. Most funders, by contrast, take an interest only in the potential proceeds from the case (claim side) or receive periodic payments from the client similar to an insurance premium (defense side). Thus, FED. R. CIV. P. 17, as it is currently written, would apply in the context of a funder taking an assignment of a claim and does not need to be revised. The vast majority of third-party funders have absolutely no connection whatsoever to the underlying substantive dispute; hence, they are not the “real party in interest” under FED. R. CIV. P. 17.

47. Examples of third-party funders that have lawyers as leaders or principals include ARCA Capital Partners, BridgePoint Financial Services, Burford Capital Group, Calunius Capital, Fulbrook Management LLC, Gerchen Keller Capital, Harbour Litigation Funding Ltd., IMF (Australia)

witnesses (although disclosures of privileged information to funders may make that information discoverable in jurisdictions that do not extend to funders certain evidentiary privileges).<sup>48</sup> Funders are not amici curiae (since they do not make submissions, although they certainly support the position of the funded party in the case).<sup>49</sup> They are certainly not judges, arbitrators, courts, or arbitral institutions (although they do make prima facie determinations about the case that may determine whether the case actually goes forward or not and, therefore, are similar to a judge or arbitrator in that respect).<sup>50</sup> Funders are not third-party beneficiaries of a contract, so they do not have the right to independently enforce the funded party's claim as a non-party to the original contract. Third-party funders would have to purchase the claim outright and become a party through assignment in order to enforce the original contract themselves.<sup>51</sup> And labeling funders as insurers does not quite fit because unlike insurance companies, third-party funders usually do not agree to pay the underlying judgment.<sup>52</sup> Most funders think of themselves as investors, and an investor in litigation or arbitration is a new species of participant—one unanticipated in the existing rules of procedure.<sup>53</sup>

Although funders do not currently fit within any of the preexisting defined roles in litigation or arbitration, they often find themselves pulled into the proceedings either directly or indirectly.<sup>54</sup> For example, most sophisticated funders are already aware of jurisdictions around the world that allow courts and arbitral tribunals to issue cost orders reaching third parties, or jurisdictions that allow litigants or parties to an arbitration to add funders as extra parties in cost proceedings.<sup>55</sup> In some jurisdictions, funders view adverse cost orders or orders for security for costs as simply the price of doing business in that jurisdiction.<sup>56</sup> In

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Ltd., Bentham IMF Ltd., IM Litigation Funding, The Judge Limited, Juridica Investments, and Therium.

48. See *infra* note 119 and accompanying text.

49. See *infra* note 241 and accompanying text.

50. See *infra* note 142 and accompanying text.

51. See *supra* note 21 and accompanying text.

52. See *infra* note 122 and accompanying text.

53. See generally MAX VOLSKY, *INVESTING IN JUSTICE: AN INTRODUCTION TO LEGAL FINANCES, LAWSUIT ADVANCES AND LITIGATION FUNDING* (2013) (describing the third-party funding industry generally and referring to funders as investors throughout the text).

54. See, e.g., *supra* note 30; *infra* note 244.

55. See, e.g., NIEUWVELD & SHANNON, *supra* note 12, at 27–28; Dmytro Galagan & Patricia Živković, *If They Finance Your Claim, Will They Pay Me If I Win: Implications of Third Party Funding on Adverse Costs Awards in International Arbitration*, EUR. SCI. J. 173, 173–81 (2015), <http://ejournal.org/index.php/esj/article/viewFile/5517/5307> [<http://perma.cc/6NYW-CVWH>].

56. See *supra* note 55.

the United States, there are state long-arm statutes and a rather low threshold for personal jurisdiction in light of the e-commerce age.<sup>57</sup> Thus, the funder's monetary contributions and other actions may create the necessary minimum contacts to subject it to the jurisdiction of a U.S. court, or to the ruling of an arbitral tribunal.<sup>58</sup> Indeed, arbitral tribunals have previously issued cost orders against funders based on the local procedural rules at the seat of arbitration, even though the funder has not signed the underlying arbitration agreement.<sup>59</sup> Courts and arbitral tribunals may also be able to exert jurisdiction over third-party funders under doctrines that allow jurisdiction over a nonsignatory to the arbitration agreement or over a nonsignatory to the underlying contract who has a financial interest in the outcome of the dispute.<sup>60</sup>

Moreover, conflicts of interest may arise if a judge or arbitrator is personally or professionally linked to the third-party funder.<sup>61</sup> If the identity of the funder is not disclosed at the outset, then later revelation of the connection could create disastrous and costly results for the parties.<sup>62</sup> From the perspective of our legal system, the main purpose of allowing third-party funders to be involved is to reduce the funded party's cost burden and thus, the party's risk of losing the case.<sup>63</sup> Nondisclosure of a funder's participation to the judge or arbitrator can lead

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57. See generally Eric C. Hawkins, *General Jurisdiction and Internet Contacts: What Role, if Any, Should the Zippo Sliding Scale Test Play in the Analysis?*, 74 *FORDHAM L. REV.* 2371, 2372 (2006) ("survey[ing] fundamental personal jurisdiction concepts and their application in the Internet age"); A. Benjamin Spencer, *Nationwide Personal Jurisdiction for Our Federal Courts*, 87 *DENV. U. L. REV.* 325, 325 (2009) ("[Rule 4] should be amended to provide that [federal] district courts have personal jurisdiction over all defendants who have constitutionally sufficient contacts with the United States . . .").

58. See *supra* note 57.

59. See NIEUWVELD & SHANNON, *supra* note 12 (citing cases in Australia, the United Kingdom, the United States, and other countries in which an arbitral tribunal or court ordered a nonparty funder to pay costs or provide security for costs); *infra* note 244.

60. See, e.g., Alison Ross & Richard Woolley, *Queen Mary Professor Challenges Thinking on Consent*, *GLOBAL ARB. REV.* (May 5, 2015), <http://globalarbitrationreview.com/news/article/33775/queen-mary-professor-challenges-thinking-consent> [<http://perma.cc/8VM3-UCT5>] ("Stavros Brekoulakis present[ed] a paper challenging the orthodoxy that a tribunal can only assume jurisdiction over a nonsignatory to an arbitration agreement with its consent, actual or implied."); see also Stavros Brekoulakis, *Parties in International Arbitration: Consent v. Commercial Reality*, *GLOBAL ARBITRATION REV.* (Apr. 19–21, 2015), [http://globalarbitrationreview.com/cdn/files/gar/articles/Stavros\\_Brekoulakis\\_speech\\_30\\_Anniversary\\_SIA.pdf](http://globalarbitrationreview.com/cdn/files/gar/articles/Stavros_Brekoulakis_speech_30_Anniversary_SIA.pdf) [<http://perma.cc/5C4V-3JGZ>].

61. See *infra* Part I.B (discussing the potential conflicts of interest that could arise due to an undisclosed connection between a judge and a funder, as well as the consequences of nondisclosure).

62. See *id.*

63. See, e.g., *Hamilton Capital VII, LLC, I v. Khorrami, LLP*, No. 650791/2015, 2015 WL 4920281, at \*5 (N.Y. Sup. Ct. Aug. 17, 2015) ("[A]s Justice Bransten explained, courts have

to additional costs for the funded party, thereby contravening the main purpose of allowing third-party funding at all.<sup>64</sup> For example, additional costs may be incurred if a judge is accused of bias under 28 U.S.C. § 144 or has to recuse herself under 28 U.S.C. § 455 because of her connection to a funder.<sup>65</sup> The funded party may also incur costs if an arbitral award or court judgment is challenged based on the appearance of bias of the judge or arbitrator because of some undisclosed connection with the funder, even if there was no actual bias or impropriety.<sup>66</sup> Revising and reinterpreting rules of litigation and arbitration procedures to address the issue of a funder's hidden participation will inform the judge or arbitrator in the case and may prevent problems from arising.

In essence, litigation and arbitration are only two types of dispute resolution funded worldwide.<sup>67</sup> Thus, regulating the participation of third-party funders must consist of revising or reinterpreting the procedural rules for litigation and arbitration—both of which are currently silent on the issue. As mentioned previously, and for the reasons discussed below in Part I.C, this Article proposes (i) reinterpreting certain rules, (ii) revising other rules, and (iii) collecting reports by judges and arbitrators on the results of implementing these revisions and reinterpretations to address issues raised by third-party funding.<sup>68</sup> This Article proposes pragmatic revisions and reinterpretations of the existing language of specific rules regarding discovery, disclosures, privileges, conflicts of interest, cost

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expressly permitted law firms to fund themselves in this manner. Providing law firms access to investment capital where the investors are effectively betting on the success of the firm promotes the sound public policy of making justice accessible to all, regardless of wealth. Modern litigation is expensive, and deep pocketed wrongdoers can deter lawsuits from being filed if a plaintiff has no means of financing her or his case. Permitting investors to fund firms by lending money secured by the firm's accounts receivable helps provide victims their day in court. This laudable goal would be undermined if the Credit Agreement were held to be unenforceable. The court will not do so.”)

64. See *supra* note 61.

65. See 28 U.S.C. § 144 (2012) (addressing bias or prejudice of a judge); 28 U.S.C. § 455 (2012) (addressing the disqualification of a judge due to, among other things, a financial conflict of interest).

66. In litigation, the party would incur costs relating to the time necessary for a new judge to be put into place and familiarize himself or herself with the dispute. In arbitration, the party would incur costs relating to paying the disqualified arbitrator for the time he or she already spent on the case; spending the time necessary to select, vet, and put in place a new arbitrator, and familiarizing the new arbitrator with the dispute.

67. See Shannon, *supra* note 32, at 886 n.137 and accompanying text (stating that funders are unlikely to fund mediation unless the mediation is part of a staged dispute resolution clause that includes litigation or arbitration).

68. See *supra* note 8 and accompanying text (discussing why this article addresses Federal Rules and not state rules of procedure).

allocation, sanctions, class actions, and enforcement.<sup>69</sup> The implementation of these proposals will provide courts and arbitrators with disclosure requirements and a framework for handling conflicts of interest and other known issues as they arise.<sup>70</sup> Additionally, courts, judges, arbitrators, arbitral institutions, and legislators will be able to gain a better sense of the prevalence of third-party funding and its effects (if any) on the dispute resolution system so that they may craft appropriate solutions in the future.

### C. The Debate: Revise or Reinterpret Procedural Rules?

Amending the Federal Rules<sup>71</sup> and amending rules of arbitration<sup>72</sup> are both complex, lengthy processes. As history indicates, revising even one rule may take years.<sup>73</sup> As a result, most rules of arbitration are revised only once or twice within a decade, and the major arbitral institutions have adopted rule revisions recently enough for additional revisions to be many years away.<sup>74</sup>

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69. The Author examined all the Federal Rules of Civil Procedure to determine whether the existence of third-party funding could have an effect on the administration of each rule. The author determined that rules relating to disclosure, discovery, privileges, sanctions, and class actions are the only rules that could potentially be affected by third-party funding. Therefore, this Article focuses only on those rules.

70. See *infra* Part II (addressing issues relating to disclosure frameworks, privileges, sanctions, and class actions).

71. For an overview of the rules revision process, see 28 U.S.C. §§ 2074–75 (2012); *About the Rulemaking Process*, U.S. COURTS, <http://www.uscourts.gov/RulesAndPolicies/rules/about-rulemaking.aspx> [<http://perma.cc/UA6H-5EUV>] (last visited Dec. 16, 2015) (describing “the procedures, governing laws, and membership and meetings of the rules committees”); *Overview for the Bench Bar and Public*, U.S. COURTS, <http://www.uscourts.gov/RulesAndPolicies/rules/about-rulemaking/how-rulemaking-process-works/overview-bench-bar-public.aspx> [<http://perma.cc/BPG3-38XR>] (last visited Dec. 15, 2015) (explaining the entire rules revision process in detail); *Pending Rules Amendments*, U.S. COURTS, <http://www.uscourts.gov/RulesAndPolicies/rules/pending-rules.aspx> [<http://perma.cc/YGL3-YKCF>] (last visited Dec. 15, 2015) (describing the procedures for revising the Federal Rules); *Procedures Governing the Rulemaking Process*, U.S. COURTS, <http://www.uscourts.gov/RulesAndPolicies/rules/about-rulemaking/laws-procedures-governing-work-rules/rules-committee-procedures.aspx> [<http://perma.cc/4JUV-G2SB>] (last visited Dec. 15, 2015) (explaining the process of rule revision in the Standing Committee).

72. See Jason A. Fry & Victoria Shannon, *The 2012 ICC Rules of Arbitration*, in CONTEMPORARY ISSUES IN INTERNATIONAL ARBITRATION AND MEDIATION: THE FORDHAM PAPERS 2011 at 187, 187–201 (Arthur W. Rovine ed., 2012) (describing the complex process for revising the ICC Rules of Arbitration).

73. See *supra* note 71; Fry & Shannon, *supra* note 72.

74. For example, six of the most widely used sets of arbitration rules in the world were revised within the past six years: two were revised in 2014, two in 2013, one in 2012, and one in 2010. See, e.g., *infra* notes 170 and 208, citing provisions from those six sets of arbitration rules.

Observing the effects of third-party funding in the litigation and arbitration systems would be ideal before proposing new rule revisions. The Advisory Committee has taken a similar approach with electronic filing, for example. The Advisory Committee has been observing the growing number of courts allowing or requiring electronic filing of documents, but has intentionally refrained (up to now) from revising the Federal Rules to address this new phenomenon.<sup>75</sup> Indeed, it was only after assessing and observing discovery disputes over electronically stored information (ESI) for several years under the current rules (modified by local case law and local rules) did the Advisory Committee amend the rules to address e-discovery.<sup>76</sup> The amendments aimed to directly address problems with ESI that had arisen in the courts.<sup>77</sup> In the case of third-party funding, more instances need to be observed in the courts and arbitrations over a longer period before comprehensive rule revision proposals can be formulated. The Advisory Committee will probably wait to see how judges (and arbitrators) handle third-party funding, in both positive and negative instances, before revising the Federal Rules.<sup>78</sup>

At present, however, potentially problematic funding arrangements are only revealed in court or during arbitration when the funding agreement is disputed or challenged.<sup>79</sup> Satisfied parties and funders proceed with their arrangements silently because the current rules contain no mechanism for requiring the

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75. *Cf. Advisory Committee on Civil Rules*, U.S. COURTS 29–30 (Apr. 10–11, 2014), <http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/Agenda%20Books/Civil/CV2014-04.pdf> [<http://perma.cc/BW2M-XNE9>] (Reflecting in the minutes of the Nov. 2013 meeting of the Advisory Committee a discussion regarding addressing electronic filings in the Federal Rules: “One reason for caution is the hope that courts and lawyers will be able to work together to develop sensible solutions to problems as they arise, and that this process will provide a better foundation for new rules than more abstract consideration. If there are no general calls for help, no widespread complaints that the rules need to be brought into the present and near future, perhaps there is no need to rush ahead on a broad basis . . . . A committee member suggested that it is worthwhile to look at these questions more thoughtfully, but not immediately. ‘There are issues out there, but they are not yet big issues. Time will bring more information.’ We should do the obvious things now, and find out whether lawyers are complaining about other things. A broader view noted that this discussion reflects a regular pattern in rulemaking. We often confront a choice. We could attempt to anticipate the future and provide for it. Or we can wait and codify what the world has come to do, at least generally. ‘We do want to reflect what people are doing. But perhaps not just yet.’ States ‘may get ahead of us.’ And we can learn from them.”).

76. *See id.* at 369–535 (detailing the history and arguments regarding Proposed Rule 37(e), which addresses evidentiary sanctions for electronically stored information).

77. *See id.*

78. *See supra* note 6 and accompanying text (quoting the Advisory Committee’s reasons for not proposing revisions to the Federal Rules to address third-party funding at this time).

79. *See, e.g., supra* note 35; *infra* note 244.

disclosure and observation of best practices.<sup>80</sup> Thus, observing third-party funding is not systemically possible under the current procedural rules since judges and arbitrators are not routinely informed when third-party funders are involved in a case. As a result, courts and arbitral tribunals are not actively encouraged to identify and observe these cases to see whether the observed problems with third-party funding are widespread or isolated. Thus, unless the procedural rules are revised, there will continue to be insufficient data on the prevalence of third-party funding in U.S. litigation and legislators will be unable to determine whether third-party funding is creating either benefits or problems in the dispute resolution system.

In the interim, litigation and arbitration procedural rules should be revised (or reinterpreted where the existing language suffices) to mandate disclosure to judges and arbitrators to ensure that the decision maker is aware of a funder's involvement in a case heard before her.<sup>81</sup> Judges and arbitrators can then observe the case and develop a sense of what is working or not working about the funder's participation and see how smoothly, efficiently, and fairly the case progresses to a resolution. Judges should be required to report this information, preferably to their districts' delegates to the Judicial Conference of the United States. Established under 28 U.S.C. § 331, the Conference was designed to consider future rule revisions to address problems concerning the business of the courts.<sup>82</sup> Arbitrators have somewhat more flexible procedural standards than judges on the other hand, and can devise procedures and rules tailored to the parties' needs and the needs of the case; they, however, ought to also be notified of the funder's participation in order to disclose potential conflicts of interest, if any.<sup>83</sup> Like judges, arbitrators should be required to report information regarding the participation of third-party funders to the arbitral institutions overseeing their

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80. See *infra* Part II.A (proposing mandatory disclosure of the identity of the third-party funder to the judge so that the judge can check for conflicts of interest and observe the funder's effect, if any, on the proceedings).

