

HEY, BIG SPENDER: Ethical Guidelines for Dispute Resolution Professionals when Parties Are Backed by Third-Party Funders

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A man without ethics is like a wild beast loosed upon this world.
— Albert Camus

INTRODUCTION

This first-of-its-kind paper introduces ethical guidelines and suggested practices for dispute resolution providers and neutrals when third-party funders provide financial backing for parties in U.S. domestic arbitrations and mediations.¹ Sophisticated third-party funders have realized that litigation and dispute resolution are fast-growing, unregulated investment opportunities.² Seizing these opportunities, third-party funders are now

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1. See LISA BENCH NIEUWVELD & VICTORIA SHANNON SAHANI, THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION 129–74 (Wolters Kluwer 2d ed. 2017); Memorandum from Patrick A. Tighe, Rules Law Clerk to Ed Cooper et al. (Feb. 7, 2018), in ADVISORY COMM. ON CIVIL RULES, AGENDA BOOK 209, 215 (2018), <http://www.uscourts.gov/sites/default/files/2018-04-civil-rules-agenda-book.pdf> [<https://perma.cc/K9EB-QL3B>]. Domestically, states have taken an inconsistent approach regarding third-party funding as evidence by states' statutes, case law and rules. Those states that have adopted any rules and regulations focus on disclosure in litigation and the boundaries of permissible funding arrangements. None of these rules and regulations address the ethical issues for dispute resolution providers and neutrals that arise when a party is receiving third-party funding.

2. See John Breslin, *Funding Litigation a Billion-Dollar Business*, LEGAL NEWSLINE (Aug. 30, 2017), <http://legalnewsline.com/stories/511198462-funding-litigation-a-billion-dollar-business> [<https://perma.cc/6XZH-GHJT>]; Vanessa O'Connell, *Funds Spring Up to Invest in High-Stakes Litigation*, WALL ST. J. (Oct. 3, 2011), <https://www.wsj.com/articles/SB10001424052970204226204576598842318233996> [<https://perma.cc/69VW-ATNM>].

making billions of dollars in profits through their strategic investments in domestic and global litigation and dispute resolution with few ethical rules or regulations to curtail their investment behavior.³ Preferring to be secretive about the terms of their funding contracts and invisible in their work, third-party funders are flourishing, in large part, by operating below the regulatory radar.⁴ The funders' behavior has been allowed to proceed invisible and unchecked because courts and dispute resolution providers and neutrals are too often unaware that a party is even receiving third-party funding. Such unawareness, however, presents a potential ethical minefield, not just for judges and litigators, but also for dispute resolution providers and neutrals.

A discordant chorus of courts,⁵ business gurus⁶ and legal scholars, slowly becoming aware of the potential ethical conflicts, have begun to voice

3. See, e.g., sources cited *supra* note 1; see also Matthew Andrews, *The Growth of Litigation Finance in DOJ Whistleblower Suits: Implications and Recommendations*, 123 YALE L.J. 2422, 2428–29 (2014) (discussing how litigation funding is a lucrative, growing industry that invests in a range of cases including personal injury, employment discrimination, intellectual property, and other commercial disputes); GEOFFREY MCGOVERN ET AL., RAND INST. FOR CIVIL JUSTICE, *THIRD-PARTY LITIGATION FUNDING AND CLAIM TRANSFER: TRENDS AND IMPLICATIONS FOR THE CIVIL JUSTICE SYSTEM* 12 (2010), https://www.rand.org/pubs/conf_proceedings/CF272.html [<https://perma.cc/QA2Z-J7U7>] (reporting that third-party funding is a multibillion dollar industry).

4. See NIEUWVELD & SAHANI, *supra* note 1, at 159–73 (indicating a growing minority of states that have statutes requiring disclosure in the litigation context); see, e.g., Maya Steinitz, *Whose Claim Is This Anyway? Third-Party Litigation Funding*, 95 MINN. L. REV. 1268, 1277–78 (2011) (“In international arbitrations, the reason for this expansion [of third-party funding] is partly a de facto absence of professional regulations that enables funders and attorneys to operate outside of the disciplinary reach of bar associations.”).

5. Compare Alison Frankel, *New York’s Top Court Clamps Down on Shoestring Litigation Funders*, REUTERS (Oct. 28, 2016, 1:50 PM), <http://www.reuters.com/article/us-frankel-litigation/new-yorks-top-court-clamps-down-on-shoestring-litigation-funders-idUSKCN12S2M3> [<https://perma.cc/36TD-APAL>] (describing recent N.Y. Court of Appeals decision that expanded the reach of champerty), and Kevin LaCroix, *Courts Throw Some Shade at Litigation Funding Arrangements*, D&O DIARY (Oct. 9, 2016), <http://www.dandodiary.com/2016/10/articles/litigation-%20financing-2/courts-throw-shade-litigation-funding-arrangements/> [<https://perma.cc/CA9H-H46P>] (describing cases in which funding arrangements were recently nullified in both Pennsylvania and Delaware), with *Digging Didn’t Help—Court Decision Supports Commercial Litigation Funding*, BENTHAM IMF (Feb. 12, 2014), <http://www.benthamimf.com/blog/blog-full-post/bentham-imf-blog/2014/02/12/digging-didn-t-help--court-decision-supports-commercial-litigation-funding> [<https://perma.cc/8EWV-QMEP>] (describing recent decision in the Northern District of Illinois that held confidential communications between party and funder were protected by work product doctrine).

6. See Alison Frankel, *Business Lobby Calls for Federal Rules to Require Litigation Funding Disclosure*, REUTERS (June 2, 2017, 11:55 AM), <http://www.reuters.com/article/us-otc-funding-idUSKBN18T2QR> [<https://perma.cc/UT2R-RJE7>]. More than two dozen business groups including the U.S. Chamber of Commerce are advocating that the Federal Rules of Civil Procedure be modified to require parties to disclose if they are backed by third-party funders.

concerns that third-party funders may be traversing proscribed ethical boundaries involving the practice of law. This growing group is calling for greater visibility, transparency and ethical scrutiny of third-party funding practice in litigation. Of course, when parties disagree, courts are the final arbiter of whether or not the practice of third-party funding is even legal.⁷ However, once courts resolve the threshold issue of legality, there is growing support among the judiciary and legal community to require litigants to disclose if they are receiving economic support by a third-party funder.⁸ Without such mandatory disclosure our legal system is unable to address the real and potential ethical concerns about how third-party funders are adversely affecting the attorney-client relationship, controlling settlement, and potentially posing conflicts of interest with all involved in the case.

Until now, such heated discourse in the United States about the ethics of third-party funders has focused primarily on the ethics of third-party funding in litigation, while only cursorily addressing the ethical issues of third-party funders in U.S. domestic arbitration, a quasi-litigation procedure.⁹ Even more curious, the ethics of third-party funders in mediation, a party-directed procedure, has been conspicuously absent from the conversation. Since the lion's share of legal cases are resolved by dispute resolution settlement rather than court judgment,¹⁰ it makes more sense that any discussion about the

7. See AM. BAR ASSOC. COMM'N ON ETHICS 20/20, INFORMATIONAL REPORT TO THE HOUSE OF DELEGATES 1 (2012), https://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.pdf [<https://perma.cc/RS55-PQK4>] [hereinafter ABA 20/20 REPORT].

8. See Dorothy Murray & Edmund Northcott, *Thoughts on Disclosure of Third Party Funding*, LEXOLOGY (June 20, 2017), <https://www.lexology.com/library/detail.aspx?g=d01612dd-5a78-4f8a-ae6c-22ba3c064630> [<https://perma.cc/VUA6-NVM4>]; Jason D. Russell & Hillary A. Hamilton, *Third-Party Litigation Financing: Mandatory Disclosure on the Horizon?*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP & AFFILIATES (Apr. 19, 2017), <https://www.skadden.com/insights/publications/2017/04/thirdparty-litigation-financing-mandatory-discl> (“Recent developments indicate that courts, rule committees and even Congress may be leaning toward mandatory disclosure of third-party litigation funding in civil litigation.”). *But see* Sam Reisman, *Critics Pushing Back on 3rd-Party Funding Disclosure Rule*, LAW360 (June 21, 2017, 7:08 PM), <https://www.law360.com/articles/935786/critics-pushing-back-on-3rd-party-funding-disclosure-rule> [<https://perma.cc/WW6H-XWXZ>].

9. Our global brethren, however, have addressed the ethics of third-party funding in the context of international arbitration. This is discussed later in the section. *See generally* INT’L COUNCIL FOR COMMERCIAL ARBITRATION, REPORT OF THE ICCA-QUEEN MARY TASK FORCE ON THIRD-PARTY FUNDING IN INTERNATIONAL ARBITRATION (2018), http://www.arbitration-icca.org/media/10/40280243154551/icca_reports_4_tpf_final_for_print_5_april.pdf [<https://perma.cc/A27G-P34A>] [hereinafter ICCA REPORT].

10. See Marc Galanter, *The Vanishing Trial: An Examination of Trials and Related Matters in Federal and State Courts*, 1 J. EMPIRICAL LEGAL STUD. 459, 461 (2004); Patricia Lee Refo, *The Vanishing Trial*, 30 LITIG., Winter 2004, at 2 (2004), https://www.americanbar.org/content/dam/aba/publishing/litigation_journal/04winter_openingst

ethical conduct of third-party funders should address the ethical conduct of third-party funders in those dispute resolution procedures that help promote settlement. The presence of a third-party funder in a dispute resolution procedure may collide with the ethical obligations of dispute resolution providers and neutrals, unless affirmative steps are taken to avoid the collision.¹¹ This paper fills in that information gap, expands the evolving discussion about the ethics of third-party funding, and refocuses on providing ethical guidance for dispute resolution providers and neutrals when litigation funders back parties in arbitration and mediation.

