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PERSPECTIVE

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Wisconsin mandates third-party litigation finance disclosure

By Jason D. Russell, Hillary A. Hamilton and Adam K. Lloyd

The rise in popularity of third-party litigation financing — the funding of litigation by entities other than the parties themselves, their insurers or their counsel — has provoked a commensurate surge in scrutiny and debate regarding the propriety of behind-the-scenes, opaque funding transactions. As third-party litigation funding becomes more widespread, courts and legislatures are demanding more transparency from entities with a direct financial interest in the outcome of someone else's cause of action.

The last decade has seen the rise of several well-capitalized investment funds, run by individuals with legal backgrounds, which specialize solely in financing litigation. These funds typically finance plaintiffs' cases by investing money up front in exchange for a percentage of a final settlement or judgment. Defense-side litigation financing, which resembles an insurance arrangement that functions to protect defendants from larger-than-expected adverse judgments or legal expenses after a lawsuit has been filed, is gaining traction as well. One third-party litigation financier boasts that it has over $3 billion committed to the legal market, while another offers funding of up to $15 million or more for a case.

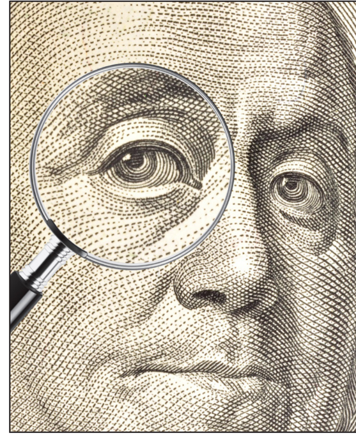
Recently, Wisconsin became the first state to mandate disclosure of third-party litigation funding arrangements in civil cases in state court. 2017 Wisconsin Act 235, which took effect April 5, requires that "a party shall, without awaiting a discovery request, provide to the other parties any agreement under which any person, other than an attorney permitted to charge a contingent fee representing a party, has a right to receive compensation that is contingent on and sourced from any proceeds of the civil action, by settlement, judgment, or otherwise."

The Wisconsin law is unique in that it requires third-party financing disclosure in all civil litigation in state courts, and requires disclosure of the litigation finance agreement itself. In contrast, at least eight other states have enacted legislation regulating third-party litigation finance to protect consumers, such as by imposing caps on the rates and fees assessed to consumers who use litigation financing, but those states do not require the disclosure of the funders' identity or their agreements in any civil action.

However, according to a report prepared for the federal judiciary's Advisory Committee on the Rules of Practice and Procedure, six U.S. Courts of Appeals have local rules requiring the identification of persons or entities that are financially interested in the outcome of the litigation, and 24 out of 94 district courts require a party to disclose any person or entity, other than the parties, that has a financial interest in the outcome of the proceeding.

Additionally, the U.S. Chamber of Commerce, along with dozens of allied business groups, recently petitioned the federal judiciary's Advisory Committee to amend Federal Rule of Civil Procedure 26(a)(1)(A) to require litigants to disclose the existence of third-party funding arrangements. The issue was set for discussion in the committee's published agenda for its April 10 meeting. Meanwhile, in March 2017, the House passed the Fairness in Class Action Litigation Act of 2017, which requires 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." The bill has been under consideration by the Senate Judiciary Committee for over a year.

One of the largest third-party litigation funders, Burford Capital LLC, dismissed the Wisconsin law as "an accidental outlier that is likely to change in due course once Wisconsin businesses realize that their legislators just overreached."



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Such self-serving rhetoric aside, the demand for transparency is easily understood, and hard to decry as burdensome. Litigation finance is a largely unregulated industry, and the potential for abuse is obvious. A disclosure obligation like Wisconsin's does not infringe on the purported purpose of third-party litigation financing, which, according to third-party litigation financier IMF Bentham Ltd., is to allow otherwise cash-strapped plaintiffs to pursue an ostensibly meritorious cause of action by placing plaintiffs on "more equal financial footing against deep-pocketed defendants." Rather, disclosure merely ensures the parties are aware of all stakeholders in the litigation who have a direct financial interest in the outcome, and allows the parties to make informed choices regarding their litigation strategy.

One issue third-party litigation financing can inject into already complex litigation is the amount of control, direct or indirect, the funder is exercising over the litigation, and whether the funder's interests are being placed ahead of the parties. Obviously, potential conflicts of interest abound.

Another concern is, as IMF Bentham Ltd. told the Wall Street Journal, that "[w]e make it harder and more expensive to settle cases." While proponents of third-party litigation finance insist that savvy funders would never invest in frivolous cases, that assertion rings hollow. In our experience, the presence of third-party litigation funders has prolonged litigation by leading plaintiffs to reject reasonable settlement offers on weak claims, likely to appease their financiers' demands for a higher rate of return on their investment in the lawsuit.

Third-party litigation funders have complained that Wisconsin's disclosure requirement will create more discovery disputes over the production of funding documents that contain assessments of a case's strengths and weaknesses. This concern is overblown. While some may attempt to argue that such agreements are covered by the attorney-client privilege or the work-product doctrine, courts can quickly resolve whether such agreements can be produced in redacted form to address any purported concerns. At that point, any minimal additional discovery burden that disclosure imposes would be outweighed by a party's right to know who is controlling the litigation, who has a financial stake in the outcome for the opposing side and whether this creates ethical issues due to conflicts of interest.

Given the justifiable concerns about the surge in third-party litigation funding and its apparent entrenchment in modern litigation, it seems likely that Wisconsin's new disclosure law will be the first of many, as courts and legislatures struggle to shed light on who, exactly, stands to recover in a given litigation.

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