81. See *infra* Part II (proposing rule revisions and reinterpretations).

82. See 28 U.S.C. § 331 (2012) (describing the function of the Judicial Conference of the United States, which includes "mak[ing] a comprehensive survey of the condition of business in the courts," "submit[ting] suggestions and recommendations to the various courts to promote uniformity of management procedures and the expeditious conduct of court business," "carry[ing] on a continuous study of the operation and effect of the general rules of practice and procedure now or hereafter in use as prescribed by the Supreme Court for the other courts of the United States pursuant to law," and "recommend[ing] [rule changes] . . . from time to time to the Supreme Court for its consideration and adoption, modification or rejection, in accordance with law.").

83. See *infra* note 216 and accompanying text.

cases.<sup>84</sup> This reporting requirement will help educate those undertaking the lengthy rule revision processes, long before amendments would actually be proposed.

Although rule revision seems to be the most appropriate and beneficial solution, there are some compelling arguments against revising the rules to address third-party funding at this time.<sup>85</sup> First, the Advisory Committee has rightly stated that third-party funding “takes many forms that may present distinctive questions” and that “the questions raised by third-party financing are important [b]ut . . . have not been fully identified, and may change as practices develop further.”<sup>86</sup> Given that third-party funding is an understudied and evolving phenomenon, formulating comprehensive rule revisions at this stage could be viewed as reactionary if those rules largely address observed problems that may be outliers instead of addressing widespread systemic issues to encourage good behavior more effectively.<sup>87</sup> Revising procedural rules based on incomplete information could create new unforeseen problems, particularly this early in the existence of the third-party funding industry.

Similarly, arbitral institutions worldwide are refraining from revising their rules in order to avoid clashing with the applicable national laws regarding third-party funding or the laws of the procedural seat of arbitration, thereby maintaining the trans-substantivity of arbitration rules.<sup>88</sup> The International Bar

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84. In the case of ad hoc arbitration, the arbitrator should report to the appointing authority if there is one involved. If there is no appointing authority, then that particular arbitrator will likely not have a duty to report the involvement of the third-party funder to any outside entity. The arbitrator should, however, have to report to the parties in the ad hoc arbitration if the arbitrator has a conflict of interest with respect to the third-party funder's participation.

85. See CAMPBELL, *supra* note 2, at 3–4.

86. *Id.* at 4.

87. *Cf.* *N. Sec. Co. v. United States*, 193 U.S. 197, 400–01 (1904) (Holmes, J., dissenting) (“Great cases, like hard cases, make bad law. For great cases are called great, not by reason of their real importance in shaping the law of the future, but because of some accident of immediate overwhelming interest which appeals to the feelings and distorts the judgment. These immediate interests exercise a kind of hydraulic pressure which makes what previously was clear seem doubtful, and before which even well settled principles of law will bend.”); *Winterbottom v. Wright* (1842) 152 Eng. Rep. 402, 405 (K.B.) (J. Rolfe concurring) (“This is one of those unfortunate cases in which . . . it is, no doubt, a hardship upon the plaintiff to be without a remedy, but by that consideration we ought not to be influenced. Hard cases, it has been observed, are apt to introduce bad law.”).

88. Arbitration is supposed to transcend substantive laws, but also be compatible with those laws. Parties can choose which arbitration rules to use, which procedural seat to use, and which substantive laws they want the arbitrators to apply to their dispute. There are dozens of arbitration rules in use worldwide, and parties can even fashion their own arbitration procedure by agreement, if they prefer. In this way, arbitration is trans-substantive. Some countries or states

Association (IBA) is the only organization that has revised any arbitration-related rules to address third-party funding.<sup>89</sup> The IBA Guidelines are optional rather than mandatory, however, so the systemic impact of their revisions remains uncertain. In essence, the third-party funding industry is nascent and understudied in the United States and many other jurisdictions around the world, so rule revisions undertaken now may not be thoroughly informed.

The Federal Rules nevertheless authorize “construing” the Federal Rules and allow for local court and judicially-created rules when needed, which may be sufficient to address issues relating to third-party funding.<sup>90</sup> Rule 1, for example, provides that the rules “should be construed and administered to secure the just, speedy, and inexpensive determination of every action and proceeding,”<sup>91</sup> and the revised Rule 1 puts the same duty on the parties to each case.<sup>92</sup> Arbitration rules also contain a similar provision.<sup>93</sup> Furthermore, Rule 83 authorizes the creation of new procedural rules at the grassroots level to address new situations and

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prohibit third-party funding while others allow it. Many more jurisdictions have no laws at all regarding third-party funding. Arbitral institutions cannot adopt arbitration rules that conflict with any of those positions. Moreover, arbitral institutions will likely not change their arbitration rules to address third-party funding, because it would be too difficult to come to a consensus about what the new rule should be. Therefore, arbitral institutions will likely remain neutral and not address third-party funding in their arbitration rules. There will continue to be no uniform way of addressing third-party funding in arbitration. Thus, the best vehicle to address third-party funding in arbitration is through guidelines or codes of best practices. See Jim Saksa, *Victoria Shannon Discusses The State of the Legal Funding Industry at Home and in International Arbitration*, LEGAL FUNDING CENT. 360 (July 31, 2014), <http://legalfundingcentral.com/lfc360/new/legal-funding-expert-victoria-shannon-discusses-state-industry-home-international-arbitration> [<http://perma.cc/668Y-Y3YC>]; cf. *infra* note 299 (regarding the debate over the trans-substantive nature of the Federal Rules of Civil Procedure).

89. See *infra* note 98.

90. See *infra* notes 92 and 94.

91. FED. R. CIV. P. 1.

92. Note that the revised Rule 1 would add a duty on the parties to employ the rules in a cooperative manner. See *Advisory Committee on Civil Rules*, *supra* note 75, at 92–93 (“The published proposal amends Rule 1 to direct that the rules ‘be construed, ~~and~~ administered, and employed by the court and the parties to secure the just, speedy, and inexpensive determination of every action and proceeding . . . .’ Cooperation among the parties was a theme heavily and frequently emphasized at the Duke Conference. It has been vigorously urged, and principles of cooperation have been drafted by concerned organizations. There is little opposition to the basic concept of cooperation . . . . A more specific question, largely ignored in the comments, asks whether the parties should be directed to construe and administer the rules, as well as to employ them, to the desired ends. The rule could be written: ‘construed and administered by the court, and employed by the parties, to secure \* \* \*’ But on balance it seems better to retain the hint that the parties should undertake to construe the rules for their intended purposes, and—to the extent that the parties commonly administer the rules, as in discovery—to administer them for the same purposes.”) (asterisks and strikethrough in original).

93. See, e.g., *infra* note 291.

needs.<sup>94</sup> For example, Rule 83(a) grants district courts the ability to make their own local rules if there is no preexisting federal rule on the subject, and Rule 83(b) states that “a judge may regulate practice in any manner consistent with federal law, rules adopted under 28 U.S.C. § 2072 [rules made by the U.S. Supreme Court], and § 2075 [bankruptcy rules], and the district’s local rules.”<sup>95</sup> Thus, litigation and arbitration procedural rules already give judges and arbitrators the authority to construe and apply the existing rules, or to create new local rules (or case-specific rules in arbitration) to take into account third-party funding. In fact, some perceptive judges have occasionally asked parties outright if a funder is involved when they suspect that might the case.<sup>96</sup> The main disadvantage of these local or ad hoc approaches, however, is that conflicting judicial practices on third-party funding could lead to confusion over how third-party funding is or should be handled by federal courts.

Finally, there is another hurdle to clear before rule revision would be effective: Writing an effective Federal Rule or rule of arbitration likely requires coming up with a definition of “third-party funding” or “third-party funder,” and this has proved to be very difficult.<sup>97</sup> An example of a recent attempt to define “third-party funder” can be found in the revised IBA Guidelines on Conflicts of Interest in International Arbitration, addressing arbitrator conflicts of interest.<sup>98</sup> The explanation to one of the Guidelines states that a third-party funder “may have a direct economic interest in the award” and would be “any person or entity that is contributing funds, or other material support, to the prosecution or

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94. See FED. R. CIV. P. 83 (authorizing district courts to “adopt and amend rules governing its practice,” providing that “[a] local rule must be consistent with—but not duplicate—federal statutes and rules,” and authorizing that “[a] judge may regulate practice in any manner consistent with federal law, [the Federal Rules of Civil Procedure, the bankruptcy rules], and the district’s local rules.”).

95. See *id.*

96. Cf. *Abu-Ghazaleh v. Chaul*, 36 So. 3d 691, 693–94 (Fla. Dist. Ct. App. 2009) (exemplifying a case in which a judge directly investigated the involvement of the financier and concluded that the financier should be treated as a party).

97. Cf. *infra* note 292 and accompanying text (exemplifying a global task force that is attempting to devise a definition of third-party funding).

98. See INT’L BAR ASS’N, IBA GUIDELINES ON CONFLICTS OF INTEREST IN INTERNATIONAL ARBITRATION 13–25 (2014) [http://www.ibanet.org/Publications/publications\\_IBA\\_guides\\_and\\_free\\_materials.aspx](http://www.ibanet.org/Publications/publications_IBA_guides_and_free_materials.aspx) [<http://perma.cc/W6QP-ESAY>] [hereinafter “IBA GUIDELINES”] (referencing third-party funding as: “a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration” in the General Standard 6, Explanation to General Standard 6, and General Standard 7; “a direct economic interest in the award to be rendered in the arbitration” in the Explanation to General Standard 7, Non-Waivable Red List § 1.2, Orange List § 3.4.3; and “a direct economic interest in the award” in the Orange List § 3.4.4).

defence [sic] of the case and that has a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration.”<sup>99</sup> This definition was coined in the context of international arbitration, but it is relevant to litigation as well. Nevertheless, this definition is both overinclusive—lumping third-party funders together with regular bank loans and insurance policies containing “duty to defend” provisions—and underinclusive—given the potential for third-party funding transactional structures to fall outside this definition.

Regardless, even before a clear definition can be articulated, the words “third-party funding” and “third-party funder” may be used to write and implement effective rules to address this phenomenon. Take the U.S. constitutional “obscenity” test for publications as an example. One could say the obscenity test—that is, determining when a publication is obscene—takes a “know it when you see it” approach to the definition of the term “obscenity,” and this is likely appropriate for third-party funding as well.<sup>100</sup> Such a test would be easy to apply because parties know when they are funded and funders know when they are funding, regardless of the structure of the arrangement. Thus, the rules could direct parties to disclose the existence of their funding arrangement without having to define “third-party funding” or “third-party funder” explicitly in the rules. For example, Rule 26(a)(1)(A)(iv) already requires disclosure of a defendant’s insurance arrangement, where the insurer is potentially liable for paying for the judgment.<sup>101</sup> Yet, the Federal Rules do not define the word “insurance,” rightfully presuming that defendants know whether they are insured.<sup>102</sup> Similarly, Rule 26(b)(3)(A) limits disclosure of trial preparation documents and protects documents prepared by other representatives or entities assisting a party such as a “consultant, surety, indemnitor, insurer, or agent” without defining any of those terms.<sup>103</sup> This approach has proved successful. Thus, effective rule revisions may not require defining “third-party funder” or “third-party funding” in order to

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99. *Id.* at 14–15.

100. *See, e.g., Miller v. California*, 413 U.S. 15, 39 (1973) (Douglas, J., dissenting) (“But even those members of this Court who had created the new and changing standards of ‘obscenity’ could not agree on their application. And so we adopted a *per curiam* treatment of so-called obscene publications that seemed to pass constitutional muster under the several constitutional tests which had been formulated. Some condemn it if its ‘dominant tendency might be to ‘deprave or corrupt’ a reader.’ Others look not to the content of the book but to whether it is advertised “to appeal to the erotic interests of customers.” Some condemn only ‘hardcore pornography’; but even then a true definition is lacking. It has indeed been said of that definition, ‘I could never succeed in [defining it] intelligibly,’ but ‘I know it when I see it.’”) (internal footnotes omitted).

101. *See* FED. R. CIV. P. 26(a)(1)(A)(iv).

102. *See id.*

103. *See* FED. R. CIV. P. 26(b)(3)(A).

achieve the baseline goals of encouraging the disclosure, observation, and reporting of third-party funding instances.

In sum, there are appropriate rule revisions that deserve future consideration and even without revisions, judges and arbitrators can use their inherent powers under the existing rules to address third-party funding. In particular, judges and arbitrators can observe how third-party funding affects dispute resolution until the Advisory Committee and arbitral institutions decide to address it directly in the procedural rules.<sup>104</sup>

## II. THE SOLUTION: PROPOSED RULE REVISIONS AND REINTERPRETATIONS IN LIGHT OF THIRD-PARTY FUNDING

This Part proposes revisions to the Federal Rules of Civil Procedure where appropriate and gives guidance to judges regarding how to interpret and administer the existing Federal Rules when they encounter third-party funding in a case.<sup>105</sup> This Part also proposes revisions to rules of arbitration and incorporates guidance to arbitrators regarding how to handle third-party funding under the existing rules of arbitration procedure.

This Article addresses litigation and arbitration together for several reasons. First, at its foundation, arbitration is a quasi-judicial process, as rules of litigation have informed the development and interpretation of rules of arbitration worldwide.<sup>106</sup> Second, arbitration relies on courts to perform many essential procedural functions that either arbitrators do not have the power to perform or the parties choose to have the court perform instead, such as issuing subpoenas,

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104. See *supra* note 88.

105. See *supra* notes 4–6 and accompanying text.

106. See e.g., *Dispute Settlement: 5.1: International Commercial Arbitration*, U.N. CONF. TRADE & DEVELOPMENT 19 (2005), [http://unctad.org/en/Docs/edmmisc232add38\\_en.pdf](http://unctad.org/en/Docs/edmmisc232add38_en.pdf) [http://perma.cc/A9PV-YAD2] (“Most societies developed at an early date systems [sic] of ‘arbitration’ for the settlement of disputes. Disputes between private parties that are settled by arbitration might be of a family nature, concern labor relations or be between two commercial enterprises. In the past such disputes were almost exclusively domestic and the systems of arbitration that developed reflected the nature of the particular society. It is no surprise, therefore, to find vast differences between domestic arbitration in Continental Europe, Latin America, Islamic countries, the United States and China. In some countries, particularly in Latin America and in England, arbitration was traditionally seen as an extension of the State system of litigation. In such an atmosphere the procedure followed in arbitration was necessarily closely modelled on the procedure followed in litigation in the courts. Even where arbitration was not seen as an extension of the State system of litigation, and the law did not require the local court procedure to be followed in arbitration, the habits developed by lawyers in the courts were carried over into arbitration.”).

attaching assets, issuing injunctions, enforcing an arbitration agreement, and recognizing or enforcing arbitral awards.<sup>107</sup> Thus, the two processes are never completely separate and ultimately dovetail at the enforcement stage.<sup>108</sup> Third, arbitration either borrows privilege rules from the domestic court system of the seat of arbitration or implements tailored privilege rules chosen by the parties.<sup>109</sup> There are no privilege rules specific to arbitration.<sup>110</sup> Fourth, both judges and arbitrators need disclosure from the funded party in order to carry out their duties with respect to handling conflicts of interests as they relate to third-party funding.<sup>111</sup> Fifth, many procedural devices that may be affected by third-party funding are used in both litigation and arbitration, such as class actions, cost sanctions, and fee shifting.<sup>112</sup> Finally, courts enforce both judgments and arbitration awards; arbitrators and arbitral institutions have no power to enforce the awards they issue.<sup>113</sup>

As discussed in the upcoming Subparts, pragmatic revisions and reinterpretations of the rules of litigation and arbitration procedure should be made in a number of areas as a result of the third-party funding phenomenon:

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107. See Shannon, *supra* note 32, at 886–88 (describing various essential functions that courts perform with respect to arbitration proceedings).

108. See *infra* Part II.D.

109. See Klaus Peter Berger, *Evidentiary Privileges: Best Practice Standards Versus/ and Arbitral Discretion*, 22 ARB. INT'L 501, 501 (2006) (“It has been said about the determination of privileges in international commercial arbitration that ‘[t]he only thing that is clear is that nothing is clear in this area’, that the law of evidentiary privileges in international arbitration is ‘substantially unsettled’ and that ‘there is very little authority addressing how international arbitrators should proceed when presented with a claim of privilege.’”) (internal footnotes omitted); Richard M. Mosk & Tom Ginsburg, *Evidentiary Privileges in International Arbitration*, 50 INT'L & COMP. L.Q. 345, 345 (2001) (“Evidentiary rules employed in judicial proceedings are not strictly applied in international arbitration. Although this flexibility with regard to evidentiary matters is often considered a benefit of international arbitration, in certain situations it can lead to unpredictability and conflicts with national law.”); Jack M. Sabatino, *ADR as “Litigation Lite”: Procedural and Evidentiary Norms Embedded Within Alternative Dispute Resolution*, 47 EMORY L.J. 1289, 1335 (1998) (“Trade secrets, lawyer-client communications, attorney work-product, self-incrimination rights, marital privacy, and other privileged matters may warrant protection during the course of the arbitration, mediation, or other form of ADR. . . . [A] few statutory and court-annexed ADR provisions mirror court rules of evidence by allowing the participants to invoke specific privileges within the ADR process. Likewise, some private ADR rules expressly honor privilege claims.”); see also *infra* Part II.A.

110. See *supra* note 109.

111. See *infra* Part II.B.

112. See *infra* Part II.C.

113. See *infra* note 282 and accompanying text; see also *infra* Part II.D (regarding the enforcement of arbitral awards).

discovery, disclosures, privileges, conflicts of interest, cost allocation, sanctions, class actions, and enforcement.

### A. Judging Discovery, Disclosures, and Privileges

#### 1. Litigation: Initial Disclosures, Pretrial Conferences, and Evidentiary Privileges

The unifying theme of all calls to regulate third-party funding is some form of disclosure, but many more questions are raised by calls for disclosure than are answered by them. When must information be disclosed? And to whom: the decision maker or the opposing side? What information should be disclosed: the identity of the funder, a summary of the terms of the funding agreement, or the actual text of the agreement? Should evidentiary privileges extend to privileged information that parties disclose to funders or to work product created by funders? These questions may be answered by examining Rule 26, Rule 16, and privileges under U.S. common law.

