Schnader | The Higher Calling of the Law

Published by The New Jersey Law Journal – https://www.law.com/njlawjournal/2021/07/21/new-local-rule-allows-disclosure-of-litigation-funding-in-njs-federal-courts/

New Local Rule Allows Disclosure of Litigation Funding in NJ's Federal Courts

New Jersey's new local federal rule seems intended to strike a balance, requiring a showing of good cause before chasing down records that might be compromising.

By **Carl J. Schaerf and Gary N. Smith** | July 21, 2021

New local Rule 7.1.1 (effective Aug. 5, 2021), changes the landscape of litigation funding disclosure in New Jersey's federal courts. The District of New Jersey will now require all parties to file statements setting forth information about any non-party person or entity that is "providing funding for some or all of the attorney fees and expenses for the litigation on a non-recourse basis" in exchange for either "a contingent financial interest based upon" the litigation's results or a "non-monetary result that is not in the nature of a personal or bank loan, or insurance."

The new disclosure requirements are straightforward. The disclosing party must file a statement within 30 days of the filing of an initial pleading or removal, and would need to include: (1) the identity of the funder(s), including name, address, and place of formation (if a legal entity); (2) whether the funder's approval is "necessary for litigation decisions or settlement decisions," and if so, "the nature of the terms and conditions relating to that approval"; and (3) a description of the nature of the financial interest involved. Although the statement itself is uncomplicated, the consequences of the disclosure are significant.

What Is Litigation Funding?

Generally, there are three types of litigation funding in the United States: (1) investments in commercial claims where the financer covers the costs of associated litigation expenses for a return of a share of the lawsuit's proceeds; (2) financing directly to the plaintiff's law firm; and (3) direct loans to litigants.

The mechanism of litigation funding generally involves a third-party financial arrangement with the plaintiff to cover the costs of litigation and other expenses while the plaintiff's case is pending. In a personal injury context, litigation funding typically involves a non-party financer providing a loan to the plaintiff, with the financer attaching a high fixed interest rate, potentially as much as two to five percent monthly, to be paid only on the plaintiff's recovery. (The interest rate structure is not dependent upon the plaintiff's recovery, which may evade applicable state law restrictions on usury.)

When assessing a plaintiff's request for litigation funding, and in turn the prospect of a return investment, third-party financers evaluate the merits of the case through the plaintiff's risk profile,

case strengths, weaknesses, and litigation strategies. (Avraham and Sebok, Third-Party Litigation Funding with Informative Signals: Equilibrium Characterization and the Effects of Admissibility, 61 J. Law & Econ. 637.) For example, in a case that involves a slip and fall incident, the financer typically collects information about the type of injury suffered by the client, client medical history, length of medical treatment potentially resulting from the accident, and a description of the facts surrounding the accident. This information often comes from the plaintiff's attorney, raising potential issues of conflict and divided loyalties.

District of New Jersey Breaks From the Trend

The emerging trend has been to extend privacy protections to litigation funding materials under the work-product doctrine, and generally to deny production or use of such materials in litigation. New Jersey federal courts seem to be charting a different path, and one that may influence other courts to reexamine their own rules and practices.

Part of the stated basis for the new Rule 7.1.1 is to allow judges sufficient information to decide recusal issues for potential pecuniary interest and conflict. However, the Rule's actual impact may be broader, as the Rule also provides that a party may seek discovery "of the terms of any such agreement upon a showing of good cause that the non-party has authority to make material litigation decisions or settlement decisions, the interests of the parties or the class (if applicable) are not being promoted or protected, or conflicts of interest exist, or such other disclosure is necessary to any issue in the case." So, although information about the funding is disclosed, a party seeking discovery about the terms must still demonstrate good cause to get additional information. That line of thinking is consistent with the case-by-case analysis generally applied to discovery of litigation funding documents.

