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Time For Sunshine On 3rd-Party Litigation Funding

By **Mary Novacheck** (July 23, 2018, 5:32 PM EDT)


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On July 1, Wisconsin became the first state in the nation to require parties in lawsuits to disclose the use of an increasingly common and sometimes troubling aspect of the legal system: third-party litigation financing which is contingent on the outcome of cases.

Wisconsin's action aligns with six U.S. courts of appeals and roughly 25 percent of U.S. district courts that have local rules requiring disclosure of litigation funders, according to a survey of federal courts conducted earlier this year.[1] U.S. Senate Judiciary Committee chairman Charles Grassley, R-Iowa, introduced legislation this spring that is intended to provide uniform disclosure requirements for all federal civil cases.

The number and variety of attempts to require more transparency is a sure sign that courts, policymakers and many members of the bar view contingent third-party funding as controversial and overly secret. These concerns are clearly warranted. An annual survey sponsored by one of the largest litigation funders, Burford Capital, found in 2017 that use of third-party financing for litigation has increased exponentially: 28 percent over the past year and 414 percent since 2013.

Among U.S. law firms, more than one-third (36 percent) reported that they use litigation funding.[2] Moreover, the growing use of third-party financing is stoking its supply; Longford Capital recently reported that it raised and capped its litigation finance fund at $556 million,[3 and Burford announced that it invested nearly half a billion dollars in litigation in just the first half of 2017, a 150 percent increase from the prior year.[4]

This funding raises multiple legal and policy concerns that are driving growing calls for greater disclosure and transparency. First, it is not traditional bank funding, where a borrower agrees to repay a principal with a fixed or even variable interest rate. Instead, the funds agree to invest in a litigation in return for a substantial payback if the recipients prevail in the litigation or obtain a cash settlement.

A recent expose in The New York Times reported that Law Cash, a lender that provides high-interest loans to plaintiffs to be repaid only if they receive a legal settlement, was encouraging them to have unnecessary surgery to remove medical devices as a way to make their cases more valuable.[5] These outsized returns have raised concerns about whether the high interest rates charged for services to fund potentially unnecessary surgeries for device removal skirt the law, because the money is considered an advance — not a loan — and therefore not subject to state laws against unreasonably high interest rates.[6] The loans for medical fees and up to 100 percent interest charges are recovered by the funder, if the plaintiff collects money from a lawsuit, thus reducing the amount of any financial recovery for the plaintiff.[7]

Some participants at the recent Duke Law School conference on multidistrict litigation observed that third-party financing agreements might violate legal ethics by permitting nonparties to exercise influence over a litigation — such as whether a party should settle rather than face long-term litigation. Still others, such as Senator Grassley, question whether there could be unknown conflicts caused by the involvement of undisclosed parties with interests in the litigation.[8] A case in point: Recent motions in the Chinese drywall MDL in the Eastern District of Louisiana revealed that a plaintiffs lawyer involved in the case sat on the board of a bank that benefited from the deposit of that same MDL's plaintiff's fee fund.[9]

Additionally, the proportionality amendment to Rule 26(b)(1) of the Federal Rules of Civil Procedure on the scope of discovery requires the court and the parties to take the "parties' resources" into consideration when debating whether a certain type of discovery should be permitted. Without disclosure of third-party financing, the court cannot fully or accurately consider the parties' financial resources.

This is particularly important given the growing movement to shift the costs of discovery to requesting parties. A court would be much more willing to shift the cost of marginally relevant but grossly expensive e-discovery to the requesting party if that party is funded by a third party, especially in well-funded product liability MDLs against pharmaceutical and medical device manufacturers.

While the efforts of individual states and federal courts to shed more light on these funding arrangements are laudable, thus far they provide only a patchwork system that fails to impose consistent disclosure requirements for all federal civil cases. That's why many now believe that the Federal Rules, which govern all civil cases in the federal system, need to be changed to require that nonparties with a financial interest in the outcome of the litigation should be disclosed. A special subcommittee of the Federal Committee on Rules of Practice and Procedure is now weighing whether a litigation disclosure rule should be added to the Federal Rules, and a decision is expected in the coming months.

Adding a disclosure requirement would provide consistency to all cases, as these rules have long sought. Disclosure would also help address conflicts and the potential roles of nonparties in litigation. And, it would provide the sunshine required to promote proportionality as well as greater public accountability, including compliance with state lending laws and the use of such funding to encourage unnecessary medical procedures.

Still, getting a rule change will not be easy. Litigation funders benefit from secrecy, and certainly have the financial means to resist efforts to require further disclosure proposals. But there are some new signs of division within the funding industry. Alan Zimmerman, the CEO of the Law Finance Group, recently commented that he had no problem with disclosure proposals and thought transparency might help speed resolution of a case.[10]

Clear, uniform rules are the most fundamental part of the mission of the Rules Committee, and given the growing problem and diversity of solutions imposed by various district and circuit courts, there is a clear, present and pressing need for action.

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[1] Memorandum from Patrick A. Tighe, Rules Law Clerk, to Ed Cooper, Dan Coquillette, Rick Marcus, Cathie Struve, Survey of Federal and State Disclosure Rules Regarding Litigation Funding (Feb. 7, 2018), Agenda Materials at 209.

[2] “2017 Litigation Finance Survey: Latest Research Shows Continued Strong Growth,” Burford Capital survey conducted by ALM Media, May 17 to June 16, 2017.

[3] “Longford Capital Closes Fund II at $500 Million,” Longford Capital news release, Sept. 18, 2017.

[4] “Burford Capital Delivers 151% Growth in First Half Operating Profit,” Burford Capital Limited news release, July 27, 2017.

[5] Goldstein and Silver-Greenberg, “How Profiteers Lure Women Into Often-Unneeded Surgery,” The New York Times, April 14, 2018.

[6] Matthew Goldstein and Jessica Silver-Greenberg, “How the Finance Industry Is Trying to Cash In on #MeToo,” The New York Times, Jan. 28, 2018

[7] Ibid.

[8] “Grassley, Tillis, Cornyn Introduce Bill to Shine Light on Third Party Litigation Financing Agreements,” U.S. Senator Chuck Grassley, news release, May 10, 2018.

[9] In re: Chinese Manufactured Drywall Products Liability Litigation, MDL Docket No. 2047, Judge Eldon F. Fallon, United States District Court, Eastern District of Louisiana, June 12, 2018.

[10] David Lat, “The Evolving Regulatory Landscape For Litigation Finance,” Above the Law, June 8, 2018.