The purpose of Rule 26 is to guide the parties through the process of discovery and disclosure.<sup>114</sup> Rule 26(f) also instructs the parties to agree on a discovery plan during a pretrial conference separate from the conference required by Rule 16, although both conferences together may result in a joint plan for discovery and scheduling.<sup>115</sup> Rule 26(b)(1) limits discovery to any “nonprivileged matter that is relevant to any party’s claim or defense.”<sup>116</sup> Rule 26 does not define the term “relevant,” but the Advisory Committee Notes to the 2000 amendments to Rule 26 state that the focus of discovery should be the actual claims and defenses in the action, and that discovery should not be used to develop new claims or defenses not already pled.<sup>117</sup> In light of this, the existence or terms of the funding agreement would not be relevant or material to any of the

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114. See *infra* note 131 and accompanying text.

115. See FED. R. CIV. P. 26(f); see also *infra* note 158 (regarding the FED. R. CIV. P. 16 pretrial conference).

116. See FED. R. CIV. P. 26(b)(1). A 2015 revision to FED. R. CIV. P. 26(b)(1) includes a proportionality element, but should not change the effect on third-party funding because the phrase “the parties’ resources” remains in the rule. See *Advisory Committee on Civil Rules, supra* note 75, at 79–93, (discussing proposed revisions to Rule 26), 97–105 (presenting actual markup of revisions to Rule 26).

117. See FED. R. CIV. P. 26(b)(1) advisory committee’s note to 2000 amendment.

pled claims and defenses relating to the merits of the case.<sup>118</sup> Funders are also not witnesses or experts subject to disclosure, as they will not testify at trial and are not employed as experts by the parties.<sup>119</sup> Thus, third-party funding ordinarily would not be subject to general discovery or initial disclosure under the language of Rule 26.<sup>120</sup>

Fed. R. Civ. P. 26(a)(1)(A) governs initial disclosures that parties must make to one another at the outset of their dispute.<sup>121</sup> Rule 26(a)(1)(A)(iv) requires a party in discovery to disclose any insurance agreement where the insurer is potentially liable for paying or reimbursing the insured party for all or part of the judgment.<sup>122</sup> The rule contemplates insurers who would pay the underlying judgment if the defendant loses.<sup>123</sup> The Advisory Committee Notes from the time of the adoption of this disclosure requirement impose the following limitations on the insurance disclosure requirement:

The amendment is limited to insurance coverage, which should be distinguished from any other facts concerning defendant's financial status (1) because insurance is an asset created specifically to satisfy the claim; (2) because the insurance company ordinarily controls the litigation; (3) because information about coverage is available only from defendant or his insurer; and (4) because disclosure does not involve a significant invasion of privacy. Disclosure is required when the insurer "may be liable" on part or all of the judgment . . . . The provision applies only to persons "carrying on an insurance business" and thus covers insurance companies and not the ordinary business concern that enters into a contract of indemnification. Thus, the provision makes no change in existing law on discovery of indemnity agreements other than insurance agreements by persons carrying on an insurance business. Similarly, the provision does not cover the business concern that creates a reserve fund for purposes of self-insurance . . . . The insurance application may contain personal and financial information concerning the insured, discovery of which is

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118. This is separate from the party disclosing this identity of the funder to the judge, *in camera*, under the proposed revisions to FED. R. CIV. P. 7.1 and 28 U.S.C. § 455 (2012). *See infra* Part II.B.1.

119. *See* FED. R. CIV. P. 26(a)(3)(A) (regarding witnesses that must be disclosed) and FED. R. CIV. P. 26(a)(2) (regarding experts that must be disclosed).

120. *See* FED. R. CIV. P. 26(b)(1) advisory committee's note to 2000 amendment (stating that the parties cannot use discovery to develop new claims or defenses).

121. *See generally* FED. R. CIV. P. 26(a)(1)(A) (outlining initial required disclosures that parties must make).

122. *See* FED. R. CIV. P. 26(a)(1)(A)(iv).

123. *See id.*

beyond the purpose of this provision. In no instance does disclosure make the facts concerning insurance coverage admissible in evidence.<sup>124</sup>

Based on the foregoing explanation from the Advisory Committee, third-party funding agreements are not required to be disclosed under Rule 26(a)(1)(A)(iv). Third-party funders only finance legal expenses and costs, so the litigation funding agreement is not an asset created specifically to satisfy the claim.<sup>125</sup> In the rare instance that a funder agrees to pay the underlying judgment, the funding agreement might be classified as liability insurance and subject to disclosure under Rule 26(a)(1)(A)(iv) but only if the funder is deemed to be carrying on an insurance business.<sup>126</sup> Furthermore, if the funder is deemed to be an ordinary business concern that enters into a contract of indemnification and not carrying on an insurance business, then disclosure is not required under Rule 26(a)(1)(A)(iv).<sup>127</sup> Finally, unlike an insurance company, the third-party funder ordinarily refrains from controlling the litigation in order to avoid running afoul of attorney ethics rules.<sup>128</sup> Thus, Rule 26(a)(1)(A)(iv) does not implicate traditional third-party funding agreements.<sup>129</sup>

The Advisory Committee declined to further pursue an outside, formal proposal to amend Fed. R. Civ. P. 26(a)(1)(A) that would require disclosure of third-party funding agreements to the opposing party for inspection and copying.<sup>130</sup> The Advisory Committee made the right choice because the proposal did not align with the purpose and goals of Rule 26 and could have led to satellite litigation.<sup>131</sup> The first three required initial disclosures listed under the

124. FED. R. CIV. P. 26, advisory committee's notes to 1970 amendment.

125. *See id.*

126. *See id.*

127. *See id.*

128. *See id.*

129. A third-party funding agreement involving an assignment of a claim or liability to the funder might fall within Rule 26(a)(1)(A)(iv) depending on the structure of the agreement. *See supra* notes 17, 21, and 46, and *infra* note 133 for a primer on the implications of third-party funding agreements involving assignment. A detailed discussion of such arrangements is outside the scope of this Article.

130. *See supra* note 6 and accompanying text; *see also* Letter from the U.S. Chamber Inst. for Legal Reform et al., to Jonathan C. Rose, Sec'y of the Comm. on Rules of Practice and Procedure, at 8, (Apr. 9, 2014), <http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/cv-suggestions-2014/14-CV-B-suggestion.pdf> [<http://perma.cc/X34P-94RF>] [hereinafter Letter].

131. *See* FED. R. CIV. P. 26(a)(1) advisory committee's note to 2000 amendment ("Purposes of amendments. The Rule 26(a)(1) initial disclosure provisions are amended to establish a nationally uniform practice. *The scope of the disclosure obligation is narrowed to cover only information that the disclosing party may use to support its position.* In addition, the rule exempts specified categories of proceedings from initial disclosure, and permits a party who contends that disclosure is not appropriate in the circumstances of the case to present its objections to the court, which must then

existing rule all relate to witnesses or evidence that will be presented at trial, while the fourth addresses insurance agreements that may be used to satisfy, indemnify, or reimburse all or part of the monetary judgment.<sup>132</sup> The funding agreement does not relate to witnesses or evidence that will be presented at trial, and the vast majority of nonparty litigation funders do not agree to pay the underlying judgment.<sup>133</sup> In addition, as mentioned above, under Fed. R. Civ. P. 26(b)(1), the terms of the funding agreement are not relevant to any party's claim or defense nor would disclosure of the terms of the funding agreement lead to the discovery of admissible evidence.<sup>134</sup> Thus, the proposal falls outside the purpose and goals of Rule 26 as a whole.<sup>135</sup> Furthermore, such an amendment would likely lead to satellite litigation over the terms of the funding agreement or to the parties comparing and contrasting the terms of their funding agreements if both sides are funded in the case.<sup>136</sup> In sum, the proposed amendment was not the right

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determine whether disclosure should be made.”) (emphasis added); *infra* note 136 (listing sources discussing the dangers of satellite litigation over the funding arrangement).

132. FED. R. CIV. P. 26(a)(1)(A)(i) (requiring disclosure of “the name . . . address and telephone number of each individual likely to have discoverable information . . . that the disclosing party may use to support its claims or defenses . . .”); FED. R. CIV. P. 26(a)(1)(A)(ii) (requiring disclosure of “a copy . . . of all documents, electronically stored information, and tangible things that the disclosing party . . . may use to support its claims or defenses . . .”); FED. R. CIV. P. 26(a)(1)(A)(iii) (requiring “a computation of each category of damages claimed by the disclosing party” and “the documents or other evidentiary material . . . on which each computation is based, including materials bearing on the nature and extent of injuries suffered”); FED. R. CIV. P. 26(a)(1)(A)(iv) (requiring disclosure of “any insurance agreement under which an insurance business may be liable to satisfy all or part of a possible judgment in the action or to indemnify or reimburse for payments made to satisfy the judgment.”).
133. If the funder has purchased an assignment of the claim or liability, then the funder has agreed to pay the underlying judgment (if any) and would be named as a party to the case. Most funders are not parties, however, and do not agree to pay the underlying judgment, even on the defense side. *See* NIEUWVELD & SHANNON, *supra* note 12, at 5–6. This is different from a liability insurance arrangement in which the insurer does agree to pay the judgment. If a third-party funder does agree to pay the underlying judgment, then that agreement would be subject to disclosure under the existing FED. R. CIV. P. 26(a)(1)(A)(iv).
134. *See* FED. R. CIV. P. 26(b)(1) (“Parties may obtain discovery regarding any nonprivileged matter that is relevant to any party’s claim or defense . . . Relevant information need not be admissible at the trial if the discovery appears reasonably calculated to lead to the discovery of admissible evidence.”).
135. *See supra* note 131.
136. *See, e.g., Satellite Litigation*, ATHERTON GODFREY SOLICITORS, <http://www.athertongodfrey.co.uk/satellite-litigation> [<http://perma.cc/FN4E-GBE8>] (last visited Dec. 16, 2015) (“Satellite litigation can take up more than an ‘appropriate share of the Court’s resources’, tends not to help with either expedition or the saving of expense and perhaps more than anything leads to disproportionality. Recent years have seen many of the issues arising from the last significant procedural and funding reforms gradually resolved, though not without much satellite litigation on the way. It would be regrettable if further proposed

solution and would likely have distracted the parties from pursuing the merits of their underlying dispute.

While the funding agreement may not be discoverable and disclosure of its terms may not be required, a funder's participation may be relevant to a court assessing the parties' resources when determining whether to limit the frequency and extent of discovery.<sup>137</sup> This is important because the participation of the funder may indicate that the party has more resources for litigation costs—including discovery—than its personal financial status may suggest. Alternatively, if the term "resources" is not construed to include sources of third-party funding, then Rule 26(b)(2)(C)(iii) should be revised to include third-party funding expressly.<sup>138</sup>

Rule 26 also addresses privileges, which are another source of uncertainty in procedural rules with respect to third-party funding. The main privileges that would protect a party's documents and information in federal court would be the attorney-client privilege and the work-product doctrine.<sup>139</sup> Both privileges are subject to waiver by disclosure of the document or information to a third party, unless an exception to waiver applies.<sup>140</sup> The exceptions to waiver listed in

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changes lead to a similar period of uncertainty, cost and delay."); LAW COUNCIL OF AUSTRALIA, REGULATION OF THIRD PARTY LITIGATION FUNDING IN AUSTRALIA 3 (2011), <http://www.lawcouncil.asn.au/lawcouncil/images/LCA-PDF/a-z-docs/RegulationofthirdpartylitigationfundinginAustralia.pdf> [<http://perma.cc/2FKF-GURP>] ("The purpose of the paper was to set out areas in which regulation may be required for consumer protection, to minimise conflicts of interest and put an end to expensive satellite litigation over the propriety of litigation funding agreements."); *Litigation Funding*, SIMPSON GRIERSON FYI. at 1 (Oct. 2012) <http://www.simpsongrierson.com/assets/sm/upload/6p/ka/pc/bq/FYI%20Litigation%20-%20Litigation%20Funding%20October%202012.pdf> [<http://perma.cc/MR25-6N79>] ("Strategically minded defendants are also interested in knowing about the plaintiffs' funding arrangements, so as to be able to undermine them and potentially defeat even meritorious claims through satellite litigation.").

137. See FED. R. CIV. P. 26(b)(2)(C)(iii); cf. Letter, *supra* note 130, at 4–5 (discussing the potential for cost-shifting for "complex discovery disputes" if a third-party funder is involved).
138. For example, FED. R. CIV. P. 26(b)(2)(C)(iii) could be revised to say "the parties' resources (including third-party funding)."
139. See FED. R. EVID. 502(g) (defining "attorney-client privilege" and "work-product protection"). Other privileges—such as the doctor-patient, priest-penitent, and accountant-client privileges—would not apply to third-party funding. Also, note that FED. R. EVID. 502 applies in diversity cases and in state courts. FED. R. EVID. 502(f).
140. See FED. R. EVID. 502 (stating that the exceptions to waiver of the attorney-client privilege and the work-product doctrine are: disclosure in a separate federal proceeding [502(a)], disclosure to a federal office or agency [502(a)], inadvertent disclosure [502(b)], disclosure in a separate state proceeding [502(c)], a court order stating that the privilege is not waived [502(d)]; an agreement among the parties stating that the effect of disclosure is not waiver of the privilege [502(e)]). Also, note that FED. R. EVID. 502 applies in diversity cases and in state courts. FED. R. EVID. 502(f).

Federal Rule of Evidence 502 do not expressly include disclosure of the privileged information to a third-party funder.<sup>141</sup>

In order to determine whether to fund a case, funders may require parties to divulge information about their case that may be privileged under applicable law.<sup>142</sup> There is currently no rule that includes the funder within the exceptions to waiver of evidentiary privileges; thus, privileged documents or information may become discoverable by the opposing side once the party discloses them to the funder.<sup>143</sup> At least one federal district court has stated that a preexisting confidentiality agreement between the funder and the funded party may protect the disclosed information under the work-product doctrine, but not under the attorney-client privilege.<sup>144</sup> In the absence of a clear rule, however, parties may be wary about seeking funding for fear that they will waive their privileges by sharing information with a prospective funder.

The evidentiary privileges applied in federal courts, and the exceptions to waiver of those privileges, derive from sources of law outside the Federal Rules of Civil Procedure.<sup>145</sup> Federal common law privileges can be amended by federal judges on a case-by-case basis, but each state's legislature or supreme court would have to amend the exceptions to waiver of its common law attorney-client privilege and work-product doctrine in order to reach disclosures made to the funder.<sup>146</sup> This solution would increase the security of confidential information that a party must share with potential funders, without penalizing the party for seeking funding by protecting against the potential waiver of its evidentiary privileges. In the interim, under Rules 16 and 26(f), parties may discuss and make an agreement regarding the applicability of evidentiary privileges and

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141. See FED. R. EVID. 502.

142. See NIEUWVELD & SHANNON, *supra* note 12, at 20–21, 23.

143. See generally *Miller UK Ltd. v. Caterpillar, Inc.*, 17 F. Supp. 3d 711 (N.D. Ill. 2014) (upholding protection under the work product doctrine for documents disclosed to the funder due to a preexisting confidentiality agreement between the client and the funder, but not upholding protection under the attorney-client privilege, because the court did not view the funder as falling within the “common interest” exception to waiver). It is important to note, however, that federal district court opinions do not create binding precedent on other jurisdictions. Thus, the confidentiality agreement may or may not be sufficient to protect against the waiver of privileges, depending on the jurisdiction.

144. See *id.*

145. See FED. R. EVID. 501 (stating that federal common law governs privileges in federal court, unless the Constitution, a federal statute or the Supreme Court provides otherwise; in diversity cases, “for which state law supplies the rule of decision,” state law governs privileges in federal court; Federal Rules of Civil Procedure do not govern privileges in those cases); FED. R. EVID. 502 (discussing the codified exceptions to waiver of the attorney-client privilege and the work-product doctrine).

146. See *supra* note 145.

exceptions to waiver for information disclosed to the funder.<sup>147</sup> The parties should also strongly consider asking the judge to memorialize their agreement in a court order.<sup>148</sup> While it may be rare in practice for parties to be able to agree on evidentiary privileges, it is important to recognize that an agreement between the parties about evidentiary privileges would be recognized as binding according to the existing Federal Rules.<sup>149</sup> Thus, parties should feel empowered to decide the effect of third-party funding on privileges in their particular case and, indeed, they should be encouraged to do so in light of their duty under the revised Rule 1.<sup>150</sup>

Regardless, although the privileges and protections for the funded party's documents and information are presently unclear, the documents and information prepared *by the funder* are clearly protected by Rule 26.<sup>151</sup> The work-product doctrine codified in Rule 26(b)(3)(A) prohibits discovery of "documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative[s]," except in exigent circumstances.<sup>152</sup> Furthermore, the rule states that the term "representative[s]" includes a "consultant, surety, indemnitor, insurer, or agent."<sup>153</sup> At a minimum, a funded party consults the funder about the financial aspects of the case, so a funder likely falls within the consultant subcategory of representatives.<sup>154</sup> The funder may fall within other subcategories depending on the structure of the arrangement and the actual services the funder provides to the funded party. Furthermore, Rule 26(b)(3)(B) protects the representatives' "mental impressions, conclusions, opinions, or legal theories."<sup>155</sup> Thus, documents and information created by the funder with respect to a potential or current funded party would already be

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147. See FED. R. CIV. P. 16(b)(3)(B)(iv) (2015 revision); FED. R. CIV. P. 26(f)(3)(D) (2015 revision); FED. R. CIV. P. 16 advisory committee's note to 2015 amendment ("The [Rule 16(b) scheduling] order also may include agreements incorporated in a court order under Evidence Rule 502 controlling the effects of disclosure of information covered by attorney-client privilege or work-product protection, a topic also added to the provisions of a discovery plan under Rule 26(f)(3)(D)."); FED. R. CIV. P. 26 advisory committee's note to 2015 amendment ("Rule 26(f)(3) is amended in parallel with Rule 16(b)(3) to add two items to the discovery plan—issues about preserving electronically stored information and court orders under Evidence Rule 502.").