There is some similar language to be found in other jurisdictions. Judge Liman of the Southern District of New York recently passed on the discoverability of litigation financing in *E Profit Corp v. Strategic Vision US*, 18-cv-2185 (LJL) (S.D.N.Y. Dec. 18, 2020):

> The exercise is a context-specific one that depends, in part, on the reasons for which the admission is offered and its relationship to the claims and defenses in the trial. "Since what might make a species of documents relevant in one case does not necessarily make it relevant in all others, it is inappropriate for courts to be guided by past judicial evaluations of the relevance of seemingly similar evidence." *Benitez v*. *Lopez*, 2019 WL 1578167, at *2 (E.D.N.Y Mar. 14, 2019) (citation omitted). Courts have admitted funding documents, such as indemnification agreements among co-defendants, when such documents are relevant to credibility issues and to show the bias of one party for or against another. *See, e.g., Kaplan*, 2015 WL 5730101, at *5; *Concepcion v. City of N.Y.*, 2006 WL 2254987, at *4 (S.D.N.Y. Aug. 4, 2006); *see also Bonumose Biochem, LLC v. Zhang*, 2018 WL 10068639, at *3 (W.D. Va. Sept. 10, 2018). On the other hand, courts in this Circuit have rejected claims for such documents when the only asserted relevance is that they will permit the requesting party to peer into its adversary's strategy, the adversary's reasons for pursuing what the requesting party might believe is baseless litigation, and the adversary's rationale for accepting or rejecting settlement offers. *See, e.g., Benitez*, 2019 WL 1578167, at *1-2; *MacKenzie*

Architects, P.C. v. VLG Real Ests. Devs., LLC, 2017 WL 4898743, at *3 (N.D.N.Y. Mar. 3, 2017).

Rule 7.1.1 may also affect other aspects of the legal process involving litigation funding issues. For example, the battle of discoverability in the personal injury context may involve the issue of litigation funding *for unnecessary surgery*—an issue that has received substantial media attention. Physicians, of course, have been bound since Hippocrates to "first do no harm." Lawyers are bound to zealously advocate for their client, but they are not permitted to "prejudice or damage" the client. DR 7-101. If a surgery is unnecessary, it seems potentially anomalous to shield the funder from disclosure, while leaving the physician and the attorney answerable under the Canons of Professional Ethics.

The general trend, however, has been away from allowing discovery of litigation funding and materials submitted to the funder. *Kaplan v. S.A.C. Cap. Advisors*, No. 12 Civ. 9350 (VM) (KNF), 2015 WL 5730101, at *5 (S.D.N.Y. Sept. 10, 2015).

In short, it appears that the District of New Jersey has adopted a modest rule, requiring a showing of good cause before such discovery may be had. Whether New Jersey's approach, as well as Judge Liman's approach, reflects a new trend remains to be seen.

Practical Takeaways

New Jersey's new local federal rule seems intended to strike a balance, requiring a showing of good cause before chasing down records that might be compromising. However, the idea that a funder is a real party in interest to be disclosed at the outset is, in and of itself, not insignificant, particularly as mainstream financial institutions continue to take on this type of funding arrangement. The implications for recusal are real, and courts should have the existence of the agreement and identity of the funder as a basis for decision.

If you are in a forum where discovery is difficult to obtain, consider public records searches. Litigation funding agreements are often filed to perfect secured interests in the case under the UCC. In addition, consider subpoenas tailored in such a way as to seek transmitted information (to which no privilege attaches). Also, ask, at deposition, whether a nondisclosure/confidentiality agreement exists between the plaintiff, attorney or client, and the third-party financer. Depending on the jurisdiction, a confidentiality agreement may constitute a waiver of the work-product protection. Inquire further about whether any attorney-client privileged materials (generally documents that are not fact-based or materials prepared in anticipation of litigation) were shared with the third-party financer. The exchange of these documents to those outside the attorney-client relationship may waive any protection.

As both federal and state judges continue to deal with the discoverability of litigation funding materials, plaintiffs and defendants will continue to battle over what is protected and what is not. As litigation funding grows in the American legal landscape—from high stakes commercial litigation, to securities actions, to personal injury cases—the issues of discoverability will increasingly influence how litigants develop their litigation tactics.

New Jersey's new Rule 7.1.1 is a step in the direction of discoverability. Presumably this is a debate that is far from over, and will only gain in importance as more mainstream financial institutions enter the litigation funding realm.

Carl J. Schaerf *is a partner with Schnader Harrison Segal & Lewis LLP in New York, and serves as chair of the firm's Antitrust and Trade Regulation Practice Group.*

Gary N. Smith *is counsel in the Litigation Services, Real Estate Transactions and Retail Industry teams at Schnader Harrison Segal & Lewis LLP.*