

Claimants Shouldn't Be Forced To Disclose Litigation Funding

By **Matthew Harrison and John Harabedian** (June 11, 2018, 3:42 PM EDT)

On May 10, 2018, Republican Senators Chuck Grassley, R-Iowa, Thom Tillis, R-N.C., and John Cornyn, R-Texas, introduced a bill called The Litigation Funding Transparency Act of 2018.[1] Despite the many rejections of automatic disclosure rules for litigation funding arrangements by the Advisory Committee on Rules of Civil Procedure to date, after careful consideration of the proposals by that committee, the bill would require a claimant to reveal the existence of litigation funding and terms themselves in any federal class action and any federal claim aggregated into a federal multidistrict litigation proceeding.

In the wake of that announcement, many members of the legal community — presumably defense-oriented lawyers — commented that the proposed bill is sensible and fair in light of the requirement in federal courts that defendants disclose insurance coverage information at the outset of any case. This is not a new argument: the U.S. Chamber of Commerce has taken this position for years.[2] Initial disclosures under Federal Rule of Civil Procedure 26(a)(1) require a party to divulge “any insurance agreement under which an insurance business may be liable to satisfy all or part of a possible judgment in the action or to indemnify or reimburse for payments made to satisfy the judgment.”[3] But the argument that the respective disclosures are equivalent is misguided for a number of reasons.

Disclosure of Funding Arrangements Prejudices Plaintiffs

To begin with, required disclosure of liability insurance policies ultimately helps the disclosing party — the insured defendant — by discouraging plaintiffs from pursuing even meritorious claims when there is little to no insurance coverage in place or, when plaintiffs do file claims, from demanding more than the policy limits. In 1993, when insurance coverage became a mandatory part of initial disclosures under Federal Rule of Civil Procedure 26(a)(1), the advisory committee noted that insurance coverage was “basic information that is needed in most cases to prepare for trial or make an informed decision about settlement” and was the “type[] of information that ha[d] been customarily secured early in litigation through formal discovery.”[4] Thus, the rationale for the disclosure of insurance policies is tied to an early assessment of a defendant’s ability, or possible inability, to pay a judgment or settlement based on the merits of the case. In contrast, forced disclosure of litigation financing arrangements would harm the disclosing party — typically the claimant — by revealing its ability to pay legal fees and costs, which



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would give defendants enormous leverage to force unjust settlements on plaintiffs, with no connection to the merits of the claims or defenses.

Indeed, the proposed disclosure of litigation financing arrangements would divulge far different information from liability insurance policies. The truth is that beyond the basic ownership information required in initial disclosures, defendants are not required by the courts to disclose any specific financial information, including their sources of financing for the defense of cases or their litigation budgets. Liability insurance policies include amounts that a third-party insurance company could contribute to a defendant's case, either in helping to satisfy a settlement or judgment or paying attorney's fees and costs (depending on specific policy terms). But they do not disclose the defendant's ultimate financial risk tolerance, i.e., the amount that the defendant is able and willing to spend defending and resolving the case. And because liability insurance policies are purchased prior to the underlying event of the claim occurring, the policy limits do not disclose a defendant's confidential financial assessment of the claim at issue and, therefore, do not prejudice a defendant's ability to defend itself.

This is precisely the prejudicial effect that mandatory disclosure of litigation financing arrangements would have on plaintiffs, both those utilizing litigation funding and those that are not. For plaintiffs that have secured litigation funding, disclosure of the claimant's funding agreement would reveal to its adversary both information about the company's financial means and its maximum litigation budget, as well as potential pressure points along the way, based on the economic structure of the deal. This type of disclosure essentially provides the defendant with a roadmap to the plaintiff's litigation strategy. And for the majority of plaintiffs without litigation funding, defendants will immediately know that these plaintiffs lack third-party financial support and may not have the wherewithal to withstand a barrage of defense motions and still prosecute the case through trial and appeal.

Funding Arrangements and Insurance Coverage Disclosures Do Not Have the Same Policy Rationale

This unnecessary harm to claimants would come with none of the policy justifications that supported the mandatory disclosure of defendants' insurance policies. When FRCP 26 made insurance policies formally discoverable in 1970, the advisory committee specifically noted that insurance coverage "should be distinguished from any other facts concerning defendant's financial status (1) because insurance is an asset created specifically to satisfy the claim; (2) because the insurance company ordinarily controls the litigation; (3) because information about coverage is available only from defendant or his insurer; and (4) because disclosure does not involve a significant invasion of privacy."^[5] As the Advisory Committee aptly recognized, obtaining detailed financial information about a defendant's ability to defend a case — such as its cash position on its balance sheet, litigation reserves, or the availability of lines of credit from a financial institution — would prove extremely useful for a plaintiff and, conversely, prejudicial for the defendant. The plaintiff undoubtedly would gain knowledge of the defendant's financial risk tolerance and ability to defend itself, and utilize that information to advantageously prosecute the case to the defendant's detriment, regardless of the merits of the case.

