April 9, 2014

Mr. Jonathan C. Rose
Secretary of the Committee on Rules of
Practice and Procedure of the Administrative
Office of the United States Courts
One Columbus Circle, NE
Washington, D.C. 20544

RE: Proposed Amendment to Fed. R. Civ. P. 26(a)(1)(A)

Dear Mr. Rose:

On behalf of the U.S. Chamber Institute for Legal Reform, the American Insurance Association, the American Tort Reform Association, Lawyers for Civil Justice, and the National Association of Manufacturers, we are writing to urge the Advisory Committee on Civil Rules (the "Committee") to adopt an amendment to Rule 26(a)(1)(A) of the Federal Rules of Civil Procedure that would require disclosure of third-party investments in litigation (also called "third-party litigation funding" or "TPLF") at the outset of a lawsuit. A draft of that proposed amendment is attached as Appendix A.

TPLF occurs when a person or entity with no other connection to a lawsuit (usually a specialized investment company) acquires a right to an outcome-contingent payment from any proceeds produced by the case. Typically, the TPLF investor obtains that right by paying money to the plaintiff (or plaintiff's counsel). In many instances, that money is used to finance prosecution of the case (e.g., discovery costs, attorneys' fees, expert witness expenses). Often, plaintiff's counsel takes the lead in securing the third-party investment; in addition, they sometimes receive the money and agree to make the specified outcome-contingent payment to the TPLF investor from their fee recovery.

TPLF is a burgeoning aspect of civil litigation in the United States. As a recent article put it: "[T]he American TPLF market in complex commercial cases has

exploded."[1] We are concerned about the potentially adverse effects TPLF may have on our civil justice system.[2] At the very least, if TPLF is to be part of our legal system, its use should be transparent. Whenever a third party invests in a lawsuit, the court and the parties involved in the matter should be so advised.

The proposed amendment to Rule 26(a)(1)(A) would simply add to the list of required "initial disclosures" in the existing provision a requirement that "a party must, without awaiting a discovery request, provide to the other parties . . . for inspection and copying as under Rule 34, 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." (New language underscored.) We believe that this amendment would serve several important purposes, all related to transparency.

First, by identifying persons/entities with a stake in the outcome of the litigation, the contemplated disclosures would allow courts and counsel to ensure compliance with ethical obligations. Many TPLF entities are either publicly traded companies or companies supported by investment funds whose individual shareholders may include judges or jurors.[3] Thus, without disclosure of TPLF, a

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[1] Jasminka Kalajdzic, Peter Cashman & Alana Longmoore, *Justice for Profit: A Comparative Analysis of Australian, Canadian and U.S. Third Party Litigation Funding*, 61 Am. J. Comp. L. 93, 145 (2013); *see also* Cassandra Burke Robertson, *International Law in Domestic Courts: The Impact of Third-Party Financing on Transnational Litigation*, 44 Case W. Res. J. Int'l L. 159, 181 (2011) ("Third-party litigation finance is a growing industry. The market for lawsuit investment is already quite large in . . . the U.S.").

[2] *See* U.S. Chamber Institute for Legal Reform ("ILR"), *Selling Lawsuits, Buying Trouble: The Emerging World of Third-Party Litigation Financing in the United States* (Oct. 28, 2009) and U.S. Chamber Institute for Legal Reform, *Stopping the Sale on Lawsuits: A Proposal to Regulate Third-Party Investments in Litigation* (Oct. 24, 2012) for additional background from ILR regarding TPLF.

[3] Credit Suisse, for example, recently "spun off its 'litigation risk strategies' division into a standalone litigation financing firm." *See* Bert I. Huang,, *The Democratization of Mass Litigation?: Litigation Finance: What Do Judges Need to Know*, 45 Colum. J.L. & Soc. Probs. 525, 527 (2012) (citing Jennifer Smith, *Credit Suisse Parts with Litigation Finance Group*, WALL ST. J. L. BLOG (Jan. 9, 2012, 6:13 PM), http://blogs.wsj.com/law/2012/01/09/credit-suisse-parts-with-litigation-finance-group). In addition, Citigroup financed an investment firm that funded the multi-million-dollar lawsuit brought by 9/11 ground zero workers. *See* Binyamin Appelbaum, *Betting on Justice: Putting Money on Lawsuits, Investors Share in the Payouts*, N.Y. TIMES, Nov. 15, 2010, at A1. And Burford Capital Limited raised funds from institutions that had shareholders who could have been connected to the litigation in order to bankroll a lawsuit against Chevron in Ecuador. A Special Master appointed in an ancillary proceeding to that case explained that disclosure of the TPLF arrangement was necessary to ensure that U.S. judges hearing aspects of the case had no relationship with Burford that might disqualify them

judge or juror may unwittingly sit in judgment of a case in which he or she has a financial interest, a scenario that creates an appearance of impropriety and may violate applicable ethics rules. Further, counsel in the case may have investment or representational ties to a funding entity that they may need to disclose to their clients, consistent with their zealous representation obligations. For example, if a defendant's counsel is a shareholder in an entity that may profit from a plaintiff's victory in the litigation, that counsel would need to appropriately address that conflict with his/her client. The proposed amendment would thus aid in the identification of potential ethical issues and thereby protect the integrity of the judicial process.

