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Inoperability of Arbitration Agreements due to Lack of Funds? Revisiting Legal Aid in International Arbitration

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In a recent decision, the Swiss Federal Tribunal rejected an appeal to set aside a final award of the Court of Arbitration for Sport ("CAS") (Decision of the Swiss Federal Tribunal ("DFT") of 11 June 2014, 4A_178/2014). The appellant, a professional cyclist who faced disciplinary charges after testing positive in an anti-doping test, argued *inter alia* that the CAS tribunal had violated the principle of equal treatment and public policy by rejecting his request for legal aid. The Federal Tribunal, however, found that the appellant's arguments failed for lack of substantiation. It particularly held that since legal aid is excluded for domestic arbitration in Switzerland (Article 380 Civil Procedure Act), there is no reason why this principle should not also apply to international arbitration.

For procedural reasons, the Swiss Federal Tribunal then left open the issue whether and under what conditions a party may unilaterally terminate an arbitration agreement for lack of financial resources to initiate and pursue arbitration proceedings, in order to then bring its case before the state courts, along with a request for legal aid. In doing so, the Federal Tribunal however referred to several legal scholars in Switzerland that all acknowledge the impecunious parties' right to free themselves of an arbitration agreement they have entered into for good cause, to ensure that they can exercise their right of access to justice as guaranteed particularly under Article 6(1) of the European Convention on Human Rights (reference was particularly made to Berger/Kellerhals, International and Domestic Arbitration in Switzerland, 2nd ed. 2010, N 1043; Kaufmann-Kohler/Rigozzi, Arbitrage International, 2nd ed. 2010, N 280; Dasser in: Oberhammer *et al.* (eds), Kurzkommentar ZPO, 2nd ed. 2013, Article 380 N 3).

A comparative analysis of different arbitration laws reveals that diverging views exist as to whether the lack of sufficient funding may have an impact on the applicability of arbitration agreements. For example, while the right to terminate the arbitration agreement was originally also acknowledged in Germany, the German Federal Court of Justice ("Bundesgerichtshof") went one step further in its bespoken "plumber's case", when it ruled that the impecuniosity of a party may render the arbitration agreement "inoperative or incapable of being performed", thus allowing the impecunious party to validly commence proceedings before state courts (Bundesgerichtshof, 14 September 2000, III ZR 33/2000, BGHZ 145, 116). English courts adopted a different view when they held that the lack of sufficient funding should only justify the rendering of arbitration agreements as "incapable of being performed" or "inoperative", if the lack of funding is due to the

same breach of contract which is the issue in dispute (Janos Paczy v. Haenlder & Natermann GmbH [1981] 1 Lloyd's Rep 302 (CA); see also Wagner, Impecunious Parties and Arbitration Agreements, SchiedsVZ 2003, Heft 5, pp. 206 *et seq.*).

By balancing the right of access to justice with the principle of *pacta sunt servanda*, these approaches tend to refer impecunious parties to state courts if their right of access to justice appears to be at risk. The consequences are far-reaching: Valid arbitration agreements are set aside and cases are brought before state courts, despite the parties' agreement on a settlement of their dispute by means of arbitration before a neutral forum. Not least in view of possible strategic attempts to circumvent arbitration agreements in this manner, it is not surprising that a cautious and restrained acknowledgment of such cases has been called for (see, e.g., Kühner, The Impact of Party Impecuniosity on Arbitration Agreements: The Examples of France and Germany, Journal of International Arbitration 2014, Volume 31 Issue 6, p. 816; Wagner, loc. cit., pp. 211, 213-214). What these discussions however generally do not address are the questions whether and, if so, how legal aid or other forms of financing access to justice should be made available or can be improved for international arbitration. The reason for such an omission may well be that it is rather difficult to find mechanisms which provide a solution to the problem.

In state court proceedings, the right to legal aid is acknowledged as a means to prevent a party's lack of financial resources resulting in a loss of its rights. Legal aid generally comprises an exemption from the obligation to pay advances and provide security, an exemption from court costs, as well as the appointment – usually by the court – of a legal agent at the government's expense, if this is perceived as necessary to protect the rights of the party concerned.

The right to legal aid however does not apply to arbitration proceedings in numerous jurisdictions (Berger/Kellerhals, loc. cit., N 572 and N 1043). The exclusion of legal aid for Swiss domestic arbitration – to which the Swiss Federal Tribunal referred in its decision – is frequently explained with the argument that arbitration lies outside of the scope of state court proceedings. According to this line of argument, it is not the state's responsibility to make proceedings before tribunals more accessible if they are not part of the state judiciary (see DFT 99 Ia 325, consid. 3b). Furthermore, it is generally pointed out that the parties that submit to arbitral proceedings do so on a voluntary basis and thus renounce to the advantages of state court proceedings, which include the possibility of requesting legal aid (Dasser, loc. cit., Article 380 N 2, N 6 *et seq.*; Stacher in: Boog *et al*. (eds), Berner Kommentar zur Schweizerischen Zivilprozessordnung, Band III 2014, Article 380 N 2).

The question that remains for both domestic and international arbitration is how to deal with situations in which the parties to the dispute do not meet on equal terms for financial reasons. Legal scholars have particularly pointed this out in view of recent developments to include arbitration clauses in consumer contracts as well as employment contracts or contracts on medical care – a development that is currently particularly observed in the United States (see, e.g., Niedermaier, Arbitration Agreements between Parties of Unequal Bargaining Power, ZDAR 1/2014, pp. 12-13).