Moreover, unlike an indemnity insurance policy, a litigation funding arrangement cannot "satisfy the claim." Disclosure of its terms would not enable counsel to make a realistic appraisal of the potential value of the case or to settle or dismiss the matter where pursuing litigation would not likely yield a better outcome. Thus, the respective disclosures vary widely on their potential to influence settlement. In response to the Chamber's 2014 proposal to amend Rule 26 to require automatic disclosure of litigation funding arrangements in every case, the advisory committee acknowledged that "knowing that the other side has an 'unlimited budget' to continue the litigation might prompt a party to settle if it had believed before that the adverse party's litigation budget was strapped." ^[6] But providing a defendant

with the knowledge of whether it is able to bleed the plaintiff dry in litigation certainly does not furnish rational policy support for disclosure of litigation funding as a way to facilitate settlement. As the advisory committee concluded: “[T]hat does not seem to be the reason that discovery of insurance agreements was authorized in 1970, and discovery of [funding] agreements seems to raise different issues.”[7]

The rationale behind the advisory committee’s 1970 rule changes for insurance coverage differs in two other important ways from disclosure of funding arrangements. Unlike an insurance company, a litigation funding company ordinarily does not control the litigation. And unlike disclosure of an insurance policy, disclosure of a litigation funding agreement does involve a significant invasion of privacy and of attorney work product. The only thing that insurance policies and litigation funding agreements have in common from the advisory committee’s list is that they are both only available from the adverse party in the litigation. But this is true of many kinds of information which would never be subject to automatic disclosure.

Disclosures of Funding Arrangements and Insurance Coverage Do Not Carry the Same Protections

Another important distinction between automatic disclosure of litigation funding arrangements and disclosure of insurance coverage is the respective protections in place for confidential information shared among the relevant parties. In the insurance context, historically state and federal courts have routinely protected communications between insurance companies, the insured defendant and defendant’s counsel from disclosure to third parties under the common interest or joint defense doctrine. While the analysis can be fact dependent, generally any tripartite communications will be protected when the insurer has a duty to defend, there is no conflict between the insured defendant and insurer, and the insurer selects and pays for counsel for the defendant.[8]

In contrast, and in part because litigation funding in the United States is less ingrained in the judicial system than liability insurance coverage, courts have been reluctant to recognize the applicability of the common interest doctrine or joint prosecution privilege for communications between litigation funders and claimants and their counsel. Although the vast majority of courts protect from disclosure claimants’ communications with litigation funders under the attorney work product doctrine and on relevance grounds, the proposed disclosure of funding arrangements simply does not carry with it the same “default” privileges and protections in the courts that insurance arrangements do. Defendants are therefore undeterred from engaging in discovery expeditions designed to expose underlying confidential communications and shared information among funders, claimants and claimants’ attorneys. As such, claimants often find themselves in the conflicted situation where they often would prefer to disclose their funding arrangement to signal that they are invested in litigating until a fair result is reached, but ultimately decline to do so to avoid the inevitable attempts by defendants to delve into attorney work product-protected evidence.

United States District Court Judge Dan Polster of the Northern District of Ohio recently demonstrated in the opioid multidistrict litigation how courts can review litigation financing arrangements without subjecting claimants to costly discovery sideshows aimed at uncovering claimants’ communications with litigation funders. He required the lawyers in the case to disclose relevant litigation financing arrangements for his in camera review only. This exercise — of existing judicial powers — balanced his need to learn about the existence of any funding arrangements for specific, narrow purposes, and the reality that the funding terms would likely be wholly irrelevant to the cases themselves. Judge Polster’s order concluded, “absent extraordinary circumstances, the Court will not allow discovery into [third-party litigation] financing.” If adopted by courts on a broad scale, this approach would establish a

reasonable middle ground for judges to assess financing agreements without affording defendants an unfair advantage.

Conclusion

While it may seem superficially appealing to compare disclosures of litigation funding arrangements and liability insurance coverage, the disclosures are far different in nature. The disclosure of both insurance coverage and litigation funding ultimately benefits defendants, while the latter undoubtedly prejudices claimants. One could imagine a situation where opposition by funders and claimants to appropriate disclosures of their arrangements would fall away to some extent if the long-established protections and privileges in place for insurance carriers were applied to litigation funders. Until that framework exists though, disclosure of litigation funding arrangements will inevitably result in costly discovery sideshows that unnecessarily burden claimants and the courts — concerns that rarely, if ever, arise in the insurance coverage context.

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[1] See Grassley, Tillis, Cornyn Introduce Bill to Shine Light on Third Party Litigation Financing Agreements, May 2018, located at <https://www.judiciary.senate.gov/press/rep/releases/grassley-tillis-cornyn-introduce-bill-to-shine-light-on-third-party-litigation-financing-agreements>

[2] See, e.g., Litigation Finance: Stop The Hide-And-Seek Game, August 2016, The D&O Diary, located at <https://www.dandodiary.com/2016/08/articles/litigation-financing-2/guest-post-litigation-finance-stop-hide-see-game/>.

[3] Fed. R. Civ. Proc. 26, located at <https://www.federalrulesofcivilprocedure.org/frcp/title-v-disclosures-and-discovery/rule-26-duty-to-disclose-general-provisions-governing-discovery/>

[4] Notes of Advisory Committee on Rules—1993 Amendment, located at https://www.law.cornell.edu/rules/frcp/rule_26.

[5] Notes of Advisory Committee on Rules—1970 Amendment, located at https://www.law.cornell.edu/rules/frcp/rule_26.

[6] See Advisory Committee Memo on Third-Party Litigation Funding, Submission 14-CV-B, October 2014, Advisory Committee on Civil Rules, located at www.lfcj.com/uploads/3/8/0/5/38050985/committee_tplf_memo_oct_2014.pdf (internal page 116 of 588).

[7] *Id.*

[8] See Confidentiality and Privilege in the Insurer–Policyholder–Defense Counsel Relationship, April 2012, American Bar Association, located at <http://apps.americanbar.org/litigation/committees/insurance/articles/marapr2012-confidentiality-privilege.html>