Second, the proposed amendment would satisfy defendants' entitlement to know who is really on the other side of an action. The decision in *Conlon v. Rosa* is illustrative.[4] In that case, the plaintiffs challenged a decision of a zoning board of appeals to allow a developer to demolish existing buildings and construct a Walgreens drugstore on the site. One of the plaintiffs owned property near the site and leased her property to Brooks Drugs, a competitor of Walgreens. The developer challenged the plaintiff's asserted status as a real party in interest and demanded disclosure of any funding agreement between her and Brooks Drugs, contending that Brooks Drugs was driving the litigation. The plaintiff objected, contending that evidence of such an agreement was not relevant. But the court disagreed, holding that litigation funding was "surely a relevant subject to explore in discovery."[5] In so holding, the court warned that "[s]uch hidden funding can introduce a dynamic into a plaintiff's case – an agenda unrelated to its merits, a resistance to compromise – that otherwise might not be present and, unless known, cannot be managed or evaluated."[6]

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from acting as neutral arbiters in the case. *See* Roger Parloff, *Have you got a piece of this lawsuit?*, Fortune, June 28, 2011, http://features.blogs.fortune.cnn.com/2011/06/28/have-you-got-a-piece-of-this-lawsuit-2/.

[4] Nos. 295907, 295932, 2004 Mass. LCR LEXIS 56, at *5 (Mass. Land Ct. July 21, 2004).

[5] *Id.* at *6-7.

[6] *Id.* In its ruling, the court in *Conlon* noted that "[a] surprising number of plaintiff's lawsuits are secretly funded by outsiders" and relied on several unreported trial court rulings ordering the production of documents pertaining to litigation funding. *Id.* at *5-6 (citing *Jones v. Clinton*, No. LR-C-94-290 (E.D. Ark. Dec. 4, 1997) (ordering production of documents showing contributions to plaintiff); *Jones v. Clinton*, No. LR-C-94-290 (E.D. Ark. Nov. 25, 1997) (same); *Margolis v. Gosselin*, No. 95-J-959 (Mass. App. Ct. Dec. 18, 1995) (upholding Superior Court Order allowing discovery into whether plaintiff filed and pursued her lawsuit "in aid of a super-market operator that competed with Star Market"); *Triandafilou v. Kravchuk*, No. 95-J-355 (Mass. App. Ct. May 30, 1995) (directing production of documents showing funding of challenge to supermarket expansion by a competing supermarket chain).

That troubling dynamic is particularly apparent when it comes to settlement efforts. A party that must pay a TPLF entity a percentage of the proceeds of any recovery may be inclined to reject what might otherwise be a fair settlement offer in the hopes of securing a larger sum of money. In short, the party will seek extra money to make up at least some of the amount (likely substantial) that will have to be paid to the TPLF entity. Further, some of the TPLF agreements that have become public reveal that TPLF entities often structure their agreements to maximize their take of the first dollars of any recovery, thereby deterring reasonable settlements.[7] In fact, in the first empirical study of the effects of TPLF, researchers in Australia (where TPLF is prevalent) found that increased litigation funding was "associated with slower case processing, larger backlogs, and increased spending by the courts."[8] Disclosures stating that TPLF investments are present in a case will allow both courts and defendants to more accurately evaluate settlement prospects and to better calibrate settlement initiatives. Further, it will allow courts to structure settlement protocols with greater potential to succeed. For example, if a litigation funder controls settlement decisions (in whole or in part), the court may wish to require that funder to attend any mediation. Absent the proposed disclosures, the funder's presence as a player in the settlement process likely will remain hidden.

