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Calif. Court Gets Automatic Funding Disclosure Right

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Last month, the U.S. District Court for the Northern District of California declined to adopt a proposal requiring automatic disclosure of third-party funding arrangements in every civil case filed there. The court considered adding three words (in italics below) to Local Rule 3-15, which requires a civil litigant to file a "Certification of Interested Entities or Persons" at the outset of any case:

> The certification must disclose any [persons or entities] other than the parties themselves (*including litigation funders*) known by the party to have either: (i) a financial interest of any kind in the subject matter in controversy or in a party to the proceeding; or (ii) any other kind of interest that could be substantially affected by the outcome of the proceeding.

After taking public comments and deliberating for over six months, the court dropped that language, which would have made clear that anyone providing funding to a civil litigant must be disclosed. Instead, it modified its global standing order to require disclosure of a funder's presence only in a "class, collective or representative action." The court may have taken this approach because amending the standing order does not require public comment.

Detractors of litigation funding have strained to characterize the court's amendment of the standing order as significant headway in their crusade against the industry. In truth, this is a victory for both the funding industry and those in need of capital to bring meritorious claims against wrongdoers in an often prohibitively expensive legal system.

As the court presumably concluded after carefully considering the impact of a broad rule, automatic disclosure is untethered to any determination of relevance. Nor does it present any compelling policy justification. The adoption of such a rule would have had unfortunate consequences for all civil litigants and the court, and not just litigation funders.

Court Follows Advisory Committee Approach on Rule 26

Far from being a harbinger of all-encompassing future disclosure rules, the court's decision follows the approach of the Advisory Committee on Rules of Civil Procedure. In December 2014 (and again in April

2016), the Advisory Committee rejected as premature a proposed amendment of Rule 26 offered by the U.S. Chamber of Commerce seeking automatic disclosure of funders at the outset of all civil cases. Among other things, the Advisory Committee noted that "judges currently have the power to obtain information about third-party funding when it is relevant in a particular case."[1] Precisely.

The bottom line, as both the Advisory Committee and presumably the court concluded, is that the presence of a funding arrangement (let alone its details) is irrelevant in nearly every civil case in which a funder is involved. And if on the off chance it happens to be germane, the Federal Rules already provide procedures for discovering relevant evidence. We can only speculate about the court's deliberative process. But the Advisory Committee ultimately concluded that a court can easily compel disclosure of funding in situations like adverse costs awards, discovery cost-shifting and monetary sanctions orders — i.e., when the financial resources of a claimant are actually at issue.[2]

Meanwhile, proponents of automatic disclosure would have every court in America adopt a regime (via the Federal Rules or otherwise) that shares no rational nexus with the cornerstone of discovery: relevance. They often assert that a funder is a "real party in interest" or express a prurient interest in knowing who is "behind the scenes" in any litigation. But a commercial litigation funder is not a real party in interest, which has been aptly described as "the person holding the substantive right sought to be enforced, and not necessarily the person who will ultimately benefit from the recovery."[3]

Nor does a litigant's curiosity about who is providing capital to its opponent make it relevant to the claims and defenses of a case under Federal Rule of Civil Procedure 26(b)(1). Remember, under revised Rule 26 only relevant, proportional evidence is discoverable. The industry's detractors simply do not offer a cogent argument for disclosure in every case under that standard. Instead, they promote the nebulous concept of "transparency" — ironically, more often than not failing to disclose whose interests they represent.

The conclusion about relevance follows even if the funder is entitled to be apprised of settlement negotiations and offer nonbinding views. Indeed, as the American Bar Association Commission on Ethics concluded in 2012, there is no reason as a matter of contract law to render unenforceable contractual provisions allowing a litigation funder to interfere with a client's right to make decisions respecting settlement, absent evidence of duress or unconscionability.[4] Under the ABA Model Rules of Professional Conduct, a lawyer could not contract for irrevocable settlement rights because he or she is a fiduciary.[5] A funder is not. It is a party to an arms-length contract with another sophisticated party represented by competent counsel. And again, if a funder has some say on settlement (which is uncommon in the experience of the authors), a court or neutral has the power to require anyone with such authority to attend a mediation.[6] Relevance strikes again.

