Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Big Business Lobby Tries To Hobble Litigation Finance, Again

By **Allison Chock, Matthew Harrison and Priya Pai**

Law360, New York (June 6, 2017, 8:01 PM EDT) --
The U.S. Chamber of Commerce, and its affiliated Institute for Legal Reform, tout the lofty goals of promoting a free market approach to innovation and growth,[1] being committed to small businesses,[2] and fighting for the belief that "[e]very American who has been legitimately wronged deserves his or her day in court."[3] Yet their repeated attempts to thwart the litigation finance industry run directly contrary to these positions. Instead, the Chamber is promulgating regulation designed to hamper and constrain litigation finance, a free market solution to the high financial barriers to our justice system.

Allison Chock

In its most recent petition advocating mandatory disclosure of litigation finance, the Chamber simply rehashes the same arguments from its failed 2014 efforts to convince the Committee on Rules of Practice and Procedure of the dire implications of undisclosed funding relationships. The Chamber points to the growth of the industry as raising alarm bells, but its fear-mongering about the industry's success contradicts the Chamber's own aggressively anti-regulation position in nearly every other context. Its renewed efforts also fly in the face of its stated commitment to small businesses, many of which cannot afford equal access to the judicial system, and turn to litigation finance for help.

Matthew Harrison

The Chamber's motives are clear. It is no longer interested in promoting free markets, small businesses or access to justice. This special-interest lobbying group appears focused on protecting the advantages of only its largest members, because litigation finance removes one of the advantages that those large corporations otherwise have in almost any high-stakes commercial dispute: superior financial resources.

Priya Pai

The Proposed Regulation Is Unfairly One-Sided

The Chamber's proposed regulation seeks disclosure of not just the existence of financing, but also the financing details, in every jurisdiction regardless of state regulation of the industry. The breadth of the proposed rule reveals its true purpose: to expose only one side's (usually the plaintiff's) litigation resources without requiring a reciprocal disclosure. The Chamber's analogy to the mandated disclosure of liability insurance misses the mark. By disclosing financing agreements, the proposed rule revision would require a claimant to disclose its litigation budget. Disclosing liability insurance does not have the same consequences; the purpose of that mandated disclosure is to ascertain the ability of a defendant to pay a judgment. That disclosure encourages settlements (or dismissals) of cases where there is no capacity to pay. The disclosure of liability insurance is not, however, directed at the defendant's ability to finance its defense. A true counterpart to the rule the Chamber now is advocating would be to require that defendants disclose not only the existence of insurance, but also their own financial arrangements with their defense lawyers (including in-house budgets and external counsel budgets).

It is also notable that while the Chamber analogizes its proposed rule to the rule requiring automatic disclosure of liability insurance, it fails to acknowledge the broad protections in place surrounding such mandated disclosures to ensure fairness to all parties in the litigation. For instance, in the insurance context, the attorney-client privilege is extended under the "joint defense" or "common interest" doctrine, to provide an exception to waiver of attorney-client privilege. Indeed, the Chamber itself points to the danger of waiver of confidential client communications with funders as a concern. (Query whether that concern is genuine, since defendants routinely attempt to pierce those privileges and protections the moment they become aware of funding — wasting the parties' time and resources and placing additional burdens on the courts.)

Similarly, references to liability insurance in front of a jury are generally disallowed. As with the attorney-client privilege extension, this now-established rule prohibits the other side from gaining an unfair advantage (in the case of insurance, potentially making it more likely for a jury to render any, or a larger, award than it otherwise would). A similar rule should apply to references to a litigation funder, for similar reasons (in the case of a funder, disclosure to a jury might potentially make members less likely to enter any, or a smaller, award if they think some of it may go to a third party).

But these safeguards, necessary to ensure fairness in litigation, have yet to be put in place broadly with respect to litigation finance. When the attorney-client privilege is expressly extended to communications with a funder, and when a rule prohibiting reference to a third-party funder in front of a jury becomes commonplace, it would not be surprising to see many litigation funders' objections to disclosure recede, if not disappear altogether.

A broad automatic disclosure rule also would have the effect of revealing to the other side not only when a party is well-financed, but also when they are not. Thus, an automatic disclosure rule would confer an unfair advantage to defendants — telling them exactly how much funding a plaintiff has to spend in a case and worse, when a plaintiff has no financial backing at all. Such plaintiffs would then be vulnerable to being overwhelmed by discovery and motion practice, and pressured to accept lowball settlements. That would be the opposite of true justice. This bias is perhaps unsurprising when one looks at many of the other signatories to the Chamber's petition: namely, the insurance industry, the defense bar, and big pharma.

Debunking the Chamber's Unfounded Concerns

The Chamber raises several supposed concerns about litigation finance to justify its overbroad proposed rule, which is rather obviously meant to reveal a plaintiff's ability to withstand protracted litigation.

For example, the Chamber argues that automatic disclosure ensures that defendants can enforce maintenance and champerty regulations. This ignores the fact that these antiquated doctrines from feudal England were, in many states, never adopted or are now abolished. But the Chamber makes no effort to limit its disclosure rule to those jurisdictions where maintenance and champerty are relevant.