Our global brethren, who have long embraced litigation funding as an economic necessity to fund the escalating costs of litigation, have also begun to heed this warning and promulgate ethical rules to guide third-party funders' behavior in dispute resolution.¹² Globally, there are now legislative and regulatory initiatives that require greater transparency when litigation funders are providing financial backing for parties in international arbitration and mediation.¹³ In the United States, however, there is ambivalence about the legitimacy of litigation funding.¹⁴ This paper is the first proposal for coordinated ethical guidelines for alternative dispute resolution providers and neutrals to follow when third-party funders are backing parties in domestic arbitration and mediations.

In order to develop responsive ethical guidelines for working with third-party funders in dispute resolution, we must first grasp the complexities and nuances of third-party funders, and this paper provides that context. Part I chronicles the evolutionary role of third-party funders. It explains who third-party funders are, why they were once prohibited, and the many permutations in which they now exist. Part II provides an overview of two global initiatives that provide ethical guidance when litigation funders are backing parties in a dispute resolution procedure. Even though global legal regimes present different ethical challenges, it is instructive to take the international pulse on this emerging issue and see which ideas can be transported to the United States.

In Part III, the discussion focuses on the U.S. response to third-party funders by highlighting notable court decisions, the American Bar Association's Commission on Ethics 20/20 report, and public interest research on this emerging topic. Part III helps identify the U.S. areas of

atement.authcheckdam.pdf [https://perma.cc/W9X6-QXGX] (stating that approximately 1.8% of federal cases were actually decided by an adjudicated decision).

11. See Victoria Shannon Sahani, *Reshaping Third-Party Funding*, 91 TUL. L. REV. 405, 426–28 (2017).

12. See generally ICCA REPORT, *supra* note 9.

13. See generally *id.*

14. See NIEUWVELD & SAHANI, *supra* note 1, at 157.

agreement and concern that need to be incorporated into any ethical guidelines and best practices for dispute resolution providers and neutrals. Part IV outlines suggested ethical guidelines and best practices for dispute resolution providers, arbitrators, and mediators to follow when parties are receiving third-party funding. This discussion concludes by recognizing that this paper is an overdue acknowledgment that third-party funders are backing parties in dispute resolution procedures and a recognition that additional ethical issues will emerge. The reader is left with additional questions that the dispute resolution community may want to consider as third-party funders continue to play an evolving role in dispute resolution.

I. THE EVOLVING ROLE OF THIRD-PARTY FUNDERS

The narrative about how third-party funding has evolved from a proscribed practice to an economic reality sheds light on the vestiges of concern about third-party funders that persist today. It also provides a historical context for readers to better understand the ethical concerns that should be addressed when third-party funders are backing a party in a dispute resolution mechanism.

Historically, legal systems have had a long-standing antagonism towards those third parties who try to inject themselves into the litigation of others. In large part, courts believed that adjudication should involve only the litigants and the judge, and courts feared that those outsiders who attempt to inject themselves in these legal proceedings do so solely because they have a nefarious purpose that would subvert the integrity of the justice system.¹⁵ Such a hostile intrusion was considered harmful to both the individual litigants and the system as a whole. As you will read, that fear was founded. In legal systems dating back from ancient Greek and then Roman times, there was a commitment to safeguard justice by barring any outsider who attempted to inject himself between the litigants and the judge.¹⁶ These outsiders took different forms. In the fifth and fourth centuries B.C., there were political clubs, known as sycophants, who would ban together and

15. See Marc DeGirolami, *On the Intellectual Origins of the Crime of Barratry*, MIRROR JUST. (Nov. 18, 2010), <https://mirrorofjustice.blogs.com/mirrorofjustice/2010/11/on-the-intellectual-origins-of-the-crime-of-barratry.html> [<https://perma.cc/9BNJ-NAW7>] (describing how champerty harmed the individual client and the legal system as a whole).

16. Max Radin, *Maintenance by Champerty*, 24 CALIF. L. REV. 48, 50 (1935). There was a recognized primacy in the relationship between the litigants and the judge. *Id.* The litigant spoke directly to the judge. *Id.* Family and friends were encouraged to attend the court proceedings only as providers of moral support for the litigant. *Id.* It was considered a “serious fraud on the court” if a stranger attended, pretending to be a friend of the litigant. *Id.*

provoke litigation against their political adversaries.¹⁷ Similar to the Greek sycophant, Romans had the calumniator—those who commenced baseless litigation for the sole purpose of agitating the government.¹⁸

This suspicion towards the intervention of outsiders to litigation continued into the Middle Ages and was codified into both the common law and old English statutes.¹⁹ Barratry, champerty and maintenance are the codifications of three categories of proscribed interference into the legal system.²⁰ Barratry described the offense of those agitators who would provoke legal disputes.²¹ Maintenance is the general term used to describe when an outsider to the litigation advances money to support an ongoing litigation without receiving a portion of the outcome.²² Champerty, a type of maintenance, refers to an outsider to the litigation who advances money to support litigation with the understanding that he will receive in return for his contribution, a profit or portion of the proceeds.²³

Over time, as legal systems strengthened their due process procedures to address these concerns, courts, in their wisdom, also began to realize that not all outsiders to litigation were a nefarious group, and that some outsiders even helped advance justice. Thus, a more nuanced approach to outsiders was warranted. In 1886, Judge Thayer in the *Dahms v. Sears* case opined that “[m]any of the evils which the law was intended to remedy have been overcome by countervailing circumstances that have arisen, and, in effect, have been extinguished.”²⁴ With this more nuanced perspective, for example, it was recognized that maintenance could be re-characterized as an altruistic act that promotes social good by providing public interest groups needed funding to bring forward a worthy claim without the funders getting any money in return.²⁵ Yet even today, as the following sections illustrate, domestic and global courts still maintain a cautious approach to third-party funders. Vestiges of this mistrust continue to be evidenced in our modern-day law. Such legal doctrines as unconscionability in contract law, usury in consumer law and the laws regarding assignment of claims are examples of

17. *Id.* at 49–51.

18. *Id.* at 53.

19. *See id.* at 57–58; *see also* S.J. Brooks, *Champerty and Maintenance in the United States*, 3 VA. L. REV. 421, 421–22 (1916).

20. Brooks, *supra* note 19, at 421.

21. *Id.* at 423.

22. *Id.*

23. *Id.*

24. *Id.* at 425 (quoting Judge Thayer in *Dahms v. Sears*, 11 P. 891, 898 (Or. 1886)).

25. Simon Fodden, *Barratry, Champerty, Maintenance, Oh My!*, SLAW (Sept. 20, 2011), <http://www.slw.ca/2011/09/20/barratry-champerty-maintenance-oh-my/> [<https://perma.cc/G4K2-XV9N>].

continued modern-day vigilance of third-party funders' actions.²⁶ Fueling this mistrust in part is the difficulty involved in discerning who is a funder and whether the funder is conducting himself within the permissible bounds of the law.

In its most elemental form, third-party funding involves a funding entity who provides financial support to a litigant in return for a share of the proceeds from a settlement or judgment.²⁷ However, third-party funders come in many forms: banks, hedge funds or individuals or entities that provides funding with the expectation of profits.²⁸ The variations that exist in different types of third-party funding are determinant in assessing whether the funding typology is legal and has a permissible business purpose.²⁹ Furthermore, the characterization of a third-party funder is important, because different disclosure and ethical obligations attach to each characterization.³⁰

The contract between the funder and the litigant defines the financial relationship between the funder and the funded party, the funder's role in the management of the case, and the allocation of responsibilities between the funder and funded party. Yet, third-party funders resist disclosing these contracts, insisting that the contracts are proprietary.³¹ The third-party funding contract varies from recourse to nonrecourse agreements.³² Furthermore, there is no one typology of a third-party funder; consequently, each third-party funding agreement differs in purpose, form and context.³³ Even the name "third-party funder" may in many cases be a misnomer, because the funder, depending on the terms of the contract, is often not an

26. See NIEUWVELD & SAHANI, *supra* note 1, at 136–37, 143–44.

27. See ABA 20/20 REPORT, *supra* note 7, at 1; Victoria Shannon Sahani, *Judging Third-Party Funding*, 63 UCLA L. REV. 388, 392 (2016).

28. Sahani, *supra* note 27, at 392; ICCA REPORT, *supra* note 9, at 50–51.

29. See Victoria A. Shannon, *Harmonizing Third-Party Litigation Funding Regulation*, 36 CARDOZO L. REV. 861, 877–79 (2015).

30. *Id.* at 903–04.

31. See Victoria Shannon Sahani, *Blurred Lines Between Third-Party Funders and Law Firms*, KLUWER ARB. BLOG (Nov. 3, 2016), <http://kluwerarbitrationblog.com/2016/11/03/blurred-lines-between-third-party-funders-and-law-firms/> [<https://perma.cc/E6X8-SXYH>] (citing to an emerging financial relationship in which the third-party funder is playing a more active role in the case).

