Feature

US Litigation funding arrangements: towards disclosure?

Introduction

It's no secret that commercial litigation in the US is expensive. So it shouldn't come as a surprise that litigation funding – a solution that's been proposed to deal with these ever-increasing costs – has come to the fore in the last few years. But what exactly is litigation funding?

Also called litigation finance or third-party funding, it is the provision of capital to a claimholder or law firm in exchange for a portion of the proceeds from the litigation (or arbitration). In other words, companies will fund costs and expenses on behalf of a party in exchange for a portion of the judgment award if the party prevails. If the party is unsuccessful, the company bears the cost.

According to a survey by a prominent litigation finance firm, since 2013 there has been a startling estimated 414% increase in the use of litigation finance by US law firms. Yet despite this almost exponential growth on the business side, the law surrounding litigation funding has struggled to keep up. With judicial opinion on the topic constantly evolving, there's a current lack of cohesion in the law governing legal issues relevant to cases with litigation funding.

One of the most hotly debated topics in this space is whether the existence and/or details of a funding arrangement must be disclosed in litigation and, if so, to what extent and to whom. Recent judicial and congressional developments hint at a possible trend – albeit a slow-moving one – towards requiring some form of mandatory disclosure, particularly in multidistrict litigations ("MDLs").

Disclosure developments in the courts

In most states, there is no clear legislative guidance on whether third-party funding must be disclosed at all in litigation, let alone to whom, how, or at what point such disclosure should take place. Rather than wait on the sidelines, some federal judges are taking action on these issues – most notably in the MDL context. Recent orders by Judges Rodgers, Grimm and Polster in the 3M Earplug, Marriott Breach and Opioid MDLs have demanded disclosure of litigation funding information.

Courts moving towards disclosure in MDLs

In MDL cases, one critical mandate for the transferee judge involves selecting counsel for leadership positions. Determining the appropriate leadership structure and selecting the right lawyers to fill those positions is one of the first and most important case-management tasks. Depending on the nature of the claims, the number of individual cases, and the variety and complexity of interests involved, the MDL transferee judge may select attorneys for the positions of lead counsel, liaison counsel, steering committee and/or settlement committee.

Their roles can include presenting positions on procedural issues during the course of the litigation, undertaking administrative matters, handling discovery and other day-to-day aspects of the litigation, and conducting settlement negotiations. In selecting attorneys for these positions, judges have typically focused on qualities like cooperative tendencies, reputation, and expertise. But two MDL judges recently emphasised the importance of considering another factor: the attorney's involvement in litigation funding.

Both Judge Casey Rodgers of the Northern District of Florida and Judge Paul Grimm of the District of Maryland issued orders requiring third-party financing disclosures from counsel seeking leadership appointments in their respective MDLs. However, they limited the scope of these disclosures so counsel would only be required to submit information on litigation funding to the court, not the parties, and submission of the underlying funding agreements was not required.

Although there was no outside financing in the Marriott data breach litigation, Judge Grimm made clear that he would take that into account for selection purposes if such financing existed. He went on to explain how important it is for judges to know the existence of every party with a stake in the case when selecting attorneys for key MDL leadership positions: "If you have third-party funding…[and] [t]hen, when it comes to resolve the case, those people are not in the room, and if they have minimal expectations of what they must recover in order to maximize their investment, that is an influence, a potential influence, in how the litigation is conducted and how the litigation might be resolved."

Opioid MDL attorneys must also disclose outside funding to the court

Earlier in May 2018, Judge Dan Polster also issued an order in the MDL Opioid litigation requiring attorneys to disclose any financial backers that stand to profit from settlements in the case – but only to the court. The order applies to third-party contingent litigation funding (“3PCL financing”), which the court defined as “any agreement under which any person, other than an attorney permitted to charge a contingent fee representing a party, has a right to receive compensation that is contingent on and sourced from any proceeds of an MDL case, by settlement, judgment, or otherwise.”

Specifically, any attorney in any MDL case that obtained 3PCL financing must provide a description of the financing along with sworn affirmations – one from counsel and one from the lender – that the funding does not create a conflict of interest, undermine counsel’s obligation of “vigorous advocacy”, affect professional judgment, hand over any control of the litigation to lenders or affect party control of settlement.

While Judge Polster’s disclosure order came after the appointment of leadership positions in the Opioid MDL – unlike the circumstances under which Judge Grimm and Judge Rodgers demanded disclosure – these three instances of court-ordered disclosures point to a general growing concern among the judiciary.

This concern arises from the potential for improper influence from litigation funders and recognition that at least some form of mandatory disclosure is warranted to protect the integrity of the MDL structure and process. The orders also signal a general trend of judges ordering narrow disclosures by ex parte submission made only to the court, not opposing parties, and solely for ethics-related concerns.

The Litigation Funding Transparency Act

Unlike the approaches taken by federal MDL judges, lawmakers appear to be pushing for a broader and more aggressive form of mandatory disclosure of litigation funding. In February 2019, Senators Chuck Grassley (R-Iowa), John Cornyn (R-Texas), Thom Tillis (R-North Carolina), and Ben Sasse (R-Nebraska) reintroduced the Litigation Funding Transparency Act (S.2815) (the “LFTA”), a bill aimed at establishing uniform disclosure requirements in certain federal civil cases. A version of the LFTA was first introduced last year but failed to make it out of committee. Notably, the latest version of the bill proposes going much further on disclosure than any of the recent orders from the judiciary.

The current proposal, which seeks to amend title 28 of the United States Code to “increase transparency and oversight of third-party litigation funding”, would require counsel in class actions and MDLs to disclose in writing to both the court and other parties the identity of “any commercial enterprise” that has a contingent interest in settlements or judgments in the case. In addition to the automatic mandatory written disclosure, counsel would be required to turn over any funding agreements “for inspection and copying”. The bill also sets a timeline for disclosure – 10 days from the execution of the funding deal or when the suit is filed, whichever is later.

The reintroduction of the LFTA comes on the heels of similar steps taken by states like California (by local rule) and Wisconsin (by statute) requiring mandatory automatic disclosure of funding agreements in civil cases. It also follows signs of increased support by the Federal Advisory Committee on the Rules of Civil Procedure for modifications to Rule 26 that would explicitly require disclosure of litigation finance arrangements. The future of the LFTA, however, remains unclear at best. It failed to gain traction when Republicans controlled Congress, and with Democrats regaining power in the House, it seems unlikely to pass in the near future, if at all.

Comment

The prominence of the Opioid MDL, as well as the similar disclosure orders recently entered by Judge Rodgers and Judge Grimm in two other major MDLs, may lead other courts – and certainly those in the MDL arena – to adopt a mandatory but narrow disclosure approach when it comes to litigation funding.

On the other hand, Congress and rules committees are certainly contemplating more extensive disclosure requirements motivated by a broader interest in levelling the litigation playing field and increasing transparency between parties, rather than a concern for potential conflicts of interest or other ethics-related issues. In any event, one takeaway seems relatively clear: the number of recent attempts to require more transparency when it comes to litigation funding agreements is a sign that courts, policymakers, and many members of the bar view contingent third-party funding as warranting at least some level of oversight.

How much is required, however, remains to be seen. The Federal Committee on Rules of Practice and Procedure has yet to issue any decision on its own proposed potential rule change for third-party funding disclosure. But the drastic difference in the approaches coming from the judiciary and the legislature may work towards tipping the scale in favour of such a revision.

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