Similarly, the Chamber's stated concerns about conflicts are unfounded. Existing rules of conduct for judges and attorneys already address conflicts. For example, the code of conduct for United States judges advises them to "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."[4] While there is some remote theoretical risk that a judge may have an investment in a litigation funder, the judicial canons counsel judges away from that. As for attorneys, they are fiduciaries to their clients and are subject to strict rules about client conflicts of interest. Litigation finance changes nothing about that relationship, and the Chamber's fear that lawyers cannot be trusted to follow these existing rules is paternalistic, if not insulting. This argument also ignores the fact that the Civil Rules Advisory Committee considered this exact concern and determined that current ethical rules governing the attorney-client relationship were sufficient to avoid such conflicts,[5] as did the American Bar Association.[6]

Nor is a funder automatically converted into a "real party in interest" to the suit simply by virtue of providing capital to pursue a case or keep a business afloat during high-stakes litigation, as the Chamber claims. It is well-understood that a real party in interest is "the person holding the substantive right sought to be enforced, and not necessarily the person who will ultimately benefit from the recovery."[7]

Mandating Disclosure of Irrelevant Financing Would Waste Time and Resources

The urged rule mandating automatic disclosure of funding (and the associated discovery battles that would inevitably follow) fly in the face of both relevancy standards and the recent proportionality requirement imposed by Federal Rule of Civil Procedure 26(b)(2)(1). Under revised Rule 26, only relevant, proportional evidence is discoverable. Courts that have considered disclosure of funding arrangements have rightly focused on the relevance of the arrangement to the merits of the litigation.[8] That a defendant may want to know about an adversary's litigation budget does not make it relevant to any claim or defense under the Federal Rules.

Nor does the increase in law firm portfolio financing support automatic disclosure. Portfolio financing, compared to single case funding, is not novel or unique to the litigation finance industry. Law firms have long had access to capital from banks and other lending institutions. When a litigation financier funds a portfolio of cases, its funding is akin to that of any other financial institution, but with the added benefit that that funding is nonrecourse. The nonrecourse nature of this lending means that, unlike a typical bank, a litigation financier is financially motivated to delve deeply into the merits of the cases supporting the financier's investment in the firm. If not, that financier is not likely to be in business for very long. Nor does firm portfolio financing constitute prohibited fee-splitting, just as other law firm payments to bank loans, staff and other creditors do not constitute prohibited fee-splitting.

Litigation finance naysayers lament the fact that it may prolong litigation. This may be true in some situations, but contrary to the Chamber's negative spin, it is one of the many positive effects of funding. Litigation finance does not undermine legitimate settlement discussions. But it does reduce the likelihood that a plaintiff will be forced to accept a lowball settlement offer simply because it knows it lacks the financial resources to take its claims to trial (and in some cases, through multiple appeals). It is hard to see how increasing the odds that a case will be decided on its merits — rather than being settled due to a disparity in resources — is harmful to our judicial system. As one legal scholar aptly put it: "No legitimate policy can support denial of funding as a way to squeeze plaintiffs without financial reserves and thereby force an early unjust settlement, especially when defendants can use procedural strategies to buy delay."[9]

It is also hard to see how contractual provisions requiring a funder to be informed and consulted during settlement discussions, but without any approval or veto authority, somehow confer control over settlement. Moreover, as the ABA Commission on Ethics concluded in 2012, there is no reason contractual provisions allowing a litigation funder to interfere with a client's right to make decisions respecting settlement should be held to be unenforceable, absent evidence of duress or unconscionability.[10] Under the ABA Model Rules of Professional Conduct, a lawyer may not contract for irrevocable settlement rights because he or she is a fiduciary.[11] A funder, however, is not a fiduciary; it is a party to an arms-length contract with another sophisticated party represented by competent counsel. And if a funder has some authority over settlement, a court or neutral always has the power to require anyone with settlement authority to attend a mediation.[12]

Let's Get Real

Litigation finance is a positive development in our legal industry. It helps alleviate the unfairness of the deepest pockets inevitably prevailing in high-stakes protracted litigation. Unless a financing arrangement is shown to be directly relevant to the merits of the claims at issue, disclosure of funding will lead to expensive and irrelevant discovery sideshows, the inequitable disclosure of one side's resources, and an increase in the cost of funding arrangements. It may also have the unintended effect of limiting a funder's ability to properly analyze the merits of a case. These negative consequences of the Chamber's proposed rule would stifle an industry that is providing a needed solution to our often prohibitively expensive legal system.

Allison K. Chock is chief investment officer, U.S., and legal counsel at IMF Bentham Ltd. in Los Angeles.

Matthew D. Harrison is an investment manager and legal counsel and Priya G. Pai is legal counsel at IMF Bentham in San Francisco.

[1] https://www.uschamber.com/financial-regulation

[2] See https://www.uschamber.com/members/small-business

[3] https://www.uschamber.com/legal-reform

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

[5] 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.

[6] American Bar Association Commission On Ethics 20/20, Informational Report to The House of Delegates (February 2012), located at http://www.americanbar.org/content/dam/aba/administrative/ethics_2020/20111212_ethics_20_20_a

lf_white_paper_final_hod_informational_report.authcheckdam.pdf

[7] 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)).

[8] 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).

[9] S. Gillers, Waiting for Good Dough: Litigation Funding Comes to Law, 43 Akron L. Rev. 16 (2010).

[10] 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

[11] Id.

[12] 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).