32. ABA 20/20 REPORT, *supra* note 7, at 5–6. Recourse funding requires the funded party to pay the funder for the cost of money, regardless of whether the party prevails. *See id.* at 6. Nonrecourse funding requires the funded party to pay the funder only if the funded party prevails. *Id.* at 7.

33. See Sahani, *supra* note 11, at 411–12; ICCA REPORT, *supra* note 9, at 47–48.

actual party to the litigation.³⁴ Therefore, disclosure about the presence of funders and their contractual relationship with the litigant is relevant to dispute resolution providers and professionals who will be facilitating the settlement of the case.³⁵

II. GLOBAL EXPERIENCE SHAPES ETHICAL RULES AND GUIDELINES

Our global brethren have embraced third-party funding as an economic necessity to fund the escalating costs of litigation and international dispute resolution.³⁶ Along with such cumulative experience with third-party funders, however, comes a heightened awareness about the potential ethical minefields that may occur when third-party funders participate. This heightened awareness has served as the global impetus to promulgate ethical rules and develop best practices for dispute resolution providers and neutrals that require greater transparency of third-party funders.³⁷ The global community recognizes that without these defined boundaries, third-party funders, untethered by rules or regulations,³⁸ will continue to ethically collide with lawyers, dispute resolution providers and neutrals, whose professional behaviors are defined by their respective ethical rules of conduct.³⁹ In order for mediators and arbitrators to follow-through on their ethical mandates about disclosure of conflicts of interest and impartiality, they must first be

34. This author met with Alan Zimmerman, CEO and Legal Counsel of Law Finance Group, a funding provider, on June 19, 2017. During our conversation, Mr. Zimmerman noted how the term “third-party funder” is not an accurate label, because funders are not a party to the litigation.

35. See *infra* Part IV.

36. See *Third Party Funding in International Arbitration*, ASHURST (Sept. 4, 2018), <https://www.ashurst.com/en/news-and-insights/legal-updates/quickguide---third-party-funding-in-international-arbitration/> [<https://perma.cc/DS2P-DNV4>] (discussing the approaches to the legality of third-party funding taken by various jurisdictions, including those that embrace it, such as Hong Kong and Singapore, and those that have rejected it, such as Ireland); see also ICCA REPORT, *supra* note 9, at 17; Arbitration and Mediation Legislation (Third Party Funding) (Amendment), No. 6, (2017) Cap. 609, A137, § 98 (H.K.).

37. See sources cited *supra* note 36.

38. See, e.g., THE ASSOCIATION OF LITIGATION FUNDERS OF ENGLAND AND WALES, CODE OF CONDUCT FOR LITIGATION FUNDERS (Nov. 2011), [https://www.judiciary.uk/wp-content/uploads/JCO/Documents/CJC/Publications/CJC+papers/Code+of+Conduct+for+Litigation+Funders+\(November+2011\).pdf](https://www.judiciary.uk/wp-content/uploads/JCO/Documents/CJC/Publications/CJC+papers/Code+of+Conduct+for+Litigation+Funders+(November+2011).pdf) [<https://perma.cc/7LVC-TQF2>] (providing guidelines for funders about adequacy of funds and accuracy of promotional literature, including the requirement that litigation funding agreements (“LFAs”) should include the litigation funder’s role in settling the case and withdrawing from the funding agreement).

39. CATHERINE A. ROGERS, *Gamblers, Loan Sharks, and Third-Party Funders*, in ETHICS IN INTERNATIONAL ARBITRATION 177, 182 (2014).

made aware that a third-party funder with whom they have had previous commercial transactions is now funding a participant in the current matter.⁴⁰

This section highlights two global initiatives that are shaping the participatory boundaries of third-party funders in dispute resolution: the passage of Hong Kong's Bill 2016, Arbitration and Mediation Legislation,⁴¹ and the ICCA-Queen Mary College of the University of London Task Force.⁴² Although each initiative has different purposes, both share common threads. Both recognize that there needs to be disclosure about third-party funders in arbitration and mediation, and that failure to have disclosure will perpetuate ethical violations of dispute resolution tenets. Both recognize third-party funder is an umbrella term that describes many permeations of economic support, some legal and others of questionable integrity. And both initiatives call for greater oversight of third-party funders.

A. Hong Kong's Bill 2016, Arbitration and Mediation Legislation

The passage of Hong Kong's Bill 2016, Arbitration and Mediation Legislation (Third-Party Funding) ("HK Bill 2016") on June 14, 2017, is the first global legislation that affirms the legitimacy of third-party funding in international dispute resolution.⁴³ This legislation synchronizes Hong Kong's Law on third-party funding in international dispute resolution with the practices of China's International Dispute Resolution providers by reaffirming that the common law offenses of maintenance and champerty do not apply to third-party funding in international dispute resolution.⁴⁴ Significantly, HK Bill 2016 applies not only to the conduct of third-party funders in international arbitration, but also in international mediation.⁴⁵ The HK Bill 2016 provides in its salient parts directives regarding the regulation and disclosure of third-party funders participating in arbitration and mediation.

40. See Sahani, *supra* note 27, at 401–02.

41. See Cap. 609, A137, § 98.

42. ICCA REPORT, *supra* note 9.

43. See *Bills Committee on Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016*, LEGIS. COUNCIL H.K. SPECIAL ADMIN. REGION CHINA, <https://www.legco.gov.hk/yr16-17/english/bc/bc102/general/bc102.htm> [<https://perma.cc/B6K5-BJUT>]. See also Cap. 609, A137, § 98E(a). It is important to emphasize that this applies only to domestic arbitration. Third-party funding is still prohibited in Hong Kong domestic litigation.

44. Cap. 609, A137, § 98K; see also *Third-Party Funding in International Arbitration*, *supra* note 36.

45. Cap. 609, A137, § 98F.

The law requires that a Code of Practice be developed that provides “practices and standards” for third-party funders to follow.⁴⁶ The Code of Practice is currently in development by the HK government.⁴⁷ A third-party funded agreement must be in writing,⁴⁸ and must also explicitly state the risk and terms and include:

- (i) the degree of control that third party funders will have in relation to an arbitration [or mediation];
- (ii) whether, and to what extent, third party funders (or persons associated with the third party funders) will be liable to funded parties for adverse costs, insurance premiums, security for costs and other financial liabilities; and
- (iii) when, and on what basis, parties to funding agreements may terminate the funding agreements or third party funders may withhold arbitration funding.⁴⁹

HK Bill 2016 also provides additional mandates that should be included in the Code of Practice for third-party funders to ensure ethical practice. For example, prior to a party entering into a third-party funding agreement, third-party funders should advise potential funded parties to consult with independent legal counselors before entering into the third-party funding agreement.⁵⁰ Third-party funders are required to have a “sufficient minimum amount of capital.”⁵¹ Moreover, third-party funders are required to have in place procedures to respond to “potential, actual or perceived conflicts of interest,”⁵² and when complaints do arise, “effective procedures” and “meaningful remedies” to address those complaints.⁵³

In large part, Hong Kong enacted this groundbreaking legislation to reinforce Hong Kong’s stature as a leading center for international dispute resolution in the Asia-Pacific region.⁵⁴ The impact of this legislation is not limited to China, but rather establishes regulation and disclosure standards

46. *Id.* § 98P.

47. Joseph Chung, *Draft Code of Practice for Third Party Funding of Arbitration and Mediation*, DEACONS (Oct. 26, 2018), <https://www.deacons.com.hk/news-and-insights/publications/draft-code-of-practice-for-third-party-funding-of-arbitration-and-mediation.html> [<https://perma.cc/KY7X-FF7G>].

48. Cap. 609, A137, § 98H.

49. *Id.* § 98Q(1)(b).

50. *Id.* § 98Q(1)(c).

51. *Id.* § 98Q(1)(e).

52. *Id.* § 98Q(1)(f).

53. *Id.* § 98Q(1)(g).

54. LEGIS. COUNCIL, REPORT OF THE BILLS COMMITTEE ON ARBITRATION AND MEDIATION LEGISLATION (THIRD PARTY FUNDING) (AMENDMENT), No. CB(4)1161/16-17, ¶ 8 (2016) (H.K.).

concerning third-party funders that can help shape the ethical contours of third-party funding in global dispute resolution.⁵⁵

B. ICCA Report Addresses the Ethical Issues Presented by Third-Party Funders in International Arbitration

In 2013, the International Council for Commercial Arbitration (“ICCA”) in collaboration with the Queen Mary College of the University of London formed a Task Force to provide “greater understanding about what third-party funding is and . . . the issues it raises in international arbitration.”⁵⁶ In large part, the Task Force came together to address the reality that litigation funders were investing in international arbitration because such arbitrations were of high value and offered little opportunity for appeal.⁵⁷ Furthermore, there was concern that funders are able to structure their funding agreements by choosing choices of law and forums to avoid scrutiny of their investing practices.⁵⁸ In April 2018, the Task Force issued a Report on its findings.⁵⁹

In order to accommodate “the range of existing third-party funding models” and anticipate new developments, the Report adopted a broad working definition of third-party funders and funding.⁶⁰

55. See Singapore Civil Law Act (Chapter 43) Civil Law (Third-Party Funding) Regulations 2017, c. 43, § 68. The Singapore Law followed on the heels of the Hong Kong Law, as each center tried to gain control of the international arbitration and mediation market. It is important to note that Singapore, like Hong Kong, does not permit third-party funding in domestic Singaporean courts. See *Third Party Funding of Arbitration in Singapore and Hong Kong: A Comparison*, ASHURST (Feb. 13, 2017), <https://www.ashurst.com/en/news-and-insights/legal-updates/third-party-funding-of-arbitration-in-singapore-and-hong-kong-a-comparison/> [<https://perma.cc/XQC3-UG7W>].