Third, a litigation-funding disclosure provision would facilitate a fuller, fairer discussion of motions for cost-shifting in cases involving onerous e-discovery. Courts confronted with cost-shifting requests typically consider a party's financial ability to pay in determining whether to impose cost-shifting in complex discovery disputes.[9] If

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[7] The most notorious example of this problem was the $4 million investment by a fund associated with Burford in the lawsuit against Chevron filed in an Ecuadorian court alleging environmental contamination in Lago Agrio, Ecuador. The investment agreement included a "waterfall" repayment provision, which provided for a heightened percentage of recovery on the first dollars of any award. Under the agreement, Burford would receive approximately 5.5% of any award, or about $55 million, on any amount starting at $1 billion. But, if the plaintiffs settled for less than $1 billion, the investor's percentage would actually go up. *See* Funding Agreement Between Treca Financial Solutions and Claimants, *Chevron Corp. v. Donziger*, No. 11-cv-0691 (S.D.N.Y.), Docket No. 356, Ex. B. In a March 4, 2014, opinion in the *Chevron* case, Judge Kaplan found that the Ecuadorian plaintiffs' "romancing of Burford," led plaintiffs' counsel to adopt a litigation strategy against Chevron designed to maximize plaintiffs' ability to collect on any judgment – rather than focus on securing a just and speedy resolution. *See Chevron*, Docket No. 1874, at 175.

[8] Daniel Chen, *A Market for Justice: A First Empirical Look at Third Party Litigation Funding* (January 2012), at 27, www.law.upenn.edu/cf/faculty/dabrams/workingpapers/MarketforJustice.pdf.

[9] *See, e.g.*, *Xpedior Credit Trust v. Credit Suisse First Boston (USA), Inc.*, 309 F. Supp. 2d 459, 466 (S.D.N.Y. 2003) (refusing to order cost-shifting even though the information was not reasonably accessible largely

a plaintiff's suit is being financed by a lucrative TPLF company, the calculus may differ from a case in which funding is not present. Indeed, the involvement of a TPLF company that has invested to profit from a lawsuit might make cost-shifting all the more appropriate. For this reason too, disclosure of TPLF arrangements at the beginning of civil litigation makes sense.

For similar reasons, a disclosure provision would be particularly appropriate if the Supreme Court adopts the Advisory Committee's current proposal to amend Rule 26(b)(1) to include a proportionality element. The Committee's proposed amendment to Rule 26(b)(1) would make the scope of discovery "proportional to the needs of the case, considering . . . the parties' resources . . . [and] whether the burden or expense of the proposed discovery outweighs its likely benefit." When a TPLF entity acquires an outcome-contingent right to proceeds in a case, it becomes a real party in interest for practical purposes: the TPLF investor pays to prosecute the case; it presumably is involved in strategic decision-making;[10] it presumably communicates with attorneys;[11] and it often stands to recover the lion's share of any recovery.[12] Moreover, unlike an

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because the defendant's "assets clearly dwarf[ed] [plaintiff's]"); *Lent v. Signature Truck Sys.*, No. 06CV569S, 2009 U.S. Dist. LEXIS 95726, at *7 (W.D.N.Y. Oct. 14, 2009) ("In light of the . . . relative financial resources of the parties, the Court declines to shift the cost of the inspection to the plaintiff."); *see also Annex Books, Inc. v. City of Indianapolis*, No. 1:03-cv-918-SEB-TAB, 2012 U.S. Dist. LEXIS 34247, at *9 (S.D. Ind. Mar. 14, 2012) (basing discovery cost decision in large part on possibility that "the Defendant, a municipality, has greater financial resources than Plaintiffs.").

[10] The lawsuit-investment industry makes no secret of its interest in protecting litigation investments by influencing cases. A principal of investor BlackRobe Capital Partners, LLC, was quoted as saying his firm would take a "'pro-active' role in lawsuits." A former Burford chairman said that his new investment company would not "control" litigation, but would "do[] more than was done before." *See* Nate Raymond, *Sean Coffey Launches New Litigation Finance Firm with Juridica Co-Founder, Vows to Move Beyond 'Litigation Funding 1.0,'* The American Lawyer (June 17, 2011).

[11] Recent commercial arbitration between a company called S&T Oil Equipment & Machinery Ltd. and the Romanian government is illustrative. S&T had sought financing for its case from Juridica Investments Limited, and, under their agreement, Juridica paid some legal fees for S&T in exchange for a percentage of arbitration proceeds. After Juridica withdrew funding, causing S&T's case to collapse, a sealed complaint filed by S&T against Juridica in Texas federal court alleged that S&T's own lawyers had begun seeking legal advice from Juridica after Juridica began paying their fees, and that Juridica required the lawyers to share with Juridica their legal strategy for the arbitration and any factual or legal developments in the case. *See* B.M. Cremades, Jr., *Third Party Litigation Funding: Investing in Arbitration*, Transnational Dispute Management, Vol. 8, Issue 4 (Oct. 2011), at 25-33, 27 n.105 (citing *S&T Oil Equip. & Mach. Ltd. v. Juridica Invs. Ltd.*, No. H-11-0542 (S.D. Tex. Feb. 14, 2011), sealed complaint, ¶¶ 29, 30.

