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Dark Money: Why Courts Should Enforce Disclosure of Third-Party Litigation Funding

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Third-party litigation funding ("TPLF") has grown into a multi-billion-dollar business in the United States. This once fledgling industry is valued at approximately $15 billion globally and over $3 billion domestically. And TPLF is projected to grow to an astounding $25-30 billion by the end of the decade.[1] TPLF offers an alternative investment vehicle to diversify holdings, secure high rates of return, and invest in a fund that is "largely uncorrelated with macroeconomic risks."[2] Moreover, TPLF firms claim to serve as the "great equalizer," eliminating financial barriers parties may face in complex litigation. TPLF has become a crucial part of the plaintiffs' bar's litigation strategy. In addition to providing immediate income to plaintiffs' counsel, funding can be used for sophisticated advertising campaigns to help amass an inventory of hundreds (or thousands) of plaintiffs and increase costs to defendants (including in mass tort litigation, which makes up the bulk of cases in federal courts). Many cases may lack merit but are nonetheless used to demand large settlements. And third-party litigation funders can play a role in litigation and settlement strategy to advance their interests, often at the expense of the plaintiffs themselves.[3] Parties in litigation, however, are typically in the dark as to whether the opposing side is receiving TPLF.

The lack of transparency hampers the public's and defense bar's insight into the influence third parties have on litigation. The role of these firms is shrouded in mystery, and parties can only speculate as to the fairness of the proceedings.

What can be done about this problem? The solution lies with the courts, who have the power to require disclosure of TPLF, and with the Judicial Conference's Advisory Committee, which can prompt a change to the federal rules.

Judges Can and Should Require Disclosure of Third-Party Litigation Funders in the Interest of Justice.

Courts have inherent power to "protect their proceedings and judgments in the course of charging their traditional responsibilities."[4] As part of this inherent power, courts should require

[1] *Global Litigation Funding Investment Market is poised to touch US $ 24.3 billion by the end 2028, driven by increasing awareness about litigation*, RationalStat, (Aug. 9, 2023); GAO, *Third-Party Litigation Financing: Market Characteristics, Data, and Trends*, (Dec. 2022); Michael E. Leiter, et al., *A New Threat: The National Security Risk of Third Party Litigation Funding*, (Nov. 2022), U.S. Chamber of Commerce Institute for Legal Reform.

[2] Dr Thomas Holzheu, et al., *US litigation funding and social inflation: The rising costs of legal liability*, Swiss Re Institute, (Dec. 2021).

[3] *See* Letter from The Allstate Corporation, et al. to Hon. James Comer and Hon. Jamie Raskin (Oct. 31, 2023) (noting that "for every dollar paid in damages through tort litigation, only 53 cents actually reaches the claimants' pockets.").

[4] *Degen v. United States*, 517 U.S. 820, 823 (1996) (citing *Chambers v. NASCO, Inc.*, 501 U.S. 32, 43-46 (1991)).

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disclosure of TPLF. A few federal courts already have utilized their authority to require disclosure of TPLF, and more courts should follow suit.

One notable example of a court exercising its authority to require disclosure of TPLF lies with Chief Judge Colm Connolly of the District of Delaware. In April 2022, Judge Connolly issued a standing order applicable to all cases before him noting the necessity for heightened funding disclosure. Judge Connolly's order requires law firms to disclose "the name of every owner, member and partner of the party, proceeding up the chain of ownership until the name of every individual and corporation with a direct or indirect interest in the party has been identified."[5]

In a clear indication of a desire to enforce transparency, Judge Connolly questioned plaintiffs' adherence to his order in a recent patent litigation.[6] He allowed the defendant, Amazon, to conduct discovery regarding funding and stayed the proceedings until the issue was resolved. Both parties then entered a stipulation of dismissal with prejudice, which Judge Connolly granted.[7] Several months later, in November 2022, a party in a different patent case filed a petition for writ of mandamus in the Court of Appeals for the Federal Circuit to vacate an order of Judge Connolly's requiring disclosure of certain TPLF documents. The Federal Circuit denied the writ.[8]

Other federal courts likewise require disclosure of TPLF. The District of New Jersey requires in its local rules, disclosure of information regarding third-party funders to a litigation, and specifies that the court retains the discretion to require additional discovery if there is any indication that a third-party entity has exercised or may exercise authority in litigation decisions.[9] Similarly, the Northern District of California requires parties to certify all interested parties in class action lawsuits.[10]

But these courts represent only a small minority of judges and courts who have taken action to look behind the curtain and examine the entities that are holding the purse strings and/or making the decisions. Accordingly, to ensure fairness and transparency in litigation, particularly for corporate defendants inundated with lawsuits, more courts must exercise their authority to require disclosure of TPLF.