56. ICCA REPORT, *supra* note 9, at 3; see also *id.* at 7 (describing the scope of the Task Force’s work to include “analysis of specific issues that directly affect international arbitration proceedings and are capable of being addressed at an international level (i.e., conflicts of interest, privilege, and costs and security for costs)”).

57. See, e.g., *id.* at 4 (“Since the Task Force was initially constituted in 2013 The funding market has expanded in several respects. The number of funded cases has increased significantly. The number and geographic diversity of third-party funders has also increased, with new entities continuing to enter the market and consequently increase the aggregate amounts available for funding.”); see also *id.* at 25–27 (discussing the economics and return structures of third-party funding).

58. See Rebecca Mulder & Marc Krestin, *Third-Party Funding in International Arbitration: To Regulate or Not to Regulate?*, YOUNG ICCA BLOG (Dec. 18, 2017), <http://www.youngicca-blog.com/third-party-funding-in-international-arbitration-to-regulate-or-not-to-regulate/> [<https://perma.cc/XW7A-73YJ>].

59. ICCA REPORT, *supra* note 9, at i.

60. *Id.* at 50.

The Report defines “third-party funding” as:

[A]n agreement by an entity that is not a party to the dispute to provide a party, an affiliate of that party or a law firm representing that party,

a) funds or other material support in order to finance part or all of the cost of the proceedings, either individually or as part of a specific range of cases, and

b) such support or financing is either provided in exchange for remuneration or reimbursement that is wholly or partially dependent on the outcome of the dispute, or provided through a grant or in return for a premium payment.⁶¹

It goes on to define a third-party funder as:

[A]ny natural or legal person who is not a party to the dispute but who enters into an agreement either with a party, an affiliate of that party, or a law firm representing that party:

a) in order to provide material support for or to finance part or all of the cost of the proceedings, either individually or as part of a specific range of cases, and

b) such support or financing is either provided in exchange for remuneration or reimbursement that is wholly or partially dependent on the outcome of the dispute, or provided through a grant or in return for a premium payment.⁶²

In addition to the working definitions, the Task Force addressed four ethical issues that are raised when third-party funders provide support in international arbitration: (1) the potential conflicts of interest between the arbitrator and third-party funder; (2) how sharing information with a third-party funder might affect the attorney-client privilege; (3) whether there is a need for third-party funding to provide security for costs; and (4) how the presence of a third-party funder affects the allocation of costs.⁶³

61. *Id.* See also *id.* at 56–70 for a survey of existing definitions.

62. *Id.* at 50.

63. *Id.* at 12.

1. Conflicts of Interest Between the Arbitrator and Third-Party Funder⁶⁴

The Report recognizes that the international arbitration community has become an insular club in which third-party funders, attorneys and arbitrators have ongoing contact.⁶⁵ Contributing to this insularity, attorneys on one case may switch hats and serve as an arbitrator on another case.⁶⁶ Adding to this insularity, third-party funders are increasingly tapping experienced attorney from this pool to work for the funders and serve on their advisory boards.⁶⁷ Despite some disagreement, the Report proposed “systematic disclosure” because “disclosure by the funded party of the existence and identity of funders is necessary so that arbitrators [can] make appropriate disclosures and decisions regarding potential conflicts of interest.”⁶⁸ Accordingly, the Report calls for parties to “disclose the existence of a third-party funding arrangement and the identity of the funder to the arbitrator . . . as part of a first appearance . . . or as soon as practicable.”⁶⁹ This proposal is “in keeping with global trends in regulation of third-party funding,” consistent with an ICCA survey that found broad support for disclosure of third-party funding arrangements and funders,⁷⁰ and recognizes the many potential conflicts between arbitrators and funders that could arise in several circumstances.⁷¹ Colleagues in the arbitrator’s law firm might be working with the third-party funder on another matter.⁷² In another example, the arbitrator could be the arbitrator on a case funded by the third-party funder, and then counsel on another case funded by the same third-party funder.⁷³ Without disclosure of these conflicts, the arbitrator’s impartiality and commitment to maintaining an international arbitration of integrity would be called into question.⁷⁴

64. *Id.* at 63, 81–115 (discussing the revision of the International Bar Association (IBA) Guidelines on Conflicts of Interest).

65. *See id.* at 82.

66. *See* Jennifer A. Trusz, *Full Disclosure? Conflicts of Interest Arising from Third-Party Funding in International Commercial Arbitration*, 101 GEO. L.J. 1649, 1669–71 (2013).

67. ICCA REPORT, *supra* note 9, at 82.

68. *Id.* at 83.

69. *Id.* at 81.

70. *Id.* at 83.

71. *Id.* at 82.

72. *See id.* at 111.

73. *Id.* at 112.

74. *See id.* at 87.

2. Confidentiality and Attorney Client-Privilege⁷⁵

Prior to deciding to fund a case, third-party funders gather information from the attorney and client to assess the viability of funding that case.⁷⁶ Is the sharing of that information done so in a way that waives the attorney-client privilege or is it done so in a way that protects the attorney-client privilege? As the Report notes, “[t]he rise of third-party funding has added new complexities to existing ambiguities about privilege in international arbitration.”⁷⁷ The Report identifies three categories of information that implicate these complexities.⁷⁸ The first category is privileged information that is provided to a third-party at the “initial due diligence phase”⁷⁹ and after it has committed to funding the party.⁸⁰ The second category involves the funding agreement itself.⁸¹ The final category includes documents produced and held by the funder, such as the funder’s assessment of the case, “documents relating to the negotiation of the funding agreement,” and legal opinions on the strength of the case generated by the funder.⁸²

The Report takes the position that the “existence of funding and the identity of a third-party funder is not subject to any legal privilege.”⁸³ The specific provisions of a funding agreement, on the other hand, “may be subject to confidentiality obligations . . . and may include information that is subject to a legal privilege.”⁸⁴ Production of these specific provisions should be ordered by the arbitral tribunal only “in exceptional circumstances.”⁸⁵ Finally, on the question of waiver, the Report states that the mere fact that privileged information is furnished to a third-party funder should not waive the privilege, so long as the information was provided “for the purpose of obtaining funding or supporting the funding relationship.”⁸⁶

75. *Id.* at 117.

76. *See id.*

77. *Id.* at 118.

78. *Id.* at 118–19.

79. *Id.* at 118. The Report describes that phase as “where funding is first requested and the third-party funder requires information in order to decide whether or not to provide financing.”
Id.

80. *Id.* at 119.

81. *Id.*

82. *Id.*

83. *Id.* at 117.

84. *Id.*

85. *Id.*

86. *Id.*

3. Allocation of Costs and Security of Costs⁸⁷

The Report also examined how to respond to security of cost applications at the beginning of the arbitration and applications for allocation of costs at the end of the arbitration when one or both parties are funded by a third-party funder.⁸⁸

As mentioned in the introduction of this article, the global legal regimes are different than the U.S. legal system. One glaring difference is that the English rule requires the losing party in litigation to pay the winner's attorney's fees, while the American rule followed in the United States requires each party to be responsible for its respective legal fees.⁸⁹ In arbitration, however, arbitrators may award costs in a different proportion than the "all or nothing" English rule would suggest.⁹⁰ In another departure from the distinction between the American and English rule, the Federal Arbitration Act provides that U.S. domestic arbitrators may enforce international arbitration awards that allocate costs in a manner different than the American rule.⁹¹ Thus, some of the advances cannot be transported wholesale because of these differences.

However, these initiatives can also generate ideas about what should be included in U.S. ethical guidelines for dispute resolution providers and neutrals. Alternative Dispute Resolution ("ADR") providers and neutrals should consider requiring disclosure of third-party funding of a party participating in arbitration and mediation. Another consideration is what information can be shared with the other party because the attorney-client privilege has been waived and what information remains privileged. In another example, the awarding of third-party funding costs as part of the arbitration award may be one global practice that may be transported to the United States and have ethical ramifications.⁹²

87. *Id.* at 146.

88. *Id.*

89. Theodore Eisenberg & Geoffrey P. Miller, *The English Versus the American Rule on Attorney Fees: An Empirical Study of Public Company Contracts*, 98 CORNELL L. REV. 327, 327 (2013).

90. See *Counting the Costs of Arbitration*, BIRD & BIRD (Dec. 2005), <https://www.twobirds.com/en/news/articles/2005/counting-the-cost-of-arbitration> [<https://perma.cc/7YYP-PWEG>].

91. See 9 U.S.C. § 207 (2018).

92. See John Fellas, *Can Arbitrators Award Third-Party Funding Costs in International Arbitration?*, N.Y. L.J. (June 30, 2017), <https://advance.lexis.com/api/permalink/4b4d371e-8751-4f20-8d3a-331c417074e4/?context=1000516> [<https://perma.cc/ST4Q-TZ3T>] (explaining how cost-shifting, in which the arbitrator orders the losing party to pay the costs of the prevailing party, is part of international arbitration. Litigation funding is now an included part of those costs.