148. See *supra* note 147 and accompanying text (discussing applicable revisions to Rules 16 and 26).

149. See *id.*

150. See *supra* note 36 and accompanying text (discussing an applicable revision to Rule 1).

151. See *supra* note 103 and accompanying text.

152. FED. R. CIV. P. 26(b)(3)(A).

153. *Id.*

154. See *id.*

155. FED. R. CIV. P. 26(b)(3)(B).

protected under the existing rule.<sup>156</sup> This existing protection also further implies that the exceptions to waiver of the common law attorney-client privilege and work-product doctrine should be amended to extend to disclosures made to the funder.

Nevertheless, despite the unclear status of evidentiary privileges for client documents and information disclosed to funders, the parties can make an enforceable agreement during their pretrial conference regarding how such information will be handled in their case.<sup>157</sup> Rule 16 gives the court the authority to order the parties to hold a pretrial conference to work out many issues, including disclosures, scheduling, and other issues before trial.<sup>158</sup> Rule 16 further stipulates, among other things, that parties may make an agreement to modify the extent of discovery,<sup>159</sup> honor claims of privilege over documents or protection over trial preparation materials,<sup>160</sup> and handle other appropriate matters as they agree.<sup>161</sup> In addition, courts may consider and take action on “facilitating in other ways the just, speedy, and inexpensive disposition of the action.”<sup>162</sup> Courts may also impose sanctions under Rule 16(f)(1)(C) against a party or a party’s attorney (but not a funder) for failure to obey a scheduling or other pretrial order.<sup>163</sup> This is reasonable because the funder does not appear or present documents or testimony in the case.

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156. See *supra* note 144; see also *supra* note 103 and accompanying text.

157. See FED. R. EVID. 502(e) (providing that a party agreement regarding the “disclosure of a communication or information covered by the attorney-client privilege or work-product protection” may be “incorporated into a court order”); FED. R. CIV. P. 16(b)(3)(B)(iv) (revised on Dec. 1, 2015 to “includ[e] agreements reached under Federal Rule of Evidence 502”); FED. R. CIV. P. 26(f)(3)(D) (revised on Dec. 1, 2015 to include parties “ask[ing] the court to include their agreement in an order under Federal Rule of Evidence 502”); see also *supra* notes 147–150 and accompanying text. This solution addresses the situation in which a funding agreement was signed before the case was first filed. It is important to note that funders also may fund pending cases or cases that already have been filed. In addition, defense-side funders often have to make a decision regarding whether to fund the defendant after the case has been filed, since the defendant may not even be aware of the dispute until the case is filed. Cf. Molot, *supra* note 23, at 378–439 (proposing defense-side funding in the United States that would be similar to after-the-event insurance in Europe); Bernardo M. Cremades, Jr., *Third Party Litigation Funding: Investing in Arbitration*, TRANSNAT’L DISP. MGMT., Oct. 2011, at 16–25 (discussing several arrangements for defense-side funding in which the funder is only paid if the defendant/respondent wins the case).

158. See FED. R. CIV. P. 16(a) (“[T]he court may order the attorneys and any unrepresented parties to appear for one or more pretrial conferences . . .”).

159. See FED. R. CIV. P. 16(b)(3)(B)(ii).

160. See FED. R. CIV. P. 16(b)(3)(B)(iv).

161. See FED. R. CIV. P. 16(b)(3)(B)(vi).

162. FED. R. CIV. P. 16(c)(2)(P).

163. See FED. R. CIV. P. 16(f)(1)(C).

Under the existing Rule 16, the parties can make an agreement regarding how the disclosure of the funding arrangement will be handled and whether documents shared with or prepared by funders would be protected under either the attorney-client privilege or the work-product doctrine.<sup>164</sup> Such an agreement may be memorialized in a discovery plan under Rule 26(f)(3).<sup>165</sup> The parties are most likely willing to make such an agreement when funders back both sides. If the agreement is memorialized in a scheduling order, then the party or the party's attorney could be sanctioned by the court for noncompliance.<sup>166</sup> While the existing wording of Rule 16 provides a catchall that would cover third-party funding,<sup>167</sup> it would be clearer to revise the rule to add language referencing third-party funding to the lists under Rule 16(b)(3)(B) and Rule 16(c)(2).<sup>168</sup> If the parties make no agreement under Rule 16 about the treatment of documents disclosed to and prepared by the funder, then the foregoing discussion suggests that the default position for federal courts regarding those documents should be that they are privileged in the absence of an express waiver by the funded party.

## 2. Arbitration: Evidentiary Disclosures and Privileges

Currently no rules of arbitration require disclosing the participation of a third-party funder to the opposing party as a matter of general evidentiary disclosure.<sup>169</sup> The arbitrators, in consultation with the parties and in compliance with the arbitration clause, govern all rules of evidentiary disclosure and

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164. See *Advisory Committee on Civil Rules*, *supra* note 75, at 91 (discussing additions to Rule 16(b)(3): “The proposal also adds two subjects to the list of contents permitted in a scheduling order: the preservation of ESI, and agreements reached under Evidence Rule 502. Parallel provisions are added to the subjects for discussion at the parties’ Rule 26(f) conference.”); *id.* at 96–97 (presenting the markup of the revisions to Rule 16 and the Committee Notes, which state, “The [scheduling] order also may include agreements incorporated in a court order under Evidence Rule 502 controlling the effects of disclosure of information covered by attorney-client privilege or work-product protection, a topic also added to the provisions of a discovery plan under Rule 26(f)(3)(D).”).

165. See *supra* note 164.

166. See FED. R. CIV. P. 16(f)(1)(C).

167. See *supra* note 161.

168. See FED. R. CIV. P. 16(b)(3)(B) (describing permitted contents of a scheduling order); FED. R. CIV. P. 16(c)(2) (listing matters for consideration at a pretrial conference).

169. If the parties choose for the IBA Rules to apply to the arbitration, then the funded party will be required to disclose the identity of the funder to the arbitrator. In turn, the arbitrator will be required to disclose any conflicts of interest relating to the participation of the funder to the arbitral institution overseeing the arbitration or, if the arbitration is ad hoc, to the parties themselves. See *supra* note 98. Outside of these circumstances, there are no rules requiring the funded party to notify the opposing party regarding its use of third-party funding.

privileges in a given arbitration proceeding.<sup>170</sup> The arbitrators determine on a case-by-case basis whether privileged information disclosed to a third-party funder is admissible and whether the disclosure waived any applicable evidentiary privileges.<sup>171</sup> Creating an arbitration rule that governs the effect of third-party funding on the waiver of evidentiary privileges would infringe on the parties' rights to choose—if they wish to do so—the evidentiary and privilege rules that will apply to their arbitration proceedings, including those effecting the waiver of privileges.<sup>172</sup>

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170. *See, e.g.*, ARB. INST. STOCKHOLM CHAMBER COM. [SCC], 2010 ARBITRATION RULES at art. 26(1) (2010), [http://www.sccinstitute.com/media/40120/arbitrationrules\\_eng\\_webbversion.pdf](http://www.sccinstitute.com/media/40120/arbitrationrules_eng_webbversion.pdf) [<http://perma.cc/5TRZ-WQDT>] [hereinafter SCC RULES] (“The admissibility, relevance, materiality and weight of evidence shall be for the Arbitral Tribunal to determine.”); *id.* at art. 26(3) (tribunal may order the production of evidence relevant to the outcome of the case, which would usually not be the third-party funding agreement); HONG KONG INT’L ARB. CTR. [HKIAC], ADMINISTERED ARBITRATION RULES at art. 22.2 (2013), <http://www.hkiac.org/en/arbitration/arbitration-rules-guidelines/hkiac-administered-arbitration-rules-2013> [<http://perma.cc/WN4J-FSHL>] [hereinafter HKIAC RULES] (“The arbitral tribunal shall determine the admissibility, relevance, materiality and weight of the evidence, including whether to apply strict rules of evidence.”); INT’L CTR. FOR DISP. RESOL. [ICDR], INTERNATIONAL DISPUTE RESOLUTION PROCEDURES at art. 20(6) (2014), [https://www.icdr.org/icdr/faces/i\\_search/i\\_rule/i\\_rule\\_detail?\\_afWindowId=exo0mv9ra\\_68&\\_afLoop=1768552008878792&doc=ADRSTAGE2025301&\\_afWindowMode=0&\\_adf.ctrl-state=exo0mv9ra\\_71](https://www.icdr.org/icdr/faces/i_search/i_rule/i_rule_detail?_afWindowId=exo0mv9ra_68&_afLoop=1768552008878792&doc=ADRSTAGE2025301&_afWindowMode=0&_adf.ctrl-state=exo0mv9ra_71) [<https://perma.cc/4X9N-FV9B>] [hereinafter ICDR RULES] (“The tribunal shall determine the admissibility, relevance, materiality, and weight of the evidence.”); *id.* at art. 22 (“The arbitral tribunal shall take into account applicable principles of privilege, such as those involving the confidentiality of communications between a lawyer and client. When the parties, their counsel, or their documents would be subject under applicable law to different rules, the tribunal should, to the extent possible, apply the same rule to all parties, giving preference to the rule that provides the highest level of protection.”); LONDON CT. OF INT’L ARB. [LCIA], LCIA ARBITRATION RULES at art. 22.1(vi) (2014), [http://www.lcia.org/Dispute\\_Resolution\\_Services/lcia-arbitration-rules-2014.aspx](http://www.lcia.org/Dispute_Resolution_Services/lcia-arbitration-rules-2014.aspx) [<http://perma.cc/98SB-HSYP>] [hereinafter LCIA RULES] (tribunal has the authority “to decide whether or not to apply any strict rules of evidence [or any other rules] as to the admissibility, relevance or weight of any material tendered by a party on any issue of fact or expert opinion; and to decide the time, manner and form in which such material should be exchanged between the parties and presented to the Arbitral Tribunal”); SINGAPORE INT’L ARB. CTR. [SIAC], ARBITRATION RULES OF THE SINGAPORE INTERNATIONAL ARBITRATION CENTRE at art. 16.2 (2013), <http://www.siac.org.sg/our-rules/rules/siac-rules-2013> [<http://perma.cc/F27W-VZHN>] [hereinafter SIAC RULES] (“The Tribunal shall determine the relevance, materiality and admissibility of all evidence. Evidence need not be admissible in law.”); *id.* at art. 24.1(p) (arbitral tribunal has the power to “determine any claim of legal or other privilege”).
171. *See supra* note 170.
172. In the absence of an agreement between the parties, the arbitrator would articulate evidentiary parameters that are compatible with the parties’ arbitration clause, the chosen rules of arbitral procedure, and the mandatory procedural rules of the seat of arbitration. *Cf. supra* note 109 and accompanying text.

## B. Judging Conflicts of Interest of the Decision Maker

### 1. Litigation: Party Disclosure Statements to Judges

In order for a judge to check for financial conflicts of interest, the parties must disclose to the judge their relevant corporate relationships.<sup>173</sup> Fed. R. Civ. P. 7.1 requires that corporate parties make disclosures about their corporate ownership in case the presiding judge has a potential conflict of interest mandating disqualification under 28 U.S.C. § 455 and the Code of Conduct for United States Judges.<sup>174</sup> Rule 7.1 was modeled after Federal Rule of Appellate Procedure 26.1.<sup>175</sup> The purpose of both Rule 7.1 and Appellate Rule 26.1 is to provide financial disclosures to facilitate judicial recusal decisions in circumstances where automatic financial interest disqualification is required under 28 U.S.C. § 455.<sup>176</sup> The Advisory Committee Notes to Rule of Appellate Procedure 26.1 state that the rule represents a minimum disclosure requirement and that courts can require additional information through a local rule.<sup>177</sup>

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173. See 28 U.S.C. § 455 (2012); FED. R. CIV. P. 7.1; FED. R. APP. P. 26.1 advisory committee's notes to 1989 amendment; JUDICIAL CONFERENCE, CODE OF CONDUCT FOR UNITED STATES JUDGES CANON 3C(1)(c) (2014).

174. See *supra* note 173.

175. See FED. R. CIV. P. 7.1 advisory committee's notes to 2002 amendment.

176. See *id.*

177. See FED. R. APP. P. 26.1 advisory committee's notes to 1989 amendment ("The committee believes that this rule represents minimum disclosure requirements. If a Court of Appeals wishes to require additional information, a court is free to do so by local rule. However, the committee requests the courts to consider the desirability of uniformity and the burden that varying circuit rules creates on attorneys who practice in many circuits."); FED. R. APP. P. 26.1 advisory committee's notes to 2002 amendment ("Rule 26.1(a) does not require the disclosure of all information that could conceivably be relevant to a judge who is trying to decide whether he or she has a "financial interest" in a case. Experience with divergent disclosure practices and improving technology may provide the foundation for more comprehensive disclosure requirements. The Judicial Conference, supported by the committees that work regularly with the Code of Judicial Conduct and by the Administrative Office of the United States Courts, is in the best position to develop any additional requirements and to adjust those requirements as technology and other developments warrant. Thus, Rule 26.1(a) has been amended to authorize the Judicial Conference to promulgate more detailed financial disclosure requirements—requirements that might apply beyond nongovernmental corporate parties. As has been true in the past, Rule 26.1(a) does not forbid the promulgation of local rules that require disclosures in addition to those required by Rule 26.1(a) itself. However, along with the authority provided to the Judicial Conference to require additional disclosures is the authority to preempt any local rulemaking on the topic of financial disclosure.").

The influence of third-party funders raises concerns similar to that of corporate influence, as both are types of nonparty related entities that may attempt to exert control over the proceedings. In addition, the vast majority of third-party funders are private companies, so disclosure is even more critical.<sup>178</sup> Therefore, it is appropriate to apply the purpose of the disclosure statement required for corporate relationships to the disclosure of the identity of a participating third-party funder as well. The timing of the corporate disclosure—at the party’s first contact with the court, whether in person or in writing—is also the appropriate timing for disclosing the identity of the third-party funder.<sup>179</sup> In addition, parties must promptly file a supplemental disclosure if circumstances change, which would be appropriate where a third-party funder begins to fund a pending case or withdraws from an ongoing case.<sup>180</sup> Furthermore, courts have applied wide-ranging sanctions when a party persistently does not file the disclosure statement, even after the court has directly requested the party to file the disclosure.<sup>181</sup> The threat of sanctions ensures that parties will make the required disclosures in a timely fashion.<sup>182</sup>

The Advisory Committee stated that Rule 7.1 does not mention third-party funders in its December 2014 report, which rejected the aforementioned proposal to revise Rule 26.<sup>183</sup> In light of the Advisory Committee’s statement,

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178. See Shannon, *supra* note 32, at 867, 912 n.286, and accompanying text (giving an example of how difficult it is to get data and information from private third party funders).

179. See FED. R. CIV. P. 7.1(b)(1) (“[A party must] file the disclosure statement with its first appearance, pleading, petition, motion, response or other request addressed to the court.”).

180. See FED. R. CIV. P. 7.1(b)(2) (“[A party must] promptly file a supplemental statement if any required information changes.”).

181. See, e.g., *Curtis v. Illumination Arts, Inc.*, No. C 12-0991 JLR, 2013 WL 1148802, at \*2 (W.D. Wash. Mar 19, 2013) (ordering the counsel for two noncomplying defendants to pay \$500 for failing to file the corporate disclosure statement and threatening to enter default judgments against those defendants if the statement is not filed within 14 days); *Medmarc Cas. Ins. Co. v. Sterling & Dowling PC*, No. 10-cv-694-JPG, 2010 WL 3747754, at \*1 (S.D. Ill. Sept. 20, 2010) (threatening noncompliant party with dismissal of the case); *Hanratty v. Watson*, No. 10-cv-662-JPG, 2010 WL 3522996, at \*1 (S.D. Ill. Sept. 2, 2010) (threatening party with striking appearance and jury demand); *Feezor v. Big 5 Corp.*, No. CIV. 2:09-1909 WBS CMK, 2010 WL 308751, at \*1-3 (E.D. Cal. Jan. 15, 2010) (imposing modest monetary sanction on nondisclosing defendant); *Am. Gen. Life Ins. Co. v. Lawson Bros. Trucking Co.*, No. 08-cv-103-DRH, 2008 WL 4899425, at \*1 (S.D. Ill. Nov. 13, 2008) (holding attorney-of-record in contempt and directing a \$100 per day fine to accrue against the attorney until the disclosure statement was filed).