A Revision to the Federal Rules of Civil Procedure Should Be Made to Promote Uniformity and Address the Issue of TPLF More Broadly.

In addition to courts exercising their inherent authority to require disclosure of TPLF, the federal rules should be amended. Federal Rule of Civil Procedure 7.1 requires corporate defendants to file a statement that "identifies any parent corporation and any publicly held corporation owning 10% or more of its stock."[11] The purpose of Rule 7.1 is largely designed to help judges identify any conflicts of interest and provide the judge with an opportunity to recuse themselves.

[5] *See* Standing Order Regarding Third-Party Litigation Funding Arrangements (D. Del. Apr. 18, 2022).

[6] *See* Oral Order, *Longbeam Techs. LLC. v. Amazon.com, Inc. et al.*, No. 1:21-cv-01559 (D. Del. Aug. 17, 2022), ECF No. 37.

[7] *See* Order re Stipulation of Dismissal, *Longbeam Techs. LLC v. Amazon.com, Inc., et al.*, No. 1:21-cv-01559 (D. Del. Oct. 17, 2022), ECF No. 41.

[8] *See* Order, *In re Nimitz Technologies LLC*, No. 23-103 (Fed. Cir. Dec. 8, 2022), ECF No. 44.

[9] Disclosure of Third-Party Litigation Funding, N.J. L. Civ. R. 7.1.1.

[10] Disclosure of Conflicts and Interested Entities and Persons, N.D. Cal. L. Civ. R. 3-15.

[11] Fed. R. Civ. P. 7.1(a)(1)(A).

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But there is no corresponding obligation if a plaintiff receives TPLF. The role TPLF plays in funding litigation for plaintiffs is akin to identifying interested corporations beyond a named party who have financial interests in the litigation for the sake of transparency. As TPLF continues to grow, there remains the potential that a judge could have an interest in corporations owning a portion of the funder or indirect ownership through another investment vehicle.

There have been several proposals over the years to amend the Federal Rules of Civil Procedure to require disclosure of TPLF, most notably proposals to amend Rule 26(a)(1)(A) and Rule 16(c)(2). The proposed amendment to Rule 26(a)(1)(A) would add a requirement that "a party must, 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."[12] The efforts to amend Rule 26 have failed to gain traction even as various industry associations took a renewed interest in 2023 and submitted additional comments to the Rules Advisory Committee.[13]

Lawyers for Civil Justice ("LCJ") and the U.S. Chamber of Commerce Institute for Legal Reform ("ILR") proposed amending Rule 16(c)(2). Where Rule 16(c)(2) lists "matters for consideration," LCJ and the ILR proposed adding the following language: "Consider whether any person (other than named parties or counsel of record) has a right to compensation that is contingent on obtaining proceeds from the civil action, by settlement, judgment or otherwise." This proposal also failed to gain traction with the Rules Committee.

But it is time to call attention back to these proposals, which should be revisited considering the significant impact TPLF has on our litigation in the United States. It is time to create a more transparent judicial system and peel back the layers on the currently clandestine operations of third-party litigation funders.

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[12] Letter from Lisa A. Rickard, President, U.S. Chamber Institute for Legal Reform to Rebecca A. Womeldorf, Secretary of the Committee on Rules of Practice and Procedure of the Administrative Office of the United States Courts (June 1, 2017).

[13] Letter from Advanced Medical Technology Association, et al. to H. Thomas Byron, III, Secretary, Committee on Rules of Practice and Procedure, Administrative Office of the United States Courts (May 8, 2023).

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