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When the Empty ADR Chair is Occupied by a Litigation Funder

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By Professor Elayne E. Greenberg

Introduction


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The discussion about the $140 million jury verdict against Gawker media for posting a sex video of Terry Bollea, professionally known as Hulk Hogan, having sex with his best friend's wife, quickly shifted to a conversation about the ethics of litigation funding when it was finally disclosed that Peter Thiel had funded Bollea's litigation.[1] The backstory reveals that Gawker outed Thiel, revealing his homosexuality ten years earlier in a more conservative time when such a revelation might have impacted Thiel's earning capacity. Thiel, an icon in Silicone Valley and a co-founder of PayPal, promised revenge. Thiel got his revenge, and Gawker is now bankrupt.

Alternative litigation finance ("ALF"), known by some as litigation funding and pejoratively referred to by others as "pay to play," is the term used to describe

> the funding of litigation activities by entities other than the parties themselves, their counsel or other entities with a preexisting contractual relationship with one of the parties. These transactions are generally between a party to litigation and a funding entity and involve an assignment of an interest in the proceeds from a cause of action.[2]

To date, the discussion about the ethics of litigation funding has centered on ethics in the litigation context. This column will begin to broach the previously untouched ethical issues that litigation funding in arbitration and mediation raise for dispute resolution professionals. As background, this column will review the ethical concerns raised about litigation funding in the adjudication context. Then, the discussion will shift to the mediation and arbitration contexts and preview the ethical concerns and strategies mediators and arbitrators should consider if a litigation funder is occupying the empty chair in your ADR process.

Ethical Concerns About Litigation Funding in the Litigation Context

In the litigation context, it seems that most have an opinion about the ethics of litigation funding. Some accept litigation funding as a natural evolution of our capitalistic society.[3] Others remind us that litigation funding is just another litigation funding source like insurance. Viewed from the opposite perspective, others view litigation funding as a sign of the ethical corruption of our justice system that must be stopped. Still others are unsure which side of the discussion they are on, but they know that the sinking feeling in the pit of their stomach probably signals ethical caution.

If we expand our inquiry from personal opinions to ethical directives and proposed court rules about litigation funding, we learn that litigation funding is ethical provided that certain caveats are observed. For example, the New York State Bar Association Committee on Professional Ethics has issued two ethics opinions that support the use of litigation funding with some cautionary warnings. First, in a 1994 opinion, the Committee affirmed a lawyer's right to refer a client to a litigation funder to cover the cost of the client's living expenses during the client's claim for personal injuries when such repayment of the funding was contingent on the client prevailing on his claim.[4] The opinion clarified that the mere referral was not per se unethical so long as the attorney did not compromise the attorney-client confidentiality; the lawyer had the client's informed consent for any disclosures that had to be made; and the lawyer did not receive any compensation, ownership interest or referral fee from the funding corporation. The Committee reminded that the old English prohibitions against "maintenance," "champerty" as a form of maintenance, and "barratry" are still proscribed in New York.[5]

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Then, in 2003 the NYSBA Committee on Professional Ethics weighed in once more on the ethics of litigation funding when it opined that a lawyer representing a client on a personal injury matter may also represent that client and charge the client an additional fee in arranging litigation funding for the client with a funding institution.[6] However, the lawyer must be vigilant that such representation does not compromise the lawyer's independent judgment about the client's case. The Committee restated all the caveats it had issued in its earlier opinion.

The Committee also emphasized that the lawyer needs to explain and stress that such representation does not mean that the lawyer endorses the transaction. Moreover, the Committee recommended that the lawyer prepare a revised representation agreement to reflect the attorney's expanded scope of responsibility. Although the Committee would not comment on the legality of litigation funding, it did say that if litigation funding were found to be illegal, it would be a violation of the lawyer's ethical code to assist a client in a fraud. Rather than add clarity to the issue of litigation funding, the Committee's opinion could be interpreted as a statement that reflects the ethical ambivalence about litigation funding.