Sports arbitration has also been the subject of criticism in this regard, due to the fact that arbitration is generally mandatory for athletes. In response to this situation, legal aid as well as "pro bono counsels" have been made available for arbitration before the CAS, thereby proving the Swiss Federal Tribunal's finding wrong according to which legal aid is not applicable to international arbitration. Pursuant to Article 5 of the Guidelines on Legal Aid that have entered into force as of 1 September 2013 (available at), "*legal aid is granted (…) to any natural person provided that his*

income and assets are not sufficient to allow him to cover the costs of proceedings, without drawing on that part of his assets necessary to support him and his family". Legal aid is however refused "*if it is obvious that the applicant's claim or grounds of defence have no legal basis*" as well as "*if it is obvious that the claim or grounds of defence are frivolous or vexatious.*" Applicants are requested to make their requests in writing by enclosing a completed and signed "Legal Aid Application Form" to the CAS Court Office. It is then the President of the International Council of Arbitration for Sport ("ICAS") that decides on the requests for legal aid and gives reasons for his decision (for an overview see also Rigozzi/Hasler, Chapter 5, Part III: Commentary on the CAS Procedural Rules, Article R64, in: Arroyo (ed.), Arbitration in Switzerland, The Practitioner's Guide 2013, pp. 1069-1071). Whether similar mechanisms are conceivable for other areas of arbitration, remains questionable at present.

This is not least due to the fact that one of the first issues that comes up when discussing legal aid in arbitration is where the required funding can be made available from. An approach that has been suggested for institutional arbitration involves the creation of respective funds by arbitration centers that are fed by surpluses of fees levied in other arbitration cases, as most if not all institutions do not have any other resources. In practice, however, such a mechanism of legal aid has not been established and it appears to be questionable, whether such a form of "public service" should at all be made available for arbitration (see, e.g., Kudrna, Arbitration and Right of Access to Justice: Tips for a Successful Marriage, in: New York University Journal of International Law and Politics Online Forum, February 2013, p. 8 with further references [available at]; Cremades, La falta de recursos economicos para participar al arbitraje pactado, in: Fernàndez-Ballesteros/Arias (eds), 2010 Spain Arbitration Review, Issue 8, pp. 162-163). It will be particularly interesting in this context to follow the legislative process in Switzerland regarding the Swiss Federal Financial Services Act, as the current draft seeks to facilitate the adjudication of private clients' claims *vis-à-vis* financial service providers. For this purpose, the draft Act suggests a cost-effective or cost-free arbitration solution or as an alternative a "procedural costs fund" as a new form of financing – the latter, however, limited to state court proceedings. The parliamentary discussion of the draft has yet to follow.

But there are also other means of facilitating impecunious parties' access to arbitration. For example, one party may agree to pre-finance the costs of its counterparty in whole or in part until the final award is rendered. Such a solution is envisaged, for example, by the model arbitration clauses for trusts and foundations under the 2012 Rules of Arbitration of Liechtenstein (available at). Where institutional rules provide for a system that allows parties to also pay their counterparty's share of the advance on costs if that party is in default, this generally only works in situations where the respondent party is in default and the claimant party is willing to bear additional costs in order to be able to bring its case before an arbitral tribunal. But the situation is quite different when it is the claimant party that lacks financial resources, since a respondent party will have little cause to help fund the counterparty's claim.

Particularly in order to address constellations in which the claimant is unable to pay its share on the advance on costs, it is at least conceivable that an arbitral institution could lower the advance that would normally result from the institution's scale of costs. It is also imaginable that the impecunious party would be allowed to pay the advance on costs in installments. In practice, however, arbitral institutions will usually be reluctant to accord any special treatment to a party because of its alleged impecuniosity, particularly in view of the principle of equal treatment (see Cremades/Mazuranic, Chapter 9: Costs in Arbitration, in: Geisinger/Voser (eds), International Arbitration in Switzerland: A Handbook for Practitioners, 2nd ed. 2013, p. 186).

Where classic legal aid mechanisms that involve the judicial system's support are not available, private funding mechanisms may provide remedies. However, bank-related instruments such as bank loans or bank guarantees for example, tend to only be available to parties that are financially sound at the time of contracting with the banks (see, e.g., Kröll, Bank-related Instruments to Secure the Right to Arbitration despite the Impecuniousness of a Party, in: German Institution of Arbitration (ed.), Financial Capacity of the Parties, 2004, pp. 151-164; Cremades, loc. cit., pp. 161-163). Additionally, third-party funding may be an option. Third-party funding is an increasingly used mechanism, according to which a professional of the finance industry bears all the costs related to the arbitration proceedings against a portion of the proceeds collected from the losing party if the case is won. If the case is lost, the funded party has no reimbursement obligation towards the funder. As confirmed by the Swiss Federal Tribunal, third-party funding is allowed in Switzerland (DFT 131 I 223). However, it is important to consider in advance the questions that such a financing mechanism may raise. For example, confidentiality issues may arise. Additionally, third-party funding will generally have to be disclosed, not least to avoid conflict of interest situations (see, e.g., Roney/von der Weid, Third-Party Funding in International Arbitration: New Opportunities and New Challenges, in: Müller/Rigozzi (eds), New Developments in International Commercial Arbitration 2013, 2013, pp. 183 *et seq.*). Perhaps the contingent fee practice could also be of some use in situations of impecunious claimant parties, but it may raise issues of admissibility under ethical provisions of the applicable bar rules and would most likely leave the burden of the cost of the arbitral tribunal on the shoulders of the losing party.

As this brief outline shows, with the exception of the CAS legal aid guidelines, there are practically no available mechanisms that correspond with the traditional system of legal aid granted by state courts. Elaborating further on possible solutions to avoid that arbitral agreements become inoperative remains an interesting challenge.

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