Automatic Disclosure Leads to Wasted Resources, Other Negative Consequences

Automatic disclosure also would undoubtedly lead to wasteful attempts to expose underlying confidential communications and shared information among funders, claimants and their attorneys. The industry's detractors often speak pejoratively about funders hiding in the "shadows." In truth, claimants often want to disclose funding to signal that they are in it for the long haul. But inevitable attempts to delve into attorney work product-protected evidence causes great reluctance to disclose the arrangement altogether.

To begin with, it is expensive for funders to fight meritless discovery into protected communications that claimants share under nondisclosure agreements. It considerably increases the cost of funding, with a corresponding decrease in the benefit conferred to claimants with strong cases and insufficient means. It also causes a heavy burden on judges in the form of endless motions to compel — a factor that presumably had some influence on the court's decision with respect to Local Rule 3-15.

Moreover, the potential discovery of these materials prompted by automatic disclosure of a funder's presence would likely impede its ability to ensure the filing of only meritorious cases. That is, a claimant may be hesitant to share attorney work product analyzing the case if there is an increased risk of it falling into its adversary's hands. Of course, the great weight of authority on this issue protects disclosures made under a nondisclosure agreement under the attorney work product doctrine.[7] And while proponents of automatic disclosure incorrectly claim that funding promotes frivolous litigation,[8] inevitable attempts to delve into protected communications would only serve to chill the flow of information needed to carefully analyze the merits of each case.

Nor is automatic disclosure necessary to identify potential conflicts for judges. Existing rules of conduct for judges and attorneys address this concern. For example, the Code of Conduct for United States Judges states that they "should refrain from financial and business dealings that ... involve the judge in frequent transactions or continuing business relationships with lawyers or other persons likely to come before the court on which the judge serves."[9] While there is some theoretical risk that a judge may have an investment in or business connection with a litigation funder, the judicial canons counsel judges away from those types of relationships. The minute chance of a conflict does not justify an overarching rule in light of the competing negative consequences. The court certainly must have weighed these competing factors in reaching its decision.

Another question left unanswered by proponents of automatic disclosure of litigation funding is where it ends. A "litigation funder" (language proposed by the court) could encompass any number of arrangements, including plaintiff contingency fee agreements, law firm receivable funding from a bank, pro bono representation, assistance from a trade union, or even a loan from one's wealthy and benevolent aunt in Wisconsin. Surely the disclosure originally proposed by the court was not intended to cover these arrangements. But it is hard to imagine where it stops, without more.

Finally, a rule requiring the disclosure of funding in every case would provide an inequitable informational advantage for defendants. Plaintiffs are the largest users of litigation funding. But funding is used in less than one-tenth of one percent of civil cases filed in the U.S. Thus, under a sweeping disclosure rule, defendants would know not only when a party is well funded, but also when the reverse is true in nearly every case. That is, defendants would know in over 99.9 percent of civil cases whether or not a party has the deep reserves necessary to conduct protracted litigation. If the goal of litigation is to resolve a case on its merits, then this would be a patently unfair and indiscriminate disclosure.

A Victory for the Rule of Relevancy and for Fairness

So where does this leave us? The Northern District now requires litigants to disclose the presence of a funder only in class, collective or representative actions. The court got it right after engaging in a deliberative process. But this rule does not appear to impact the vast majority of funded cases. There has been some noise lately in the press about funders willing to finance class actions on a single-case basis (i.e., unlike funding a law firm like Citibank or Chase). In a single-case investment, funders typically contract directly with the claimant to ensure their return does not come from the attorneys' fees. To do otherwise would violate the universal rule forbidding lawyers from splitting fees with nonlawyers.[10] With exceptions that do not apply to litigation funders, the rule prohibits such fee-sharing to ensure that there is no interference with or influence over the lawyers' independent professional judgment.[11]

Of course, this arrangement is not possible in the U.S. opt-out class action context (and often in the group context), where claimants are far too numerous. And under the rules of professional responsibility, sharing the contingency fee with a lawyer representing the class falls under no exception to ABA Model Rule 5.4 and its state corollaries.[12] The court's revision to the standing order is therefore unlikely to have any impact on most if not all funding arrangements.