182. See, e.g., *supra* note 181.

183. See CAMPBELL, *supra* note 2, at 3 (“[Disclosure] will protect against unknown conflicts of interest by ensuring judges have access to information, not provided by Rule 7.1 disclosures, identifying third-party financing entities in which the judge may have an interest.”).

the Federal Rules should be revised to require that parties supported by third-party funding disclose to the judge the identity of their funder(s).<sup>184</sup> Rule 7.1 explicitly orders only corporate parties to file a disclosure statement regarding their shareholders and investors, but is silent regarding other types of parties.<sup>185</sup> Funded parties may be natural persons or other noncorporate parties, so Rule 7.1 might not be the best place to address funded parties. Instead, a new Rule 7.2 should be adopted to require that any party—whether a natural person, corporation, or otherwise—supported by a third-party funder must disclose the identity of its third-party funder to the judge only, in camera, for reasons discussed further below. Until such a revision is accomplished, judges can implement a local rule requiring such disclosure in accordance with Rule 83 and the spirit of the Advisory Committee Notes to Appellate Rule 26.1.<sup>186</sup> The purpose would be to notify the judge of the funder’s participation so that he or she may determine if any financial conflicts of interest exist.<sup>187</sup> The Advisory Committee Notes accompanying Rule 7.1 state that the disclosure is intended to be very limited—only enough to notify the judge as to whether financial conflicts exist.<sup>188</sup> This disclosure will be particularly crucial if consumer investment portfolios—such as pensions and mutual funds—begin to include

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184. See JOHN H. BEISNER & GARY A. RUBIN, U.S. CHAMBER INST. FOR LEGAL REFORM, STOPPING THE SALE ON LAWSUITS: A PROPOSAL TO REGULATE THIRD-PARTY INVESTMENTS IN LITIGATION 14 (2012), [http://www.instituteforlegalreform.com/uploads/sites/1/TPLF\\_Solutions.pdf](http://www.instituteforlegalreform.com/uploads/sites/1/TPLF_Solutions.pdf) [<http://perma.cc/UW77-R8FS>] (suggesting that FED. R. CIV. P. 7.1 be revised to require parties to disclose third-party funding to the judge); cf. CAMPBELL, *supra* note 2, at 3.

185. See FED. R. CIV. P. 7.1(a) (currently mandating that “[a] nongovernmental corporate party” must file a disclosure statement; not referencing any other type of parties, such as natural persons or unincorporated associations).

186. See *supra* note 177 and accompanying text.

187. See *supra* note 65.

188. See, e.g., FED. R. CIV. P. 7.1, committee notes on 2002 rules (“The information required by Rule 7.1(a) reflects the ‘financial interest’ standard of Canon 3C(1)(c) of the Code of Conduct for United States Judges. This information will support properly informed disqualification decisions in situations that call for automatic disqualification under Canon 3C(1)(c). It does not cover all of the circumstances that may call for disqualification under the financial interest standard, and does not deal at all with other circumstances that may call for disqualification. Although the disclosures required by Rule 7.1(a) may seem limited, they are calculated to reach a majority of the circumstances that are likely to call for disqualification on the basis of financial information that a judge may not know or recollect. Framing a rule that calls for more detailed disclosure will be difficult. Unnecessary disclosure requirements place a burden on the parties and on courts. Unnecessary disclosure of volumes of information may create a risk that a judge will overlook the one bit of information that might require disqualification, and also may create a risk that unnecessary disqualifications will be made rather than attempt to unravel a potentially difficult question. It has not been feasible to dictate more detailed disclosure requirements in Rule 7.1(a).”).

third-party funding as an alternative investment.<sup>189</sup> If third-party funding becomes part of consumer investment portfolios, then individual investors who invest in third-party funding companies could potentially be anyone—including judges, attorneys, or jurors.<sup>190</sup> In light of this, regulators may wish to expressly prohibit judges from knowingly investing in litigation funding companies.<sup>191</sup>

Rule 7.1 does not state whether the disclosure statement must be served on the opposing party.<sup>192</sup> At least one court has ruled that Rule 7.1 does not

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189. If all judges in a particular jurisdiction would be disqualified on the basis of their consumer or retirement investments having a connection to the funder, then the rule of necessity would intervene to allow a conflicted judge to hear the case to ensure that a funded plaintiff would still have a forum. *See* *United States v. Will*, 449 U.S. 200, 213 (1980) (“However, in the highly unusual setting of these cases, even with the authority to assign other federal judges to sit temporarily under 28 U.S.C. §§ 291–96, it is not possible to convene a division of the Court of Appeals with judges who are not subject to the disqualification provisions of [28 U.S.C.] § 455. It was precisely considerations of this kind that gave rise to the Rule of Necessity, a well-settled principle at common law that, as Pollack [sic] put it, ‘although a judge had better not, if it can be avoided, take part in the decision of a case in which he has any personal interest, yet he not only may but must do so if the case cannot be heard otherwise.’”). Furthermore, potential jurors may also have a connection to the funder through their consumer or retirement investments as well as their potential status as a former funded litigant. *See, e.g.*, Letter, *supra* note 130, at 2–3 (stating that individual jurors may be shareholders of a funder). A judge who has been notified regarding the participation of the funder under FED. R. CIV. P. 7.1 can then determine whether it would be appropriate to question the jurors under FED. R. CIV. P. 47(a) regarding their potential connections to third-party funders. *See* FED. R. CIV. P. 47(a) (authorizing “the court . . . to examine prospective jurors . . . itself”).
190. *See, e.g.*, Jumpstart Our Business Startups (JOBS) Act, Pub. L. 112-106, 126 Stat. 306 (2012) (amending Securities Exchange Act of 1934, 15 U.S.C. §§ 77–78, 7213, 7262 (2012)); *see generally* Darian M. Ibrahim, *Equity Crowdfunding: A Market for Lemons?*, 100 MINN. L. REV. (forthcoming 2016), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2539786](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2539786) [<http://perma.cc/Z8UV-6RA5>] (discussing the implications of allowing retail investors to invest directly in startups, which could include litigation finance companies). A litigation finance company called LexShares already invites so-called “accredited investors” (not retail investors) to invest in litigation directly under the JOBS Act. *See also* *How Does the JOBS Act Impact LexShares?*, LEXSHARES, <https://lexshares.desk.com/customer/portal/articles/1543554-how-does-the-jobs-act-impact-lexshares> [<https://perma.cc/2ZM8-8Q53>] (last updated Aug. 6, 2014, 7:38 PM) (“The interests offered for sale through LexShares rely upon an exemption under Rule 506(c) enabled by Title II of the JOBS Act which went effective on September 23, 2013. This exemption permits an issuer to engage in general solicitation or general advertising of the offering and selling of securities pursuant to Rule 506, provided that (1) all purchasers of the securities are accredited investors and (2) the issuer takes reasonable steps to verify that such purchasers are accredited investors.”).
191. *Cf. supra* note 188 (referencing “the ‘financial interest’ standard of Canon 3C(1)(c) of the Code of Conduct for United States Judges” which requires disqualification of the judge in such circumstances). The Author thanks Doug Rendleman for this suggestion.
192. *See* FED. R. CIV. P. 7.1 (discussing only the content and timing of the disclosure and saying nothing about to whom the disclosure must or may be shared).

require such service.<sup>193</sup> Conversely, at least one observer of the third-party funding industry has proposed amending the Federal Rules of Civil Procedure to include a requirement that funding relationships be disclosed to the opposing party.<sup>194</sup> The argument that funding should be disclosed to the other side rests on the assumption that a secretly funded party may have a tactical advantage in the litigation.<sup>195</sup>

Tactical advantages are not a compelling reason, however, for disclosing funding to the other side. Parties have all sorts of tactical advantages in litigation for which disclosure is not required simply in the name of leveling the playing field. The source of funding—whether from a third-party funder or otherwise—is not discoverable information because the participation of the funder is not relevant or material to the merits of the case.<sup>196</sup> Furthermore, the Advisory Committee Note to Rule 26(a)(1)(A)(iv) also supports not requiring disclosure of third-party funding arrangements to the opposing side under the proposed new Rule 7.2.<sup>197</sup>

In sum, required disclosure under the proposed new Rule 7.2 should be limited to disclosure of the identity of any third-party funder to the judge in camera at the time of the party's first appearance in or communication with the court. If a funder enters or withdraws from a pending case, the new Rule 7.2 should require the funded party to notify the judge of this changed circumstance by copying the existing language of Rule 7.1(b)(2) to the new Rule 7.2.<sup>198</sup> The judge should not share this information with the opposing party because neither Rule 7.1 nor Rule 26(a)(1)(A)(iv) require such a disclosure.<sup>199</sup> If there is a financial conflict of interest, the judge will recuse himself or herself and the other side does not need to know the reason.<sup>200</sup> This disclosure is enough to prevent the situation in which a later conflict of interest requires the judge to recuse herself or a losing party challenges the final judgment on the same basis,<sup>201</sup> yet

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193. *See, e.g.*, Plotzker v. Lamberth, Civil No. 3:08cv00027, 2008 WL 4706255, at \*12 (W.D. Va. Oct. 22, 2008) (holding that service is not required because the statements are only to assist judges in determining whether they must be disqualified from hearing the case).

194. *See supra* notes 6, 130, and accompanying text.

195. *See id.*

196. *See supra* note 131 and accompanying text.

197. *See supra* Part II.A.1 (examining the Advisory Committee Note and explaining why third-party funding agreements are not required to be disclosed as insurance under Rule 26(a)(1)(A)(iv)).

198. *See supra* notes 124, 180 and accompanying text.

199. *See id.*

200. The “rule of necessity” will ensure that the case will be heard if all judges in a given jurisdiction or court have a relationship to the funder. *See supra* note 189.

201. *See supra* notes 65 and 200.

does not go so far as to create a situation where parties are required to disclose their funding sources to each other beyond the intended scope of Rule 26(a)(1)(A)(iv).<sup>202</sup>

Furthermore, disclosure of the identity of the funder to the judge is sufficient. The actual terms of the funding arrangement need not be disclosed, unless special circumstances are involved.<sup>203</sup> The purpose of the disclosure is to avoid additional costs by identifying judicial conflicts of interest early on, rather than have a party pursue a case through to a judgment and have it be challenged because of undisclosed conflicts of interest.<sup>204</sup> The identity of the funder is key for determining conflicts of interest, not the terms of the funding arrangement.<sup>205</sup> At least one observer has suggested that a particularly unscrupulous funder could try to fund both sides of a case in order to hedge its investment.<sup>206</sup> Under the proposed new Rule 7.2, since all funded parties would have a duty to disclose the identity of their funders to the judge, the judge would learn whether the same funder is funding more than one side of the case. In that specific situation, given the potential for a single funder to secretly manipulate both sides of a case to achieve a certain outcome, the judge could rightly notify both funded parties about the identity of their common funder. In essence, the proposed new Rule 7.2 strikes a delicate and necessary balance between the court's interest in gleaning critical financial information and the funded party's interest in preserving its litigation strategy.

## 2. Arbitration: Arbitrator Disclosure Statements to Parties

One of the major distinctions between litigation and arbitration is that arbitrators go through a two-step process of nomination and confirmation before they see any of the documents filed in the case, whereas the plaintiff in litigation cannot typically vet the judge before filing the case with the court. The two-step process for appointing arbitrators gives parties and arbitral institutions the opportunity to detect potentially problematic conflicts of interest before the case

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202. *See supra* note 124 and accompanying text.

203. Special circumstances might occur, for example, if the case involves a party for whom the judge would have to approve any settlement (e.g., a minor), a class action under FED. R. CIV. P. 23, an assessment of the funded party's resources relating to a discovery request or order under FED. R. CIV. P. 26, or a winning funded party's request for attorney's fees under FED. R. CIV. P. 54.

204. *See supra* note 65 and accompanying text.

205. *See id.*

206. This observation was made by a participant at the Washington and Lee Roundtable on Third-Party Funding of Litigation and Arbitration from November 7–8 in 2013.

has gone too far into the merits and before the parties have spent significant funds on the case.<sup>207</sup> The nomination and confirmation process seeks to identify potential independence and impartiality issues, which parties can either waive (in most instances) or use to disqualify the arbitrator from consideration on that particular case.<sup>208</sup> Alternatively, a potential arbitrator could simply decline to be appointed in lieu of providing the requested information. A similar procedure exists to some extent for judges when one of the parties is a corporate entity that must file a disclosure statement under Federal Rule 7.1. The main difference is

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207. See, e.g., Jennifer A. Trusz, Note, *Full Disclosure? Conflicts of Interest Arising From Third-Party Funding in International Commercial Arbitration*, 101 GEO. L.J. 1649, 1666–67 (2013) (discussing the procedure for disqualifying a potential arbitrator or challenging a sitting arbitrator under the major rules for international commercial arbitration). While parties generally have contractual freedom in arbitration, for arbitrations administered by an arbitral institution, parties cannot contract around the arbitral institution's rules regarding checking whether arbitrators have conflicts of interest. Parties can feel free to waive most (but not all) types of disclosed conflicts, however, and accept the arbitrator anyway. For ad hoc arbitrations, however, the parties would determine the suitability of their arbitrators themselves and may (imprudently) decide not to check for conflicts of interests.
208. See, e.g., SCC RULES, *supra* note 170, at art. 14(2)–(3) (potential arbitrator must disclose “any circumstances which may give rise to justifiable doubts as to his/her impartiality or independence” and has an ongoing obligation to disclose any such circumstances that arise during the course of the arbitration); HKIAC RULES, *supra* note 170, at art. 11.1 (“An arbitral tribunal confirmed under these Rules shall be and remain at all times impartial and independent of the parties.”); *id.* at art. 11.4 (explaining that potential arbitrator must “disclose any circumstances likely to give rise to justifiable doubts as to that person's impartiality or independence” and has an ongoing obligation to disclose any such circumstances that arise during the course of the arbitration); ICDR RULES, *supra* note 170, at art. 13(2)–(3) (explaining that potential arbitrator must “disclose any circumstances that may give rise to justifiable doubts as to the arbitrator's impartiality or independence and any other relevant facts the arbitrator wishes to bring to the attention of the parties” and has an ongoing obligation to disclose any such circumstances or facts that arise during the course of the arbitration); INT'L CHAMBER OF COM. [ICC], INT'L CT. OF ARB., RULES OF ARBITRATION at art. 11(2)–(3) (2012) [hereinafter ICC RULES], <http://www.iccwbo.org/products-and-services/arbitration-and-adr/arbitration/icc-rules-of-arbitration> [<http://perma.cc/Q2K8-W2YW>] (explaining that potential arbitrator must “disclose in writing to the Secretariat 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, as well as any circumstances that could give rise to reasonable doubts as to the arbitrator's impartiality” and has an ongoing obligation to disclose any such circumstances that arise during the course of the arbitration); LCIA RULES, *supra* note 170, at art. 5.4–5.5 (explaining that potential arbitrator must disclose “any circumstances currently known to the candidate which are likely to give rise in the mind of any party to any justifiable doubts as to his or her impartiality or independence” and has an ongoing obligation to disclose any such circumstances that arise during the course of the arbitration); SIAC RULES, *supra* note 170, at art. 10.4–10.5 (explaining that potential arbitrator must disclose “any circumstance that may give rise to justifiable doubts as to his impartiality or independence as soon as reasonably practicable” and has an ongoing obligation to disclose any such circumstances that arise during the course of the arbitration).

the timing. The judge is already in place at the time of the Rule 7.1 filing, so the appropriate course of action in the event of a conflict of interest would be for the judge to recuse herself.<sup>209</sup> There is also the rule of necessity, which requires that if all judges in a particular jurisdiction would be disqualified for the same reason, then any judge can hear the case.<sup>210</sup>

In order to limit disruption and cost to the parties, ideally, any conflicts of interest relating to the funder's involvement should be addressed before the arbitrator accepts the appointment.<sup>211</sup> Otherwise, the arbitrator may be challenged, and if the challenge is successful, the arbitrator must be replaced—increasing time, cost, and inconvenience to the parties in a dispute.<sup>212</sup> Thus, the arbitrator should disclose connections, if any, that he or she has to the third-party funder in the case prior to the arbitrator's confirmation.<sup>213</sup>

One source of guidance regarding arbitrator disclosure obligations is the IBA's revised Guidelines on Conflicts of Interest in International Arbitration, which took effect on November 28, 2014.<sup>214</sup> These guidelines are not mandatory in any arbitration proceedings; parties or arbitrators can choose to reference them or ignore them altogether. The IBA revised several of its guidelines to require arbitrators to disclose their connections with third-party funders in order to check for potential conflicts of interest.<sup>215</sup> Likewise, the IBA revised one of its

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209. See *supra* note 65.

210. See *supra* note 189.

211. See Trusz, *supra* note 207, at 1652 (“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.”).

212. See, e.g., SCC RULES, *supra* note 170, at art. 15(1) (explaining that sitting arbitrator may be challenged “if circumstances exist which give rise to justifiable doubts as to the arbitrator’s impartiality or independence”); HKIAC RULES, *supra* note 170, at art. 11.6 (“Any arbitrator may be challenged if circumstances exist that give rise to justifiable doubts as to the arbitrator’s impartiality or independence . . . .”); ICDR RULES, *supra* note 170, at art. 14(1) (“A party may challenge an arbitrator whenever circumstances exist that give rise to justifiable doubts as to the arbitrator’s impartiality or independence.”); ICC RULES, *supra* note 208, at art. 14(1) (explaining that a sitting arbitrator may be challenged “for an alleged lack of impartiality or independence, or otherwise”); LCIA RULES, *supra* note 170, at art. 10.1 (explaining that sitting arbitrator may be challenged if “circumstances exist that give rise to justifiable doubts as to that arbitrator’s impartiality or independence”); SIAC RULES, *supra* note 170, at art. 11.1 (“Any arbitrator may be challenged if circumstances exist that give rise to justifiable doubts as to the arbitrator’s impartiality or independence . . . .”).

213. See *infra* notes 214–217 and accompanying text.

214. See IBA GUIDELINES, *supra* note 98.

215. See *id.* at General Standard 6; the Explanation to General Standard 6; the Waivable Red List § 2.2.3; the Orange List §§ 3.2.2, 3.4.3, and 3.4.4 (requiring an arbitrator to disclose its connections to third-party funders, defined as entities with a “direct economic interest in the award to be rendered in the arbitration”).

guidelines to require funded parties to disclose the identity of their third-party funder to the arbitrator.<sup>216</sup> The explanatory statement to one of the guidelines defines a third-party funder as “any person or entity that is contributing funds, or other material support, to the prosecution or defence [sic] of the case and that has a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration.”<sup>217</sup>

As such, arbitral institutions and rules may wish to borrow or reference the IBA’s definition of third-party funder in their instructions for post-nomination arbitrator disclosures, so that nominated arbitrators will know what type of relationships to disclose—even if the parties have not agreed to use the IBA Rules.<sup>218</sup> Similarly, the arbitrator needs to know about the third-party funder’s involvement in order to disclose any potential conflicts of interest. Thus, arbitral institutions should require parties to disclose the identity of their third-party funders to their arbitrator.<sup>219</sup> This identity disclosure is particularly critical in arbitration because of the so-called “double hat problem,” where an attorney can serve as counsel in one case and as an arbitrator in another case, both of which might be funded by a third-party funder.<sup>220</sup> Thus, arbitration rules should be

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216. *See id.* at General Standard 7(a) (requiring a funded party to disclose its connection to a third-party funder, defined as an entity with a “direct economic interest in . . . the award to be rendered in the arbitration”).