Echoing the concerns voiced in the NYSBA Ethics Opinions, The American Bar Association Commission on Ethics 20/20 Information Report to the House of Delegates expanded the discussion.[7] The Commission recognized that because there are so many variations of litigation funding agreements, it is challenging to identify the all possible ethical pitfalls for lawyers.[8] The Commission also reiterated that the client, as a matter of agency law, has a right to delegate revocable settlement authority to other agents such as a litigation funder.[9] Given those realities, the Commission cautioned the lawyer about any agreement with a litigation funder that would create any disincentive to the lawyer's exercise of his or her independent judgment in managing the case.[10]

Thus, in the litigation context, three caveats emerge from the ethical directives cited above. First, nothing in the litigation funding agreement may interfere with or disincentive the attorney from meeting his or her ethical obligation to exercise independent judgment.[11] Second, before the attorney shares any privileged information about the case with the litigation funding company, the client must make an informed waiver of attorney-client privilege.[12] Therefore, information that was once regarded as confidential because of the attorney-client privilege may lose its confidentiality cloak if it is shared with a litigation funder. Third, any fee-splitting arrangement between the attorney and the litigation funder may create ethical conundrums for the attorney. By way of illustration, does the fee-splitting arrangement adversely impact the attorney's independent judgment? Moreover, if the funder is a non-attorney, might it create a situation where the attorney is practicing law with a non-attorney?[13]

Stoking the controversy about litigation funding, the respective Rules Committees of the Federal Rules of Civil Procedure and the Rules of the Northern District of California have proposed modifications that would require attorneys to disclose the identity of any litigation funder backing their case.[14] Supporters and naysayers of the proposed rule modifications have seized upon this to continue debating the ethics of litigation funding.[15]

The Ethics of Litigation Funding in Dispute Resolution

Turning our conversation to the ethics of litigation funding in dispute resolution, we expect that the ethical requirements that lawyers are required to observe regarding litigation funding in the litigation context are the same ethical requirements that lawyers must continue to observe when they participate in dispute resolution. In addition, this columnist advises that lawyers participating in dispute resolution should ethically be required to disclose the identity of litigation funders at the time that lawyers and their clients consent to participate in dispute resolution. Disclosure is an important part of transparency, a fundamental ethical tenet of dispute resolution practice. Therefore, arbitrators and mediators must know the identity of litigation funders at the beginning of these procedures if these neutrals are to conduct these dispute resolution procedures in accordance with their ethical mandates and maintain the integrity of the arbitration and mediation procedures. Disclosure is needed for five reasons.

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First, disclosure is needed to identify any pre-existing conflicts between the ADR neutral and the funding organization. The integrity of mediation and arbitration is based, in part, on the neutrals disclosing any existing conflicts. The parties then have the right to decide if they want to proceed with the neutral given the conflict, or if they prefer, to employ another neutral. However, if the identifies of the litigation funders are not disclosed at the beginning, neutrals and parties may be unaware of potential pre-existing conflicts with the litigation funder.

Second, disclosure is needed for the neutral to fully understand all the interests that need to be addressed before a settlement is reached. A party's interests may be influenced, in part, by the economic support they receive from a litigation funder. This financial support may fuel the party's feeling of optimistic overconfidence and, at times, dispute the party's own interests. For example, if a party in arbitration has the economic support of a litigation funder, the party may be more likely to demand a drawn-out discovery process. In a mediation example, a party may be less receptive to considering a reasonable settlement if the party overconfidently believes they have enough economic support to secure the desired judgment that awards them all they believe they are entitled to. In another example, the litigation funder, as in the Hulk Hogan example mentioned at the beginning of the article, may have his own interests that need to be addressed before a settlement may be reached.

Third, disclosure is needed to uncover all the invisible pulls that may be dictating settlement terms. The specific economic arrangement between a party and a litigation funder may be such that a party might be less likely to consider a reasonable settlement offer if the party has to repay out of the settlement amount both the litigation funder the borrowed money with interest and also pay their lawyer for services rendered. The net balance might leave little for the party and create a disincentive to settle for anything less than the pot of gold.

Fourth, disclosure is needed to ensure that all participants, including the litigation funder, sign and abide by the agreed-upon confidentiality protections. Depending on the terms between the litigation funder and the party, the party may be required to share other confidential information about the mediation or arbitration. If the litigation funder does not sign a confidentiality agreement regarding the arbitration or mediation, then the litigation funder is not bound to keep that information confidential. This loophole in confidentiality potentially violates the confidentiality expectations of the parties, their lawyers, the neutrals and the ADR provider.

