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Skadden Discusses Third-Party Litigation Funding

By Jason D. Russell, Hillary A. Hamilton, and Matthew E. Delgado, May 2, 2017

Comment

The use of third-party litigation financing — generally defined as the funding of litigation activities by entities other than the parties themselves, their insurers or their counsel — continues to increase in the United States. One recent survey showed that nearly 30 percent of private practice attorneys and firms surveyed reported using alternative litigation funding, compared to 7 percent in 2013. In March 2017, a third-party litigation financier reported that its current average investment in new cases is approximately \$13 million, up from less than \$4 million in 2013. In 2016, the worldwide market for third-party litigation financing was estimated to exceed \$1 billion.

In response, courts, judicial officers and legislators are addressing concerns about transparency raised by defendants, insurers and opponents of third-party litigation financing as to whether the participation of nonparties with financial interests in pending litigation should be disclosed at the commencement and/or during the course of civil proceedings. Recent developments indicate that courts, rule committees and even Congress may be leaning toward mandatory disclosure of third-party litigation funding in civil litigation.

Proposed Rule Changes

In June 2016, the U.S. District Court for the Northern District of California [proposed a change](#) to Civil Local Rule 3-15, which requires the initial disclosure of any person or entity with “a financial interest (of any kind) in the subject matter in controversy or in a party to the proceeding” or “any other kind of interest that could be substantially affected by the outcome of the proceeding.” The proposed change would have added language (bolded in the excerpt below) explicitly identifying litigation financiers as those whose identities must be disclosed at any point during the proceeding:

The Certification must disclose any persons, associations of persons, firms, partnerships, corporations (including parent corporations), or other 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.

During the open comment period on the proposed change, however, third-party funders argued that it was unnecessary because the current local rule already mandated a much broader disclosure than federal rules, which require identification only of any parent corporation or publicly held corporation owning 10 percent or more of a party’s stock. One funder in particular warned against the “fact of litigation funding being used to launch a discovery sideshow, increasing the costs of litigation for the funded party and the burdens on the court.”

Ultimately, the Northern District of California elected not to issue the draft revision to Local Rule 3-15 in final form. Instead, in January 2017, it updated its [districtwide standing order](#) to add language mandating third-party litigation financing disclosure only in class actions, not all civil proceedings.

Amendments to federal rules also have been explored. The Advisory Committee on Civil Rules considered requiring automatic initial disclosure of third-party litigation financing agreements, but when the committee first addressed the issue at its October 2014 meeting, it noted that the field was evolving and chose not to act. The topic was again raised at the committee’s April 2016 meeting and remains as an open item on its agenda.

Further, in early March 2017 the House of Representatives passed the proposed Fairness in Class Action Litigation Act of 2017 ([H.R. 985](#)) with a third-party litigation funding disclosure provision requiring the prompt disclosure to the court and parties in all class actions of any entity with “a contingent right to receive compensation from any settlement, judgment, or other relief obtained in the action.”

Recent Decisions

Two federal cases from 2015 and 2016 illustrate how courts are split in grappling with the disclosure of third-party financing arrangements in the discovery context.

In *Kaplan v. S.A.C. Capital Advisors*, U.S. Magistrate Judge Kevin N. Fox of the U.S. District Court for the Southern District of New York rejected a request to compel the production of information regarding third-party funding arrangements for shareholder plaintiffs. While the defendants raised concerns about the adequacy of the plaintiffs' counsel due to potentially insufficient resources to prosecute the action and/or potential conflicts with the interests of the class, the court noted that such concerns were "purely speculative," and "[t]he plaintiffs' admission that they have entered into a litigation funding agreement does not, of itself, constitute a basis for questioning counsel's ability to fund the litigation adequately." Thus, because the defendants did not show that the requested documents were relevant to any claim or defense, they were not entitled to disclosure.

However, in August 2016, Judge Susan Illston of the Northern District of California reached the opposite conclusion in *Gbarabe v. Chevron Corp.* There, Chevron sought disclosure of information regarding the plaintiff's third-party litigation funding arrangements in a putative class action seeking damages relating to an oil rig explosion off the Nigerian coast. The plaintiff had produced a redacted copy of his litigation funding agreement in discovery, but Chevron argued that the funding agreement and related documents were relevant in determining "the resources that counsel will commit to representing the class," in accordance with the adequacy of representation analysis required for class certification under federal civil procedure. The court agreed and ordered the plaintiff to produce the funding agreement for Chevron. The court rejected the plaintiff's proposal to submit an unredacted copy for *in camera* review as "inadequate because it would deprive Chevron of the ability to make its own assessment and arguments regarding the funding agreement and its impact, if any, on plaintiff's ability to adequately represent the class." In a footnote, the court noted that the defendant had also sought to compel compliance with the disclosure requirements of Rule 3-15 but found "it prudent to defer resolution of this question until the Northern District acts on the proposed revision."

While the tide of legislative and judicial opinion seems to be turning toward disclosure, this issue has not yet been squarely addressed in most jurisdictions. Absent any national regulation by the House bill or the federal rules committee, rules will continue to be crafted on a jurisdiction-by-jurisdiction basis. Parties should be mindful of the swiftly changing judicial and jurisdictional approaches to these issues in pending and threatened litigation.

This post comes to us from Skadden, Arps, Slate, Meagher & Flom LLP. It is based on the firm's client update, "Third-Party Litigation Financing: Mandatory Disclosure on the Horizon?" dated April 19, 2017, and available [here](#).

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