III. IN THE UNITED STATES, A SLOWER PULSE

In contrast to the welcome global embrace for third-party funders, the United States has maintained an ambivalent and cautious approach towards third-party funding. Domestically, U.S. courts have divided on the legality of third-party funders.⁹³ Some courts have abandoned barratry, champerty and maintenance, while other courts still rely on these prohibitions to help define permissible outsider conduct.⁹⁴ To this day, courts still frown upon those outsiders to litigation such as third-party funders who instigate, control, fund, and profit from litigation to which they are not a party.⁹⁵ The litigant-judge relationship remains sacrosanct.⁹⁶ One reason proffered for the U.S.'s hesitance about third-party funding is a long-held value that one shouldn't profit from another's harm.⁹⁷ This section will provide a snapshot of the U.S.'s reaction by highlighting three spheres of influence that are shaping the U.S.'s response to third-party funding: the courts, the American Bar Association, and public interest groups such as the Rand Institute and the U.S. Chamber Institute for Legal Reform.

A. *Survey of Court Responses*

The U.S. courts have had a range of responses to third-party funders from acceptance,⁹⁸ conditional acceptance,⁹⁹ to outright rejection of the concept.¹⁰⁰ *Miller UK Ltd. v. Caterpillar, Inc.*¹⁰¹ is an instructive case that highlights the layers of confidentiality issues raised by the presence of third-party funders. As a threshold issue, the court found that litigation funding is legal in Illinois, because the doctrines of maintenance and champerty “have been narrowed to a filament.”¹⁰² Moreover, the purpose of the funding in the case at bar was not “to promote strife or contention,” but to provide needed economic backing to advance the party's claim.¹⁰³

Mr. Fellas posits that the Federal Arbitration Act could also be interpreted to mean that costs include the cost of litigation funders.).

93. See ABA 20/20 REPORT, *supra* note 7, at 9–12; MCGOVERN ET AL., *supra* note 3, at 11–12, 129 (discussing contemporary U.S. domestic court responses to third-party funding).

94. See ABA 20/20 REPORT, *supra* note 7, at 11–12.

95. MCGOVERN ET AL., *supra* note 3, at 23.

96. See *id.* at 10–11.

97. *Id.* at 23.

98. See ABA 20/20 REPORT, *supra* note 7, at 9–12.

99. See *Justinian Capital SPC v. WestLB AG*, 65 N.E.3d 1253, 1256 (N.Y. 2016).

100. See, e.g., *Johnson v. Wright*, 682 N.W.2d 671, 677–78 (Minn. Ct. App. 2004).

101. 17 F. Supp. 3d 711 (N.D. Ill. 2014).

102. *Id.* at 727.

103. *Id.* at 726.

Instructive to our discussion, the court explained analogizing third-party funding to insurance is an inaccurate comparison because litigation funding and insurance each create distinct financial relationships: “Abraham Lincoln once was asked how many legs a donkey has if you call its tail a leg. His answer was four: calling a tail a leg does not make it one.”¹⁰⁴ With insurance, the relationship between insurer and insured is one of indemnification. The insurance company, as the subrogee, is “limited to reimbursement for what it paid its insured and no more.”¹⁰⁵ In contradistinction, the relationship between a litigation funder and the party it funds is limited by the amount of funds the litigation funder has agreed to loan the fundee. The funder is not a subrogee and will not pay for the fundee’s losses or indemnify the funder.¹⁰⁶

The court also addressed whether privileged attorney-client information shared with a third-party funder waived that confidentiality privilege or remained privileged because the third-party funder shared a “common interest in the successful outcome of the litigation.”¹⁰⁷ The court opined the sharing of information with litigation funders was not protected by the common interest doctrine, because the relationship was about money, not legal strategies or opinions.¹⁰⁸ However, the court found that even though the information shared with the third-party funder was not protected by the “common interest” doctrine, it was protected by the confidentiality agreement that was signed by the funder prior to receiving the privileged information.¹⁰⁹

B. *ABA Commission on Ethics 20/20*

The American Bar Association Commission on Ethics 20/20 Information Report to the House of Delegates (the “ABA 20/20 Report”) focuses on how the third-party funders might ethically compromise the attorney-client relationship.¹¹⁰ The Commission cautioned about potential ethical threats to lawyers’ professional responsibilities in three areas. First, the lawyer should ensure that any third-party funding agreement or relationship does not compromise or disincentivize the lawyer’s independent professional judgment in the attorney-client relationship.¹¹¹ Thus, lawyers should avoid

104. *Id.* at 729.

105. *Id.*

106. *Id.*

107. *Id.* at 731–35.

108. *Id.* at 732–34.

109. *See id.* at 736–39.

110. ABA 20/20 REPORT, *supra* note 7, at 15–29.

111. *Id.* at 22.

third-party funding agreements that attempt to overtake control of the case.¹¹² Second, the lawyer should take care that when the client or lawyer share privileged information protected by the attorney-client privilege with the third-party funder, the lawyer should take steps to protect that confidentiality.¹¹³ Third, the lawyer should have an adequate understanding of how third-party funders work so that the lawyer may inform and counsel the client about any potential risks associated working with funders.¹¹⁴

Of particular interest to dispute resolution neutrals, the Commission raised that a contractual obligation with a third-party funder might influence a party's decision-making process regarding settlement.¹¹⁵ Some agreements with third-party funders explicitly state that the funder has to approve the settlement.¹¹⁶ Yet, even if the contractual agreement is silent on this point, the funded party may "implicitly" consider the funded amount in assessing whether the settlement number is adequate.¹¹⁷

The Commission recognized that because there are so many variations of third-party funding agreements, it is challenging to identify all the possible ethical issues for lawyers that may arise from these different permeations.¹¹⁸ Moreover, as third-party funders continue to evolve and offer different types of financial support, new ethical challenges could emerge.¹¹⁹ The Commission reinforced that the client, as a matter of agency law, has a right to delegate revocable settlement authority to other agents such as a third-party funder.¹²⁰ However, any agreement with a third-party funder should not interfere with a client's option of terminating the lawyer-client relationship at any time.¹²¹

112. *Id.* at 21.

113. *Id.* at 30.

114. *Id.* at 38.

115. *Id.* at 27.

116. *Id.*

117. *Id.* at 28.

118. *Id.*

119. *Id.* at 5.

120. *Id.* at 27.

121. *Id.* at 16.

C. Public Interest Research

1. The Rand Report—Third Party Litigation Funding¹²²

In 2009, the UCLA-RAND Center for Law and Policy convened *Third-Party Litigation Funding and Claim Transfer: Trends and Implications for the Civil Justice System* (the “Rand Report”), the first U.S. symposium on third-party funding.¹²³ Bringing together representatives from the business, legal, academic, and not-for-profit communities, the group investigated how third-party funding will impact the civil justice system.¹²⁴ The group did not anticipate that third-party funders would provoke a rise in frivolous cases.¹²⁵ Rather, the group concluded that more research was needed on whether third-party funders could use risk analysis to identify and support more meritorious cases.¹²⁶ The group discussed the ethical concerns raised by third-party funders such as the confidentiality issues in the lawyer-client relationship.¹²⁷ Participants expressed that there exists sufficient elasticity in the existing ethical rules to accommodate these ethical concerns.¹²⁸

In a noteworthy follow-up to the 2009 Rand Report, Steven Garber examined the economic, legal, and ethical issues related to third-party financing in the United States,¹²⁹ in particular its possible effects on the likelihood and timing of settlements.¹³⁰ First, Garber recognizes that disclosure of the mere existence of third-party funding may make the defendant more inclined to settle.¹³¹ This is because “a defendant who knows that the plaintiff has [funding] may infer from the existence of [such funding] that the legal claim has legal merit or high economic value”¹³² Second,

122. The Rand Corporation is a non-profit research organization which “is dedicated to making the civil justice system more efficient and more equitable.” *Rand Institute for Civil Justice*, RAND CORP., <https://www.rand.org/jie/justice-policy/civil-justice.html> [<http://perma.cc/4YPC-QL87>] (last visited Feb. 22, 2019).

123. MCGOVERN ET AL., *supra* note 3, at 1.

124. *Id.* at iii.

125. *Id.* at 20.

126. *Id.*

127. *Id.* at 16.

128. *Id.* at 17.

129. *See generally* STEVEN GARBER, RAND CORP., ALTERNATIVE LITIGATION FINANCING IN THE UNITED STATES (2010), https://www.rand.org/content/dam/rand/pubs/occasional_papers/2010/RAND_OP306.pdf [<https://perma.cc/VK5V-BJEX>].

130. *Id.* at 32.

131. *Id.*

132. Garber notes that this scenario is most plausible in the context of investments in commercial claims, however, because third-party funders in this context have rigorous claim-assessment procedures. *Id.* at 33.