[12] Litigation between a network-security company called Deep Nines and a TPLF provider that had invested in Deep Nines's prior commercial litigation against a software company illustrates this point. Deep Nines had entered into an agreement with the TPLF provider to finance patent litigation with an $8 million investment. Deep

average plaintiff, a TPLF entity's business purpose is *to raise funds to prosecute and to profit from litigation*. The existence of a TPLF agreement to fund litigation is thus relevant to the proportionality element of the scope of discovery. TPLF companies are well-heeled strangers to a case who willingly buy into the litigation hoping to profit from its successful prosecution. For the purposes of the resources element of the proportionality requirement contained in the Committee's proposed amendment to Rule 26(b)(1), any TPLF company that has bought a stake in a case should be considered as part of the "parties' resources."

Fourth, the disclosure of TPLF arrangements would be important information to have on the record in the event that a court determines it should impose sanctions or other costs. For example, in *Abu-Ghazaleh v. Chaul*, a Florida state appeals court held that TPLF funders (an individual and company) that controlled the litigation qualified as a party to the lawsuit and therefore became liable for the defendant's attorneys' fees and costs.[13] The state statute at issue in that case specifically authorized the levy of attorneys' fees on the plaintiff where the claim advanced was "without substantial fact or legal support."[14] The court found that the plaintiff's claim was bereft of such legal or factual support. The court then determined that the TPLF providers were liable for the attorneys' fees because they were essentially a "party" to the litigation (and the named plaintiff was financially unable to pay such fees, which is often the case). The court reached this conclusion by scrutinizing the agreement entered into by the plaintiff and the TPLF providers, which provided that the funders were to receive 18.33% of any award the plaintiffs received and gave them "final say over any settlement agreements proposed to the plaintiffs."[15] As evidenced by *Abu-Ghazaleh*, if courts are put on notice that a third party is financing the underlying litigation, they will be in a much better position to determine how to impose sanctions or other costs, if such costs are warranted in a given case.

Nines had a strong case, and eventually, the case settled for $25 million. After paying off the investor, as well as paying its attorneys and court costs, Deep Nines only ended up with $800,000 – about three percent of the total recovery. The TPLF investor took $10.1 million (the return of its $8 million investment, plus 10% annual interest, plus a $700,000 fee). *See* Alison Frankel, *Patent Litigation Weekly: Secret Details of Litigation Financing*, The Am Law Litigation Daily (Nov. 3, 2009); *Altitude Nines, LLC v. Deep Nines, Inc.*, No. 603268-2008E (N.Y. Sup. Ct.); *see also* Joe Mullin, *Patent Litigation Weekly: How to win $25 million in a patent suit – and end up with a whole lot less*, The Prior Art (Nov. 2, 2009).

[13] *See Abu-Ghazaleh v. Chaul*, 36 So. 3d 691, 693-94 (Fla. Ct. App. 2009).

[14] *Id.* at 694.

[15] *Id.*

For all of the foregoing reasons, we urge the Committee to consider adoption of the attached proposed amendment to Fed. R. Civ. P. 26(a)(1)(A). Your review of this proposal is greatly appreciated.

Sincerely,

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J. Stephen Zielezienski
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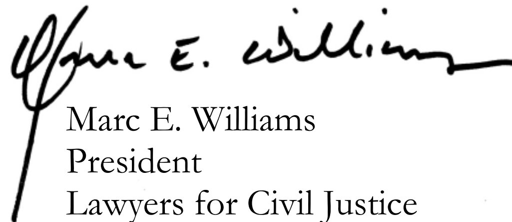

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APPENDIX A – PROPOSED AMENDED RULE

The amended Fed. R. Civ. P. 26(a)(1)(A) would read as follows, with the new proposed language in underscore and deletions in ~~strikethrough~~:

(A) In General. Except as exempted by Rule 26(a)(1)(B) or as otherwise stipulated or ordered by the court, a party must, without awaiting a discovery request, provide to the other parties:

(i) the name and, if known, the address and telephone number of each individual likely to have discoverable information—along with the subjects of that information—that the disclosing party may use to support its claims or defenses, unless the use would be solely for impeachment;

(ii) a copy—or a description by category and location—of all documents, electronically stored information, and tangible things that the disclosing party has in its possession, custody, or control and may use to support its claims or defenses, unless the use would be solely for impeachment;

(iii) a computation of each category of damages claimed by the disclosing party—who must also make available for inspection and copying as under Rule 34 the documents or other evidentiary material, unless privileged or protected from disclosure, on which each computation is based, including materials bearing on the nature and extent of injuries suffered; ~~and~~

(iv) for inspection and copying as under Rule 34, 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~~.~~; and

(v) for inspection and copying as under Rule 34, 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.