217. *Id.* at Explanation to General Standard 6(b) (“Third-party funders and insurers in relation to the dispute may have a direct economic interest in the award, and as such may be considered to be the equivalent of the party. For these purposes, the terms ‘third-party funder’ and ‘insurer’ refer to any person or entity that is contributing funds, or other material support, to the prosecution or defence [sic] of the case and that has a direct economic interest in, or a duty to indemnify a party for, the award to be rendered in the arbitration.”). Note that it is unclear whether defense-side funding would have to be disclosed based on this definition because the defense side funder may not have a direct economic interest in the award or a duty to indemnify the losing respondent.

218. *See id.* at Explanation to General Standard 6(b).

219. *See* Trusz, *supra* note 207, at 1652 (discussing how an arbitrator cannot disclose a connection with a third-party funder unless the arbitrator is made aware of the funder’s participation in the case). It is important to note that if the funder is paying fees to the arbitral institution directly on the party’s behalf, then of course, the arbitral institution would already be aware of the funder’s participation. In such a circumstance, the institution could prompt the arbitrator to check for conflicts of interest if the party does not disclose to the arbitrator the funder’s identity. If funder is not making payments directly to the arbitral institution, however, then the procedural rules should be revised to require disclosure of the identity of the funder to the arbitral institution.

220. *See, e.g.,* Dennis H. Hranitzky & Eduardo Silva Romero, *The ‘Double Hat’ Debate in International Arbitration: Should Advocates and Arbitrators Be in Separate Bars?*, N.Y. L.J. (June 14, 2010), <http://www.dechert.com/files/Publication/14aa1b72-6ec3-4dc2-9f79-0148c2f853b2/Presentation/PublicationAttachment/fe153a5d-c10a-44c9-b8c9-005e119a4fd4/070101031Dechert.pdf> [<http://perma.cc/LP2R-RPGL>] (“It is commonplace in international arbitration, as in most domestic arbitration in the United States, for experienced practitioners who actively represent parties before arbitral tribunals to serve as arbitrators in other cases. Indeed, it is not

amended to add a third-party funding disclosure rule similar to the proposed new Rule 7.2.<sup>221</sup> Such an arbitration rule would require a funded party to disclose the identity of its third-party funder to the arbitrator.<sup>222</sup> This would enable the arbitrator to make the appropriate disclosures to avoid conflicts of interest.<sup>223</sup> Going one step further, at least one scholar has proposed changing international arbitration rules to address arbitrator conflicts of interest within the existing institutional arbitration rules.<sup>224</sup>

Except for mandatory disclosures relating to conflicts of interest, arbitrators have wide latitude to tailor the proceedings to the parties' needs, which may include choosing to ignore the participation of a third-party funder.<sup>225</sup> For example, arbitral tribunals generally refrain from allowing

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unusual for an individual to represent a party in an arbitration administered by one of the larger international institutions . . . and at the same time serve as an arbitrator in another matter administered by the same institution. In recent years, this practice has come under fire from practitioners and parties alike, resulting in calls for new rules prohibiting counsel who represent parties in arbitrations from serving as arbitrators in other cases.”)

221. See *supra* Part II.B.1 (proposing a new FED. R. CIV. P. 7.2).

222. See *supra* Part II.B.1. For an example of an arbitral tribunal ordering a party to make such a disclosure, see Procedural Order No. 3, *Muhammet Çap v. Turkmenistan*, ICSID Case No. ARB/12/6 (granting the respondent's request for an order requiring the claimants to disclose whether they had entered into a third party funding arrangement and, if so, the terms of the arrangement).

223. See *supra* note 215.

224. See Trusz, *supra* note 207, at 1652 (“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.”); see also 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 financier involved, and require arbitrator nominees to disclose to the institution the identity of any financiers 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”).

225. See, e.g., HKIAC RULES, *supra* note 170, at art. 13.1 (“Subject to these Rules, the arbitral tribunal shall adopt suitable procedures for the conduct of the arbitration in order to avoid unnecessary delay or expense, having regard to the complexity of the issues and the amount in dispute, and provided that such procedures ensure equal treatment of the parties and afford the parties a reasonable opportunity to present their case.”); *id.* at art. 13.5 (“The arbitral tribunal and the parties shall do everything necessary to ensure the fair and efficient conduct of the arbitration.”);

the revelation of a third-party funder to sway their decision in awarding costs or ordering security for costs.<sup>226</sup> If, however, an arbitral tribunal did decide to consider the participation of the third-party funder, then it would have the power to allocate costs for or against a particular party on that basis.<sup>227</sup> Whether the funder pays the costs or sanctions levied against the

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ICDR RULES, *supra* note 170, at art. 20(1) (“Subject to these Rules, the arbitral tribunal may conduct the arbitration in whatever manner it considers appropriate, provided that the parties are treated with equality and that each party has the right to be heard and is given a fair opportunity to present its case.”); ICC RULES, *supra* note 208, at art. 22(1)–(2) (“The arbitral tribunal and the parties shall make every effort to conduct the arbitration in an expeditious and cost-effective manner, having regard to the complexity and value of the dispute. In order to ensure effective case management, the arbitral tribunal, after consulting the parties, may adopt such procedural measures as it considers appropriate, provided that they are not contrary to any agreement of the parties.”); LCIA RULES, *supra* note 170, at art. 14.4(ii) (explaining that arbitral tribunal has “a duty to adopt procedures suitable to the circumstances of the arbitration, avoiding unnecessary delay and expense, so as to provide a fair, efficient and expeditious means for the final resolution of the parties’ dispute”); *id.* at art. 14.5 (“The Arbitral Tribunal shall have the widest discretion to discharge these general duties, subject to such mandatory law(s) or rules of law as the Arbitral Tribunal may decide to be applicable; and at all times the parties shall do everything necessary in good faith for the fair, efficient and expeditious conduct of the arbitration, including the Arbitral Tribunal’s discharge of its general duties.”); SIAC RULES, *supra* note 170, at art. 16.1 (“The Tribunal shall conduct the arbitration in such manner as it considers appropriate, after consulting with the parties, to ensure the fair, expeditious, economical and final determination of the dispute.”).

226. *See, e.g.*, Trusz, *supra* note 207, at 1677–79 (discussing arbitral tribunals declining to consider the participation of a third-party funder when awarding costs or ordering security for costs, although some funders choose to incorporate security for costs into their business arrangements as a matter of good governance or cost of doing business).
227. *See, e.g.*, SCC RULES, *supra* note 170, at art. 43(5) (“Unless otherwise agreed by the parties, the Arbitral Tribunal shall, at the request of a party, apportion the Costs of the Arbitration between the parties, having regard to the outcome of the case and *other relevant circumstances.*”) (emphasis added); *id.* at art. 44 (“Unless otherwise agreed by the parties, the Arbitral Tribunal may in the final award upon the request of a party, *order one party to pay any reasonable costs incurred by another party, including costs for legal representation,* having regard to the outcome of the case and *other relevant circumstances.*”) (emphasis added); HKIAC RULES, *supra* note 170, at art. 24 (“The arbitral tribunal may make an order requiring a party to provide security for the costs of the arbitration.”); *id.* at art. 33.2 (“The arbitral tribunal may apportion all or part of the costs of the arbitration referred to in Article 33.1 between the parties if it determines that apportionment is reasonable, taking into account the circumstances of the case.”); *id.* at art. 33.3 (“With respect to the costs of legal representation and assistance . . . the arbitral tribunal, taking into account the circumstances of the case, may direct that the recoverable costs of the arbitration, or any part of the arbitration, shall be limited to a specified amount.”); ICDR RULES, *supra* note 170, at art. 20(7) (“The arbitral tribunal may allocate costs, draw adverse inferences, and take such additional steps as are necessary to protect the efficiency and integrity of the arbitration.”); *id.* at art. 34 (“The arbitral tribunal shall fix the costs of arbitration in its award(s). The tribunal may allocate such costs among the parties if it determines that allocation is reasonable, taking into account the circumstances of the case.”); ICC RULES, *supra* note 208, at art. 37(3) (“At any time during the arbitral proceedings, the arbitral tribunal may make decisions on costs, other than those to be fixed

funded party or its legal counsel is a separate issue usually addressed in the terms of the funding agreement.<sup>228</sup> Regardless, arbitrators have the power within the relevant procedural rules to take the funder's participation into account when allocating costs.<sup>229</sup>

### C. Judging Cost Allocation and Sanctions

#### 1. Litigation: Fee Shifting, Sanctions, and Class Action Litigation

Since funders pay the attorney's fees, filing fees, evidentiary fees, and other costs upfront, many questions arise over whether the funder's participation should affect the allocation of costs, if at all. Should the funder pay the penalty for conduct by the funded party or its attorney that leads to court-ordered sanctions under Rule 11 or Rule 37? Should the funder be reimbursed if the funded party is entitled to reimbursement of attorney's fees under Rule 54? Should the funder of a successful class action receive a portion of the judicially-approved attorney's fees under Rule 23? This Subpart addresses the impact of third-party funding on fee shifting, sanctions, and class action litigation.

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by the Court, and order payment."); *id.* at art. 37(5) ("In making decisions as to costs, the arbitral tribunal may 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."); LCIA RULES, *supra* note 170, at art. 25.1(i)–25.2 (explaining that arbitral tribunal has the power "to order any respondent party to a claim or cross-claim to provide security for all or part of the amount in dispute, by way of deposit or bank guarantee or in any other manner," to order a "cross-indemnity," and to order "security for Legal Costs and Arbitration Costs"); *id.* at art. 28.2 ("The Arbitral Tribunal shall decide the proportions in which the parties shall bear such Arbitration Costs."); *id.* at art. 28.3 ("The Arbitral Tribunal shall also have the power to decide by an award that all or part of the legal or other expenses incurred by a party (the 'Legal Costs') be paid by another party."); *id.* at art. 28.4 ("The Arbitral Tribunal shall make its decisions on both Arbitration Costs and Legal Costs on the general principle that costs should reflect the parties' relative success and failure in the award or arbitration or under different issues, except where it appears to the Arbitral Tribunal that in the circumstances the application of such a general principle would be inappropriate under the Arbitration Agreement or otherwise."); *see also* Galagan & Živković, *supra* note 55 (discussing the effect of the third-party funding on adverse costs awards); SIAC RULES, *supra* note 170, at art. 24.1(k)–(l) (tribunal may order a party to pay security for costs or security for all or part of the amount in dispute); *id.* at art. 31.1 ("Unless the parties have agreed otherwise, the Tribunal shall determine in the award the apportionment of the costs of the arbitration among the parties."); *id.* at art. 33.1 ("The Tribunal shall have the authority to order in its award that all or a part of the legal or other costs of a party be paid by another party.").

228. *See infra* note 245 and accompanying text.

229. *See supra* note 227.

Rule 54(d)(2)(B)(iv) requires that, in order for a winning party to recover attorney's fees, the party must "disclose, if the court so orders, the terms of any agreement about fees for the services for which the claim is made."<sup>230</sup> The language "if the court so orders" highlights that the judge must decide whether any such fee agreement must be divulged.<sup>231</sup> Since the essence of the funding agreement is to pay the cost of attorney's fees, the funding agreement is an agreement mainly about fees for the services for which the claim is made.<sup>232</sup> Thus, a winning funded party seeking reimbursement for attorney's fees can be required to disclose the existence of the funding arrangement, if the court so orders, in order to recover those attorney's fees.<sup>233</sup> Enforcement of this requirement could be accomplished under the existing language of Rule 54(d)(2)(B)(iv) or by revising the rule to append the phrase "including third-party funding" to the end of the sentence. Local rules may also supply specific requirements regarding the disclosure of the third-party funding agreement in the context of a claim for attorney's fees.<sup>234</sup>

In addition to making the winning party whole, an award of attorney's fees is commonly used to sanction a party.<sup>235</sup> The fundamental question with regard to sanctions is whether a funder should be liable for sanctions imposed on the funded party, or the funded party's attorney, if the funder directed or condoned the sanctioned conduct. Sanctioning the party or its attorneys increases the litigation costs.<sup>236</sup> Those costs may be borne by the funder under the terms of the funding arrangement if the sanctioned action was within the bounds of the funding arrangement.<sup>237</sup> Regardless, as currently worded, Rules 11 and 37 likely

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230. FED. R. CIV. P. 54(d)(2)(B)(iv).

231. *See id.*

232. *See id.*

233. *See id.*

234. *See* FED. R. CIV. P. 54(d)(2)(D) ("By local rule, the court may establish special procedures to resolve fee-related issues without extensive evidentiary hearings.").

235. *See, e.g.*, CAMPBELL, *supra* note 2, at 6 (referring to FED. R. CIV. P. 68, which currently provides for the plaintiff to pay the defendant's attorney fees if the plaintiff rejects the defendant's settlement offer and then fails to obtain a better judgment).

236. Sanctions normally involve a payment of a fee. If not, the nonmonetary sanction often delays the sanctioned attorney's litigation strategy, which indirectly increases the litigation costs. The funder may have to pay the fee or the increased litigation costs depending on the terms of the funding contract.

237. *Cf.* Shannon, *supra* note 32, at 875 n.71, 880 n.101, 891 n.178-79, and accompanying text (mentioning that the funding agreement would likely state which types of costs the funder may cover, including attorney fees and "loser pays" costs, which may also include sanctions, depending on the wording of the agreement).

do not reach third-party funders directly, but rather indirectly by punishing the funded party or its attorney and incurring additional costs for the funder.<sup>238</sup>

Rule 11 sanctions misconduct relating to papers presented to or filed with the court.<sup>239</sup> Rule 11(c)(1) authorizes a court to sanction attorneys, law firms, or parties; the rule does not list any other persons.<sup>240</sup> Funders take no direct action in court and make no representations to the court, so Rule 11 should not be revised to apply to funders.<sup>241</sup> The Advisory Committee Notes state that, in appropriate circumstances, courts may impose sanctions on the person—other than the party or attorney—found to be responsible for the violation of Rule 11.<sup>242</sup> This could apply directly to the funder if there were proof that the funder directed the action or if the funder takes a very active role in the litigation. The funder's actions, however, would have to be directly tied to the paper or document in question.<sup>243</sup> There has been at least one case in which the funder exercised so much control that the court treated the funder as a party for the purpose of cost allocation but not for sanctions under Rule 11.<sup>244</sup> The funding agreement may address payment for monetary sanctions and would probably govern the disposition of sanctions-related issues that may arise between funders

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238. See *supra* note 237.

239. See FED. R. CIV. P. 11(a) (stating that if a paper is not signed, “[t]he court must strike an unsigned paper unless the omission is promptly corrected after being called to the attorney’s or party’s attention”); FED. R. CIV. P. 11(b) (stating that “an attorney or unrepresented party certifies that to the best of the person’s knowledge, information, and belief,” the “pleading, written motion, or other paper” presented to the court meets the four conditions listed in the rule).

240. See FED. R. CIV. P. 11(c)(1) (“[T]he court may impose an appropriate sanction on any attorney, law firm, or party that violated the rule or is responsible for the violation.”).

241. The sole exception is if the funder has taken an assignment of the claim and is the named party in the dispute. See *supra* notes 17, 21, 46, 129, 133, and accompanying text for a primer on the implications of third-party funding arrangements involving assignment.

242. See FED. R. CIV. P. 11 advisory committee’s note to 1993 amendments (“When appropriate, the court can make an additional inquiry in order to determine whether the sanction should be imposed on such persons, firms, or parties either in addition to or, in unusual circumstances, instead of the person actually making the presentation to the court. For example, such an inquiry may be appropriate in cases involving governmental agencies or other institutional parties that frequently impose substantial restrictions on the discretion of individual attorneys employed by it.”).

243. See FED. R. CIV. P. 11(a) (stating that if a paper is not signed, “[t]he court must strike an unsigned paper unless the omission is promptly corrected after being called to the attorney’s or party’s attention.”); FED. R. CIV. P. 11(b) (stating that “an attorney or unrepresented party certifies that to the best of the person’s knowledge, information, and belief,” the “pleading, written motion, or other paper” presented to the court meets the four conditions listed in the rule).

244. See *Abu-Ghazaleh v. Chaul*, 36 So. 3d 691, 693–94 (Fla. Dist. Ct. App. 2009) (holding that the third-party funder was a “party” under Florida law for allocating costs, because the funder had substantially “controlled” the litigation); see also Letter, *supra* note 130, at 6. The vast majority of funders are very careful not to control the litigation in order to avoid causing attorneys to violate the rules of professional conduct, so *Abu-Ghazaleh* is considered an outlier.

and funded parties.<sup>245</sup> As such, the court may consider the participation of the funder if the court wishes to take into account the financial status of the funded party or its attorney when assessing monetary sanctions against them.<sup>246</sup>

Rule 37 similarly governs sanctions for failure to cooperate with discovery requests.<sup>247</sup> Rule 37 authorizes sanctions on a deponent,<sup>248</sup> a witness, a party, an officer or employee of a party, or a party's attorney; the rule does not list any other persons.<sup>249</sup> Thus, like Rule 11, the wording of Rule 37 does not contemplate sanctioning a third-party funder. The funder does not participate directly in discovery, so it would be inappropriate to revise Rule 37 to authorize sanctioning the funder directly.<sup>250</sup> Even if the opposing party can demonstrate that the fault lies with the funder—for example, if the party cannot perform certain discovery functions due to the funder's refusal to pay for a particular document production or witness travel—the court could not issue sanctions directly against the funder according to the current wording of the Rule 37.<sup>251</sup> Indeed, since funders do not present documents, signed papers, testimony, or other evidence to the court, it is unnecessary to revise Rule 11 or Rule 37 to include direct sanctions on funders.<sup>252</sup> In addition, it would likely be very difficult to prove that the funder is directly at fault and may require additional discovery that would needlessly increase the time and cost of the litigation for the parties. As mentioned above, the funding agreement may address payment for monetary sanctions and would probably govern the disposition of sanctions-related issues that arise between funders and funded parties or their attorneys.<sup>253</sup>

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245. *Cf. supra* note 237 and accompanying text.