Garber reasons that “the existence of a non-recourse loan to a plaintiff could impede settlements both early and late in the life of the underlying lawsuit, but promote settlements during a period of time in between.”¹³³

2. The U.S. Chamber Institute for Legal Reform¹³⁴

The U.S. Chamber Institute for Legal Reform, a non-profit affiliate of the U.S. Chamber of Commerce and an advocacy group to promote civil justice reform, has taken on the issue of third-party funding.¹³⁵ Unlike the Rand Report, which offers a cautiously accepting approach to third-party funding, the U.S. Chamber Institute for Legal Reform has been banging the drums and warning that “the sky is falling” unless our legal system takes affirmative steps to protect against the “parade of horrors” that third-party funders may cause.¹³⁶ The Chamber warns that unchecked, third-party funders will promote frivolous litigation.¹³⁷ In a passionate letter joined by over two dozen other business organizations, the Chamber has also called for a revision of the Federal Rules of Civil Procedure to require that parties disclose in all civil cases when they receive backing from third-party funders.¹³⁸

Although the Civil Rules Committee has yet to revise the Federal Rules of Civil Procedure, the concerns raised by the U.S. Chamber Institute for Legal Reform have been heeded. On January 17, 2017, the U.S. District Court for the Northern District of California required that parties in class actions must disclose whether they are receiving funding.¹³⁹ In an even bolder action, on

133. *Id.*

134. JOHN BEISNER ET AL., U.S. CHAMBER INST. FOR LEGAL REFORM, SELLING LAWSUITS, BUYING TROUBLE: THIRD-PARTY LITIGATION FUNDING IN THE UNITED STATES (Oct. 2009), <http://www.instituteforlegalreform.com/uploads/sites/1/thirdparty litigation financing.pdf> [<https://perma.cc/7WUH-P4KZ>].

135. *About ILR*, U.S. CHAMBER INST. FOR LEGAL REFORM, <https://www.instituteforlegalreform.com/about-ilr> [<https://perma.cc/9YQN-2J2C>] (last visited Feb. 24, 2018).

136. *See* BEISNER ET AL., *supra* note 134, at 4–5.

137. *Id.* at 5–7.

138. The Committee on Rules of Practice and Procedure has considered such a proposed amendment, once in 2014 and again in 2016. Memorandum from Hon. John D. Bates, Chair, Advisory Comm. on Civil Rules, to Hon. David G. Campbell, Chair, Comm. on Rules of Practice and Procedure (Dec. 6, 2017), *in* ADVISORY COMM. ON CIVIL RULES, AGENDA BOOK 235, 247–51, <https://www.uscourts.gov/sites/default/files/2018-01-standing-agenda-book.pdf> [<https://perma.cc/Z5TJ-VMHF>]. On both occasions, the committee concluded that the topic was not “ripe.” *Id.* at 247.

139. *See* Standing Order for All Judges of the Northern District of California, Contents of Joint Case Management Statement ¶ 19 (Nov. 1, 2018), <https://cand.uscourts.gov/whaorders> [<https://perma.cc/Q9EL-4KJF>]; Memorandum from Patrick A. Tighe, *supra* note 1, at 211.

April 3, 2018, Wisconsin enacted Wisconsin Act 235,¹⁴⁰ becoming the first state to require litigants in civil actions to disclose their litigation funding agreements whether or not they are asked to do so.¹⁴¹ Then on April 10, 2018, the Civil Rules Committee issued a 50-state survey regarding third party-funding disclosure.¹⁴²

Thus, even though the United States retains a cautionary approach to third-party funders, some states are recognizing the importance of disclosure and are beginning to enact statutes and court rules compelling disclosure.¹⁴³ The U.S. courts, however, have yet to reach consensus on the legality of third-party funders. The not-for-profits groups who have researched how litigation funders might impact litigation have focused their efforts on amplifying their concerns about how third-party funding could potentially erode the fabric of our justice system. However, while these well-intentioned organizations continue to pontificate about their concerns regarding third-party funders, the funders continue to participate in such dispute resolution processes as mediation and arbitration, invisible and unregulated. The next Part incorporates the expressed concern and advances the discussion by suggesting affirmative steps that should be taken by dispute resolution providers and neutrals to address the ethical concerns presented by third-party funders' participation in dispute resolution.

IV. PROPOSED ETHICAL GUIDELINES AND BEST PRACTICES FOR U.S. DISPUTE RESOLUTION PROVIDERS, ARBITRATORS, AND MEDIATORS

In this Part, I offer ethical guidelines and best practice suggestions for ADR providers,¹⁴⁴ arbitrators, and mediators so that the dispute resolution

140. WIS. STAT. § 804.01(2)(bg) (2018).

141. Expectedly, supporters of disclosure applauded this legislation while litigation funders voiced concerns that this legislation did not distinguish between disclosure requirements for consumer and commercial cases. Jamie Hwang, *Wisconsin Law Requires All Litigation Funding Arrangements to Be Disclosed*, A.B.A. J.: DAILY NEWS (Apr. 10, 2018, 10:45 AM), http://www.abajournal.com/news/article/wisconsin_law_requires_all_litigation_funding_arrangements_to_be_disclosed/ [https://perma.cc/3DMY-29XY]. While third-party funders have accepted disclosure as part of international practice, third-party funders continue to push back about efforts to require disclosure in the U.S. See, e.g., *Mandatory Disclosure of Funders Would Further Clog Overburdened Court Dockets*, BENTHAM IMF (June 13, 2018), <https://www.benthamimf.com/blog/blog-full-post/bentham-imf-blog/2018/06/13/mandatory-disclosure-of-funders-would-further-clog-overburdened-court-dockets> [https://perma.cc/G8PV-ULCT].

142. Tighe, *supra* note 1, at 209–29.

143. See *id.*

144. See generally CPR–GEORGETOWN COMM'N ON ETHICS AND STANDARDS OF PRACTICE IN ADR, PRINCIPLES FOR ADR PROVIDER ORGANIZATIONS (2002), <https://www.cpradr.org/>

profession may more responsively address the real and apparent ethical issues that arise when a third-party funder backs a party who is participating in a dispute resolution procedure.¹⁴⁵ The time has come for dispute resolution providers and neutrals to acknowledge the reality of third-party funding, take affirmative steps to maintain the integrity of dispute resolution practices, and consider the potential benefits third-party funders bring to settlement. Some observe and others ignore the reality that third-party funders are proliferating and backing participating parties in our arbitrations and mediations with greater frequency. This ignorance is untenable, for the presence of third-party funders that provide financial backing to dispute resolution parties may at times challenge the ethical obligations of dispute resolution providers and neutrals.

An overarching interest of dispute resolution providers, arbitrators, and mediators when parties are backed by third-party funders is to obtain adequate relevant information about third-party funders so that ADR professionals can ensure that the dispute resolution process and any resulting settlement are procedurally and substantively fair and just.¹⁴⁶ In order to address this overarching interest, I offer three suggestions. First, dispute resolution providers and neutrals should require titrated disclosure about the relationship between the third-party funder and the party. Second, neutrals must be educated about how to work with third-party funders when they are backing any of the participating parties. Third, dispute resolution intake procedures, promotional materials, contracting forms, and other required paperwork need to be modified to gather relevant information about the third-party funder. I first explain these general suggestions and then tailor the application of each of these suggestions to the three different groups.

[resource-center/protocols-guidelines/ethics-codes/principles-for-adr-provider-organizations/_res/id=Attachments/index=0/Principles-for-ADR-Provider-Organizations.pdf](https://perma.cc/958L-JSRT) [https://perma.cc/958L-JSRT] for guidance on how ADR providers should provide quality information about the services they provide to avoid ethical issues that would impugn the integrity of the organization and the dispute resolution procedures it provides.

145. In this section, ADR providers include the courts as well as private providers. Litigants may actually mediate or arbitrate their dispute in three different contexts. First, some litigants may decide on their own to mediate or arbitrate their dispute once their legal dispute arises. In those cases, the litigants may opt to select their own private arbitrators or mediators either through a private ADR provider (administered process) or on their own. Second, the court may strongly recommend that litigants mediate or arbitrate their dispute once a legal action is commenced. Third, litigants may be obligated to mediate or arbitrate a dispute pursuant to contract.

146. The measures for fair and just are measured differently in arbitration and mediation. See Judith L. Maute, *Public Values and Private Justice: A Case for Mediator Accountability*, 4 GEO. J. LEGAL ETHICS 503, 504–05 (1991).

A. *Proposal One: Titrated and Sequential Disclosure About the Relationship Between the Third-Party Funder and Party*

Disclosure remains a hotly contested and nuanced issue in which third-party funders tenaciously advocate for confidentiality of their contracting relationship with the party while those purveyors of justice, many untrusting of third-party funders, are demanding disclosure so that there is total transparency. Disclosure is not an all or nothing proposition; rather, it is a nuanced term that embraces what is disclosed, to whom disclosure is made, whether the information disclosed remains confidential, and at what phase of the dispute resolution procedure the information is to be disclosed. Acknowledging the apprehensions raised by third-party funders about disclosure and the dispute resolution profession's need for quality disclosure about third-party funders, I recommend that disclosure should be sequentially titrated and tailored to the different phases of the dispute resolution procedures. The information that is required to be disclosed should be based on the informational needs warranted at different phases of the given dispute resolution procedure. Moreover, such sequential, titrated disclosure helps avoid broad disclosure about the third-party funder in those instances when parties are not going forward with the dispute resolution procedure, or the information is not necessary.