Ultimately, this is a victory, pure and simple, for litigation funding and its clients — including many of the companies the U.S. Chamber purports to represent. It is not an indication of more drastic disclosure rules to come. To the contrary, the court followed the lead of the Advisory Committee in maintaining the confidential nature of the relationship between a funder and claimant unless it actually matters. Abraham Lincoln was once 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.[13] The same is true here. Asserting that funding arrangements are relevant under the vague concept of "transparency" does not make it so. Unless and until a litigant or a hired commentator can offer a compelling argument that a funding arrangement is relevant to the claims and defenses in a case, it should remain confidential.

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[1] David G. Campbell, Report of Advisory Committee On Civil Rules at 4 (Dec. 2, 2014), located at http://www.uscourts.gov/file/17932/download.

[2] See Minutes of Civil Rules Advisory Committee at 12-14 (Oct. 30, 2014), located at http://www.uscourts.gov/sites/default/files/fr_import/CV10-2014-min.pdf; Report of Advisory Committee On Civil Rules at 3-4; see also Gbarabe v. Chevron Corp., 2016 WL 4154849, No. 14-cv-00173, at *1-2 (N.D. Cal. Aug. 5, 2016) (compelling a class action plaintiff to produce funding agreement where the plaintiff conceded privilege and relevance to adequacy of class counsel); but see Kaplan v. S.A.C. Capital Advisors LP, 141 F. Supp. 3d 246, 247-48 (S.D.N.Y. 2015) (denying production of funding documents where the class action plaintiff objected to production and the documents were irrelevant, including as to adequacy of class counsel).

[3] Miller UK Ltd. v. Caterpillar Inc., 17 F. Supp. 3d 711, 728 (2014) (quoting Farrell Constr. Co. v. Jefferson Parish,

La., 896 F.2d 136, 140 (5th Cir.1990)).

[4] American Bar Association Commission On Ethics 20/20, Informational Report to The House of Delegates at 22-23 (February 2012), located at http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_alf_white_paper_final_hod_informational_report.authcheckdam.pdf

[5] Id.

[6] See, e.g., Minutes of Civil Rules Advisory Committee at 13, 14 (describing Advisory Committee judges' discussion of their ability to order appearance by anyone with settlement authority).

[7] See, e.g., Miller, 17 F. Supp. 3d at 735-36; Kaplan, 141 F.Supp.3d at 247-48; Mondis Tech. Ltd. v L.G. Elec., Inc., 2011 WL 1714304, Nos. 2:07–CV–565, 2:08–CV–478, at *2-3 (E.D. Tex. May 4, 2011); IOENGINE LLC v. Interactive Media Corp., No. 1:14-cv-01571 at *2 (D. Del. Aug. 3, 2016).

[8] J. Beisner & J. Schwartz, How Litigation Funding Is Bringing Champerty Back To Life, Law360 (Jan. 20, 2017), located at https://www.law360.com/articles/882069/how-litigation-funding-is-bringing-champerty-back-to-life

(asserting, with no support and failure to disclose the authors' representation of the U.S. Chamber, that litigation funding "undermines our civil justice system by encouraging the filing of dubious claims").

[9] Code of Conduct for United States Judges, Canon 4(D), located at http://www.uscourts.gov/judges-judgeships/code-conduct-united-states-judges.

[10] See American Bar Association Model Rule of Professional Conduct 5.4(a).

[11] Id. (noting in the title, "Professional Independence of a Lawyer"); accord Cal. R. Prof. Conduct 1-320(A).

[12] Id.

[13] Miller, 17 F. Supp. 3d at 730 (citing Blue Cross Blue Shield of Massachusetts Inc. v. BCS Insurance. Co., 671 F.3d 635 (7th Cir. 2011)).