246. *Cf. id.*

247. *See* FED. R. CIV. P. 37.

248. A deponent is the person who testifies during a deposition. *See Deponent*, BLACK'S LAW DICTIONARY (10th ed. 2014).

249. *See* FED. R. CIV. P. 37(b)(1) (sanctioning a "deponent"); FED. R. CIV. P. 37(b)(2)(A) (sanctioning "a party's officer, director or managing agent—or a witness designated under Rule 30(b)(6) or 31(a)(4)"); FED. R. CIV. P. 37(b)(2)(B) (sanctioning "a party"); FED. R. CIV. P. 37(b)(2)(C) (requiring a "disobedient party, the attorney advising that party, or both to pay the reasonable expenses, including attorney's fees, caused by the failure"); FED. R. CIV. P. 37(c)(1) (sanctioning "a party"); FED. R. CIV. P. 37(c)(2) (sanctioning "a party"); FED. R. CIV. P. 37(d)(1)(A)(i) (sanctioning "a party or a party's officer, director, or managing agent—or a person designated under Rule 30(b)(6) or 31(a)(4)"); FED. R. CIV. P. 37(f) (sanctioning "a party or its attorney").

250. *See supra* note 249.

251. *Cf. id.*

252. *See supra* note 251.

253. *See supra* note 237 and accompanying text.

Finally, there is a potential for third-party funding to have an impact on class actions, although class actions are generally not a very attractive market for funders in the United States. Rule 23 governs class action proceedings.<sup>254</sup> Courts already have complete control over awarding attorney's fees in the class action context.<sup>255</sup> While funders in other jurisdictions frequently fund the class itself, funders in the United States have shied away from directly funding the class representative for a variety of reasons that are beyond the scope of this Article.<sup>256</sup> More commonly, funders lend money to plaintiff-side, class action law firms, rather than fund the class of plaintiffs directly.<sup>257</sup> Given the extensive judicial oversight over class actions—including the approval of class certification, class counsel, settlement proposals, and attorney's fees—there is not yet a need to revise the class action rule to take into account third-party funding.

Hypothetically, if a funder decided to directly fund a plaintiff's class action, then Rule 23(h), in conjunction with Rule 54(d)(2)(C), would govern the recovery of attorney's fees should the funded plaintiff prevail.<sup>258</sup> Regardless of the structure of the arrangement, the funder has actually paid the litigation costs, including the attorney's fees.<sup>259</sup> In such a case, having the entire amount of the attorney's fees awarded solely to the law firm would entitle the third-party funder to

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254. See FED. R. CIV. P. 23.

255. See FED. R. CIV. P. 23(g)(1)(D) (stating that courts have the discretion to “award . . . attorney's fees or nontaxable costs under Rule 23(h)”).

256. See, e.g., NIEUWVELD & SHANNON, *supra* note 12, at 74–84 (discussing funding of class and group actions in Australia), 120–21 (mentioning that funding agreements made directly with plaintiffs in class action litigation are not prevalent in the United States.), 180–81 (discussing funding under the “Class Action Act” in the Netherlands), 185–86 (discussing class action funding in Canada). Some funders have funded plaintiff's side class action law firms. See, e.g., Engstrom, *Re-Re-Financing*, *supra* note 17. Instances of class arbitration in the United States are relatively rare, but the American Arbitration Association (AAA) has administered some class arbitrations under its “Supplementary Rules for Class Arbitration.” See also AM. ARBITRATION ASS'N, SUPPLEMENTARY RULES OF CLASS ARBITRATIONS (2003), [https://www.adr.org/aaa/ShowPDF?url=/cs/groups/commercial/documents/document/dgdf/mda0/-edisp/adrstg\\_004129.pdf](https://www.adr.org/aaa/ShowPDF?url=/cs/groups/commercial/documents/document/dgdf/mda0/-edisp/adrstg_004129.pdf) [https://perma.cc/89RD-2VSX] (last visited Dec. 17, 2015); cf. *Class Arbitration Case Docket Search*, AM. ARB. ASS'N, [https://www.adr.org/aaa/faces/services/disputeresolutionservices/arbitration/classarbitration/casedocketsearch?\\_afzLoop=1490658678193381&\\_afzWindowMode=0&\\_afzWindowId=1xjd1n3mz\\_89#%40%3F\\_afzWindowId%3D1xjd1n3mz\\_89%26\\_afzLoop%3D1490658678193381%26\\_afzWindowMode%3D0%26\\_adf.ctrl-state%3D1xjd1n3mz\\_149](https://www.adr.org/aaa/faces/services/disputeresolutionservices/arbitration/classarbitration/casedocketsearch?_afzLoop=1490658678193381&_afzWindowMode=0&_afzWindowId=1xjd1n3mz_89#%40%3F_afzWindowId%3D1xjd1n3mz_89%26_afzLoop%3D1490658678193381%26_afzWindowMode%3D0%26_adf.ctrl-state%3D1xjd1n3mz_149) [https://perma.cc/P2G8-N2FK] (last visited Dec. 14, 2015) (showing 428 class arbitration cases administered under these arbitral rules). There is no public information regarding whether any of those—or any other—class arbitrations have been supported by third-party funding.

257. For an in-depth treatment of lawyer lending, see, for example, Engstrom, *Lawyer Lending*, *supra* note 17; Engstrom, *Re-Re-Financing*, *supra* note 17.

258. See FED. R. CIV. P. 23(h); FED. R. CIV. P. 54(d)(2)(C).

259. See Steinitz (2011), *supra* note 11, at 1275–78.

recover damages for breach of contract.<sup>260</sup> Given the attorney ethical prohibition on fee sharing, however, the law firm would likely not be able to pay the funder directly from its judicially awarded fee anyway.<sup>261</sup> Despite this quandary, it would be fair for the funder to be reimbursed at least the amount it actually spent on attorney's fees and litigation costs.

One solution to the aforementioned hypothetical situation would be to base the funder's entitlement to payment on its contractual rights through the funding arrangement with the plaintiff class. The winning plaintiff class would be entitled to receive reimbursement for attorney's fees and litigation costs under Rule 23(h) in conjunction with Rule 54(d)(2)(C).<sup>262</sup> Giving this money directly to the plaintiff class, however, would be unjust enrichment because the funder already paid both the class's attorney's fees and litigation costs.<sup>263</sup> Thus, since the judge already has broad oversight over settlement and the allocation of attorney's fees, the judge should have the discretion to determine what amount of the total fee allotted from the class award would go to the funder to cover the attorney's fees and litigation costs.<sup>264</sup> This solution would satisfy the funder's contractual right to receive repayment for the attorney's fees and litigation costs without

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260. There are several theories under the law of contracts or the law of restitution under which the funder's claim might fall. *See* RESTATEMENT (SECOND) OF CONTRACTS § 349 intro. note (1981) ("Note: The current position of the American Law Institute concerning 'restitution' as a remedy for breach of contract is set forth in Restatement Third, Restitution and Unjust Enrichment (R3RUE), formally adopted in 2010 and published in 2011. Contract remedies treated in the new Restatement include rescission for material breach (R3RUE §§ 37, 54) and damages to protect both the 'reliance interest' and the 'restitution interest' (R3RUE § 38), as well as a potential liability in unjust enrichment to disgorge the profits of an 'opportunistic' breach of contract (R3RUE § 39)."). *See also* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 25(1) ("If the claimant [i.e., the funder] renders to a third person [i.e., the plaintiff class] a contractual performance for which the claimant does not receive the promised compensation, and the effect of the claimant's uncompensated performance is to confer a benefit [i.e., attorney's fees awarded] on the defendant [i.e., the class counsel], the claimant is entitled to restitution from the defendant as necessary to prevent unjust enrichment."); RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 29 cmt. c. (In the context of awarding attorney fees, describing "certain recognized features of class-action procedure [that] make it consistent, in theory at least, with the ordinary requirements of restitution . . . . So long as the award is limited (under court supervision) to a reasonable fee for services demonstrably beneficial to the class, it satisfies the usual rules establishing the measure of enrichment in restitution (§ 49(3)(a))." This principle may also be applied to a third-party funder that pays the class counsel's attorney fees.).

261. *See* ABA MODEL RULES OF PROF'L CONDUCT r. 5.4(a) (2015) (prohibiting lawyers from fee sharing with nonlawyers with a few exceptions that do not include third-party funding).

262. *See* FED. R. CIV. P. 23(h); FED. R. CIV. P. 54(d)(2)(C).

263. *See supra* note 260 (defining unjust enrichment).

264. *See* FED. R. CIV. P. 23(e); FED. R. CIV. P. 23(h).

causing the law firm to run afoul of the prohibition on fee sharing and without diminishing the amount of the judgment or settlement that would go directly to the plaintiff class.

This solution, however, would not resolve the problem of paying the funder's return on investment without further diminishing the amount of the judgment or settlement that would go directly to the plaintiff class. Judges may not be willing to approve deducting the funder's return on investment from the class judgment or settlement because the class counsel's fees would have already consumed a large chunk of the judgment. Hence, this is likely one of the many reasons why funders have chosen not to fund plaintiff classes directly in class action lawsuits. In the future, it may be appropriate to state explicitly in the rules that judges have oversight over the participation of funders in class action litigation. Nevertheless, since direct funding agreements between funders and class action plaintiffs are nearly nonexistent in the United States, amending Rule 23 to address the issue would be premature.

## 2. Arbitration: Cost Shifting, Security for Costs, and Class Arbitration

The disclosure of the third-party funder in arbitration typically arises in relation to cost allocation, either before or after the proceedings on the merits. In situations in which the third-party funder is disclosed voluntarily (or accidentally), the opposing nonfunded party sometimes then petitions the arbitral tribunal to order security for costs.<sup>265</sup> Furthermore, if the nonfunded party wins, then it may request that the tribunal order payment of costs by the funded party or even the funder directly.<sup>266</sup> A few international arbitral tribunals have ordered funders to post security for costs in advance of the proceedings, and some third-party funders view paying security for costs simply as a cost of doing business in jurisdictions that subscribe to the English (loser pays) cost allocation rule.<sup>267</sup> Some jurisdictions allow funders to be joined to cost proceedings and allow courts and arbitral tribunals to issue cost orders against them.<sup>268</sup> Thus, with respect to disclosure to the opposing party, the existing practice appears to be for

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265. See NIEUWVELD & SHANNON, *supra* note 12, at xix–xx, 4, 12–13, 23–24, 27–28, 30, 33 n.16, 61, 74–75, 82–83 (discussing examples of how security for costs and adverse costs orders under the English rule of cost allocation may be addressed in the funding agreement).

266. See *supra* note 265.

267. See *id.*

268. See *Abu-Ghazaleh v. Chaul*, 36 So. 3d 691, 693–94 (Fla. Dist. Ct. App. 2009) (holding that the third-party funder was a “party” under Florida law for allocating costs, because the funder had substantially “controlled” the litigation).

arbitral tribunals to address the issue when allocating costs on a case-by-case basis. A case-by-case approach is appropriate since arbitration awards technically do not create precedent, although they can give rise to customs and norms of practice.<sup>269</sup> Given the trend in arbitration rules worldwide of giving arbitrators wide discretion in determining cost allocation, adopting a specific cost allocation rule addressing third-party funding would be counterproductive.<sup>270</sup>

Finally, class arbitration is funded in several jurisdictions worldwide but not in the United States for reasons beyond the scope of this Article.<sup>271</sup> In all the jurisdictions outside the United States in which class action funding is allowed, the participation of the funder is usually disclosed to the decision maker and the opposing side, although the terms of the funding agreement need not necessarily be disclosed.<sup>272</sup> Class arbitration is not prevalent in the United States in light of recent Supreme Court jurisprudence making class arbitration jurisdiction nearly impossible to create.<sup>273</sup> Thus, third-party funding for class arbitrations seated in the United States is likely to continue to be nonexistent.

#### D. Judging Enforcement

Litigation and arbitration converge at enforcement, and successful enforcement is required so that a third-party funder receives payment. Both litigation judgments and arbitral awards are enforced by courts because arbitrators

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269. *But see* W. Mark C. Weidemaier, *Toward a Theory of Precedent in Arbitration*, 51 WM. & MARY L. REV. 1895 (2010) (challenging the traditional theory that arbitrators do not create precedent by asserting that arbitrators influence each other's decisions and the development of arbitration procedural norms).

270. *See supra* note 227.

271. Third-party funding of class actions is not yet prevalent in the United States, but the practice is widespread in other leading third-party funding jurisdictions, such as Australia, Canada, and the Netherlands. *See, e.g.*, Deborah R. Hensler, *The Future of Mass Litigation: Global Class Actions and Third-Party Litigation Funding*, 79 GEO. WASH. L. REV. 306 (2011); Jasminka Kalajdzic, Peter Cashman & Alana Longmoore, *Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding*, 61 AM. J. COMP. L. 93 (2013); Michael Legg & Louisa Travers, *Necessity Is the Mother of Invention: The Adoption of Third-Party Litigation Funding and the Closed Class in Australian Class Actions*, 38 COMMON L. WORLD REV. 245 (2009); Michael J. Legg, *Shareholder Class Actions in Australia—The Perfect Storm?*, 31 U.N.S.W. L.J. 669 (2008); Ianika N. Tzankova, *Funding of Mass Disputes: Lessons from the Netherlands*, 8 J.L. ECON. & POL'Y 549 (2012).

272. *See supra* note 256.

273. *See, e.g.*, Stolt-Nielsen, S.A. v. AnimalFeeds Int'l Corp., 559 U.S. 662 (2010) (ruling that class arbitration jurisdiction is not proper unless class arbitration is expressly written into all of the parties' signed arbitration agreements, including every single class member).

do not have the power to enforce their own awards.<sup>274</sup> Under the Federal Arbitration Act, both domestic and foreign arbitral awards may be enforced through the entry of a judgment, after which the arbitral award must be treated exactly as though it were a domestic court judgment.<sup>275</sup> The Federal Arbitration Act applies in state courts as well as federal courts throughout the United States.<sup>276</sup> The Full Faith and Credit Clause of the U.S. Constitution requires all states to honor the judgments of the courts of other states.<sup>277</sup> In both litigation and arbitration, there is no requirement that the judgment or award reference the participation of a third-party funder, nor does the fact that the proceedings were funded have to be disclosed in order for enforcement to be effective. Even if a U.S. state prohibits third-party funding in its domestic law, that state's courts must enforce a judgment on a funded litigation matter heard in a sister state's

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274. *See infra* note 282.

275. *See* 9 U.S.C. § 13 (2012) (“an order confirming modifying or correcting an [arbitral] award” should be “filed with the clerk for the entry of judgment thereon. . . . The judgment shall be docketed as if it was rendered in an action. The judgment so entered shall have the same force and effect, in all respects, as, and be subject to all the provisions of law relating to, a judgment in an action; and it may be enforced as if it had been rendered in an action in the court in which it is entered.”); *id.* § 201 (“The Convention on the Recognition and Enforcement of Foreign Arbitral Awards of June 10, 1958 [i.e., the New York Convention], shall be enforced in United States courts in accordance with this chapter.”); *id.* § 207 (“Within three years after an arbitral award falling under the Convention is made, any party to the arbitration may apply to any court having jurisdiction under this chapter for an order confirming the award as against any other party to the arbitration. The court shall confirm the award unless it finds one of the grounds for refusal or deferral of recognition or enforcement of the award specified in the said Convention.”); *id.* § 208 (“Chapter 1 applies to actions and proceedings brought under this chapter [i.e., Chapter 2 of the FAA] to the extent that chapter is not in conflict with this chapter or the [New York] Convention as ratified by the United States.”). The effect of 9 U.S.C. § 208 is that that, once a New York Convention arbitral award has been confirmed, the award may be enforced through the same means as a domestic arbitration award according to 9 U.S.C. § 13, as described above. The same is true for arbitral awards confirmed under the Panama Convention. *See id.* § 301 (“The Inter-American Convention on International Commercial Arbitration of January 30, 1975 [i.e., the Panama Convention], shall be enforced in United States courts in accordance with this chapter [i.e. Chapter 3 of the FAA].”); *id.* § 307 (2012) (“Chapter 1 applies to actions and proceedings brought under this chapter [i.e. Chapter 3 of the FAA] to the extent chapter 1 is not in conflict with this chapter or the Inter-American Convention as ratified by the United States.”).

276. *See* *Preston v. Ferrer*, 552 U.S. 346, 349 (2008) (“As this Court recognized in *Southland Corp. v. Keating*, . . . the Federal Arbitration Act . . . establishes a national policy favoring arbitration when the parties contract for that mode of dispute resolution. The Act, which rests on Congress’ authority under the Commerce Clause, supplies not simply a procedural framework applicable in federal courts; it also calls for the application, in state as well as federal courts, of federal substantive law regarding arbitration.”).

