U.S. CHAMBER
Institute for Legal Reform

March 26, 2019

Ms. Rebecca Womeldorf
Secretary, Committee on Rules of Practice and Procedure
Administrative Office of the United States Courts
One Columbus Circle, NE
Washington, D.C. 20544

Dear Ms. Womeldorf:

I write to respond to a February 20, 2019 letter to the Advisory Committee from Therium Capital Management, Bentham IMF and Burford Capital. In that letter, they argue against amending Rule 26(a) to require disclosure of third-party litigation finance (TPLF) arrangements, describing the proposal as "a considerable departure from the existing rules regarding discovery." [1]

In their letter, they rely heavily on Rule 26(b), which of course deals with the scope of discovery and the relevance of materials to the merits of a litigant's claim. The focus, however should be on Rule 26(a).

What a court may need to know as relevant to the administration of justice in a particular case is often broader than what would be considered relevant to the merits of a case. The undisclosed interest of outside financiers in a lawsuit raises not relevance issues, but ethical and practical issues that are important to a case, regardless of whether they are considered discoverable evidence under Rule 26(b).

For example, parties and courts have a right to know whether the judge presiding over their case or any of the jurors are investors in the funder or its affiliates; to what extent, if any, the funder maintains control or influence over the case; to what extent the interest of the party being funded is diminished under the funding agreement; and whether the funding violates any ethical or judicial standards.[2] And in some cases, the terms of funding agreements may be very relevant to application of the Federal Rules of Civil Procedure—such as in class actions, where such terms may be critical to the adequacy of representation

[1] For convenience, I attach both letters.
[2] The ethics issue is a serious one. Courts in Pennsylvania, New York and other states have struck down funding arrangements because they violate legal ethics rules barring non-lawyer entities from sharing in legal fees. *Justinian Capital v. WestLB Ag* (65 N.E.3d 1253 (N.Y. 2016; *In re DesignLine Corp*. (2017 Bankr. LEXIS 182, at *1 (U.S. Bankr. W.D.N.C. Jan. 20, 2017.

determination under Fed. R. Civ. P. 23(a)(4). *Gbarabe v. Chevron*, 2016 U.S. Dist. LEXIS 103594 (N.D. Cal. Aug. 5, 2016). Under current rules, the identity of third-party funders and their role and influence are cloaked in anonymity.

The U.S. District Court for the Northern District of California—the very court that the litigation funders extensively rely on in making their relevance argument—adopted a rule requiring disclosure in class and collective actions, despite claims of the funding industry like those asserted here. Although the Northern District did not spell out its reasoning for instituting this new requirement, the fact that it applies in ***all*** class and collective actions belies the notion that it was adopted for reasons of evidentiary relevance. Rather, the only fair reading of the rule is that it was implemented for reasons of ethics, probity and sound judicial administration—fundamental precepts that are acutely important in aggregate litigation. The Advisory Committee wrestled with a similar question almost half a century ago, when the Federal Rules of Civil Procedure were amended to require defendant companies to hand over details of their insurance coverage at the outset of a case.

The Advisory Committee concluded then: "Disclosure of insurance coverage will enable counsel for both sides to make the same realistic appraisal of the case, so that settlement and litigation strategy are based on knowledge and not speculation." Defendants were deemed to have a duty to disclose this information to defendants under Rule 26(a) in 1970, even if it might not have been considered relevant for purposes of discovery.

The rapid and unregulated growth of litigation funding has put defendants in a similar position to plaintiffs in 1970. Wall Street hedge funds, institutional investors, and public and private companies reportedly have poured as much as $100 billion into litigation finance in recent years. Yet we know almost nothing about these arrangements, and these funding sources are completely unregulated. Defendants, like plaintiffs, have a right to know what they are facing, in order to make a "realistic assessment" of a case as well as the financial resources and motivations of the parties seeking recovery from them. As stated above, they also need to know about potential conflicts of interest or ethical violations that are now wrapped in a veil of secrecy.

The funders' letter asserts that the insurance analogy is inapt because, they claim (without disclosing any evidence) that while insurers exercise control over litigation, litigation funders do not. It would be reckless to accept this assertion without examining the facts and evidence. Indeed, in the very few examples of litigation finance contracts that have come to light, we see similar provisions and even some language that goes beyond the control normally exercised by insurers. There have been clauses giving investors the power to select counsel, advise on litigation strategy and even halt funding if the case isn't proceeding the way they want. In *Gbarabe v. Chevron*, 2016 U.S. Dist. LEXIS 103594, plaintiffs' counsel negotiated an agreement with the outside funder providing for a "success fee" of up to $10.2

million plus 2% of whatever was collected by class members, apparently without their knowledge or approval.

The funders also make a privacy argument, saying a plaintiff's TPLF contract would provide "a roadmap of its litigation strategy." No more so than insurance contracts, which reveal to the opposing party a defendant's financial resources and extent of coverage under various theories of the case.

The funders make the further argument that Rule 26 affords courts the power to compel disclosure if warranted. In their letter, they say proponents of disclosure have given no explanation why this power isn't sufficient "to address potential concerns that may arise every so often in a particular case." The explanation is contained in the phrase "arise every so often." Concerns will arise unless the parties and courts have knowledge of them, knowledge they cannot obtain without seeing the funding agreements.

Finally, the funders assert companies use litigation funding. It may be true in some cases, but as one who served for more than 20 years as the general counsel and head of litigation for a major U.S. company, consider me skeptical funding is as popular as some of its supporters maintain. Companies are skilled at identifying meritorious cases and funding them. But, whether companies use funding or not has no relevance to whether these arrangements should be as secret as a Grand Cayman bank account.

The disclosure of TPLF arrangements should not be addressed on an *ad hoc* basis or in one-sided *ex parte* communications with the court. Just as with insurance information, they should be presented in open court at the outset of a case and subject to the full scrutiny and transparency of the normal litigation process. The funding industry has long existed in darkness. It is time for it to emerge into the light.

Respectfully submitted,

Brackett B. Denniston, III

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Enclosures