"Considering Paths to Disclosure in Third Party Litigation Financing," By Michael Zigelman & Kristina Duffy, Reuters, 2-22-2023

As stock and cryptocurrency markets sputter their way into the new year, one lesser-known investment strategy has demonstrated imperviousness to the broader economy. According to a June 2020 New York Times article, "Pandemic is Expected to Bring More Lawsuits, and More Backers," third party litigation financing ("TPLF") is yielding returns of up to 30 percent or more. While obscure to most investors, TPLF has garnered keen attention in the legal community due to the impact it is having on civil litigation.

TPLF is exactly what it sounds like: It takes place when a third party (often a wealthy individual, fund, family member, or other entity) provides funding to a litigant (often a plaintiff or counterclaimant) that enables the litigant to initiate or continue litigation. See "Third Party Funding in the United States: A Systemic Judicial Analysis", 32 AMRIARB 173 (2021). As discussed by one 2013 New York state trial court decision, Lawsuit Funding, LLC v. Lessoff, by providing litigants with the resources to prosecute their case more effectively, it "allows lawsuits to be decided on their merits, and not based on which party has deeper pockets or stronger appetite for protracted litigation."

TPLF's impact, however, has not been universally welcomed by the legal community. Detractors argue that claims TPLF expands access to justice are overblown given that lawsuits selected for funding are often the strongest and most likely to yield lucrative awards, not the types that would otherwise be passed over by traditional plaintiffs' law firms. It also, of course, diverts a substantial portion of any award away from the injured party to compensate the financier. See "Tilted Scales of Justice? The Consequences of Third-Party Financing of American Litigation," 63 EMORY L. JOURN. 489, 492 (2013).

Of particular note to the defense bar and insurance industry, TPLF has also had profound practical implications for how civil cases are being litigated, particularly in complex commercial matters involving claims for antitrust violation, False Claims Act and patent infringement. See Scales of Justice, supra. In such contexts, TPLF hinders defendants from negotiating a reasonable settlement. The reason for this, as described by the 6th U.S. Circuit Court of Appeals in Boling v. Prospect Funding Holdings, LLC (2019), is that "an injured party may be disinclined to accept a reasonable settlement offer where a large portion of the proceeds would go to the firm providing the loan." In other words, motivated to fill the gap between financiers' share of the settlement and plaintiffs' authentic damages, plaintiffs are discouraged from settling for an amount reflecting the true damages they sustained.

Similarly, detractors argue, mounting litigation costs, an inescapable reality that would generally nudge unfinanced plaintiffs to seriously consider fair settlement offers, are far less concerning to plaintiffs who have offloaded this burden to a third party. Rather, financed parties are more inclined to turn down otherwise attractive offers, further dragging out lawsuits and inflating settlement awards. See "US litigation funding and social inflation," Swiss Re Institute, December 2021. The resulting increase in claim costs are then borne by society as a whole in the form of higher premiums and cost of goods.

Since first emerging in earnest in approximately 2008, TPLF has operated in a largely unregulated market. For financed parties, this system has its advantages. Indeed, few jurisdictions even require litigants to disclose that they have received TPLF (see "The Economic Case Against Forced Third Party Litigation Funding," by Sharfman, Keith, New York State Bar Association, Feb. 11, 2022), which can leave unfunded parties blind to what they are up against.

Bound by Federal Rule of Evidence 401, courts throughout the country have been constrained to deny requests for TPLF information unless it has direct bearing on the claims before the court. In Eastern Profit Corporation Ltd. v. Strategic Vision US (2020), for example, the Southern District of New York noted that "courts in this Circuit have rejected claims for [litigation funding] documents where the only asserted relevance is that they will permit the requesting party to peer into its adversary's strategy" or "the adversary's rationale for accepting or rejecting settlement offers." This distinction between adversary strategy and "any fact that is of consequence to the determination of the action" under Fed. R. Evid. 401 can be a distinction without a difference, however.

In this case, the court permitted limited questioning into the financier's identity on the basis that it was relevant to counterclaimant's credibility. While opening the door to this line of questioning a crack, even this limited information ended up being quite consequential: The financier was an opponent of the counterclaim defendant's sole director and owner. In a 2021 decision on the same case, the court questioned whether the counterclaimant even "believed it was defrauded" since it didn't assert its fraud claim "until it received litigation *funding from an alleged opponent of" the owner and sole director of the opposing party.*

Courts in other jurisdictions have shown similar reluctance to ordering full disclosure of TPLF information. Both the Northern District of Illinois (in a matter captioned Miller UK Ltd. v. Caterpillar, Inc. (2014)) and the District of Arizona (in a matter captioned Continental Circuits LLC v. Intel Corp.(2020)) have found that litigation funding documents are only discoverable if relevant to an element of an existing claim or defense in the lawsuit.

In Mondis Technology, Ltd. v. LG Electronics, Inc.(2011), the Eastern District of Texas adopted a different line of reasoning only to reach the same outcome when it found that "documents and slide presentations created for potential investors … prepared in assistance with [plaintiff's] counsel for the purpose of aiding future litigation" were protected by the attorney work product doctrine and, accordingly, undiscoverable.

While the courts are constrained to analyze the discoverability of TPLF information through the lens of existing laws, parties may not be without recourse, at least in the long term. While regulations regarding the disclosure of TPLF remains limited, defendants in many jurisdictions, including New York, California, and Florida, have long been required to disclose their insurance information to opposing parties, regardless of its irrelevance to the claims, defenses, and realistic damages of the case.

On Feb. 24, 2022, the Governor of New York signed the Comprehensive Insurance Disclosure Act ("CIDA") expanding defendants' obligation to provide their insurance information. Defendants are now required to provide their insurance information automatically within 90 days of serving their answer, including the complete policy and the extent of erosion of the policy limits.

The stated purpose of this amendment is to avoid delay of "complete and accurate information about the nature and extent of insurance coverage." As relayed in NY State Senate Bill S7052, "[n]ot only do these delays clog our over-burdened courts, they force injured New Yorkers to wait for the justice they deserve." Given how in the eyes of detractors, TPLF delays settlements and diverts settlement funds away from "injured New Yorkers" waiting "for the justice they deserve," these justifications may be found to apply in equal force to the discoverability of financing agreements.

As the TPLF industry has grown in prominence, the impact it is having on the dynamics of litigants is crystallizing. Given the limitations on the courts and justification for the existing rules requiring defendants to provide insurance information, thoughtfully designed legislation may be the most organic recourse for tempering any inequities caused by TPLF's unfettered operation.

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