1. Three Levels of Sequential Disclosure During the Contracting Phase of Arbitration and the Pre-Mediation Phase

a. *Recommended Disclosure Level One*

In the initial contracting phase between a party and the dispute resolution provider, arbitrator or mediator, disclosure about third-party funders should be limited to whether or not there is a third-party funder, and if there is, the names of those in the funder's organization. The rationale for disclosing the identity of the third-party funder is to ferret out early on in the dispute resolution process any potential conflicts that may exist between the third-party funder and the neutral.¹⁴⁷

If there is a conflict, an ancillary issue that needs to be addressed at this phase is whether the conflict between the third-party funder and the neutral is a waivable one that first needs to be disclosed to the other party or is deemed to be a conflict that is not waivable. If those involved want the opportunity to waive the conflict, the identity and relationship of the funder must also

147. See ICCA REPORT, *supra* note 9, at 87.

be shared with the other party involved in the matter. Identifying conflicts doesn't necessarily mean disqualification. Customarily, when there is a conflict, conflicts can be waived at the consent of the parties.¹⁴⁸ Dispute resolution providers and neutrals can incorporate this level of disclosure into the existing conflict procedures used.

Another option is for dispute resolution providers to institute a per se rule that conflicts between the neutral and third-party funders cannot be waived. In that case, the identity of the third-party funder does not have to be disclosed. Dispute resolution professionals and providers have to decide on the rule they will choose to incorporate as part of their practice, and then notify parties about this rule.

I offer a cautionary note about considering the second option and instituting a per se ban on waiving conflicts. While some dispute resolution communities are large and have many dispute resolution professionals from which to select a neutral, some dispute resolution practice communities are insular and just have a finite number of neutrals. In those instances, it is common that arbitrations and mediations involve the same people, just wearing different hats. In those cases, neutrals and providers may want to consider the ramifications of making conflicts between neutrals and third-party funders conflicts that can't be waived.

b. Recommended Disclosure Level Two

Once conflicts between the third-party funder and neutral are addressed and it is decided that the parties wish to proceed with the dispute resolution procedure, an additional level of disclosure that clarifies the relationship between the third-party funder and participant needs to be made at the contracting phase. The importance of such disclosure is to allow the dispute resolution provider, arbitrator, and mediator to discern if the third-party funder is actually a party to the dispute resolution procedure. Of course, determining whether or not a funder is a party is controversial and is a label that third-party funders prefer to avoid.¹⁴⁹ However, our primary concern is to maintain the integrity of our dispute resolution procedures. Therefore, dispute resolution providers, arbitrators, and mediators must have knowledge of all the parties who are influencing and shaping the resolution of the dispute.

If the third-party funder is a party, then what is its level of participation in the dispute resolution procedure and the concomitant obligations that come

148. *See id.* at 81–115.

149. NIEUWVELD & SAHANI, *supra* note 1, at 47–48 discusses whether third-party funding is characterized as a loan subjecting it to usury laws versus a loan.

with that participation? For example, if the third-party funder is funding a party in mediation, shouldn't that third-party funder also be required to sign a confidentiality agreement protecting the confidentiality of mediation communications? In another example, if a party is to proceed to agreement and the party's funding agreement shows that the third-party funder is actually now a party, should the third-party funder be required to participate in the arbitration?

- i) Disclosure raises concomitant confidentiality issues if the third-party funder participates in mediation and arbitration.

An important sub-issue that should also be addressed when clarifying the relationship between the third-party funder and the party is clarifying which information that the lawyer and party shared with the third-party funder remains confidential as part of the attorney-client privilege and which information was shared in a way that waives the privilege. Whether or not the information that is shared with a third-party funder is done so in a way that waives or protects the attorney-client privilege has procedural implications in mediation and procedural and evidentiary implications in arbitration.

When it is disclosed that a third-party funder is backing a mediation party, that relationship raises three issues about mediation confidentiality that dispute resolution professionals need to address to preserve the integrity of mediation. A threshold issue that dispute resolution professionals need to clarify is how the third-party funder should be characterized. This professional characterization is important, because depending on the characterization of the third-party funder, different confidentiality concerns have to be resolved. For example, if a third-party funder learns in the course of a mediation confidential information about the other party that could give the third-party funder a trading advantage, the third-party funder should be barred from trading on that information. The second issue to be addressed is whether the dispute resolution party will communicate with the funder about mediation communications, and because there is an expectation by all mediation participants that the mediation communications are to remain confidential, should the third-party funder be compelled to also sign a confidentiality agreement or should the confidentiality agreement be amended so that it allows the dispute resolution party to consult with the third-party funders as one of its experts? So in mediation, if the participating party has a contractual relationship with the third-party funder that requires sharing of information, consultation, and direction as the case progresses,

then the mediator should also have the third-party funder sign a confidentiality agreement to protect mediation confidentiality.¹⁵⁰

If the third-party funder happens to also be a hedge fund, extra mediation confidentiality protections are needed to protect mediation confidentiality and prevent insider trading. We learn from bankruptcy mediations in which hedge funds participate that added ethical screens/walls are needed to secure the mediation communications.¹⁵¹ Another wrinkle that dispute resolution professionals need to address is that hedge funds that are also third-party funders might learn confidential information in the mediation about the other party that the hedge fund uses to trade on.¹⁵²

Unlike mediation, in arbitration, the arbitrator makes determinations and issues awards based on the evidence presented.¹⁵³ Therefore, it is important to ascertain whether information shared with the third-party funder is done so in a way that protects or waives the attorney-client privilege.

c. Recommended Disclosure Level Three

A third level of disclosure that may be necessary is the financial relationship between the third-party funder and the funded party. Although this information may be needed in both arbitration and mediation, the information is needed in each dispute resolution procedure for different reasons. In arbitration, the information may be needed either to assess the costs one party incurred to go forward with the arbitration or to ensure that the third-party funder has sufficient funds to follow-through on his funding obligations. The decision about when this disclosure should take place is context specific. For example, if the other party makes a motion at the beginning of the arbitration for a bond of sufficiency, then that information needs to be provided at the beginning of the arbitration process. However, if no such motion is made, then the request for such information might not be made until the end of the arbitration when the neutral needs to be informed

150. See *id.* at 154, stating that Indiana, Nebraska and Vermont are states who have enacted legislation providing that the attorney-client privilege includes sharing privileged work product and communication with third-party litigation funders.

151. See Charles Duhigg & Peter Lattman, *Judge Says Hedge Funds May Have Used Inside Information*, N.Y. TIMES: DEALBOOK (Sept. 14, 2011, 9:28 PM), <https://dealbook.nytimes.com/2011/09/14/judge-says-hedge-funds-may-have-used-inside-information/> [<https://perma.cc/UX9B-2UKV>].

152. See *GM Judge Aims to Prevent Insider Trading by Distressed Debt Funds*, REUTERS (July 15, 2013), <https://www.reuters.com/article/idUS162810420130715> [<https://perma.cc/DXM4-WYTJ>].

153. *Comparison Between Arbitration & Mediation*, FIN. INDUSTRY REG. AUTHORITY, <https://www.finra.org/arbitration-and-mediation/comparison-between-arbitration-mediation> [<https://perma.cc/94Y3-R8EM>] (last visited Mar. 3, 2019).

about the actual costs, including the cost of third-party funding, that the party has incurred.¹⁵⁴

In mediation, the information might be helpful to assess each party's commitment to yield a just result or to better understand the economics of a party's decision or ambivalence about settlement. Here again, the timing of the disclosure will be based on when this informational need arises. As one illustration, if a party needs to reimburse a third-party funder the borrowed amount, interest on that amount and an exponential return on any amount recovered, the party may be reluctant to accept what appears to the mediator, a reasonable settlement. Only when the party discloses the financial obligations to the funder might a mediator better understand the impasse and be able work with the parties in a more realistic way.

d. Recommended Disclosure Level Four

A fourth level of disclosure is the sharing of the third-party funder's objective assessment of the case. Because of their ability to create a matrix of information about the merits of the case with admirable objectivity, third-party funders are often considered to be super lawyers. Like other experts that are often part of arbitration and mediation processes, funders can be invited to share their analysis of the case, to provide evidence in the arbitration or to help address impasses in mediation. To date, third-party funders have resisted sharing their analysis of a case, insisting that their method of assessing whether a case is investment worthy is proprietary, and not to be shared with others. Going forward, however, as the push for greater transparency on the part of third-party funders gains momentum, dispute resolution professionals will have to work with third-party funders, as they work with other experts, to have third-party funders share their case analysis without disclosing all their proprietary methods.

B. Proposal Two: Training for ADR Providers, Arbitrators, and Mediators

Professional dispute resolution training programs should be expanded to include education about the additional skills neutrals need to work with those parties backed by third-party funders. As was mentioned in the introduction of this paper, many dispute resolution professionals and providers are unaware that parties are backed by third-party funders even though increasing numbers of parties are receiving dispute funding. Yet, as

154. See ICCA REPORT, *supra* note 9, at 146.

this article has explained, such unawareness is creating an ethical minefield that potentially undermines the integrity of dispute resolution. Thus, a specialized training module is needed to heighten a neutral's awareness about third-party funders and to provide neutrals with the requisite skills needed to maintain a dispute resolution process of integrity.

The contents of such an additional training module should include the ethical issues that neutrals need to address when parties are funded; how to modify intake and process procedures to ferret out the existence of third-party funders; how to implement titrated levels of disclosure; strategies to help neutrals manage their own cognitive biases about third-party funders; how to incorporate the third-party funder's assessment of the case into the process; and skills to manage parties' own biases about third-party funders.

At this time, those ADR providers and trainers who are ahead of the curve and wish to develop a responsive training for neutrals will find more questions raised than answers provided. The scholarship surrounding third-party funding, to date, has centered on the ethics of the practice and the question of disclosure. The specifics of how disclosure of third-party funders might actually influence the dynamics with the neutral and participants, however, remain an unexplored area. In Part V of this paper, I raise these emerging questions and posit the possible dynamic shifts that third-party funders might spark arbitration and mediation.

