NJ Fed. Rule On Litigation Funding Creates Privacy Intrusion

By **Eric Jaso** (December 6, 2021)

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A recent Law360 guest article argued that the U.S. District Court for the District of New Jersey's new Local Rule 7.1.1., which requires litigants to disclose the existence of nonrecourse litigation funding, is both harmless and ultimately wise, serving the goals of transparency and oversight.

All attorneys with civil matters in New Jersey's federal courts are familiar with this rule, having been compelled to submit filings in pending and new matters over the past several months since the rule was implemented on June 21.

That process has consumed tens of thousands of attorney hours and caused untold expense to clients, given that the district was in a state of judicial emergency with nearly 60,000 civil cases pending at the end of June.[1] Yet only a handful of litigants reported having litigation funding.

The costs and burdens of tens of thousands of litigants making these initial filings is but the tip of the iceberg, however. The rule's burden on civil litigants will be so collectively substantial, and its intrusion into parties' private commercial matters so severe, that we must question whether the rule serves any valid purpose, much less one justifying these detriments.

In particular, we must question why the vague goal of transparency should justify a significant intrusion on the privacy of a commercial arrangement between a party and a litigation funder, which demonstrably has no bearing on other parties, the court or the public.

Private Commercial Matters

Commercial litigation finance functions as a private mechanism for some parties to ensure that the underlying merits of a dispute can be properly addressed and resolved.

Importantly, commercial litigation financing supports only claims that have significant merit, as litigation funding firms are not in the business of financing parties who lack a fighting chance of prevailing in court.

Funders therefore thoroughly vet parties and their claims before even considering funding them, a process that results in only the most meritorious claims getting financial support, and conversely, withholds funding from claims that should not or will not prevail.

Thus, the very nature and practice of litigation funding is fully aligned with the public policy and overall purpose of the civil justice system — to ensure that parties with strong, meritorious legal claims receive justice and fair compensation.

Further, litigation financing arrangements typically do not transfer any of the parties' litigation rights to the funders or other third parties. Anyone with actual experience and familiarity with litigation funding knows that case strategy, decision-making and settlement authority remains with the litigant and its counsel. Rather, litigation funding broadly ensures that a good case can proceed with a focus on the merits.

The Importance of Confidentiality

All attorneys should be leery of judicial rules that amount to unjustified intrusions into private and confidential matters. As lawyers, we rely on confidentiality to advise our clients; consequently, our advice is protected via the attorney-client privilege, and our output is likewise protected as attorney work product.

This presumption of confidentiality is not merely personal to the attorneys themselves. For example, parties need not disclose the identity, nor the advice, of consulting experts that they may engage to assist with their cases.

If these points seem obvious, it is because confidential arrangements are central to the litigation process — not only the substance of those arrangements, but their very existence. Nor is there anything wrong with that, as it is consistent with the traditional, privacy-protecting presumptions of American law.

In both substance and effect, Rule 7.1.1 flies in the face of this long tradition of respecting parties' confidential arrangements and private business decisions.

Whether a party pays its attorneys directly, hires them on contingency, takes out a loan, or gets help from a wealthy aunt, the American Civil Liberties Union or a litigation finance firm, this makes no difference to the core question of the lawsuit: Who should prevail?

There are reasons one might be curious to know these things, but they are all irrelevant to the core of the case.

Further, a party to civil litigation that obtains or even seeks litigation financing necessarily will disclose highly sensitive, confidential and privileged information to potential funders.[2]

The Issue of Control

Supporters of Rule 7.1.1, including the authors of the previous Law360 article, note that the substance of the funding agreement cannot be disclosed except for good cause when the opposing party has reason to believe that litigation control or settlement authority has been transferred.

It is not difficult to envision that opposing parties frustrated with the conduct of settlement negotiations, or even just the tactics of the attorneys themselves, will weaponize this provision against parties who employ litigation financing. Alter your settlement demands, they will argue, or we will petition the court to force disclosure of your otherwise private financing arrangements.

One might argue that Rule 7.1.1 has helpful signaling value both to the court and to the opposing party, showing that the funded party will not only have sufficient resources to litigate the merits, but that a sophisticated third party agrees with the merits.

Yet there are ample — and better — reasons why a party would not want to disclose the existence of litigation finance. For example, the party's commercial competitors could view it instead as a sign of weakness rather than strength, or the selection of a particular financing firm could reveal otherwise private business arrangements.

Once again, these are private commercial matters.

The Overbreadth of Rule 7.1.1

The rule's advocates contend that a commercial funding arrangement might include provisions that transfer control of the litigation to the financing firm, and that this possibility justifies universal compelled disclosure.

