Professional Perspective

Considerations for Plaintiffs Weighing Use of Third-Party Litigation Funding

Bryan Nese and Young Kyoung (Claire) Kim, Mayer Brown LLP

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Third-Party litigation funding has become a multibillion-dollar industry. In 2021 alone, just under 50 funders managed over $12 billion in combined assets allocated to in the US. Now aware of the potentially lucrative gains long known to law firms, third-party litigation funders have been aiming at Am Law 200 and big law's share of the third-party litigation funding pie.

And their slice of that pie is considerable. According to Westfleet Advisors' annual survey, Am Law 200 firms accounted for over 40% of the 426 new litigation finance deals in the past calendar year, and 53% of the portfolio deals with a group of multiple cases.

The rise of litigation funding has also sparked a growing interest in transparency, which in turn has triggered varied judicial reactions. But why is this issue just now becoming the subject of standing orders and local rule changes? How are federal courts weighing in on this issue? And what do potential plaintiffs need to know when considering whether to use a third-party litigation funding?

The What & the Why

At its core, litigation funding is fairly straightforward. A third party provides funds for legal disputes in return for a share of the potential recovery if the claim is successful. Litigation funding companies in commercial litigation usually provide non-recourse loans—a type of loan that prevents a lender from pursuing any assets other than the collateral—to corporate plaintiffs or law firms in exchange for a portion of any judgment or settlement.

This collection could be arranged as a combination of return of funded cost, percentage of net proceeds, and time-based return with incorporated interest rates. Because these arrangements closely tie the funders' financial interests with the outcome of litigation, there has been an ongoing debate on whether the source of the litigation funding and the terms of these arrangements should be disclosed in the litigation.

In the past decade, federal courts have struggled with the question of a plaintiff's obligations, if any, to disclose certain aspects of litigation funding. While some courts have permitted discovery of third-party litigation funding arrangements, others have denied discovery in this area.

Courts' increasing attention to this issue likely reflects the increasing use of third-party litigation funding. Courts may be wary of the increasing involvement of third parties that have a financial interest but not the ethical obligations of an attorney. Balancing these concerns with a desire to avoid irrelevant discovery has prompted a myriad of judicial responses.

Judicial Treatment

A lack of federal guidance on this issue has left individual courts to handle it as they see fit. Neither Federal Rule of Civil Procedure 7.1—which provides for corporate disclosure statements—nor Federal Rule of Appellate Procedure 26.1—which requires nongovernmental parties to file a Corporate Disclosure statement—are broad enough to mandate the disclosure of litigation funder arrangements.

Yet about a quarter of district courts have implemented local rules that require the disclosure of the identity of litigation funders in at least certain circumstances. Within these jurisdictions, however, the scope of disclosure varies. For example, in 2022, the District of Delaware's chief judge issued a standing order requiring parties to identify funders, whether funder approval is necessary for litigation or settlement decisions, and a "brief description of the nature of the financial interest of the Third-Party Funder(s)." The standing order also allows parties to obtain additional discovery of the terms of a funder agreement for good cause, such as when the funder "has authority to make material litigation decisions or settlement decisions."

But this order has recently come under appellate scrutiny. Earlier this year, apparently unhappy with a party's disclosure pursuant to the standing order on this issue, the District of Delaware ordered a party to provide additional documents on its funder arrangement. See *Nimitz Techs. LLC v. CNET Media, Inc.*, No. 1:21-cv-01247 (D. Del. Nov. 16, 2022). Arguing that these materials were protected by attorney-client privilege or work product immunity, and in the interests of policy, the party petitioned the Federal Circuit to intervene. See *In re Nimitz Techs. LLC.*, No. 23-00103 (1st Cir. Nov. 16, 2022). On Nov. 17, 2022, the Federal Circuit issued an order staying the District of Delaware's subsequent order while it considered the issue. See *In re Nimitz Techs., LLC.*, No. 2023-103 (1st Cir. Nov. 17, 2022).

Still, Delaware does not stand alone. The Southern District of California has also found that, at least in patent infringement cases, litigation funding agreements and related documents were discoverable to establish the value of the patents at issue, obtain statements by plaintiff regarding the patents at issue, and refute potential trial themes. *See Impact Engine, Inc. v. Google LLC*, 2020 BL 306222 (S.D. Cal. Aug. 12, 2020). The District of New Jersey and the Northern District of California have also taken the position that the existence and identity of litigation funders may be discoverable in certain circumstances.

While some courts have mandated disclosure of funder arrangements, others have denied this discovery for lack of relevance or as shielded by the work-product doctrine and attorney-client privilege protections. For example, the Eastern District of Virginia declined to compel responses to interrogatories seeking litigation funding information in a patent litigation case on relevancy grounds. See *Asghari-Kamrani v. United Servs. Auto. Ass'n*, 2016 BL 528382 (E.D. Va. May 31, 2016). Similarly, in October 2022, the Eastern District of Texas blocked disclosure of documents shared between plaintiff's counsel and a litigation funder on the basis of privilege. See *Hardin v. Samsung Elecs. Co., Ltd.*, No. 2:21-cv-00290-JRG, (E.D. Tex. Oct. 25, 2022).

Additionally, about half of federal appellate courts have individual rules that require identification of litigation funders, partly to determine whether a particular circuit judge may be subject to disqualification or recusal. However, although the Third, Fourth, Fifth, Tenth, and Eleventh Circuits all have rules that are broad enough to include disclosure of third-party litigation funding in some circumstances, because these rules do not specifically refer to the third-party litigation funding, some take the position that these rules are inapplicable to such arrangements.

The Takeaway

Taking into account the varying treatment of third-party funding relationships to commercial litigation, particularly in the patent context, would-be plaintiffs considering this option would do well to bear the following in mind.

First, view the disclosure rules imposed by some courts as an opportunity, not a hurdle. The fact that an independent, often sophisticated entity has enough confidence to make a significant financial investment in a claim can be used to showcase the case's objective strengths. After all, if a non-party investigates the claim and decides to invest millions of dollars in a positive outcome, why hide that fact?

Second, and relatedly, recognize that plaintiffs have some say in how the agreements are drafted. Given the unsettled questions as to whether funding agreements themselves are discoverable, prudent plaintiffs might take care to craft these agreements with the assumption that they may eventually make their way to the eyes of the judge, or even the jury. Take care to limit language that could be seen as potentially undermining the merits of a claim, and seize the opportunity to include positive statements that highlight its value.

Third, if disclosure remains a large concern, consider structuring the agreement so that it falls outside the bounds of a court's disclosure rules. Depending on the circumstances, plaintiffs may be able to structure the arrangement so that it does not fall under the umbrella of third-party litigation finance. For example, just as a plaintiff's personal financial arrangements to hire counsel is likely not discoverable, not all financial arrangements are subject to these fast-changing rules, and structuring the agreement as something other than a typical funding arrangement—such as a loan, insurance product, or other financial instrument—could take the deal outside the realm of required disclosures.