V. HOW MIGHT DISCLOSURE IMPACT THE DYNAMICS OF THE DISPUTE RESOLUTION PROCESS

Once one or both parties disclose that they are receiving dispute funding, any conflicts emerging from that disclosure are addressed, and the dispute resolution process proceeds, the disclosure itself could also potentially shape the decision-making process of the neutrals and parties involved. Although there is no specific research on point, cognitive psychologists provide us with insights about how arbitrators, mediators, and disputants might be influenced by the knowledge that a dispute is receiving third-party funding.¹⁵⁵ Biases about third-party funding, the amount of funding that a party is receiving, and the terms of the funding agreement may all influence the dynamics in both arbitration and mediation.

155. See generally MAHZARIN R. BANAJI & ANTHONY G. GREENWALD, BLINDSPOT: HIDDEN BIASES OF GOOD PEOPLE (2013); Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCI. 1124 (1974).

A. *Explicit and Implicit Bias About Third-Party Funding*

Even though arbitrators and mediators are ethically mandated to be impartial,¹⁵⁶ they are also human beings who may have pre-existing ideas about the ethics of third-party funding. These pre-existing ideas or biases may cause the neutral to be explicitly or implicitly biased for or against third-party funders.¹⁵⁷ As with many biases, such bias could be formed and reinforced by the self-selected media and publications that the neutral has been exposed to about third-party funders.¹⁵⁸ For example, if a neutral is following the U.S. Chamber Institute for Legal Reform's concerted efforts to disallow third-party funders from operating "in the shadows," the neutral might be leery of funders.¹⁵⁹ However, if a neutral is enthusiastically following the success of hedge funds who are funding litigation, then the neutral might view funders more favorably.

Such biases, whether explicit or implicit, favorable or unfavorable, might influence how neutrals deviate from their ethical mandate of impartiality. Depending on the bias of the neutral, the neutral might then interpret the fact that a party is funded as an indication that the case at hand has enough merit to warrant investment or just an indication that the party needed money. Depending on the bias of the neutral, the neutral may consider the fact that a party is funded either as an indication of the level of commitment of the parties to go forward with the case or a vengeful step to drag the case on unnecessarily.

Cognitive psychologists explain that our biases are more likely to emerge in ambiguous situations where there are fewer rules to follow.¹⁶⁰ Thus, even though mediators and arbitrators might both be influenced by their biases about third-party funders, mediators might be more likely to be influenced by such bias.¹⁶¹ The structure of the mediation process is more flexible and

156. See, e.g., CPR–GEORGETOWN COMM'N ON ETHICS AND STANDARDS OF PRACTICE IN ADR, *supra* note 144, at 10 ("The ADR Provider Organization has an obligation to ensure that ADR processes provided under its auspices are fundamentally fair and conducted in an impartial manner.").

157. Jean-Christophe Honlet, *Recent Decisions on Third-Party Funding in Investment Arbitration*, 30 ICSID REV.–FOREIGN INV. L.J. 699, 699–712 (2015) (citing a case in which arbitrator Dr. Gavin Griffith Q.C. was unsuccessfully challenged because of the negative views he expressed about third-party funders).

158. BANAJI & GREENWALD, *supra* note 155, at 164; see also DAN ARIELY, PREDICTABLY IRRATIONAL: THE HIDDEN FORCES THAT SHAPE OUR DECISIONS 201–23 (Harper Perennial ed. 2010) (2008).

159. See BEISNER ET AL., *supra* note 134.

160. Tversky & Kahneman, *supra* note 155, at 1124.

161. See e.g., Gilat J. Bachar & Deborah R. Hensler, *Does Alternative Dispute Resolution Facilitate Prejudice and Bias? We Still Don't Know*, 70 SMU L. REV. 817, 821–22 (2017); see

has less defined procedures than the arbitration process. For example, mediation may be conducted in joint meetings, private caucuses, or a combination of the two. Although the mediation parties, not the mediator, have the ultimate decision-making power, the mediator, in his role as a neutral, has greater discretion than an arbitrator about how to engage with the parties and influence the contours of the agreement the parties will reach.

On a subtler level, the dollar amount of the funding agreement might also unconsciously influence both the arbitrator's and mediator's shaping of a fair and just resolution. Cognitive psychologists educate about the power of anchoring, the undue influence that an initial number is given in subsequent decision making.¹⁶² Thus, allocations of costs in arbitration and an acceptable settlement number might be unduly influenced by the amount of funding one or both parties are receiving. Might an arbitrator be influenced in making an award by the fact that one party has received a significant amount of backing by a third-party funder? Alternatively, if a defendant received a significant amount of backing by a third-party funder, might the arbitrator have greater sympathies for that defendant if the arbitrator issues an award that orders the defendant to pay for damages and costs? In mediation, how might the amount of the funding arrangements of the participants shape the mediator's prodding of a reasonable settlement?

Another yet unexplored issue is how, from the party's perspective, a party receiving funding calculates settlement decisions.¹⁶³ In part, the answer to this is likely based on the type of funding agreement that exists between a party and the funder. If a party has a recourse funding agreement in which the party is obligated to repay the funder for the borrowed money plus interest, it is reasonable to assume that such a financial obligation would be a consideration in the party assessing what a reasonable settlement would be. Might a party receiving an apology as part of that settlement might then devalue that apology if the party also has to repay the funder the borrowed money? Possibly, if a party has a nonrecourse loan, and doesn't have to repay the funder unless the party is victorious, the party may feel more empowered to proceed to judgment unless the settlement offer is as high as the expected litigated value.

also Richard Delgado et al., *Fairness and Formality: Minimizing the Risk of Prejudice in Alternative Dispute Resolution*, 1985 WIS. L. REV. 1359, 1400–04; Trina Grillo, *The Mediation Alternative: Process Dangers for Women*, 100 YALE L.J. 1545, 1587–94 (1991).

162. Tversky & Kahneman, *supra* note 155, at 1129.

163. ROBERT H. MNOOKIM, SCOTT R. PEPPET & ANDREW S. TULUMELLO, BEYOND WINNING: NEGOTIATING TO CREATE VALUE IN DEAL DISPUTES 112–13, 117–18 (2000) (describing how transaction costs can either deter or expedite settlement).

Of course, disputants may have their own biases about third-party funders. If the disputant believes that third-party funders only back cases of merit, the disputant may be more inclined to settle once the disputant learns that the other party is receiving dispute funding.¹⁶⁴ However, if a disputant believes third-party funders are unethical scammers, the disputant may become less likely to settle and more determined to pursue her claim to vindication once the disputant learns the opposing side is receiving dispute funding.

Although this is an uncharted area, these are issues that dispute resolution professionals should be considering as they more actively engage with participants and the third-party funders who back them. Of course, neutrals need to become self-aware of their biases about third-party funders, along with all their other biases, so that the bias does not adversely influence the dispute resolution process. Such heightened awareness extends beyond the initial disclosure to see if there is a conflict with the neutral. Such heightened awareness extends throughout the mediation and arbitration.

B. Proposal Three: Modification of Dispute Resolution Forms and Procedures that Acknowledge the Possibility of Third-Party Funders

One way to change the status quo practice of “don’t ask, don’t tell” that has allowed dispute resolution professionals to be unaware of the existence of third-party funders is to modify dispute resolution forms and procedures to actually ask if there is a third-party funder involved in the case. Dispute resolution forms and procedures should be modified to reflect an awareness that third-party funders may be backing one of the parties. For example, ADR providers’ promotional materials, published rules and procedures could provide that experts, including third-party funders, may have a role in the given dispute resolution procedure. As mentioned above, dispute resolution professionals may include such a query as a regular part of their intake and contracting procedures.

CONCLUSION

The invisible practice of third-party funding is becoming increasingly visible. The time has come for dispute resolution providers and neutrals to see what they have yet to see before:¹⁶⁵ Third-party funders are shaping the practice of civil dispute resolution. Whether you believe this is an economic reality needed to address the escalating costs of conflict resolution or an evil

164. See GARBNER, *supra* note 129, at 32.

165. *Mark* 4:9 (NAB) (“Whoever has ears to hear ought to hear.”).

that will erode our justice system, the dispute resolution profession must take affirmative steps to address the real and apparent ethical collisions between third-party funders and neutrals. This paper proposes ethical guidelines and best practices that provide for modification of dispute resolution providers' intake procedures, titrated disclosure of third-party funders, and training of neutrals. The goal is to help respond to the conflict and confidentiality concerns raised when third-party funders provide support for a party in arbitration or mediation.

This paper also appreciates that we are in the dawn of awareness about third-party funders. As a profession, it is challenging to speculate about what we don't know, but we must try.¹⁶⁶ Going forward, we will benefit from empirical research that clarifies how third-party funding shapes parties' decision-making about settlement. And of course, the looming overarching question is how third-party funders will influence the delivery of justice. This paper invites dispute resolution providers and neutrals to rethink their current practices, adapt, and work to create practices and guidelines that protect the integrity of the dispute resolution profession and the justice it provides.

166. "Change is the law of life and those who look only in the past or present are certain to miss the future." John F. Kennedy, President of the U.S., Address in the Assembly Hall at the Paulskirche in Frankfurt (June 25, 1963).