Fifth, disclosure is needed to ensure that the parties' procedural justice expectations are satisfied. The legitimacy of any dispute resolution procedure is based, in part, on whether the party perceives the process as fair, independent of whether or not the ultimate decision was in their favor. However, imagine how a party might feel if after a mediation or arbitration, it was disclosed that a litigation funder supported the other party. Thus, to maintain the procedural justice expectations of participants in arbitration and mediation, a party must disclose the identity of their litigation funders.

Conclusion

This is a never before broached discussion about the ethical implications of having a litigation funder support a party in arbitration or mediation. Even though litigation funding has been around for some time and is gaining popularity, little is known about how litigation funding ethically influences settlement. When a litigation funder occupies the empty chair in an arbitration or mediation, the identity of the litigation funder must be disclosed at the onset of the dispute resolution procedure. This should be a question on the forms of all providers. Disclosure is just the beginning.

However, disclosure is not the end of the ethics dilemma. Litigation funding agreements are not cookie cutter. Rather, they have varied economic terms and requirements that may implicate different ethical concerns when a dispute resolution participant is receiving the support of a litigation funder. As dispute resolution professionals, we need to examine this topic more thoroughly to preserve the integrity of our work. I welcome your thoughts and ideas about this increasingly pressing topic.

Endnotes

1. *See, e.g. Andrew R. Sorkin, Peter Thiel, Tech Billionaire, Reveals Secret War With Gawker,* N.Y. Times (Oct. 7, 2016), http://www.nytimes.com/2016/05/26/business/dealbook/peter-thiel-tech-billionaire-reveals-secret-war-with-gawker.html?_r=1; Mathew Ingram, The Gawker vs. Hulk Hogan Case Just Got a Lot More Important, Fortune, (May 25, 2016, 2:19 PM), http://fortune.com/2016/05/25/gawker-hogan-thiel/.

   > Gawker and Bollea then negotiated a settlement that reduced the amount of the jury verdict to $31 million. http://www.forbes.com/forbes/welcome/?toURL=http://www.forbes.com/sites/mattdrange/2016/11/02/gawker-media-close-to-reaching-settlement-with-hulk-hogan/&refURL=https://www.google.com/&referrer=https://www.google.com (November 14, 2016).

2. ABA Comm. on Ethics 20/20, Informational Report to the House of Delegates, at 1 (2014) [http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdfhttp://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212 (studied the impact of litigation funding on the lawyer/client relationship).

3. Alan L. Zimmerman, Fiona M. McKenna, Daniel J. Bush, & Cheryl Kaufman, *Economics and the Evolution of Non-Party Litigation Funding in America: How Court Decisions, the Civil Justice Process, and Law Firm Structures Drive the Increasing Need and Demand for Capital*, 12 N.Y.U.J.L. & Bus. 635, 636 (2016).

4. N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Advisory Op. 666 (1994).

5. *Supra* note 3 at 9."Maintenance, champerty and barratry are closely related but are not identical. '[P]ut simply, maintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome; and barratry is a continuing practice of maintenance or champerty.'"

6. N.Y. State Bar Ass'n Comm. on Prof'l Ethics, Advisory Opt. 769 (2003).

7. *See* Report to the House of Delegates, *supra* note 3, at 3.

8. *Id.*

9. *Id.* at *27.*

10. *Id.* at *28*.

11. *See, e.g.*, at Geoffrey McGovern et al., RAND Inst. for Civil Justice, Third-Party Litigation Funding and Claim Transfer: Trend and Implication for the Civil Justice System 19 (2010), http://www.rand.org/content/dam/rand/pubs/conf_proceedings/2010/RAND_CF272.pdf.

12. *See, e.g., McGovern, supra* note 11 at 17.

13. *Id.*

14. *See* http://www.therecorder.com/id=1202771211351/Move-to-Expose-ThirdParty-Case-Funding-Stirs-Debate-in-Northern-District?slreturn=20161014214119 (November 14, 2016).

15. *Id.*

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