Such an arrangement would be extraordinary, as it is not the common practice, but the argument at least sounds in traditional "real party in interest" disclosure obligations.

The previous Law360 article correctly points out that Federal Rule of Civil Procedure 7.1 already requires corporations to disclose third parties that may have a financial stake in the case, and argues that requiring parties — which, in the vast majority of cases, would be the plaintiffs — to disclose any litigation funding "introduces parity into this equation."

In part because courts are already empowered to address such concerns on a case-by-case basis upon a proper showing of good cause, Rule 7.1.1 sweeps far too broadly.[3]

A more focused rule could have limited its reach to require a party to disclose the existence of a litigation finance arrangement only if the agreement transferred authority over the litigation or settlement authorities to the financing firm or another nonparty.

If a party did have an extraordinary agreement that would trigger the real party in interest disclosure obligations, then it would quickly become apparent through those initial disclosures, and any party that believes its interests could be adversely affected or prejudiced could petition the court for discovery or other redress.

Confidential arrangements would remain confidential, and financial arrangements that could affect the substance of the litigation would be revealed to interested parties or otherwise addressed, but the court would not be forcing public disclosure of private arrangements, at a minimum, and at worst, handing a cudgel to the opposing party, as Rule 7.1.1 does now.

Context Matters

Let's speak plainly about what really drives Local Rule 7.1.1 and similar disclosure efforts nationwide.

It is no secret that many corporations represented by BigLaw firms are vehemently opposed to the mere existence of litigation finance. It is not hard to see why. Corporate defendants are accustomed to having far greater resources than plaintiffs to devote to litigation, and that financial imbalance obviously affects how cases proceed and whether the merits ever get litigated.

Yet apart from the Rule 7.1 disclosures, corporate parties do not have to reveal to anyone — much less the public — how deep their wells of resources run. The relatively recent availability of litigation finance challenges that traditional imbalance of resources.

Thus, Rule 7.1.1's purportedly innocuous disclosure requirement should be seen as what it is: part of a nationwide campaign by corporate-focused interest groups that fear a counterweight to the traditional structural imbalance.

Initially, their goal was to unduly burden litigation finance via federal rule,[4] but when that effort proved fruitless and was deemed hostile to the administration of justice, the advocates sought state-level and federal judicial district changes via new measures such as Rule 7.1.1.

Conclusion

As members of the bar, regardless of whether we represent plaintiffs or defendants, we should be very wary of the manipulation of local rules to benefit one side in litigation.

While much of my practice today is defense-side, representing corporations, I also worked on plaintiff-side civil commercial matters earlier in my career, so I have no particular dog in this fight.

Far more important to my thinking is my experience as an assistant U.S. attorney and as a senior attorney in the U.S. Department of Justice, where my role was to ensure the fair administration of justice.

Insofar as commercial litigation finance enables the civil litigation process to advance the proper and just resolution of disputes in our nation's courts by focusing on the merits, that result should be applauded, and ill-conceived and overbroad measures such as Rule 7.1.1 should be abolished.

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[1] U.S. District Courts, Civil Statistical Tables for the Federal Judiciary (June 30, 2021), available at https://www.uscourts.gov/statistics/table/c/statistical-tables-federal-judiciary/2021/06/30.

[2] See, e.g., Devon IT, Inc. v. IBM Corp., No. 10-2899, 2012 U.S. Dist. LEXIS 166749, at *3 n.1 (E.D. Pa. Sep. 27, 2012) (granting motion to quash subpoena demanding production of communications between party and funder) ("Litigation strategy, matters concerning merits of claims and defenses and damages would be revealed if the documents were produced. The matters directly involve the mental impressions of counsel and are protected from disclosure as work-product. Moreover, the production of the items subpoenaed would intrude upon attorney-client privilege under the "common-interest" doctrine.").

[3] See, e.g., In re Int'l Oil Trading Co., LLC, 548 B.R. 825, 839 (Bankr. S.D. Fla. 2016) (denying broad discovery demands including all communications between funder and party's counsel while allowing limited discovery of redacted litigation financing agreement where funder admitted "near-daily role" in litigation).

[4] Letter from Lisa Rickard, Institute for Legal Reform, et al., to Jonathan C. Rose, Secretary of the Committee on Rules of Practice and Procedure of the Administrative Office of the United States Courts (April 9, 2014) (proposing amendment to FRCP 26 requiring disclosure of all terms of legal finance agreements) (available at https://www.uscourts.gov/sites/default/files/fr_import/14-CV-B-suggestion.pdf).