277. U.S. CONST. art. IV, § 1.

court or a judgment entered by a sister state's court on a funded arbitral award.<sup>278</sup> Thus, enforcing a funded judgment or arbitral award in the United States—even in a U.S. state that disallows third-party funding—should not be difficult.

Outside of the United States, however, a winning party may encounter difficulties when trying to enforce a funded court judgment or funded arbitral award in a jurisdiction that has express laws or a public policy against funding, but only if the enforcing court finds out about the funder's involvement or that some of the awarded money will go to a funder. Many jurisdictions around the world find distasteful the idea that some money from the award or judgment will go to a private entity that became involved in the case solely for profit, even if the practice was legal at the procedural seat of the arbitration and under the applicable substantive law.<sup>279</sup>

The 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (commonly known as the New York Convention) includes a public policy exception by which an enforcing court can decline to enforce an otherwise valid arbitral award—specifically, a court can decline to enforce the award if it somehow violates public policy in the court's jurisdiction.<sup>280</sup> The United States has implemented the New York

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278. U.S. CONST. art. IV, § 1; *see also* DOUG RENDLEMAN, ENFORCEMENT OF JUDGMENTS AND LIENS IN VIRGINIA § 12.6[B] (3d ed. 2014) (“That a sister state’s judgment is based on substantive law that is contrary to the enforcing state’s public policy is an insufficient reason to deny it full faith and credit. . . . A state must allow a judgment creditor to collect a sister-state money judgment even though the sister-state substantive law the judgment is based on is repugnant to the collection state’s public policy.”).

279. *See* Catherine A. Rogers, *Gamblers, Loan Sharks, and Third-Party Funders*, in ETHICS IN INTERNATIONAL ARBITRATION 177 (2014) (discussing the historical viewpoint that money lending for lawsuits was immoral and mentioning that, in modern times, funders may be likened to vulture investors, gamblers, or loan sharks); *see also* W. Bradley Wendel, *Alternative Litigation Finance and Anti-Commodification Norms*, 63 DEPAUL L. REV. 655, 656 (2014) (“One frequently encounters a sentiment that there is something fishy, even distasteful, about ALF. For example, a widely noted article in *Fortune* magazine cast a suspicious eye at the emerging litigation funding industry, concluding: ‘Dress it up as you like, there’s something about all this secret meddling in other people’s bitterest disputes and profiting from them that doesn’t sit well. You begin to sense why those benighted Puritans of yore banned these practices.’”).

280. *See* United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art. V(2)(b), *opened for signature* June 10, 1958, 21 U.S.T. 2517, [http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/XXII\\_1\\_e.pdf](http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/XXII_1_e.pdf) [<http://perma.cc/3VAY-T3QX>] (last visited Dec. 13, 2015) [hereinafter New York Convention]. In addition, the New York Convention is the main vehicle for enforcement of arbitration awards worldwide. At the time of this writing, 155 countries have signed the New York Convention. For a current list of signatories to the New York Convention, *see Status: Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, U.N. COMM’N INT’L TRADE LAW, [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html) [[http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html)].

Convention domestically through Chapter 2 of the Federal Arbitration Act (FAA).<sup>281</sup> Notably, the FAA incorporates by reference key provisions of the New York Convention, such as in 9 U.S.C. § 207, which states that, “the court shall confirm the award unless it finds one of the grounds for refusal or deferral of recognition or enforcement of the award specified in the said Convention.”<sup>282</sup> This language refers to the public policy exception found in Article V(2)(b) of the New York Convention, which states that the court may sua sponte deny enforcement if “[t]he recognition or enforcement of the award would be contrary to the public policy of that country [where enforcement is sought].”<sup>283</sup> For the reasons discussed above, a U.S. court cannot use the public policy exception to deny enforcement to a funded arbitral award or judgment.<sup>284</sup> Given the other limited grounds for vacating or setting aside an international arbitration award under the FAA, addressing third-party funding in international arbitrations seated in the U.S. through domestic arbitration laws would be unnecessary.<sup>285</sup> Nevertheless, as mentioned in Part II.B.2, one of the grounds for refusing enforcement of any arbitral award is the revelation of an undisclosed conflict of

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perma.cc/LQ79-KG3Y] (last visited Dec. 17, 2015); *see also* Trusz, *supra* note 207, at 1668 (discussing the grounds for vacating an arbitral award under Section 10 of the Federal Arbitration Act due to the “partiality” or “corruption” of the arbitrators); *id.* at 1669 (discussing grounds for nonenforcement of an arbitral award under the New York Convention relating to an arbitrator’s connection to a third-party funder); *cf.* United Paperworkers Int’l Union v. Misco, Inc., 484 U.S. 29, 42 (1987) (“A court’s refusal to enforce an arbitrator’s award under [an arbitration] agreement because it is contrary to public policy is a specific application of the more general doctrine, rooted in the common law, that a court may refuse to enforce contracts that violate law or public policy.”).

281. *See* 9 U.S.C. § 201 (2012).

282. *See id.* §§ 9, 207 (Federal Arbitration Act sections on enforcing arbitration awards); New York Convention, *supra* note 280. Third-party funding is also prevalent in investor-state arbitration, which is typically authorized by a treaty and most often takes place under the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, also known as the “ICSID Convention” or the “Washington Convention,” which presently has 159 signatories. For a current list of signatories to the ICSID Convention, see *Database of Member States*, ICSID, <https://icsid.worldbank.org/apps/ICSIDWEB/about/Pages/Database-of-Member-States.bak.aspx> [<https://perma.cc/B6VT-KPLJ>] (last visited Dec. 15, 2015).

283. New York Convention, *supra* note 280.

284. *See supra* note 278 and accompanying text.

285. *See generally* 9 U.S.C. § 10 (2012) (listing the only available grounds for a state or federal court to vacate a domestic arbitration award); New York Convention, *supra* note 280, at art. V (listing the only available grounds for courts within contracting states, including the United States, to decline to recognize or enforce an international arbitration award). For international arbitration, promulgating guidelines at the international level through arbitral institutions and international bar associations would be most effective. For an example of a global effort to create such guidelines for international arbitration, see ICCA, *infra* note 292.

interest that leads to the appearance of bias on the part of the arbitrator.<sup>286</sup> Thus, any relationship between an arbitrator and a third-party funder should be disclosed at the outset.<sup>287</sup>

Some jurisdictions, like Hong Kong, explicitly allow third-party funding in international arbitration while generally prohibiting the practice in domestic litigation.<sup>288</sup> In contrast, other jurisdictions, like Singapore, currently prohibit third-party funding in all forums, including international arbitration.<sup>289</sup> Most countries fall somewhere in between. The current regulatory landscape in the United States is unclear at best, but it appears that the laws in roughly two-thirds of the states would allow third-party funding in international arbitration proceedings seated in the United States.<sup>290</sup>

The author has yet to hear of an example of a court declining to enforce an arbitral award solely because of a third-party funder's involvement, but there is a possibility that it may have already happened in private or that it will happen in the future. In addition, arbitral institutions and arbitrators have a duty to work to ensure the enforceability of arbitral awards to the extent that enforceability is within their control.<sup>291</sup> If we have clear standards governing the involvement of

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286. See Trusz, *supra* note 207, at 1652 (discussing how an undisclosed arbitrator conflict of interest with a funder may cause the award to be annulled or denied recognition or enforcement).

287. See IBA GUIDELINES, *supra* note 98 and accompanying text.

288. NIEUWVELD & SHANNON, *supra* note 12, at 227–31 (addressing the laws on third-party funding in Hong Kong). *But see* Law Reform Commission of Hong Kong, *Third Party Funding for Arbitration (HKLRC Consultation Paper)*, <http://www.hkreform.gov.hk/en/publications/tpf.htm> (soliciting public comment on a consultation paper released by the Third Party Funding for Arbitration Sub-committee of the Law Reform Commission (LRC) “proposing that third party funding for arbitration taking place in Hong Kong should be permitted under Hong Kong law.”).

289. See *id.* at 237–38 (addressing the laws on third-party funding in Singapore). *But see*, *Review of the International Arbitration Act: Proposals for Public Consultation*, MINISTRY L. SINGAPORE GOVT, <http://www.mlaw.gov.sg/content/dam/minlaw/corp/assets/documents/linkclickf651.pdf> [<https://perma.cc/FS9B-H4KU>] (last visited Dec. 16, 2015) (soliciting public comment on a proposed amendment to allow third-party funding in international arbitration cases over 1 million Singapore dollars, subject to certain restrictions and requirements).

290. See NIEUWVELD & SHANNON, *supra* note 12, at 144–59 (presenting a state-by-state survey of the laws regarding third-party funding as of early 2012, including all 50 states and the District of Columbia).

291. See, e.g., SCC RULES, *supra* note 170, at art. 47 (“[T]he SCC, the Arbitral Tribunal and the parties shall act in the spirit of these Rules and shall make every reasonable effort to ensure that all awards are legally enforceable.”); HKIAC RULES, *supra* note 170, at art. 13.8 (“The arbitral tribunal shall make every reasonable effort to ensure that an award is valid.”); ICC RULES, *supra* note 208, at art. 41 (“In all matters not expressly provided for in the Rules, the Court and the arbitral tribunal shall act in the spirit of the Rules and shall make every effort to make sure that the award is enforceable at law.”); LCIA RULES, *supra* note 170, at art. 32.2 (“[T]he LCIA Court, the LCIA, the Registrar, the Arbitral Tribunal and each of the parties shall act at all times in good faith, respecting the spirit of the Arbitration Agreement, and shall make every reasonable effort to

third-party funders to allay due process and undue interference concerns, then courts worldwide will be less likely to decline to enforce a judgment or award in the future simply on the basis of a third-party funder's involvement.

### CONCLUSION

This Article has proposed various revisions to, and reinterpretations for, the Federal Rules of Civil Procedure and rules of arbitration procedure to address issues relating to the phenomenon of third-party funding. A working definition of a "third-party funder" and "third-party funding" would be very helpful, even though any definition coined at this stage may be overinclusive or underinclusive.<sup>292</sup> In addition, the procedural rules identified in this Article should be revised to require funded parties to make certain disclosures to the judge or arbitrator.<sup>293</sup> The funded party should be required to disclose to the judge or arbitrator the identity of the third-party funder so that the judge or arbitrator can determine whether he or she has a connection to the funder that would require recusal.<sup>294</sup> A funded party should also be required to disclose the third-party funding arrangement to the judge or arbitrator when that party claims attorney's fees under applicable law or if the judge or arbitrator orders disclosure of any fee arrangements.<sup>295</sup> Disclosure of third-party funding to the opposing side should not be mandatory because the participation of the funder is not material to the merits of the underlying dispute or to the payment of the underlying judgment.<sup>296</sup> The parties have the power under the existing rules, however, to come to an enforceable agreement during the pretrial conference regarding the disclosure or confidentiality of funding arrangements.<sup>297</sup> Furthermore, in order to prevent waiver of evidentiary privileges for information shared with the funder, funders should be included

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ensure that any award is legally recognized and enforceable at the arbitral seat."); SIAC RULES, *supra* note 170, at art 37.2 ("[T]he President, the Court, the Registrar and the Tribunal shall act in the spirit of these Rules and shall make every reasonable effort to ensure the fair, expeditious and economical conclusion of the arbitration and the enforceability of any award.").

292. This comment was made during the February 12, 2014 and February 12, 2015 meetings of the Third-Party Funding Taskforce. See generally *Third-Party Funding*, ICCA, [http://www.arbitration-icca.org/projects/Third\\_Party\\_Funding.html](http://www.arbitration-icca.org/projects/Third_Party_Funding.html) [<http://perma.cc/PJH9-V6VX>] (last visited Dec. 16, 2015). The international arbitration community hopes to devise a set of guidelines or rules for the practice. See also IBA GUIDELINES, *supra* note 98 and accompanying text.

293. See *supra* Part II.B.

294. See *id.*

295. See *supra* Part II.C.

296. See *supra* Part II.A.1.

297. See *supra* note 147 and accompanying text.

within the exceptions to the waiver of evidentiary privileges, which would require amending state and federal common law rather than the Federal Rules.<sup>298</sup> Arbitration borrows evidentiary privileges from national laws around the world based on the preferences of the parties and arbitrators, so revising arbitration rules to address evidentiary privileges would be unnecessary and would likely violate the trans-substantive principle of litigation and arbitration rules of procedure.<sup>299</sup>

Rule revisions are not likely to happen anytime soon, but fortunately, the existing Federal Rules and rules of arbitration provide a framework for judges and arbitrators to handle potential third-party funding issues as they arise. In addition, both litigation and arbitration rules authorize the judge or arbitrator to devise case-by-case solutions to novel problems for which there is no formal rule on point. These existing features of dispute resolution will help ensure that decision makers can address any issues that may arise, even before revisions to the procedural rules. As the third-party funding industry grows and matures, rule revisions may be needed, particularly in the context of funded class action litigation under Federal Rule 23 and funded class arbitration, if those phenomena become more prevalent. Careful observation and documentation of the participation of third-party funders in the dispute resolution system will be integral and essential to any future consideration of relevant revisions to litigation or

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298. See *supra* Part II.A.1.

299. Compare Robert M. Cover, *For James Wm. Moore: Some Reflections on a Reading of the Rules*, 84 YALE L. J. 718, 718 (1975) (“We have become so transfixed by the achievement of James Wm. Moore and his colleagues in creating, nurturing, expounding and annotating a great trans-substantive code of procedure that we often miss the persistent and inevitable tension between procedure generalized across substantive lines and procedure applied to implement a particular substantive end. There are, indeed, trans-substantive values which may be expressed, and to some extent served, by a code of procedure. But there are also demands of particular substantive objectives which cannot be served except through the purposeful shaping, indeed, the manipulation, of process to a case or to an area of law. What follows is by no means an attempt to denigrate or undermine the ongoing trans-substantive achievement of the Federal Rules of Civil Procedure. Rather it is an exploration to rediscover the feel of a tension.”) with Geoffrey C. Hazard, Jr., *Discovery Vices and Trans-Substantive Virtues in the Federal Rules of Civil Procedure*, 137 U. PA. L. REV. 2237, 2244 (1989) (“The second principal criticism of the Federal Rules is that they indiscriminately govern all kinds and types of litigation, whereas civil procedure rules properly constructed would be shaped to the needs of specific categories of litigation. This critique contemplates separate sets of rules for civil rights cases, antitrust cases, routine automobile cases, and so on. The criticism has been expressed perhaps most incisively by Professor Robert Cover, esteemed colleague prematurely gone from us. Yet despite the great respectability of its source, the ‘trans-substantive’ critique seems misguided to me. It overstates the reach of the Federal Rules and underestimates the technical and political difficulties of trying to tailor procedures to specific types of controversies.”). Regarding the trans-substantivity of arbitration, compare *supra* note 88.

arbitration rules.<sup>300</sup> In the meantime, judges and arbitrators already have the tools they need to begin observing and addressing issues of third-party funding within the framework of the existing litigation and arbitration rules.<sup>301</sup>

By implementing the foregoing rule revisions and reinterpretations, judges and arbitrators will position themselves to identify and observe instances of third-party funding in their natural habitat—that is, during litigation or arbitration proceedings. Furthermore, they will be able to observe ordinary, routine instances of third-party funding, which will likely lead to more universal regulatory insights than the few outlier instances of third-party funding revealed by accident or through a party's settlement strategy. Over time, these observations will answer many of society's pressing questions to reveal the true systemic impact of third-party funding. How prevalent is third-party funding? What is the effect of third-party funding on parties, counsel, procedures, and outcomes in dispute resolution? What benefits and problems can we identify? Are those benefits and problems different or the same as we predicted or surmised? Should we incentivize those benefits and regulate those problems, and if so, how? We currently cannot answer these questions without more data. Moreover, many third-party funders are in favor of disclosure during the proceedings, and regulation of their industry makes it more reputable and legitimate.<sup>302</sup> Thus, the

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300. Cf. *Advisory Committee on Civil Rules*, *supra* note 75, at 79 (“The Conference also prompted a project launched by the Committee and the National Employment Lawyers Association to develop protocols for initial discovery in individual employment cases. The protocols were developed by a team of lawyers evenly balanced between those who commonly represent employees and those who commonly represent employers. The protocols have been adopted by numerous District Judges; experience with the protocols has led to calls for more widespread adoption, and the hope that similar protocols might be developed for other categories of litigation. These programs of education and innovative pilot projects continue.”).

301. See *supra* Part II.A (suggesting ways in which judges can interpret the existing rules of litigation procedure and arbitrators can interpret the existing rules of arbitration procedure in light of third-party funding, in addition to proposing future revisions to those rules).

302. See e.g., *Who We Are*, ALLIANCE FOR RESPONSIBLE CONSUMER LEGAL FUNDING, <http://arclegalfunding.org/about-2/> [http://perma.cc/6H43-97R4] (last visited Dec. 16, 2015) (“The Alliance for Responsible Consumer Legal Funding (ARC) is a coalition established to ensure the proper regulation of the legal funding industry in the United States. ARC aims to accomplish this mission by advocating at the state level for rules containing appropriate pricing and a high degree of consumer protection—including adequate licensing and disclosure requirements, and suitable limitations on fees—and at the federal level by working with policymakers to help ensure the alignment of federal and state regulatory efforts affecting the legal funding industry.”); *About Us*, ASS'N LITIG. FUNDERS, <http://associationoflitigationfunders.com/about-us> [http://perma.cc/GU5X-J6CW] (last visited Dec. 16, 2015) (“The Association of Litigation Funders (the ALF) is an independent body that has been charged by the Ministry of Justice, through the Civil Justice Council, with delivering self-regulation of litigation funding in England and Wales.”).

proposed rule revisions and reinterpretations should be viewed as an interim regulatory structure with the goal of gleaning more data, through disclosure and observation, about the prevalence, structures, and impact of third-party funding within litigation and arbitration. This data would inform the next step of regulation.